

# Terms of reference for the electricity price review

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## Context

Electricity prices, especially for households, have increased faster than inflation for many years, putting pressure on household budgets. After adjusting for inflation, residential customers have faced around a 50 per cent increase in real electricity prices since 2000. In comparison, real prices faced by commercial and industrial customers have remained relatively flat.

International comparisons in the International Energy Agency's (IEA) 2017 In Depth Review of New Zealand found that residential electricity prices have grown from low levels much faster than in other IEA countries. It also found that residential prices in New Zealand were well above the IEA average in 2014, while industrial prices were below the IEA average.

In addition, rapidly changing technologies and business innovations present opportunities and challenges to the operation the electricity system. Emerging technologies can contribute to the transition to a lower emissions economy through renewable energy solutions, increasing the efficiency of the grid and enabling greater energy consumption control for the consumer. To benefit from technology we need a regulatory framework that is sufficiently enabling.

In this context, the Government will undertake a review to investigate whether the electricity market is delivering efficient, fair and equitable prices to end-consumers. It will also assess whether the electricity regulatory framework will continue to be appropriate as we look to the future.

## Overarching Objective

The objective of the review is to ensure that the New Zealand electricity market delivers efficient, fair and equitable prices as technology evolves and we transition to a lower emissions future, taking into consideration the requirements of environmental sustainability and the need to maintain security and reliability of supply – the energy trilemma.

## Links to wider work

The review will take into account crossovers and linkages with existing and planned work, including the work of the Electricity Authority on transmission pricing, work on how to reach 100% renewable electricity by 2035 by the new Interim Climate Change Committee and Climate Commission, and the work of the Productivity Commission on its low emissions economy inquiry.

## Scope

1. The review will examine whether the prices paid by end-consumers for electricity are efficient, fair and equitable. Relevant perspectives on fairness and equity include:
  - Whether suppliers of electricity services have the ability to extract excessive profits over time<sup>1</sup>.
  - Whether all consumers have access to affordable electricity services, noting this depends on many factors other than electricity prices (including housing quality and income levels).
  - Whether the costs of providing electricity services are or should be socialised or spread evenly across different classes of consumers (e.g. households and businesses), or across regions, or urban and rural communities.
2. The review will:
  - Consider the entire electricity supply chain: generation, transmission, distribution, and retail.
  - Evaluate whether the regulatory framework governing both the competitive aspects of the electricity market and the monopoly aspects (i.e. transmission and distribution) are delivering efficiency and fairness.
  - Consider the ability of the market and regulatory framework to enable and benefit from emerging technologies and innovation in business models.
3. In considering whether prices are efficient, fair and equitable, the review will take issues of security, reliability and environmental sustainability into account.

## Information collection

4. The review will collect information and report on:
  - The key components of retail electricity prices, how they have changed over time and how they compare internationally.
  - Variations in price across different customer groups.
  - The proportion of household income spent on electricity bills and how this varies between different customer groups.
  - The financial performance of suppliers across the supply chain.

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<sup>1</sup> The purpose of regulation under Part 4 of the Commerce Act includes that 'suppliers [...] are limited in their ability to extract excessive profits', so the review may draw on existing information about relevant regulated services.

## Competition

5. The review will consider:

- The existence of, or potential for, factors that may form barriers to entry or limit competition across the supply chain. This should include, but not be limited to, the impact of vertical integration in parts of the supply chain.
- The existence of, or potential for, informational asymmetries, and the impact on electricity customers with differing behavioural patterns (and therefore different consumption profiles).
- The existence of, or potential for, regulatory failure – including the impact of the low fixed charge regulations, and the impact on differing customer segments.
- The role and effectiveness of the current regulatory framework in promoting competition, including at the boundaries between contestable and non-contestable services.
- The respective roles and functions of the separate regulatory agencies over the electricity sector.

## Equity

6. The review will consider:

- The impact of market conduct and regulation on a range of customer segments. This should include, but not be limited by, regional distributions, household income levels and broad consumer group (i.e. residential, industrial, and commercial).
- The nature of cost allocations and level of any cross subsidisation between consumer groups (including businesses and households, and urban and rural communities), including the impact of the low fixed charge regulations.
- The regional distributional aspects of transmission pricing.

## Future technologies

7. The review will consider:

- The potential impacts of emerging technology on services and prices, and how this may affect different customer groups.
- The current regulatory framework and its ability to promote the potential benefits from emerging technologies.

## Guidance on scope

8. The review is expected to make findings and recommendations at a level of detail appropriate to a policy review. It is not required or expected to make findings or recommendations about matters of technical regulatory detail such as how regulated weighted average cost of capital should be determined, or at how many hubs financial transmission rights should be traded.
9. In considering issues relating to the economic regulation of natural monopoly networks applied under Part 4 of the Commerce Act, the review should be mindful that this regulatory framework is also applied to the gas and international airport sectors, and any changes could have significant impacts on these sectors that would need to be carefully considered by the Government. The review should also be mindful that the input methodologies set independently by the Commerce Commission have been subject to extensive consultation, expert analysis, and review by the High Court. This previous scrutiny, the technical complexity of the issues involved, impact on investment and regulatory certainty, and their cross-sectoral application means the Government is likely to exercise considerable caution in considering changes to the Commerce Commission's input methodologies.
10. The review is not expected or required to evaluate the performance of regulatory bodies against their existing statutory objectives, but may make findings and recommendations about regulatory frameworks and institutional arrangements.

## Process and timeframe

11. The review will determine its own process, but is expected to involve wide engagement on issues and draft findings.
12. The review may be structured in stages, with initial stages focusing on determining facts and building evidence. The scope of further stages would be developed upon the findings emerging from the first stage.
13. The final report should include recommendations for any improvements to the regulatory framework, structure and design of the electricity market that are considered warranted.
14. The final report will be delivered to the Minister of Energy and Resources by April 2019.