

18 May 2021

## **Incumbent gentailer profit transparency needed to answer questions about performance of the market**

Rising residential electricity prices, and large increases in incumbent gentailer profits following the COVID19 lockdown, put into question how well competition is working for Kiwi households and businesses.

In order for the Electricity Authority to build trust in the market and operation of industry regulation, consumers need confidence they aren't paying too much for electricity and funding excessive gentailer profits.

The Government Electricity Price Review (EPR) requirement that gentailers report separately on their retail and generation profitability would help answer whether the market is delivering efficient and affordable electricity for consumers.

### **Summary of Entrust's views**

- Wholesale electricity prices have averaged over \$120MWh over the last 4 years (over \$260MWh in the last 3 months). This is more than just a seasonal blip.
- Last year, Kiwi households and businesses should have got some price relief from line charge reductions. Aucklanders didn't benefit from Vector's \$25 million price reduction. Residential prices have been increasing over the last two decades while line charges have been held in check.<sup>1</sup>
- The profits of the large gentailers have all sky-rocketed since the COVID19 lockdown, with Genesis Energy quadrupling its interim profits and having its strongest 6 months since 2014.
- The Authority's consultation paper doesn't mention the Minister of Energy's concern "about whether integrated generator-retailers are making excessive profits".<sup>2</sup>
- The Authority had previously recognised profit reporting is important for monitoring the effectiveness of competition: "No firm should be able to make supernormal profits on an ongoing basis unless it is linked to innovation and ... efficiency".<sup>3</sup>

### **Large gentailer profits and residential prices continue to rise**

Last year, Kiwi households and businesses should have got some price relief from line charge reductions totalling over \$210 million. Auckland households and businesses, struggling with COVID19, could ill afford to miss out on Vector's \$25 million reduction.<sup>4</sup> A

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<sup>1</sup> Refer, for example, to Entrust, Electricity Price Review submission, including consumer concerns about retailers' power pricing, Appendix 1: <https://www.entrustnz.co.nz/media/70017/submission-to-epr-23-oct-2018.pdf>

<sup>2</sup> Hon Dr Megan Woods, Cabinet Paper, Electricity Price Review: Government Response to Final Report, 3 October 2019.

<sup>3</sup> Electricity Authority, Industry and market monitoring: Competition Information paper, 31 August 2011.

<sup>4</sup> Distribution component only. Excludes transmission.

review of how much of the lines company price reductions were passed-through to consumers is on the Authority's work programme but remains unanswered.<sup>5</sup>

It would seem apparent the line charge decreases have been absorbed through high wholesale electricity prices.<sup>6</sup> In the last year spot prices have averaged over \$166/MWh (over \$260MWh in the last 3 months alone).

This isn't a seasonal blip that will go away once it starts raining in the South Island and the hydro dams refill.

Spot prices averaged over \$120/MWh over the last 4 years, which is 70% higher than the 5 years prior to that. The dams were full in January 2020 but spot prices were still over \$90/MWh.

The Minister of Energy asked whether current wholesale prices need to be as high as they are. It's not sufficient for the Authority to claim there are "misperceptions in the public on high spot electricity prices" or "In situations like now ... generation is priced more highly to reflect this scarcity, and the spot price increases accordingly".<sup>7</sup> This doesn't answer whether prices have gone up by more than they should.

While these questions go unanswered, the incumbent gentailers have all announced increased profits since the COVID19 lockdown.

Contact Energy's net profit for the second half of 2020 was up a third to \$78 million on the back of what it euphemistically attributed to "strong management of its assets and business, which allowed it to benefit from high wholesale prices".<sup>8</sup>

Genesis Energy quadrupled its interim profit to \$53 million and upgraded its full year earnings guidance on the back of higher retail profit margins and lower fossil fuel costs. Genesis said that its profit of \$217 million for the six months to the end of December was its "strongest first half performance since listing in 2014".<sup>9</sup>

In the same period, Mercury's profits were up \$47 million to \$130 million, despite 108 GWh lower overall generation, and only a \$7 million reduction in operating expenditure.<sup>10</sup> Meridian similarly reported a 19% increase in net profit despite generation being down 7%.<sup>11</sup>

Trustpower's underlying profit rose 7% to \$200 million in the year to March 2021.<sup>12</sup>

### **Profit disclosure is needed to address concerns about excessive profits**

While Entrust supports the Authority's proposals for gentailers to disclose Internal Transfer Prices and gross retail margins this only partially implements the Government's EPR reforms. Low retail margins can simply hide excessive generation profits.

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<sup>5</sup> The Authority's reporting of residential electricity price trends is out-of-date and only goes up to 30 June 2018:

<https://www.emi.ea.govt.nz/Retail/Reports/VBXZVQ?DateFrom=20100930&DateTo=20180630&DateBase=20100930&seriesFilter=ALL&rsdr=ALL&si=v|3>

<sup>6</sup> <https://www.ena.org.nz/news-and-events/news/lines-charge-reductions-dont-make-their-way-into-consumers-pockets/>

<sup>7</sup> <https://www.ea.govt.nz/operations/wholesale/security-of-supply/spot-prices-and-the-wholesale-market-review/>

<sup>8</sup> <https://www.rnz.co.nz/news/business/436435/contact-energy-profits-up-by-a-third>

<sup>9</sup> <https://www.stuff.co.nz/business/124318462/genesis-posts-record-result-as-it-takes-third-coalfired-turbine-out-of-storage>

<sup>10</sup> <https://www.scoop.co.nz/stories/BU2102/S00279/mercurys-earnings-up-generation-down.htm>

<sup>11</sup> <https://www.meridianenergy.co.nz/news-and-events/meridian-energy-interim-net-profit-higher-cash-earnings-lower>

<sup>12</sup> <https://www.annualreport.trustpower.co.nz/snapshot-2021/>

The Minister of Energy directed the Authority to “require vertically integrated companies to report separately on the financial performance of their retail and generation operations using a common set of rules”.

The Minister was clear, “ongoing questions about whether integrated generator-retailers are making excessive profits risks undermining confidence in the electricity market”.<sup>13</sup> The information would be useful for helping determine whether the market is delivering competitive, fair and affordable prices for consumers. The EPR commented “If there is a real competition problem that requires correcting, separate reporting should help uncover it”.

The consultation paper doesn’t mention the Minister’s concerns about excessive profits or that the EPR reforms include both generation and retail profit disclosure.

It’s not good enough for the Authority to reject segmented retail and generation profit reporting on grounds of cost, complexity or that it “may introduce a degree of arbitrariness”. These considerations were all absent from the Authority’s Transmission Pricing Methodology (TPM) decision.

The Authority can draw on precedent from other jurisdictions to address its concerns. OFGEM, for example, implemented retail-generation profit reporting requirements in 2009, and has subsequently reviewed and tightened the rules. There is a lot of international precedent but none of this is mentioned in the consultation paper.

### **Concluding remarks**

Transparency of gentailer profits matters.

In order to prove Kiwi households and businesses aren’t being ripped off the large incumbent gentailers retail and generation profits need to be transparent. This is critical for building trust and confidence in the market and assuring consumers they aren’t being exploited and paying more than they should for power.

The impact of COVID19 on ordinary Kiwi households and businesses is putting an increased focus on ensuring electricity is affordable.

Entrust considers an affordable and competitive electricity market is an important pre-condition for the electrification of the New Zealand economy and the Government’s climate change objectives. If electricity isn’t affordable the transition to electrification could be harmed.

Kind Regards,



William Cairns  
**Chairman**

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<sup>13</sup> Hon Dr Megan Woods, Cabinet Paper, Electricity Price Review: Government Response to Final Report, 3 October 2019.

**For further information, contact:**

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