

## **Fortnightly report for the Minister for Energy 7 June 2024**

This report summarises items that may be of interest to the Minister for Energy but not necessarily require a formal briefing. Further information on any topic can be provided on request. Substantive items and decision papers will be provided to the Minister in the form of briefings.

**Electricity Authority contact:** Sarah Gillies, Chief Executive

**Mobile:** s9(2)(a)

## 1. Current and upcoming publications and advice

| Strategic priority             | Title   | Purpose   | Action and timing   |
|--------------------------------|---|---|---|
| All                            | Minister for Energy's Letter of Expectations for the Authority for 2024/25 (LOE) and the Authority's response           | The Authority is seeking approval to publish the LOE, as well as our response on our corporate website for public transparency.   | Intended publication date:<br>13 June 2024<br>Approval:<br>Yes/No   |
| System security and resilience | Review of common quality requirements in the Code   | As part of the Future Security and Resilience programme we are publishing a suite of three consultation papers that address five of the seven identified issues with common quality requirements in Part 8 of the Code. | Intended publication date:<br>25 June 2024  |
| Building trust and confidence  | Review of draft statement of intent and statement of performance expectations<br><br>(Ministerial Briefing: BR-24-0019) | The SOI and SPE have been updated in response to Ministerial feedback.  | Second draft due to Minister:<br>14 June 2024<br><u>Further Minister feedback due to Authority:</u><br><u>COB 18 June 2024</u><br><br>This tight turnaround is to ensure we can include any other feedback, finalise the publication and secure board sign off in time to meet the statutory deadline.<br><br>Final copies due to Minister:<br>30 June 2024 |

|   |   |  |   |
|---|---|--|---|
| Monitoring, compliance, education and enforcement | System operator alleged breach of Policy Statement referred to Rulings Panel. | The system operator failed to correctly apply a security constraint when managing a low hydro level in Southland. The length and market impact of this alleged breach was significant. | The complaint has not been finalised. This advance notice of the complaint is provided on a confidential basis until the system operator has been notified <sup>1</sup> .<br><br>This was filed and served on Wednesday 5 June. |
|---|---|--|---|

## 2. Consultations underway

| Strategic priority | Title | Purpose | Action and timing |
|--------------------|-------|---------|-------------------|
|                    | None  |         |                   |

## 3. Upcoming Electricity Industry Participation Code Amendments

Electricity Industry Participation Code Amendments that need to be presented to the House by the Minister's office **within 20 working days** following the date on which it is made.

| Tracking number | Name | Date made | Date of Gazette Notification | Date in force | Due date for presentation to the House |
|-----------------|------|-----------|------------------------------|---------------|--|
|                 | None |           |                              |               |  |

## 4. Proposed additional verbal briefings

| Name | Purpose | Indicative date* | Authority attendees |
|------|---------|------------------|---------------------|
| None |         |                  |                     |

<sup>1</sup> Confidential under section 9(2)(ba)(i) of the Official Information Act 1982

## 5. Recent industry announcements

| Subject                    | Announcement   |
|----------------------------|--|
| Demand response (Meridian) | Meridian has issued a demand response notice to NZAS under its demand response agreement. This agreement is part of the electricity supply agreement with Meridian. The amount of demand response is 50MW. The demand response will apply between 22 June 2024 and 20 August 2024.   |
| Generation (Mercury)       | Mercury is proceeding with an expansion of the Kaiwera Downs wind farm in Southland. The wind farm's capacity is currently 43MW but it will increase to 198MW (2 <sup>nd</sup> biggest in NZ) once completed. Construction, subject to regulatory approvals, is expected to commence in June 2024 and the wind farm is expected to reach full generation by the end of 2026. |

## 6. Key external engagements

- GNS Science, Te Pū Ao EA CE meeting 10 June
- Consumer Advocacy Council and EA CE meeting 14 June
- EECA and EA CE Quarterly meeting 17 June
- EA Quarterly update (webinar): 27 June

## 7. Deep dive: internal transfer price and retail gross margin data release

### Overview

- 7.1. On Tuesday 18 June 2024 the Authority will publish a news item and dashboard on internal transfer price (ITP) and retail gross margin (RGM) data collected from gentailers and non-integrated retailers (RGM only) for the 2022/23 financial year<sup>2</sup>.
- 7.2. These disclosures provide further data points about electricity market competition and will attract attention from non-integrated retailers.
- 7.3. The key findings are:
  - (a) the ITP (the price that a gentailer's wholesale arm 'sells' electricity to its retail arm) increased for all gentailers for 2022/23 compared to previous years. Wholesale spot prices and hedge prices on the ASX also increased over the same period.
  - (b) the RGM (the retailer revenue remaining once the cost of electricity, metering, distribution, and levies have been subtracted) has decreased for most retailers (both gentailers and non-integrated retailers), as costs increased by more than revenue. This indicates all retailers absorbed at least part of the cost increases, instead of fully passing cost increases on to consumers.
- 7.4. When we publish this data, we expect non-integrated retailers will view this as further evidence in support of their concerns about electricity retail market competition.
- 7.5. We agree the data indicates that retailers are making less money, but it doesn't answer why that is occurring. Whether or not there is an underlying retail competition issue arising from retailer access to risk management contracts, or the gentailer ITPs,<sup>3</sup> is the focus of the Authority's risk management review:<sup>4</sup> that is where we are primarily considering the various concerns raised by the non-integrated retailers (Electric Kiwi, Flick, Octopus, 2degrees).

### Background

- 7.6. The 2019 Electricity Price Review noted concerns raised by some stakeholders that integrated gentailers may "be making excessive profits and favouring their retail arms to undermine competition"<sup>5</sup>, with a specific focus on the price for transferring electricity between their generation and retail businesses.

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<sup>2</sup> With over 1% of ICPs (approx. 20,000 ICPs) associated with the sale of electricity to mass market customers

<sup>3</sup> The current ITPs may not be particularly useful as a tool for assessing competition matters: the gentailers have indicated that ITPs are primarily an accounting mechanism, while non-integrated retailers have expressed concerns about the calculations and integrity of the ITP.

<sup>4</sup> Fortnightly report for the Minister for Energy 15 February 2024 (FN-24-01)

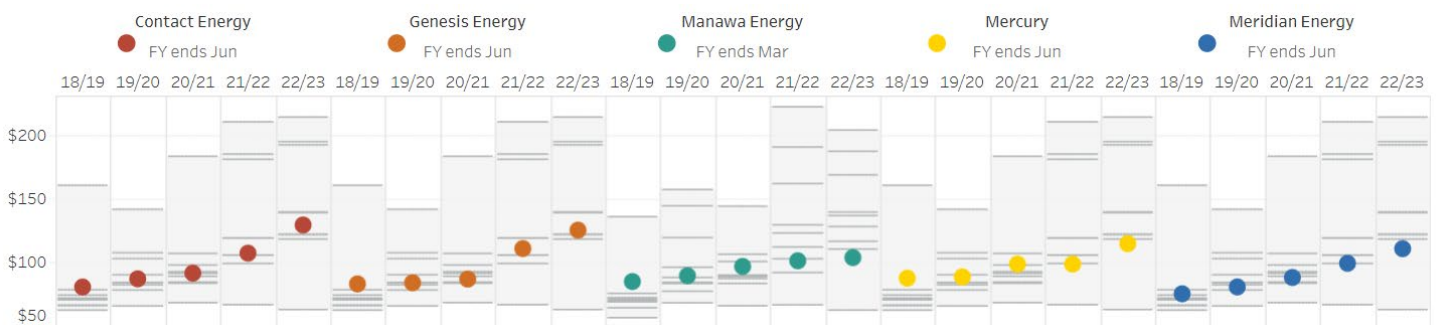
<sup>5</sup> *Electricity Price Review*, May 2019, 19 <https://www.mbie.govt.nz/assets/electricity-price-review-final-report.pdf>

- 7.7. Non-integrated retailers and consumers may be disadvantaged if large gentailers, which control the greater part of electricity supply, provide electricity at below fair market prices to their own retail arms.
- 7.8. The 2019 Electricity Price Review recommended making gentailers release information about the profitability of their retailing activities, including disclosing their ITPs.
- 7.9. In response, the Authority amended the Electricity Industry Participation Code 2010, which took effect on 30 November 2021, to require the disclosure of retail ITP information by gentailers. That Code amendment also included a requirement to disclose RGMs by all retailers with over 1% of ICPs, which in the Authority's view at the time was likely to improve all parties' understanding of the competitive behaviour of retailers.

## Findings

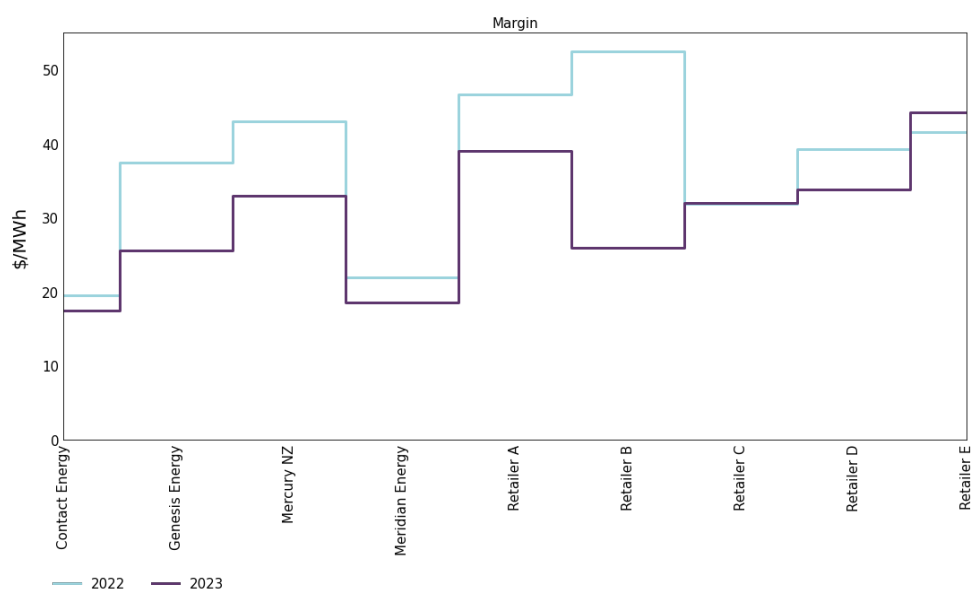
- 7.10. Figure 1 shows the disclosed ITP and benchmarks (based on ASX prices) for each gentailer for every financial year from 2018/19 to 2022/23. It shows the ITP has been increasing for all gentailers, in line with the direction of travel of most of the benchmarks.

Figure 1: Internal transfer price and benchmarks by retailer between 2018/19 and 2022/23



- 7.11. Figure 2 shows the RGM for all retailers with at least 1% of ICPs, though retailers with less than 5% of ICPs have been anonymised.
- 7.12. The average RGM decreased from \$37/MWh to \$30/MWh. The decrease in the average RGM was due to average costs increasing by \$23/MWh while average revenue increased by \$16/MWh. This indicates retailers did not pass through the full cost increases to consumers. The fall in margin tended to be larger for retailers with high margins in 2022, especially 'Retailer B' whose electricity costs was the lowest in 2022 and the highest in 2023.

Figure 2: Retail gross margin by retailer for 2022 and 2023 financial years



## Further work

- 7.13. The Authority is carrying out a post-implementation review of the RGM and ITP information disclosure provisions to better understand the value of these disclosures in promoting competition. Both gentailers and non-integrated retailers have raised questions about that value.<sup>6</sup>
- 7.14. At the same time the Authority is undertaking a broader review of price risk management options for retailers,<sup>7</sup> which will:
- test whether the availability and pricing of risk management options – which help retailers to manage the electricity cost component of the RGM calculation – is creating a barrier to entry or expansion in the retail electricity market, and therefore harming competition; and
  - consider whether gentailer internal pricing relativities (whether ITP or other) raise retail electricity market competition concerns.
- 7.15. In our view the risk management review is the most effective and timely way to assess whether gentailers, in their dual role as a core provider of risk management products, and a retail competitor, are undermining retail competition. That includes considering the key input price component of any “margin squeeze”<sup>8</sup> the non-integrated retailers have raised concerns about.

<sup>6</sup> Gentailers note that the ITPs are primarily put in place for a different purpose (accounting requirements); non-integrated retailers have questioned the calculation and integrity of the ITPs.

<sup>7</sup> That allow retailers to manage the difference between volatile wholesale electricity market prices, and the stable prices offered to mass market customers.

<sup>8</sup> A margin squeeze occurs when a vertically integrated business with sufficient market power narrows the margin between its retail prices, and the costs of essential inputs that it supplies to its rivals, such that those rivals cannot compete effectively.

- 7.16. We are progressing the investigation phase of the risk management review work as quickly as possible, while ensuring the work is robust. At this point it is too early to say what competition problems, if any, that work may uncover. We expect to discuss our initial view of any problems with the Authority Board in September, and will update you shortly after that. At that point we would also intend to release our view to stakeholders, for feedback.
- 7.17. We appreciate that the investigation process is frustrating, particularly for the non-integrated retailers that have raised concerns with you (as well as with the Authority and the Commerce Commission). We intend to update them on our process in the week of 10 June, but are not at a point where we can usefully share anything substantive with them.
- 7.18. Once we have a settled view of the competition problems, if any, we will consider what the most effective solutions to them (and associated timeframes) might be.