

2 November 2023: SUBMISSION TO MBIE REGARDING THE ENERGY TRANSITION

The energy transition needs to be affordable

Entrust supports New Zealand playing its part in tackling climate change. We consider that more can be done to support a renewable energy future. New Zealand's energy future is arriving fast.

A highly competitive market, that delivers cost-reflective and affordable pricing, and economic regulation that enables and empowers lines companies to adapt and invest, are critical pre-requisites for a successful energy transition.

Entrust is involved in many projects which support lower emissions and, as 75.1% shareholder, supports Vector's focus on new technology. Vector is leading the way in solar, battery storage, and smart technology to meet the needs of consumers.

Entrust wants to ensure electricity is supplied in an efficient and affordable way to all consumers and its beneficiaries, including the 359,000 households and businesses in its area of central, east and south Auckland.

Summary of Entrust's submission

- Electricity must be affordable for Kiwi households and businesses, and to encourage electrification. Kiwi households and businesses can't afford large cost increases.
- Stronger competition would help ensure more affordable electricity and should be prioritised by the Electricity Authority.
- Entrust supports the Ministry of Business, Innovation and Employment (MBIE) exploring structural reform options, including potential break-up of the gentailers. The break-up of Telecom's wholesale and retail businesses into Chorus and Spark provides a successful precedent for reform. We note the Electricity Authority has been clear that structural reform is outside its regulatory powers.
- Climate change, the energy transition, increasing reliance on electricity, and the power outages due to storms and cyclones the North Island experienced this year, reinforce the need for lines companies to invest in network reliability and resilience.
- Entrust considers that industry regulators should be required to take emissions and environmental impacts into account in their decision-making. Regulatory settings need to align with climate change objectives and the uplift in new infrastructure investment that is going to be needed.
- One area of uncertainty is what happens if industry regulators make decisions based on efficiency objectives which don't align with the Government's subsequent energy transition policies which will be based on a wider climate remit.
- For example, the Commerce Commission's Input Methodologies (IMs) review decisions will be made later this year and are critical for ensuring lines companies are able to adapt, and meet the new world of energy investment, innovation, affordability and reliability.

Entrust's submission

Affordability needs to be at front and centre of the reform programme

Entrust considers that energy affordability is key to managing the transition to electrification and lowering carbon emissions.

In order to ensure energy affordability, careful consideration needs to be given to the lowest cost transition path and the risk if things go wrong. For example, MBIE has made clear the important role of gas will continue during the transition. There are cost and security risks for consumers if the transition away from gas happens too quickly.

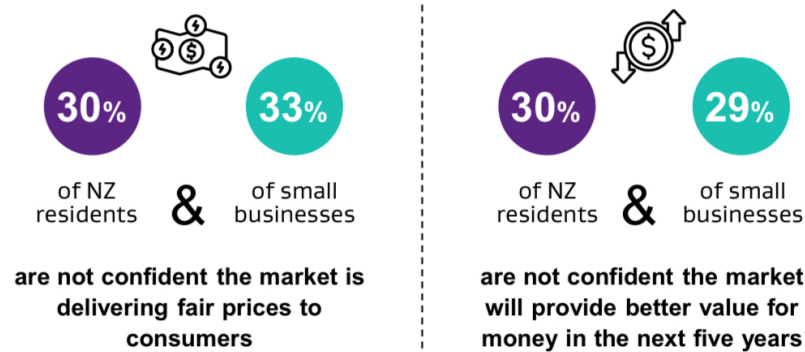
Residential gas use represents less than 1% of New Zealand's greenhouse gas emissions and it is extremely expensive for families to migrate from gas to electricity. The typical cost could be between \$15,000 to \$20,000 per household to change appliances and retrofit electricity. On the supply side there will also be extra cost to cater for the increase in demand and capacity requirements for electricity supply.

Kiwi households and businesses can't afford large cost increases.

Low confidence existing market settings will deliver affordable electricity and a successful energy transition

The Consumer Advocacy Council's consumer survey indicates most Kiwis aren't confident the electricity market is delivering fair prices and are concerned this could get worse in the next few years.¹

Do New Zealanders feel they are getting a good deal?



The Electricity Authority's survey of electricity industry participant perceptions also provides evidence Entrust's concerns about the electricity market are shared by most industry participants e.g.:²

- Only 33% of industry participants agree "Electricity market settings will support an efficient transition of the energy sector to low emissions".
- Only 29% of industry participants agree (52% disagree) that "New entrant generators can operate on a level playing field with established generators".

¹ <https://www.cac.org.nz/assets/Documents/New-Zealand-small-electricity-consumer-sentiment-survey-2022-Overview.pdf>

² ak research & consulting, Survey of electricity industry participant perceptions 2021/22, July 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/Copy-of-Survey-of-electricity-industry-participant-perceptions-2021_221377243.1.pdf.

- Only 36% agree (39% disagree) competition between electricity generators ensures they build the most efficient power stations. The number of participants that disagree has increased from 31% in 2020/21 to 39% in 2021/22.
- Only 32% agree (46% disagree) competition between electricity generators ensures wholesale market prices are set at an efficient level.

Stronger competition is needed

Entrust believes a highly competitive market that delivers affordable pricing is critical for a successful energy transition.

MBIE has commented that new renewable generation options can be lower cost than thermal and older technology. The Electricity Authority similarly expects “more renewable generation should act to depress spot prices in the long run, as they produce cheaper electricity”.³

It is far from guaranteed that the energy transition will result in better outcomes and more competitively priced electricity though.

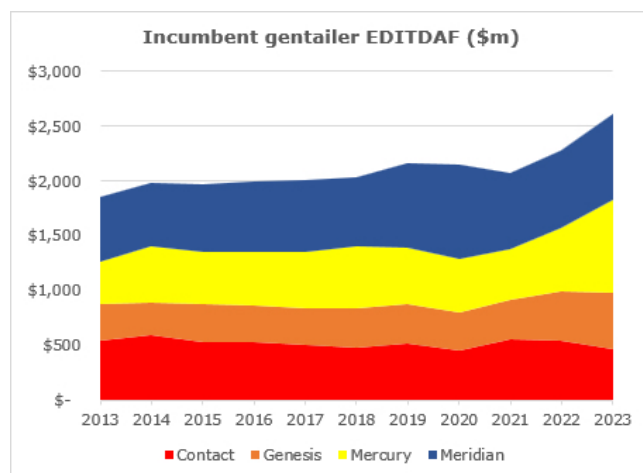
If competition issues aren’t resolved, wholesale electricity prices could remain artificially high, not only undermining electrification of the economy but the provision of affordable energy for Kiwi households and businesses.

Entrust agrees with MBIE and the Electricity Authority⁴ that there is significant risk generator market power will increase as reliance on renewable electricity increases.

There are wide-spread concerns about how well competition is working

The persistently high and record profitability of Contact, Genesis, Mercury and Meridian⁵ raises questions about the intensity of competition and the affordability of electricity for average Kiwi families.

The graph below shows that the incumbents’ earnings before interest, tax, depreciation and amortisation (EBITDAF) has increased substantially over the last two years, a time when consumers could least afford to be paying higher prices. As a consumer trust representing beneficiaries, we are concerned by what appears to be clear evidence consumers are paying too much for electricity.



³ Electricity Authority, Market Insights, New ZEALAND’S electricity future: generation and future prices, 14 February 2023.

⁴ <https://www.entrustnz.co.nz/media/awdnqpgc/2023-03-06-entrust-mdag-renewable-energy-future.pdf>

⁵ <https://www.stuff.co.nz/business/132830162/meridian-ups-annual-pay-out-to-shareholders-to-462-million>

The Electricity Authority's wholesale market review confirmed "Industry structure is relatively concentrated" and "The persistence of high spot and forward prices, well above the cost of new renewable supply raises questions about whether there are impediments (including anticompetitive barriers) to entry ..."⁶

The Electricity Authority also noted the Herfindahl–Hirschman Index (HHI) "for generation in New Zealand has been hovering around 2,000 since 2014". This meets the Authority's definition of a concentrated market (HHI between 1500 and 2500) and thresholds used by other regulators. For example, the UK Competition and Markets Authority defines a market with an above 2,000 as highly concentrated and between 1,000 and 2,000 as concentrated.

Lines companies have an important role to play in the energy transition

Entrust agrees with MBIE that lines companies have an important role in support of renewable electricity generation and electrification, and integration of distributed energy resources. This is reflected in our submissions to the Climate Change Commission (CCC),⁷ the Commerce Commission⁸ and the Electricity Authority.⁹

The Electricity Authority has similarly commented to the Economic Development, Science and Innovation Select Committee about the need to harness "the role of distribution in the transition" and "ensure that there aren't barriers to that occurring".¹⁰

Vector is leading New Zealand in creating a new energy future

As majority shareholder, Entrust supports Vector's focus on new technology initiatives and innovation, especially in the integration of consumer-owned distributed energy resources (DER), like electric vehicle (EV) chargers.

Vector is leading New Zealand in creating a new energy future through its Symphony strategy which puts consumers at the heart of the energy system. Vector owns the largest electricity network in New Zealand and is majority-owned by Auckland's consumers. The Vector group also includes Powersmart, an established solar developer operating in New Zealand and the Pacific, and HRV, one of New Zealand's leading in-home energy solutions providers.

Vector undertook New Zealand's largest EV charging trial between 2019 and 2021. The trial used smart EV chargers to successfully smooth network demand peaks and achieve high levels of customer satisfaction. Smart EV chargers also create the opportunity to take advantage of daily spot price volatility (charging batteries when prices are low), supporting New Zealand's transition to a highly renewable power system. Advanced distribution system operation will be at the heart of an affordable, highly electrified energy system.

Lines companies need to be able to adapt and invest

The electrification of the economy will require substantial network investment. The extent and timing of much of this growth will be uncertain, including how rapidly New

⁶ Electricity Authority, Promoting competition in the wholesale electricity market in the transition toward 100% renewable electricity, Issues Paper, 2022.

⁷ <https://www.entrustnz.co.nz/media/89547/Entrust-Submission-to-Climate-Change-Commission-25-March2021.pdf>

⁸ <https://www.entrustnz.co.nz/media/70492/commerce-commission-and-ea-contestable-services-project-tor12042019-1.pdf>

⁹ <https://www.entrustnz.co.nz/media/3cxkla52/submission-on-renewable-power-supply-15-march-2022.pdf>

¹⁰ <https://www.facebook.com/EDSISCNZ/videos/613768709722915>

Zealanders switch to EVs and away from gas. These changes are being reflected in line company asset management plans (AMPs), and expenditure forecasts.

Lines companies need to be able to adapt and respond flexibly to changes in technology and consumer expectations e.g. demand for new connections required for EV charging.

Regulatory settings need to change.

We agree with the CCC that “The regulatory regime must continue to adapt” and “The capacity and capability of ... lines companies will be important”.¹¹

We also agree with the CCC about the “need to ensure the overall regulatory regime is sufficiently adaptive to enable EDBs to undertake the innovation and investment required to meet climate change outcomes”.¹²

The CCC’s advice to the Government highlights the importance that industry regulators recognise the need for regulated lines companies to be able to adapt to new technologies, and environmental imperatives e.g. Part 4 Commerce Act settings need to ensure lines companies are able to invest to meet the demand growth that will be driven by electrification.

Potential reform options

There is no single ‘silver bullet’ for successfully managing the energy transition.

The Government needs to be confident industry regulators, including the Commerce Commission, Electricity Authority and Gas Industry Company, are properly considering emissions and other environmental impacts in their decision-making. This could be as simple as clarifying environmental harm should be treated as an economic cost which directly impacts the statutory objective to promote the long-term benefit of consumers and/or through a Government Policy Statement.

The Electricity Authority has been upfront it considers environmental factors outside its statutory objective and that “carbon emissions ... are being addressed by the Government’s environmental policies”.¹³

Entrust agrees with MBIE about the critical role of a highly competitive market in ensuring the right decisions are made about new generation investment and timing, and for affordable electricity pricing that is not inflated due to monopoly power.

The Electricity Authority has detailed various reform options for promoting competition, including Resource Management Act reform and structural options (break-up of the gentailers), which it considers to be outside its jurisdiction.¹⁴ These merit consideration as part of MBIE’s wider energy strategy remit.

It is also important the Electricity Authority prioritise promotion of competition in its work programme. There are ongoing and increasing concerns about the state of

¹¹ Climate Change Commission, Ināia tonu nei: a low emissions future for Aotearoa Advice to the New Zealand Government on its first three emissions budgets and direction for its emissions reduction plan 2022 – 2025, 31 May 2021.

¹² Climate Change Commission, Ināia tonu nei: a low emissions future for Aotearoa Advice to the New Zealand Government on its first three emissions budgets and direction for its emissions reduction plan 2022 – 2025, 31 May 2021.

¹³ Electricity Authority, Interpretation of the Authority’s statutory objective, 14 February 2011.

¹⁴ Refer to the “Actions that are for other government entities to progress” in Electricity Authority, Promoting competition in the wholesale electricity market in the transition toward a renewables-based electricity system, Decision Paper, May 2023.

competition in the wholesale electricity and retail markets and access to hedge products needed to enable risk management and competition.

Entrust agrees with MBIE that there will be a need for a substantial increase in network investment, and that it is better to invest early than late.

The Commerce Commission's IMs review decisions will be made later this year and are critical for ensuring lines companies are empowered and able to deal with the challenges and uncertainty that the energy transition will throw at them. The importance of financeability has been a key theme in lines company submissions. Entrust has been clear the Commission should address these financeability concerns to ensure a successful energy transition.¹⁵

One area of uncertainty is what happens if industry regulators make decisions based on efficiency objectives which don't align with the Government's subsequent energy transition policies which will be based on a wider climate remit.

Concluding remarks

It is important the energy transition is affordable.

Moving to more sustainable energy solutions, if managed well, should help put downward competitive pressure on wholesale electricity costs and prices for consumers. This will require stronger competition which delivers cheaper, more environmentally friendly options.

While the transition presents opportunities there are also risks such as from transitioning away from gas and the potential MBIE identifies for the electricity market to become less competitive. These risks and potential costs for Kiwi households and businesses need to be fully understood and addressed.

If the competition issues are not resolved, market concentration could worsen and wholesale prices could remain artificially higher than they should, undermining electrification of the economy and provision of affordable energy for Kiwi households and businesses.

Lines companies need to adapt to new technologies and the impact on their networks. The electrification of the economy will require substantial electricity network investment to meet future capacity needs. It is vital the regulatory environment allows lines companies to respond to changing technologies and consumer demand.

Kind Regards,



Alastair Bell
Chair of Regulation and Policy Committee

¹⁵ Entrust, SUBMISSION TO THE COMMERCE COMMISSION REGARDING THE 2023 INPUT METHODOLOGIES REVIEW DRAFT DECISIONS, New Zealand's energy future is arriving faster than expected, 19 July 2023, available at: <https://www.entrustnz.co.nz/media/zutnphnc/2023-07-19-submission-ims-decision.pdf>.

About Entrust

Entrust (formerly Auckland Energy Consumer Trust) is a consumer trust that owns the majority of Vector on behalf of its 359,000 beneficiaries.

Entrust owns 75.1% of shares in Vector. The shares are held in trust for energy consumer beneficiaries in the Entrust District of central, east and south Auckland who are paid a cash dividend each year.

The organisation was created in 1993 to make sure power lines remained in the control of electricity consumers and was established under a trust deed on behalf of electricity consumers in the area previously served by the Auckland Electric Power Board.

For further information, head to www.entrustnz.co.nz or www.facebook.com/entrustnz