

# A strange view of 'fair' power pricing

## Geoff Bertram

Victoria University economist

The Electricity Price Review has produced its second report, outlining options for making electricity pricing more "fair". Big corporates and their shareholders can sleep easy.

"Fairness", as conceived by the review panel, turns out to mean protection for the industry's asset values and profits against anything that might seriously break down its monopolistic stranglehold on residential consumers.

As expected, it recommends taxpayer subsidies to help the poorest households pay their bills, underwriting the industry's revenues. Other recommendations usefully address two retail-market ills: early-payment discounts that benefit the rich at the expense of the poor, and predatory pricing "win-back" practices.

Banning early-payment discounting, the panel suggests, might save consumers up to \$45 million a year – about half of 1 per cent of total industry revenues. So much for fiddling at the margins. What about the big elephants in the room: structural features baked into the market design, that underpin the big monopoly profits and hydro rents?

Take first the asset valuations used by the Commerce Commission to set the

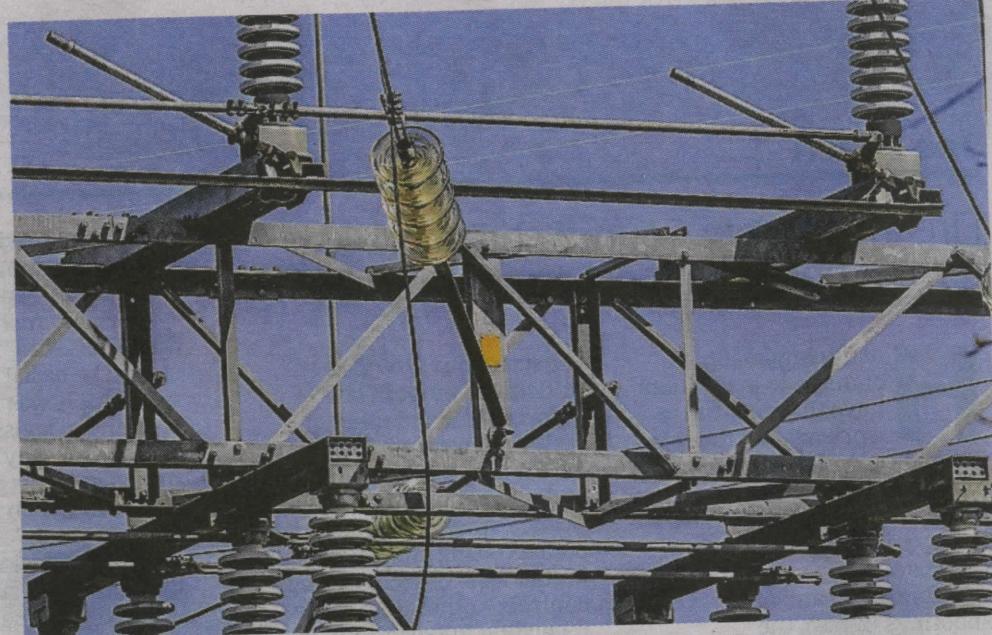
price consumers must pay to the distribution companies. The review acknowledges that going back to historic-cost valuations as the basis for regulated lines charges would benefit consumers. But the protection of shareholder value is paramount: "There is little gain in trying to unwind revaluations more than two decades old".

My estimate of the "little gain" is a potential saving to consumers of about \$200 million a year. "We do not favour this option," the review panel concludes.

Then comes splitting up the vertically integrated gentailers which is, unsurprisingly, vigorously opposed by industry insiders. It would, as the review panel correctly points out, "substantially change New Zealand's electricity market and disrupt many businesses". But again it does "not favour this option".

Next, logically, would come the option of unwinding another element of the 1998 "Bradford reforms" – the "lines/energy split" which tightly restricts construction and operation of generation facilities and retail operations by lines companies, and thereby blocks the emergence of locally based integrated community energy providers that could combine distribution networks with distributed supply from solar panels, batteries, wind and small hydro. That could pose a really serious competitive threat to the big incumbents. The review panel doesn't even mention it.

How about renationalising the industry and returning to the old model of providing electricity at cost as an



essential service? "Unnecessary or impracticable", says the review panel, before excluding this from its list of options put out for consultation.

Other possibilities for direct Government intervention – construction and operation of renewables-based generation on the margin of the wholesale market, to restrain spot prices and cover the dry-year problem that three decades of the market-based experiment have failed to solve – don't rate a mention.

What then of the excess profits secured by manipulation of the market spot price by the big gentailers? Two economic studies, by Frank Wolak and Stephen Poletti, have found that the excess of spot prices over short-run marginal cost has amounted to billions of dollars. The industry's limp excuse, echoed by the review panel, is that the excess margin is needed "to cover fixed costs".

So here's the problem. "Fairness" is a contested notion. When she set up the

review, Energy Minister Megan Woods provided no definition. The review team, as it is entitled to do, has taken the view that it would be unfair to disrupt established businesses, property rights, profit expectations, and legally acquired market power, just to make life easier for residential consumers.

The present structure of the industry, including its right to extract excess profits from consumers, has been hard-wired into law by our elected Parliament. More affordable electricity would increase "wellbeing" – but would come at the expense of industry stakeholders who would undoubtedly see it as "unfair".

Yet the review agrees there is "a regulatory gap in the protection of household and small business consumers", and feels the need to point out that "consumer protection is consistent with the 'long-term benefit of consumers'", even if the Electricity Authority disagrees. Watch this space – but don't hold your breath.

The Electricity Price Review has produced its second report, outlining options for making electricity pricing more “fair”. Big corporates and their shareholders can sleep easy. “Fairness”, as conceived by the review panel, turns out to mean protection for the industry’s asset values and profits against anything that might seriously break down its monopolistic stranglehold on residential consumers.

As expected, the report recommends taxpayer subsidies to help the poorest households pay their bills, underwriting the industry’s revenues. Other recommendations usefully address two well-known retail-market rorts: the use of early-payment discounts that benefit the rich at the expense of the poor, and predatory-pricing “win-back” practices.

Banning early-payment discounting, the panel suggests, might save consumers up to \$45 million a year - about half of one percent of total industry revenues. Adopting all the competition-enhancing recommendations in the report might at best cut 1% off the industry’s \$7 billion of total revenues.

So much for fiddling at the margins. What about the big elephants in the room – structural features baked into the market design, that underpin the big monopoly profits and hydro rents?

Take first the asset valuations used by the Commerce Commission to set the price consumers must pay to the distribution companies. The Review acknowledges that going back to historic-cost valuations as the basis for regulated lines charges would benefit consumers. But the protection of shareholder value is paramount: “there are costs, in terms of investment certainty, to trying to unwind historic revaluations .... There is little gain in trying to unwind revaluations more than two decades old”. My estimate of the so-called “little gain” is a potential saving to consumers, and corresponding loss to the companies, of around \$200 million a year, with the lion’s share of the gains going to households. “We do not favour this option” the review panel concludes.

Then comes splitting up the vertically-integrated gentailers which is, unsurprisingly, vigorously opposed by industry insiders. It would, as the Review panel correctly points out, “substantially change New Zealand’s electricity market and disrupt many businesses”. But “so far as we are aware, no country has required separation of generation and retailing”. That careful wording delicately avoids any need to mention that the UK regulator in 1995 actively blocked vertical mergers of large generators and retailers because of the anti-competitive implications. It also saves the panel from having to even mention the Labour-Greens 2013 “single buyer” proposal. “We do not favour this option” the panel hastily concludes.

Next, logically, would come the option of unwinding another element of the 1998 “Bradford reforms” – the “lines/energy split” which tightly restricts construction and operation of generation facilities and retail operations by lines companies, and thereby blocks the emergence of locally-based integrated community energy providers that could combine distribution networks with distributed supply from solar panels, batteries, wind and small

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Other possibilities for direct Government intervention – for example, construction and operation of renewables-based generation on the margin of the wholesale market, as a means of restraining spot prices and covering the dry-year problem that three decades of the market-based experiment have failed to solve – don't rate a mention.

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