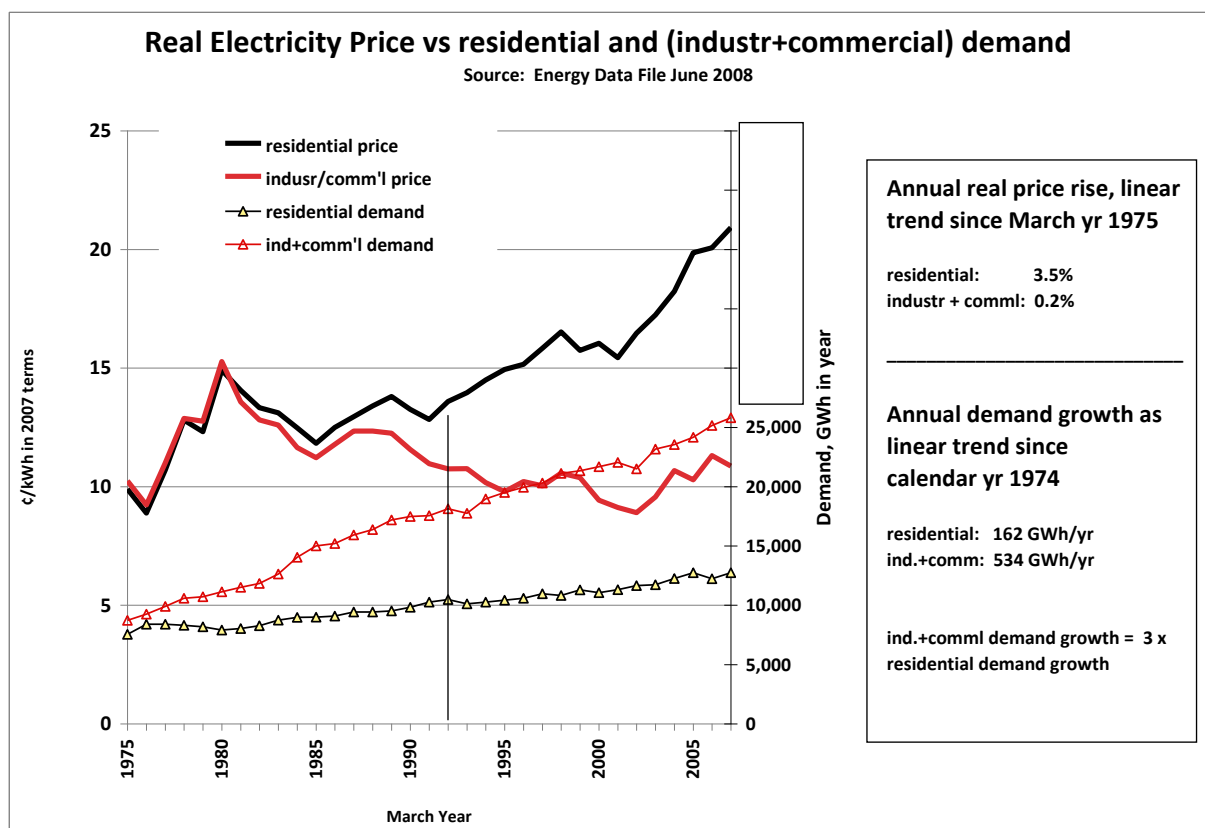


## JUNE 2009 DEUN POSITION STATEMENT ON ELECTRICITY PRICES

### What has been happening to electricity prices:



What this graph shows is that:

- Residential and industrial/commercial prices tracked each other closely until 1992, when strict market principles were adopted by the restructured electricity retailers.
- Since March 1975, residential prices have risen on average by 3.5% more than inflation per year.
- Per household, residential demand has not risen since 1975.
- Industrial/commercial prices have risen by only 0.2% more than inflation per year.
- From 1975, industrial/commercial demand began to rise much more steeply than residential demand.

### Over-charging confirmed

- The Commerce Commission's assessment of market power in the New Zealand electricity market is based on a technical report by Professor Frank Wolak.
- Wolak says the increasing gap between residential and commercial electricity prices is due to the greater bargaining power of large consumers. Yet the Commerce Commission abandoned its original plan to investigate retail market power.

- The Commerce Commission has stated that the most likely explanation for the large increase in retail electricity prices is the effect of increased wholesale prices. This does not explain the differences in retail prices paid by residential compared to other consumers.
- Wolak found that wholesale electricity had been overpriced by \$4.3 billion between 2001 and 2007.
- Residential consumers use only 33% of electricity but pay 46% of the nation's total power bill. They pay a disproportionate amount of the wholesale overcharging.

### **Current government policies on residential electricity pricing**

- Government has told its state-owned energy companies that they are not making enough profit on their investments.
- Embarrassed by the Wolak report, Minister of Energy Gerry Brownlee has warned companies not to raise prices again before the Ministerial Inquiry on electricity issues its report, which is due in September.
- There is currently no known other government action on pricing.

### **New trends in electricity pricing and supply**

- Wholesale prices rose dramatically in the dry years, 2001 and 2003. They rose even higher in 2008 because diesel instead of gas was used to meet hydro energy shortfalls.
- The 2008 event was notable because two major assets were shut down – the New Plymouth power station and half of the Cook Strait converter station. This restricted electricity flows between the two Islands, making the high wholesale prices last much longer,
- In April and May 2009, the diesel-fired station again drove wholesale prices up – even though hydro energy was being spilled in the South Island, and there was plenty of thermal capacity in the North. What happened this time was that up to three power stations were out of action at once.
- Building more power stations does not guarantee security of supply, because companies can and do shut down existing stations or withhold generation from them.

### **Who needs new power stations, and who pays for them?**

- Extra generation is required mainly by industrial/commercial consumers, because it is their demand that is increasing much more rapidly than residential demand.
- A surplus of power favours large consumers, because it drives down wholesale prices. The cost of creating that surplus by building new power stations is therefore borne by residential and other small consumers.

- The use of diesel to make up hydro shortfalls is expected to increase, because gas which could have been used in existing power stations is now being made into methanol for export. Government is now advised that a gas shortage will probably lead to the use of liquefied natural gas (LNG) for electricity by 2020. LNG will cost around three times the present cost of gas for electricity.
- Sustainable energy providers (including small-to-medium scale generators and energy efficiency businesses) can barely compete, despite these rising electricity costs. This is because electricity market rules are biased in favour of the large players in the market.

## Conclusions

- It is clear that the current government is determined to promote resource development to assist economic growth. This will require additional electricity production.
- Current policies lead to high-cost ways of producing electricity, while the much more cost-effective approaches of reducing electricity demand through energy efficiency and conservation are much less commercially attractive, so are weak by comparison.
- Transfers of wealth from small consumers to suppliers and to major electricity (and also gas) users will increase. Regulatory action on these wealth transfers seems unlikely.
- **Small consumers and communities urgently need to get together to improve public understanding of the likely impacts and outcomes of Government policies.**

**These are some of the important points to make:**

**Electricity is essential to life as we know it.**

**Residential consumers are paying too much for electricity by comparison with other consumers.**

**Competition favours big electricity users; domestic users only see rising prices.**

**A future shortage of gas will lead to even higher wholesale prices and profits. Government should consider an increased resource levy on gas.**

**Electricity supply companies must be given incentive to profit from efficient use of resources rather than from creating scarcity.**

**Government should restructure and regulate electricity companies to rebalance the pricing between residential and large electricity consumers.**

**This will take time. Excess profits are now so large that some should be applied to ensuring that vulnerable consumers are not deprived of the electricity they need.**