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Consultation: Advancing New Zealand's energy transition
Energy and Resource Markets
Building, Resources and Markets
Ministry of Business, Innovation and Employment
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The energy transition needs a highly competitive market that isn't beholden to a small number of dominant players

Electric Kiwi welcomes the opportunity to submit in response to the MBIE energy transition omnibus. This submission is in addition and complementary to the joint 2degrees, Electric Kiwi, Flick Electric and Pulse Energy (the independent retailers) submission.

Electric Kiwi believes in markets and market-led solutions.

A highly competitive market that does not rely on the individual decisions of a small number of dominant players is the key to a successful, affordable energy transition. Highly competitive markets are needed to ensure Kiwi families don't feel a disproportionate financial burden as we transition.

There isn't an 'easy' route for the energy transition and policy reform. The worst response to a complex problem is thinking there is a simple solution.[1] Either the reforms needed to ensure a highly competitive market are adopted or NZ Inc will have to rely on increasingly heavy-handed regulation and Government interventions to deliver the outcomes the MBIE consultation is seeking.

It seems incongruent that at a time when the incumbent generators are continuing to make record profits from their wholesale businesses, Genesis Energy is putting its hand out for taxpayer money to fund programmes to reduce its emissions.[2]

[1] https://www.linkedin.com/posts/the-energy-charter_thankyou-bettertogether-activity-7114804531036655619-v7fb?utm_source=share&utm_medium=member_ios
[2] Genesis Energy chief executive Malcolm Johns complained that Genesis couldn't access GIDI to fund the transition of its Huntly operation off fossil fuels: Climate Change and Business conference in Auckland on 19 September.

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New Zealand needs strong competition to make the most of markets and market-led solutions

MBIE have noted "Our electricity system relies on a multitude of different parties each making their own investment and operational decisions based on their own assessments of costs and benefits, and all using different sources of information".

The wider range and diversity of market participants and competitors making their own decisions, each of which will is getting it right or wrong to varying degrees, the better the outcomes will be for the market as a whole, and for New Zealand Inc and the environment.

Different market participants responding to their own organisational, commercial and regulatory incentives – without an "active system architect … to guide or coordinate the fragmented decisions of individual actors" – is how markets work best. Competition is the most reliable way of managing rapid market, geopolitical and technological change while avoiding wasted investment.

To the extent individual market participants make wrong decisions which result in wasted investment the cost is borne (appropriately) by shareholders and not consumers or the taxpayer (via subsidies or higher prices). Individual market participants will inevitably get it wrong but collectively we will get it right.

A well-functioning, highly competitive market, with a large, diverse numbers of participants, is more important than ever to manage "rapid market, geopolitical and technological change". A central focus of the energy transition programme should be on ensuring competition works as it should; be it through Government reform or industry regulator driven reforms. The very real prospect competition could be (further) weakened during the transition only serves to amplify the importance of eliminating or reducing barriers to entry and competition.

Initial establishment of the wholesale market was a big first step in the right direction

Prior to the structural reforms in the 1990s New Zealand was beholden to the judgement and decisions of ECNZ.

ECNZ effectively served as "system architect" and was responsible for a series of bad decisions. The drought in 1992 and ECNZ's slow response provides a good illustration of what happens when the market is beholden to the decisions of a single operator.[3,4]

The electricity sector and New Zealand as a country has come a long way from the state-owned, monopoly-controlled electricity market but the wholesale market remains strongly oligopolistic and has remained stubbornly so since the break-up of ECNZ. The organic reduction in market share of the baby-ECNZs that was expected at the time has not eventuated.

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[3] Notoriously, ECNZ only pulled an advertising campaign aimed at encouraging greater electricity usage at the 11th hour during the 1992 drought.

[4] Marsden B was never used and eventually shipped to India to operate as a thermal (coal) station without the environmental protections and safeguards that would have functioned if it was operated in New Zealand. The baby-ECNZ, Mercury Energy, essentially exported carbon emissions to India.

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Meridian, in particular, is simply too large. Previously it was the case that if ECNZ got it wrong, New Zealand got it wrong. Now it is the case that if Meridian gets it wrong, New Zealand gets it wrong. That's not good for Meridian and it's not good for New Zealand.

We still have a way to go to realise the benefits of a fully competitive electricity market.

The large incumbents collectively reported record profits this year

The profits of the large electricity gentailers – Contact, Genesis, Mercury and Meridian – have ballooned since Covid-19. They're making record profits at the expense of energy affordability and the wellbeing of Kiwi households and businesses. These four have announced that over the past year they have made over $7 million a day in profits.

The Governments focus on the challenge of how to increase the share of renewable energy, while providing affordability and reliability, brings these issues to the fore. Electric Kiwi believes that it's time for the Government to step in and address the excess profits these incumbent gentailers are extracting from the electricity market.

The latest annual financial results for the listed gentailers reported under NZ IFRS 8 as detailed below highlights a 21% one year rise in earnings to a total of $2.65 billion. This builds on a 9% increase in earnings between FY21 to FY22.

Against a backdrop of a 30% increase in wholesale profits during FY23, reported profits from retail arms have further declined over the same period. Collectively the gentailers earnt over 103% of their EBITDAF from their wholesale businesses in the last final reporting period.

Historical Segmental EBITDAF - Gentailer Sector[5,6,7]

EBITDA $m	Wholesale	Retail	Other	Total
Contact	631	-14	-44	573
Genesis	520	-11	-52	457
Mercury	844	-5	2	841
Meridian	760	103	-80	783
Sector - FY23	2,755	73	-174	2,654
Sector - FY22	2,122	198	-129	2,190

[5]Segmental reporting from gentailer 30 June annual financial statements
[6]Contact FY23 Wholesale EBITDAF adjusted to 'underlying EBITDAF' after removal of onerous Ahuroa Gas Storage Facility provision of $113m, as per Pg4 of Contact FY23 results presentation
[7]Genesis Wholesale EBITDAF excludes Kupe gas exploration joint venture

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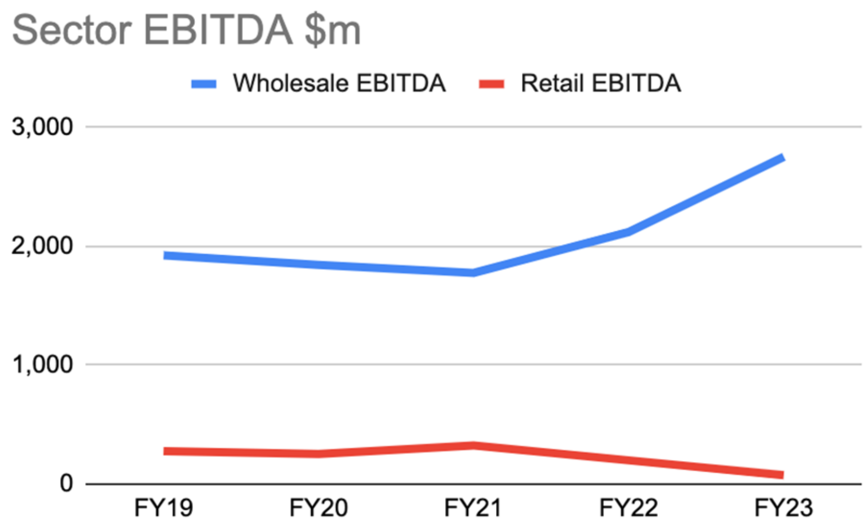
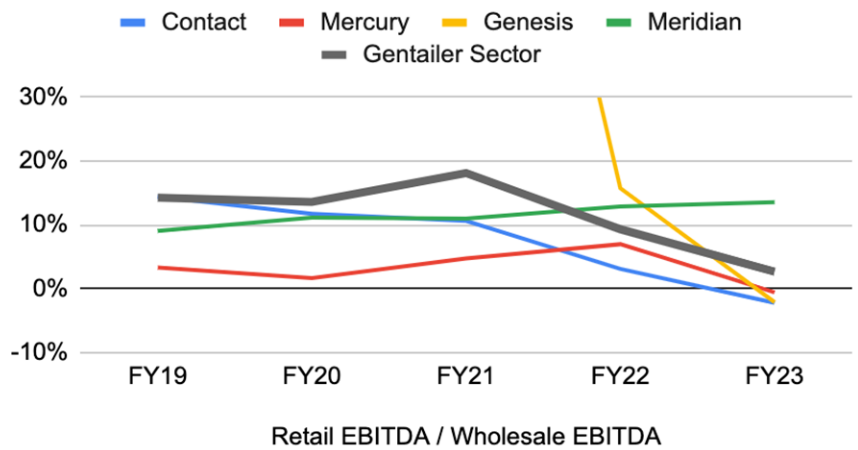
EBITDA $m	Wholesale	Retail	Other	Total
Sector - YOY change	30%	-63%	-34%	21%





The above figures are likely to understate the actual extent of the gentailers' retail losses because (especially in the case of Meridian) they are based on artificially low ITPs for the supply of electricity to their retail arms (based on segmental results reported under NZ IFRS 8). The 2019 Electricity Price Review also noted these concerns.[8]

[8] "The 2019 Electricity Price Review noted concerns that the pricing practices used within integrated generator retailers for transferring electricity between their generation and retail businesses may be undermining competition". Also "Independent retailers and consumers may be disadvantaged if large generator-retailers, which control the greater part of electricity supply, provide electricity at below fair market prices to their own retail arms".
(https://www.ea.govt.nz/projects/all/internal-transfer-pricing-and-profitability/)

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If gentailers were to use the wholesale cost attainable by Electric Kiwi (or any other sophisticated non-vertically integrated retailer) their retail businesses would be even further loss making.

For gentailers, to the extent that retail prices have not keeping up with wholesale price increases simply results in a transfer of profits from their retail arms to wholesale generation businesses (essentially, gentailers are cross-subsidising their retail businesses). However, for non-vertically integrated retailers, this margin squeeze prevents sustainable operations aligned with prudent risk management.

Independent retailers like Electric Kiwi are paying for the incumbent gentailers' record profits through higher wholesale costs. This is squeezing our margins and the space we have to innovate and undercut the incumbents. We pride ourselves on the money our customers are saving through lower and more affordable electricity, but it's getting harder and harder, and customers ultimately bare this cost.

Evidence required to determine problems in the market

One question we have in relation to all the reviews, analysis and submissions on competition matters is what kind of evidence or evidential standard is required to establish there are serious problems that need to be addressed?

This is seen vividly by the Authority's wholesale market review (WMR).[9]

It is unclear why the Authority felt there was uncertainty about whether there is a problem based on the sound problem analysis it undertook.

Apart from the Authority not addressing the sustained high profits of the gentailers in the review (in contrast to the Commerce Commission market studies), the Authority produced extensive and robust evidence of problems in the wholesale market. The Authority was able to comprehensively refute all the criticisms of the work. We felt the Authority should have been in a position to reach firm conclusions about problems in the market on a par with the conclusions the Commerce Commission has reached in its various market studies. The only uncertainty should have been about how large is large, not whether there is a problem.

It is time for the Government to be bold

The reforms in the 1990s transformed the electricity market from a monopoly to an oligopoly. The next step should be to a fully-fledged competitive market.

The independent retailer joint submission highlights that the large, expected increase in generation investment creates a 'window of opportunity' to reduce the market power of the incumbent gentailers through diversification of generation types and ownership.

[9] We also consider that the ITP/gross margin disclosures provide strong prima facie evidence of problems: see the joint independent retailer submission for a discussion on this matter.

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This can only happen if market and regulatory settings are conducive to an increase in the relative level of new entrant and independent generation investment on a scale that we haven't seen over the last 25-years to reduce market concentration and the market power of the baby-ECNZs.

There needs to be some honest conversations with industry regulators about whether this magnitude of change can happen under existing regulatory settings or the current highly vertically-integrated oligopolistic structure will continue as a permanent 'feature' and blight on the market. The Authority is presently too cautionary and wedded to incremental changes to make the changes needed to address the fundamental problems in the market.

There are changes that could be made, such as RMA reform to make it easier for independent generators to enter the market, regulated wholesale access to hedge and risk management products, and retail-wholesale financial separation that aligns with the EPR recommendations, which would help.

Structural reform is the only option on the table that would address the underlying problem

Electric Kiwi considers further structural reform is also needed as part of the mix. The best thing would be to get on and do it, as soon as practicable.

The telecommunications market provides salutary lessons about the benefits of market reform and that the sky won't fall in if the Government makes bold changes. The Government's should be concerned about protecting and promoting markets not protecting and promoting individual market participants.

The Government eventually got fed up with Telecom. Wholesale price regulation was introduced, and in 2011 the Government forced Telecom to split its wholesale and retail businesses into Chorus and Spark.

Electric Kiwi considers 'what is good for the goose, is good for the gander'. The telecommunications reforms have been very successful and enabled new entry and stronger competition, driving down prices and resulting in far better service. There is no reason why consumers couldn't benefit from similar reforms in electricity.

If the Government wants to lower the cost of electricity, it needs to be bold and should adopt structural reform.

Yours sincerely,