

Keynote address from Deborah Hart at Downstream 2024

Published: 7 March 2024

Business as unusual - what consumers need and want from the electricity sector

As New Zealand transitions towards a low carbon future, the landscape for the electricity sector is undergoing profound change. Consumers and what they want and need from the electricity system must be at the forefront of the changes. This presentation will explore the settings needed to meet residential and small business consumer priorities and a just transition. It will challenge the sector, regulators, investors, suppliers and government to innovate, cooperate and change to meet the evolving needs of consumers.

I was born in an era, when there was an incinerator in the garden and the weekend smells were lamb roasting, freshly-cut lawns and burning rubbish. Whilst the lamb and lawn odours remain, most of us accept we cannot keep burning stuff in the backyard or elsewhere.

The climate is warming and we are experiencing extreme weather events. Consumers are being asked to electrify and change the way they use energy in a cost-of-living crisis. The price for electricity is rising and we need more electricity. And yet large numbers of people can't afford electricity now.

And there is more change coming. That change could provide safe, warm homes for all, super-charge businesses, generate affordable prices and build a cleaner environment. Get it wrong and it will worsen the energy divide, dampen the economy and slow the transition to a low carbon future.

I have met so many smart and good people in the electricity sector, who are so focused on getting the transition right. But today I want to challenge you to forget business as usual and instead undertake your business as unusual.

Firstly let's consider what consumers want.

We need to accept that electricity is an essential service. Everyone needs it, with very few exceptions. For now at least the vast majority need it to be delivered by the electricity sector - most consumers are not making their own electricity or enough of it to be self-sufficient.

The Consumer Advocacy Council's 2023 Sentiment Survey shows that affordability is most important for eight out of ten households and almost nine out of ten small businesses, likewise a similar number rate resilience as important. Replacing coal and gas plants with more efficient technology - slightly lower, six out of ten for households and small businesses.

There is a lot of discussion about reducing consumer demand and increasing energy efficiency.

Most consumers make changes that they think they can in their electricity consumption, often prompted by a desire to cut costs and reduce environmental impacts. But there is more innovation and efficiency possible if we focus on whether it is cheaper to increase efficiency and innovation or build capacity.

Our 2023 behavioural survey found that most households and small businesses were interested in using new technology to manage energy bills.

The Electricity Authority in its 2024 Potential solutions for peak electricity capacity issues paper identified that “.....it is likely that those consumers most able to reduce demand without impacting their lifestyle will be wealthier consumers with more discretionary electricity consumption. This means that, once any compensation payments to flexible consumers are considered, consumers without flexibility will likely disproportionately bear the burden of paying for the standby ancillary service.”

Without intervention, those consumers who can afford technology for demand reduction will benefit, those that can't, won't and will be worse off.

Our survey found that while there's interest in energy saving technology, there is less appetite to let power companies take control of smart appliances. Close to half of households and small businesses are open to using appliances that are linked to their electricity retailer. But most wanted to retain control of them.

We know from overseas experience that it is possible to get consumers to turn off appliances by allowing them choice and financial incentives. But then many consumers and businesses would find it hard to switch to using appliances at off-peak times when power can be cheaper.

There is a balancing act to incentivise changes that could significantly dampen demand, without causing harm and penalising those who can't take advantage of off-peak use, and innovation. We must pursue this and get the balance right.

Business as usual is keep building networks and generation and passing the cost to consumers.

Business as unusual is optimising efficiencies and innovation and ensuring they are available for all.

Business as unusual is applying the test: Is it cheaper for consumers to increase efficiency and innovation or build capacity?

Our Sentiment Survey found 65% of households were concerned about the cost of power, a 7% increase from the prior year. Two out of every five households experienced financial pressure from electricity bills. MBIE analysis from 2022 found that 110,000 households were unable to afford to heat their homes. That is every home from here in the Hutt Valley through to and including Wellington. That's at least 1/4M people affected.

Consumers hear there needs to be more investment in network, transmission, generation and storage to meet increased demand for electricity. They know all of that is costly and will have an impact on the price of electricity that they pay.

Mercury NZ says its prices will rise by between 5 to 8 percent for most consumers from April 1. Both Genesis and Contact Energy have also announced price rises. On 19 February, Contact Energy warned consumers, they face significantly higher power bills from April 2025.

To offset these price rises, Mike Fuge, of Contact Energy said that “...consumers would begin to reap the savings once the country converted to 100% renewable energy generation without the need for thermal.”

Although there are differing views about prices, the consistent message to consumers is that prices will rise, and they have little say in the system that charges these costs.

We are aware of great initiatives to help those experiencing energy poverty. However, the Energy Hardship Expert Panel heard from many submitters “... on a lack of leadership, accountability and coordination.” They commented on the plethora of services and support all acting “in isolation.” These piece-meal initiatives do not deliver the coordinated system that was envisaged by the Electricity Price Review and 5 years on we still have people unable to afford an essential service.

Consumers hear this idea a lot about short-term pain for long-term gain, but we ask what happens to those who cannot afford the pain when electricity is an essential service? There does not seem to be a reality check that consumers cannot simply pay more and more. We are going to have to be more innovative than simply increasing prices.

When will the mythical reaping of savings occur? Or does the promise of cheaper costs mean that there may be some small saving in costs that will have escalated significantly over time? How can consumers be assured that they will have cheaper prices? By the way, consumers have heard the promise of lower prices before - then Energy Minister Max Bradford in 1998 said, and I quote, “The Electricity Industry Reform Bill is important microeconomic legislation designed to give consumers choice and lower prices.”

There is a tension in providing an essential service when it is delivered largely by for-profit entities which, not unreasonably, look to maximise shareholder value. Investors and consumers pay for everything in our electricity system. Investors invest to make money. They get a say in the performance of their investments and they are highly likely to get a return on electricity investments. Recently there have been numerous sizeable dividends to investors. On the other hand, consumers are right at the end of the investment chain, with no say and their sole return being electricity at whatever price is set for them.

Business as usual is the assurance from those in the electricity sector to consumers of lower prices in the future.

Business as usual is not adequately dealing with energy poverty in a joined-up effective way.

Business as unusual is government, the sector, social agencies and consumers agreeing how every person can afford electricity through the transition and the sector making a contract with consumers as to when and how their electricity prices will decrease.

In our system, competition is key to ensuring downward pressures on prices.

The market relies on a uniform marginal pricing mechanism that drives spot price spikes and high forward prices. Since 2018, when prices rose dramatically because of the Pohukura outage, they did not return to the lower prices when the outage was fixed.

Electricity spot prices and forward prices have generally remained well above the cost of new renewable supply. The market settings then could be seen to incentivise incumbent generators to delay investment in projects that would reduce prices and help decarbonisation.

The persistently high prices indicate that the pricing methodology developed in 1996 and the Authority's approach to promoting competition may no longer be an effective mitigation against the exercise of market power.

After 2018, there was stress particularly on new entrant retailers who could not purchase hedges to protect against high spot prices and thus enable them to compete against large gentailers. Evidence of this is that between 31 August 2018 and 30 June 2020, 8 relatively new entrant retailers exited the electricity market and those remaining are squeezed for hedge pricing.

We do not believe the market is working as well as it should to competitively facilitate fair pricing or incentivise investment in new renewable generation to ensure demand capacity and reserves can be reliably met at all times, for a fair and reasonable price to consumers.

We are not the only ones to think this.

In its recent briefing to the minister, MBIE said, "We are concerned that the wholesale market is not as competitive as it could be. The transition to more renewables and an associated increasing reliance on lake storage could lead to increases in market power that could raise prices for consumers."

EA's 2022 Market Development Advisory Group issues paper on price discovery in a renewables-based electricity system identified the need to strengthen competition as a vital ingredient to successfully shift to a renewables-based system.

Just this year, the Commerce Commission determined that it lacked the resources to probe the market. But it said it would help the Authority in a review of electricity trading rules, saying in advice obtained under an OIA that there was evidence suggesting the big four gentailers may be in breach of the recently toughened Commerce Act (Section 36) by restricting competition.

Marcia Poletti from Octopus Energy in the UK, in a public talk last year commented that “...for the last 20 years in NZ wholesale prices have been 20% higher than needed because NZ doesn’t have a competitive wholesale power market.” She described this as consumers “ ... getting ripped off.”

Octopus Energy, here said, "A vibrant retail electricity market is being quashed by a gentailer margin squeeze right when we need the engagement, investment and innovation of retailers to keep costs down for the consumer."

To be frank, consumers experience the transfer of wealth from them to shareholders, and a system which increasingly leaves those in hardship behind. Consumers would like to see a transition to a truly consumer-focused industry that properly balances their needs with those of investors; a just transition.

That challenge is for the sector to meet, not consumers. But on behalf of them we offer four principles we think underpin a healthy and functioning market:

1. It must foster competition and incentivise the allocation of resources towards more renewable generation.
2. There must be sufficient supply or demand control to meet the increased demand for renewable electricity at any time, including periods of peak demand and dry years.
3. The price of electricity must be fair and reasonable such that it is affordable for everyone; and
4. It must encourage New Zealand to move toward decarbonisation.

We recommend investigation of alternative models, including treating renewables and non-renewables separately in the wholesale market. Such a market could be a mix of energy-only and capacity markets, with thermals on a capacity market and green sources on an energy-only market. That would mean that the expensive cost of dry year support could not impact on the cost of greener forms of energy and could help ensure security in dry years. It could lower prices and incentivise the building of new green energy sources.

We also recommend investigation of the impact vertical separation of the gentailers could have to help ensure a more competitive market.

Business as usual is allowing prices to increase and more Kiwis to suffer energy poverty.

Business as usual is market settings that don’t of themselves incentivise innovation and decarbonisation.

Business as unusual is an admission that the system is not working as well as it could and it won’t until we have a paradigm shift in the market settings.

Most consumers recognise we need to decarbonise and as a nation we have set ourselves a target to be net carbon zero by 2050.

Our electricity is now usually delivered by 87% renewable sources. But Energy

The 2023 Concept generation investment survey for the EA found that:

Committed generation is increasing as is the pipeline of “actively pursued” generation.

There has been a surge in development of distributed generation, including large utility-scale projects. Developers are pursuing solar, wind or geothermal projects. There is also some interest in batteries and other flexible plant.

In addition to what has been completed or committed, Concept estimated that more new generation will need to be built.

There seems to be a slew of projects at or close to final investment decisions.

Despite all this news about development of generation capacity, consumers hear a recurring pre-winter message from Transpower that things are tight and there might be electricity cuts. Large business contracts, like the recent Rio Tinto - Meridian deal include an agreement to reduce load in winter, if necessary. It doesn't exactly engender business or consumer confidence that the electricity system is working well if that is what the system has to rely upon.

The questions for consumers remain - is there sufficient generation being built to ensure that electricity will be available when it is needed including on cold, dark, windless winter evenings?

Are comments like there are “... sufficient generation projects now built or committed to displace uneconomic thermal”, correct on an instantaneous basis that includes factors such as dry years, or peak winter demand when solar is not available; or perhaps the comment only relates to average annual energy generation available in a normal year.

Chair of the Authority, Anna Kominick yesterday said, “...the Authority is responding to the repeated call for certainty in an increasingly volatile context.” She's right. Consumers try to make sense of all of this information. This is not a simple comms problem. They need answers sufficiently clear to give them confidence in the electricity sector - from the system operator, regulators, retailers, generators and network companies. In the absence of that, they are losing trust.

Business as usual is a mix of messaging from the sector that all is well and there will be power now and into the future. And quite the contrary message.

Business as unusual is clear answers to consumers that the electricity sector has the problems solved and how. And if not, what is being done.

I wonder when companies are looking at managing risk to effectively protect shareholder value, if they consider loss of social licence and how they could mitigate that risk to their own businesses.

Here are some proof points for your consideration on the loss of public trust.

Our sentiment survey last year found most New Zealanders, whether households or small businesses do not have confidence in the electricity industry to provide affordable power, a reliable supply and a renewable system in the future:

1. Just one in five New Zealanders are confident that the sector is delivering fair prices to consumers or that this will improve in the next five years.
2. Over half (52%) of New Zealanders thought electricity will become unaffordable for them in the next 10 years.
3. 65% were concerned that the electricity system is not resilient to extreme weather.
4. Late last year, the Electricity Authority received a huge number of consumer submissions on the consumer care guidelines. The CEO of the Authority Sarah Gillies called the engagement “remarkable”. Usually, we are the only ones submitting on consultations on behalf of consumers. What led hundreds of consumers to submit on basic consumer protections?
5. An increasing number of people cannot afford electricity.

What is the tipping point at which the erosion of social licence is such that the government steps in and regulates or fundamentally changes the market structure? Compare it to when the telcos were split up. Compare it to the pressure coming to bear on the supermarket duopoly. It would be a mistake to think that increasing numbers of Kiwis are going to remain silent while their electricity becomes progressively unaffordable or that any NZ government, whatever the flavour, could withstand that pressure.

Business as usual is nothing changes except more comms to consumers.

Business as unusual is an acceptance that profound change is still needed.

I was struck by something Alison Andrew, Transpower’s CEO, said to Kathryn Ryan last month. She said, “We don’t have a central planner in our system”. I would add neither do we have an energy strategy.

The energy transition involves many players. What that transition should involve is a coordinated approach by all participants in the electricity industry, regulators, a number of government ministries, and consumers.

Business as usual is expecting a joined-up, effective response to the decarbonisation challenge in the absence of an energy strategy and central planning.

Business as usual is piece-meal solutions with various organisations vying to create the solutions that, call me a cynic but I think, often best work for them, rather than consumers.

Business as unusual is centralised and transparent planning and an agreed strategy that everyone, including consumers, feed into at every step in the process. Couldn't we all just demand and participate in that?

Consumers need to be at the heart of all changes and the difficult decisions to decarbonise.

I was on a call with many sector representatives a couple of weeks ago and they were at pains to say that they put consumers "front and centre". I don't doubt their sincerity and efforts. But their insights might not be as pure as those of consumers and their advocates. I ask you to seek out and listen to those of us who unambiguously speak for consumers, even though we might tell you things that are uncomfortable or inconvenient.

The disability sector has a saying - nothing about us without us. Please apply it to the decarbonisation journey.

Business as usual is believing because you have customers, you can speak for consumers.

Business as unusual is listening to consumers and their organisations directly by having them in your boardrooms as directors, having their advocates meet with you regularly, using their data, inviting consumers in as part of the solutions.

Business as usual is dismissing consumer advocates when they tell you things that you don't want to hear and whispering, not so quietly, that they don't know what they are talking about - it's all too complex and confusing.

Business as unusual is actually listening to consumers and their representatives. And with that, I thank each of you who have been doing just that this morning, listening to me.

Thank you.