



COVERSHEET

Minister	Hon Simon Watts Hon Shane Jones	Portfolio	Energy Resources
Title of Cabinet paper	Electricity market performance review	Date to be published	12 February 2025

List of documents that have been proactively released

Date	Title	Author
November 2024	Electricity market performance review	Office of the Minister for Energy and Resources
6 November 2024	Electricity Market Performance Review ECO-24-MIN-0245 Minute	Cabinet Office

Information redacted

YES / NO (*please select*)

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In Confidence

Office of the Minister for Energy

Office of the Minister for Resources

Cabinet Economic Policy Committee

Electricity market performance review

Proposal

- 1 This paper seeks agreement to the key parameters of the electricity market performance review.

Relation to government priorities

- 2 The proposals in this paper contribute to goals around rebuilding the economy. In particular, they play a key role in ensuring that climate change policies are aligned and do not undermine national energy security as per the National/NZ First coalition agreement.

Executive Summary

- 3 Electricity demand is expected to grow significantly as the economy electrifies, and this will require significant investment in generation and other infrastructure and resources. Technology changes in generation, storage, and demand management offer opportunities to improve security of supply and reduce costs for consumers. But they also present risks to be managed.
- 4 New Zealand's electricity system ranks well when considered against many comparable countries in terms of reliability, prices and sustainability. However, comparative performance is mixed and falling in some important respects, including international price competitiveness and public confidence in security of supply.
- 5 Electricity and gas markets experienced significant stress in 2024. A shortage of natural gas coincided with low hydro inflows and low wind generation. This contributed to high electricity spot prices which were a factor in terms of the closure of some businesses. These events also heighten the cost of living concerns facing electricity consumers, in light of expected increases in regulated transmission and distribution charges in 2025.
- 6 It is timely to review the performance of the electricity market to ensure that regulation and market design are helping rather than hindering the provision of reliable and affordable electricity to all classes of consumer.
- 7 The proposal seeks to balance the tension between undertaking a comprehensive review and minimising investment uncertainty for consumers and market participants. The proposed review is not designed to move us away from our market-led approach

to electricity. We do not wish to signal that our current system is fundamentally broken. Rather, we are looking to build on the strengths of our current system. To that end, the terms of reference (ToR) stress the importance of focussing on the most important areas, with a view of providing no more (and ideally less) than 10 recommendations for consideration.

Background

- 8 New Zealand electricity system has been relatively stable for a period of time but is now entering a period of change.
- 9 The significant pressure in the electricity market of late has brought into focus the need for our regulatory settings and institutional arrangements to be as effective as possible. High wholesale market prices, reductions in industrial activity and, in some cases, industrial closures where energy prices have been a contributing factor, cannot become the norm in times of system stress.
- 10 While there isn't unanimity of views about market performance, concerns expressed by some stakeholders include that: the current market design creates incentives for investments to occur "just-in-time", there is insufficient "firming" and "peaking" in the system, new generators face significant barriers to entry, and independent retailers struggle to bring the innovation they can bring to the system due to the power of incumbents.¹
- 11 In reviewing of our electricity system, we must be cognisant that winter 2024 was a period of fuel shortage. A gas shortage and a dry and relatively still period were all factors that in combination drove the high wholesale market electricity prices. In many ways, the gas and electricity markets behaved as we would want them to behave; higher prices brought on more generation and different types of generation, and demand responses from some industries allowed fuel to move from lower to higher value uses. However, we also saw non-willing demand response in the form of business closures, with a detrimental effect on the economy and jobs.
- 12 What happened over the past few months is not sustainable. Firms must be able to invest and operate with the confidence that they will have internationally competitive energy and electricity prices. Our electricity system must operate efficiently and effectively for the long-term benefit of consumers.
- 13 Electricity demand will grow as the economy electrifies. Meeting this growth will require significant investment in generation and other infrastructure and resources. Technology changes in generation, storage, and demand management offer opportunities to improve security and reduce costs for consumers. But they also present risks to be managed, including increasing generation intermittency from solar and wind generation that will affect the economics of flexible sources of energy and storage.

¹ The term firming refers to the addition of another energy resource to a renewable source of power to balance the intermittent variation of renewable resources. The term peaking refers to ensuring there is sufficient electricity to maintain supply in times of peak power demand (such as cold winter evenings).

Various workstreams are underway to improve energy market performance

14 A number of electricity / energy-related workstreams are underway. Included amongst these are the following:

15 Initiatives to support domestic gas production

We are putting in place a series of policies to incentivise the ongoing production of domestic gas. In addition to the work already done around removing the 100% renewables target and getting Lake Onslow off the work programme, this involves ensuring decommissioning regulations are appropriate, removing the ban on offshore oil and gas exploration and looking at the royalty regime for gas.

16 Enabling a liquified natural gas (LNG) import facility

This work programme will create a clear enabling framework to support the development of a LNG import facility. This, along with the work on supporting domestic gas production, will ensure New Zealand is better placed from a fuel security viewpoint than we are at present.

17 Promulgation of a Government Policy Statement (GPS) on electricity

The Government has issued an electricity GPS to ensure there is sufficient priority given to the changes needed to electricity market settings to promote competition and security of supply.

18 Establishment of an Energy Competition Task Force:

The Commerce Commission and the Electricity Authority have formed a taskforce to look at competition in the electricity market. The particular outcomes being sought are to support new generators and independent retailers to enter and better compete in the market, and to provide more options for end-users of electricity (such as requiring retailers to buy power from end users on fair terms).

19 Completion of the Electricity Authority's risk management review

This work programme was established in response to complaints by independent retailers relating to price and access barriers to hedge contracts. It is considering whether the availability and pricing of over the counter (OTC) risk management contracts (a financial hedge), and other risk management options, is effectively creating a barrier to entry or expansion in the retail electricity market for retailers, and therefore harming competition.

20 The work areas listed above are not a complete list. Other relevant initiatives include freeing up the Resource Management system through Electrify NZ and the fast-track legislation, and bespoke work such as enabling carbon capture utilisation and storage and putting in place a regulatory system to support offshore wind developments. Also relevant is the work to reduce restrictions on electricity distribution businesses ownership of generation assets.

These work streams are not sufficient

21 The workstreams identified above are critical but not sufficient. We need to look across the system as a whole, including consideration of the role of the gas market, to ensure our electricity market serves us as well as it can for the next decade and beyond. The following work areas are included in the draft terms of reference (ToR) for the proposed electricity market performance review.

Work Area	Descriptor
Investment and access to capital	This work area pertains to how business ownership, market structure and design affect incentives or opportunities to invest
Hedging	This work area will investigate how developments in the gas market have affected the electricity market and how generation investment is affected by hedge contracts with major electricity users.
Market rules and competition	This work area will look at market design in the round, with particular focus on competition
Managing risk	This work area is designed to examine information provision to the market, and also ways that risk is managed. This will include specific consideration of information pertaining to gas, as there is a very close link between gas availability and prices, and the electricity market
Market institutions	The regulator (the Electricity Authority) and the system operator (Transpower) have significant roles in the electricity system. This work stream will examine if those roles are appropriate
Market performance monitoring	This work area will examine our market monitoring and compliance enforcement system

22 Whilst there are only six questions listed in the ToR, these are very broad and open-ended. There are two risks worth noting.

23 The first is around incentives to invest while the review is underway, and while the findings of the review are being considered. We wish for the review to be undertaken as expeditiously as possible, including any decisions to be taken following consideration of its recommendations.

24 The second is that such a broad ToR means that the review may not cover all of the topics identified in sufficient depth, or that implementation challenges are not considered adequately. Retaining an element of flexibility as the review proceeds is important. We will stress to the reviewers to pursue with the most vigour the areas that they consider most important to investigate.

25 Even though this is the electricity market performance review, the reviewers will need to consider the broader energy markets to some extent at least. The links to gas are particularly important as gas plays critical firming and peaking roles in our electricity system at present, and is likely to do so for a significant period to come.

Timing and process going forward

- 26 The review team must be independent and bring new (and clear) thinking to the task. Our intent is that the review is carried out primarily by experts that can provide fresh perspectives and insights from other markets. The review team should also have access to New Zealand specific expertise and will be supported by a MBIE-based secretariat. The extent to which they engage with players in the electricity system will be determined by the review team – we do not intend to mandate for them to do so.
- 27 Once Cabinet agrees the ToR for the review, MBIE will issue a Request For Proposals. Depending on availability of the selected review team, our expectation is that the review will commence early in the New Year. This will enable the review to be completed and presented to government in quarter two 2025. Officials will prepare advice following receipt of the review’s findings and recommendations, in time for Cabinet to consider and respond ahead of winter 2025.

Cost-of-living Implications

- 28 No cost of living implications.

Financial Implications

- 29 The cost of the review will be met from baselines. At this stage a budget of \$600,000 has been identified for the reviewers, including peer review.

Legislative Implications

- 30 It is possible legislative change will be needed following the electricity market performance review.

Regulatory Impact Statement

- 31 A RIS is not required.

Climate Implications of Policy Assessment

- 32 Not relevant.

Population and Human Rights Implications

- 33 Not relevant.

Use of external Resources

- 34 This paper has been prepared without the use of external resources.

Consultation

- 35 The Treasury has been consulted on this paper. The Department of the Prime Minister and Cabinet (Policy Advisory Group) has been informed.

Communications and Proactive Release

- 36 We intend to communicate the ToR of the review in due course. This paper will be proactively released as soon as practicable, subject to appropriate withholdings.

Recommendations

- 37 The Minister for Energy and the Minister for Resources recommend that the Committee:
- 1 **note** that New Zealand's electricity system has recently experienced a period of particularly high prices, and that these prices have had a significant impact on our industrial base
 - 2 **note** that New Zealand must have internationally competitive energy and electricity prices, and that firms must be able to invest with the confidence that we will have internationally competitive energy and electricity prices
 - 3 **note** that there are a number of workstreams underway relevant to the electricity and energy system
 - 4 **note that** while these workstreams are all necessary, they are not sufficient to ensure the electricity system is fit for purpose for the next decade
 - 5 **agree** to undertake an electricity market performance review focussing on the following, as per the attached terms of reference:
 - 5.1 investment and access to capital
 - 5.2 hedging
 - 5.3 market rules and competition
 - 5.4 management of risk
 - 5.5 market institutions, and
 - 5.6 performance monitoring of the market
 - 6 **agree** that the review will be undertaken by suitably qualified experts with expertise and experience in electricity markets in comparable countries, but also with access to experts in NZ's electricity market and regulatory system
 - 7 **note** that the review is intended to be completed by June 2025
 - 8 **delegate** authority to the Minister for Energy and the Minister for Resources to amend the terms of reference in line with the directions of this paper, including after initial engagement with the review team

- 9 **direct** the Minister for Energy and the Minister for Resources to report to the Cabinet Economic Policy Committee on the outcomes of the review and the process to follow by June 2025.

Hon Simeon Brown
Minister for Energy

Hon Shane Jones
Minister for Resources