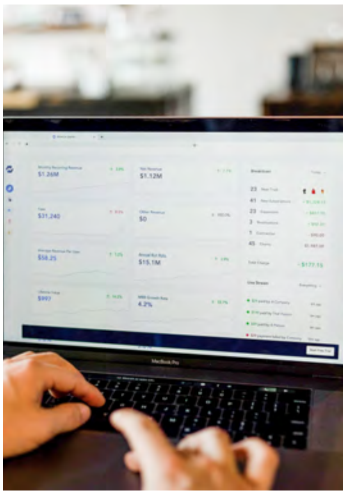
GENERATING SCARCITY: 2023 UPDATE

A joint report by 350 Aotearoa, the NZ Council of Trade Unions, and FIRST Union

NZCTU Te Kauae Kaimahi
350 AOTEAROA
WORKERS FIRST FIRST UNION

TABLE OF CONTENTS




TAX
SUPERMARKETS
TAX
POWER COMPANIES
POWER UP
FREE DENTAL
TAX
POWER COMPANIES
POWER UP

EXECUTIVE SUMMARY

In November 2022, 350 Aotearoa, NZCTU and FIRST Union released a report claiming that from 2014 to 2021, the four generator-retailer "gentailers" – that dominate 87 percent of the NZ electricity market – had collectively paid out $3.7 billion in excess dividends to shareholders. An *excess* dividend is when the amount distributed in dividends to shareholders is greater than the after-tax profit generated by the company. Excess dividend distribution surged in the wake of the Key Government's partial privatisation of Genesis, Meridian and Mercury, putting upward pressure on electricity prices and slowing the energy transition away from fossil fuels.

Since the report's release, communities across the country have faced the impacts of increasingly powerful extreme weather events alongside a cost-of-living crisis. Cyclones and flooding events have hammered areas like Taitokerau, Tamaki Makaurau and Tairāwhiti, destroying livelihoods and bringing into question the long-term viability of entire industries like horticulture and forestry in these areas. The need for a just transition is greater than ever before.

This briefing updates that report with the latest data, insights from engagement with policymakers, and new developments in our campaign for an electricity system that works for people and planet:

- In 2023 the gentailers distributed $1.1 billion in dividends to shareholders from net profit after tax of only $521 million, an excess dividend of $638 million (Meridian: $423 million, Mercury: $194 million, and Contact: $116 million). This is the third-highest excess dividend paid to shareholders since partial-privatisation ($817 million in 2015 and $639 million in 2016).
- In the decade to 2023, dividends have totaled almost $10.8 billion (including excess dividends of $4.2 billion), while investment on plant, property, and equipment over the decade came to only $4.5 billion. For every dollar spent on

plant, property, and equipment, $2.41 has been spent paying shareholder dividends.

- 2023 is the first year since 2013 that cumulative gentailer investments in plant, property, and equipment were higher than cumulative gentailer dividends. However in the last decade, total generating capacity has increased by only one percent.

With a new Government formed, discussions about the role of the private sector in the transition to a low-emissions energy future are crucial. National Governments privatised Contact in 1996, split the Electricity Corporation into competing state-owned enterprises in 1998, and partially-privatised Genesis, Mercury and Meridian in 2013. Coalition agreements and other proclamations commit to doubling renewable electricity by 2050, but also scrap the 100% renewable energy target and the Onslow pumped hydro scheme.

A decade of data shows next to no growth in national generating capacity against $11 billion in dividends for shareholders, 142 percent of net profit after tax. These costs slow the expansion of generating capacity and the decarbonisation of industrial and transport emissions, as well as impact the competitiveness of domestic manufacturing and job creation. This data shows that privatisation has failed to deliver for people and planet.

INTRODUCTION

Last year's *Generating Scarcity* report was met with significant interest from consumers, investors and policymakers. Contact Energy Chief Executive Mike Fuge, for example, acknowledged concerns but told the NZ Herald, "[w]e are putting our money where our mouth is – we are not spending it on acquisitions or on excess dividends. We are spending it on quality renewable investments, which will help us completely decarbonise."[1] In a post-Cabinet press-conference, then-Minister of Finance Grant Robertson acknowledged the report's findings but was unwilling to commit to calls for a minimum profit reinvestment target, or windfall taxes.[2]

The findings of that report remain largely uncontested. One piece of critical engagement – authored by the head of retail investment at a fund with gentailer holdings – notes that the definition of excess dividends was not adjusted for "'front-loaded' depreciation charges across the industry", which would see distribution rates of "circa 80 percent" over the past five years.[3] The author also states that gentailer shares have performed well since partial-privatisation, citing strong dividends and increasing share prices.

Some took issue with the proposition that the payment of excess dividends resulted in higher residential electricity prices, noting that since partial privatisation residential prices have increased at a lower rate than inflation. Electricity Retailers' Association of New Zealand (ERANZ) chief executive Bridget Abernethy, for instance, told *Stuff.co.nz* that over the past five years the average household electricity bill had increased slower than the rate of inflation.[4]

1 Jamie Gray "Contact Energy CEO Mike Fuge hits back at excessive profit claims" (16 November 2022) NZ Herald. https://www.nzherald.co.nz/business/contact-energy-ceo-mike-fuge-hits-back-at-excessive-profit-claims/DMP6G6C6RRFXZF2LEUTETJXJ3U/

2 Honourable Grant Robertson "Post-Cabinet press conference" (14 November 2022), from 22m30 to 26m35. https://www.facebook.com/watch/live/?ref=watch_ permalink&v=450613927207556

3 Although the graph presented suggests they are closer to 90%. *See* Greg Smith, "'Excess dividends' in the Electricity sector – the other side of the argument" (28 November 2022) Good Returns. https://www.goodreturns.co.nz/article/976521083/excess-dividends-in-the-electricity-sector-the-other-side-of-the-argument.html

4 Tom Pullar-Streckar "Energy Minister downplays accusation power firms engaged in 'asset stripping' (14 November 2022). https://www.stuff.co.nz/business/130454686/energy-minister-downplays-accusation-power-firms-engaged-in-asset-stripping

By diverting capital from investment in new generating capacity, the distribution of excess dividends puts upwards pressure on electricity prices. If gentailers had invested in additional renewable capacity rather than distributing excess dividends, households could have experienced real declines in household energy prices. Our electricity network could be a hedge against inflation when times are tough.

Household energy costs are now rising at their highest rate since 2011,[5] in line with other economic stresses. Energy hardship has not been widely discussed during the cost-of-living crisis, however the recently-released of the Energy Hardship Reference Group (a recommendation from the 2018-19 Electricity Price Review) sheds some light on this issue:

- In the year to June 2022 110,000 households could not afford to keep their homes adequately warm.
- Maori, Pasifika, renters and low-income households experiencing greater energy hardship than other groups.

As part of that work, MBIE developed a set of energy hardship measures, that include not being able to pay utility bills more than once in the last year, not being able to keep the house adequately warm, or putting up with feeling cold to keep costs down.[6]

Photo by: Rebecca McMillan

5 See "Household living-costs price indexes" (26 October 2023) Stats NZ. https://www.stats.govt.nz/information-releases/household-living-costs-price-indexes-september-2023-quarter/

6 Energy Hardship Expert Panel Report to the Minister "Te Kore, Te Po, Te Ao Marama. Energy Hardship: the challenges and a way forward" (July 2023) New Zealand Government. https://www.mbie.govt.nz/dmsdocument/27802-doia-2324-0860-response-for-publishing-pdf

In the months that followed the release of the report, much of the North Island was hit with consecutive extreme weather events, including Cyclone Hale and the Auckland Anniversary Weekend floods in January, followed by Cyclone Gabrielle in February. On the Anniversary flooding, NIWA reported that an entire summer's worth of flooding fell within one day,[7] and the event is considered to be the worst flooding in Auckland's history. Cyclone Gabrielle battered Northland and Auckland, but its largest impact was in the Gisborne and Hawkes Bay regions, which experienced 488mm of rain. Heavy rain dislodged swathes of forestry slash, washing out bridges and covering farms and beaches. Orchards across the region were buried in silt and the horticulture industry experienced significant damage. RBNZ estimates suggest the combined insurance costs of the Auckland flooding and Cyclone Gabrielle will be around $3 to $4.2 billion, making them the costliest weather event insurance claims in New Zealand's history.[8]

In July 2023, faith-based campaign group Common Grace launched a campaign calling for the Electricity Authority to ban disconnection fees on customers who can't afford to pay. According to campaigner Kate Day, Genesis disconnected 1012 post-pay households for 24 hours or more, while Mercury disconnected 2705 (the company claims it was only 629). Fees can be as high as $192.[9]

The gentailers reported results in August 2023, earning a record $2.7 billion in EBITDA.[10] At the time, *Consumer NZ* chief executive John Duffy also revealed survey results suggesting 60% of New Zealanders were concerned about the cost of energy, noting that "the optics of huge profits at the height of a cost-of-living crisis aren't great". Duffy told *Stuff.co.nz* that Consumer had estimated "40,000 households have gone without power at some point in the past year because they couldn't afford to pay".[11] That same month, the Government announced a "first-of-its-kind" $2 billion climate infrastructure fund, partnering with asset management giant Blackrock, with the goal of making New Zealand the first country in the world to reach 100 percent renewable electricity.[12] We will discuss this in more detail in Section 4.2.

7 "Auckland suffers wettest month in history" (2 February 2023) NIWA. https://niwa.co.nz/news/auckland-suffers-wettest-month-in-history

8 "Financial stability implications of recent North Island weather events" (3 May 2023) Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/fsr-may-23-special-topic-2

9 Brianna Mcilraith "Advocates want electricity disconnection fees banned as people struggle to afford power" (21 August 2023) Stuff.co.nz. https://www.stuff.co.nz/business/132780662/advocates-want-electricity-disconnection-fees-banned-as-people-struggle-to-afford-power

10 Earnings before interest, taxation, depreciation and amortisation, a key measure of profitability.

11 Esther Taunton "'Big four' power companies earning $7 million every day" (31 August 2023) Stuff.co.nz https://www.stuff.co.nz/business/132841291/big-four-power-companies-earning-7-million-every-day

12 "PM Hipkins hails $2b BlackRock climate investment fund for renewable energy" (8 August 2023) RNZ. https://www.rnz.co.nz/news/political/495339/pm-hipkins-hails-2b-blackrock-climate-investment-fund-for-renewable-energy

Photo by: 350 Aotearoa

In September 2023, retailer Electric Kiwi filed a complaint with the Commerce Commission, alleging the big four gentailers had violated Section 36 of the Commerce Act. Chief Executive Luke Blincoe told Stuff.co.nz that "the gentailers are [sic] misusing their power in wholesale markets by refusing to supply 'shaped' hedge products to non-vertically integrated retailers… [As a result], in the past five years we have seen more than 20 retailers leave the market."[13]

October 2023 was consumed by the election, and November focused largely on coalition negotiations between the National, Act and NZ First parties. A new government has now been formed, and we will discuss the policies of the new Government in relation to the electricity section in Section Four, after the updated discussion on excess dividends in Section Two, and its impact on investment in Section Three.

13 Tom Pullar-Streckar "Electric Kiwi takes complaint over 'big four' power firms to Commerce Commission" (6 September 2023) Stuff.co.nz. https://www.stuff.co.nz/business/132884157/electric-kiwi-takes-complaint-over-big-four-power-firms-to-commerce-commission

A DECADE OF EXCESS DIVIDENDS

In 2023, gentailers distributed $1.1 billion in dividends to shareholders from net profit after tax of only $521 million, an excess dividend of $638 million, the third-highest excess dividend paid to shareholders since partial-privatisation. In the decade to 2023, dividends have totaled almost $10.8 billion, including excess dividends of $4.2 billion.

The gentailers have now reported 2023 results, meaning we now have a decade's worth of data to evaluate the costs of privatisation in the electricity sector. Conditions have certainly been favourable. Heavy rainfall at the end to 2022 and beginning of 2023 greatly benefited profitability for the gentailers with significant hydro assets, with hydro generation reaching a record 26,013MW. This equates to a 60% share of total electricity generation, the highest-equal level since 2004. This helped push the renewable share of generation to 87.1% in the 2022 calendar year, also a new record. While full-year 2023 generation data is not yet available, the respective renewable and hydro shares are also likely to be similarly high.

This was reflected in firms' results in the 2023 financial year. Cumulative revenue declined for its second year running, a trend consistent across everyone except Mercury. However cumulative gentailer earnings (i.e. EBITDAF[14]) surged to $2,607 million, its highest level on record. Cumulative EBITDAF margins reached 25 percent in the 2023 financial year, in line with 2011 and 2017 records.

Excess dividends reached record lows in the 2022 financial year. Contact was the only gentailer to pay an excess dividend in 2022, of $60 million ($242 million in dividends off $182 million in net profit after tax). This likely has more to do with the doubling of cumulative gentailer net profit after tax, from $749 million in 2021 to $1,537 million in 2022. These results were supported by asset sales, notably the sale of Meridian Energy Australia (which recorded a net gain on sale of $214 million)[15] and a $367 gain related to Mercury Energy's disposal of shares in Tilt Renewables Limited.[16]

2023, on the other hand, saw cumulative net profit down to $520 million, while cumulative dividends rose to $1,108 million, creating a cumulative excess dividends of $638 million. This is the highest level since 2016 and the third-highest since partial-privatisation. More than half of the quantity of excess dividends distributed in 2023 – $328 million – were distributed by Meridian. Mercury accounted for almost a third of 2023 excess dividends at $194 million, and Contact another $116 million.

Cumulative dividends distributed for the 2023 financial year reached 213 percent of net profit, meaning excess dividends reached 113 percent. The Government collected $266 million of those excess dividends from its 51 percent shares in Meridian and Mercury (Genesis did not pay an excess dividend in 2023). While cumulative dividends in 2023 are up slightly on the 2021 and 2022 tallies, the surge in excess dividends is driven largely by a more than a billion dollar decline in net profit after tax, falling from $1,536 million in 2022 to $521 million in 2023.

---

14 The measure used here is EBITDAF (earnings before interest, tax, depreciation, amortisation and change in fair value of assets), a key measure of firm profitability.

15 Meridian 2022 annual report, p149. https://www.meridianenergy.co.nz/public/Investors/Reports-and-presentations/Annual-results-and-reports/2022/Integrated-Annual-Report-30-June-2022.pdf

16 Mercury 2022 annual report, p63. https://issuu.com/mercurynz/docs/mer0006_ar22_report_pp6_lr

Over the decade, gentailers collectively paid out $10.8 billion in dividends off $7.6 billion in net profit after tax, an excess dividend of $4.2 billion, an average of $422 million per year. In other words, over the last decade cumulative dividends were equal to 142 percent of net profit after tax. Meridian was responsible for 42 percent of this total ($1.8 billion), followed by Contact at 28 percent ($1.2 billion), Mercury at 16 percent ($670 million) and Genesis at 14 percent ($582 million). Dividends over this decade have averaged 11.7 percent of revenue over that decade, while net profit after tax has averaged only 7.8 percent.

The total Government share of these excess dividends came to $1,541 million, 36.5 percent of total excess dividends over the decade since partial privatisation. Total government dividends over the decade came to $4,189 million, indicating that excess dividends accounted for more than a third of total dividends received by the Government over this period.

Private shareholders, on the other hand, accounted for the other 63.5 percent of excess dividends over this period some $2,682 million in excess dividends. Private shareholders earned a total of $6,632 million, indicating that excess dividends accounted for 40 percent of total dividends received by private shareholders. This relatively higher rate likely accounts for the fact that Contact, which is completely privately-owned, accounted for 28% of gentailer excess dividends over the last decade, while only accounting for 24 percent of gentailer revenue.

Comparing the scale of gentailer dividend distribution across the decade to the scale of investments in new renewable capacity shows

Photo by: Thomas Coker

a clear focus on the short-term by rewarding shareholders to the long-term detriment of consumers. Over the decade to 2023, the gentailers have distributed a total of $10.8 billion in dividends while investing only $4.5 billion into plant, property and equipment. In other words, for every dollar of new investment, gentailers have collectively paid out $2.41 in dividends.

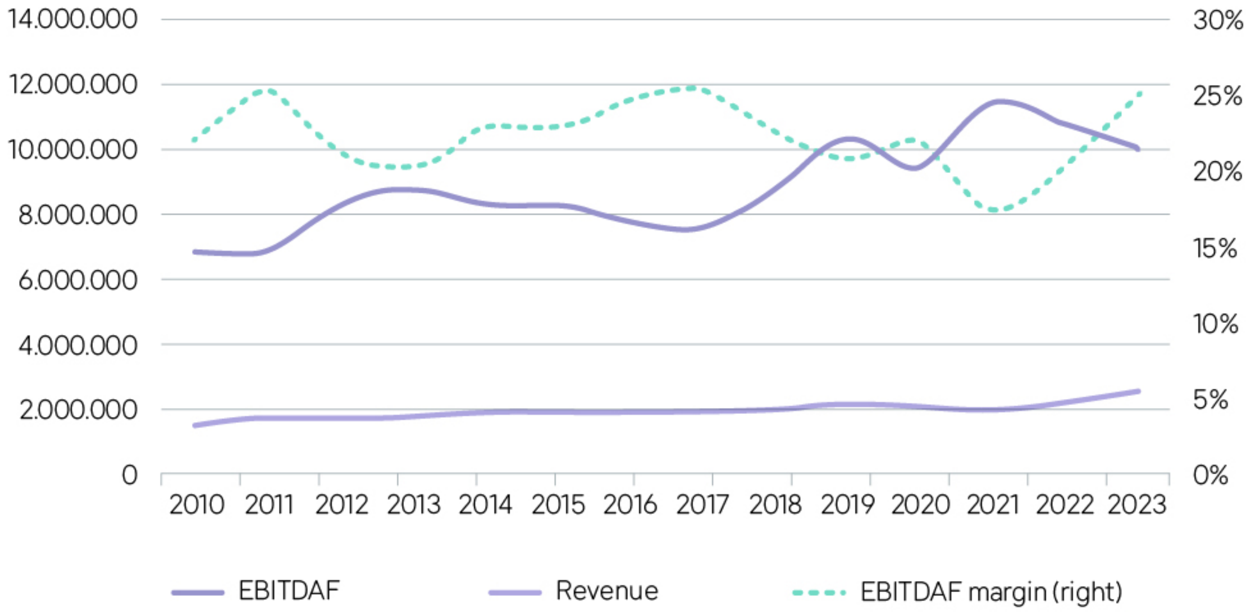
As a percentage of gentailer dividends over the decade, investment averaged only 42 percent, less than half. This was most pronounced at Meridian, where investment for the decade was only 26 percent of dividends (roughly a quarter), while Mercury was the only gentailer where investment for the decade reached half of dividends (53 percent).

GENTAILER EXCESS DIVIDENDS, 2014 TO 2023

	Contact	Genesis	Meridian	Mercury	TOTAL
Excess dividends	$1,201 million	$581.6 million	$1,770.6 million	$670 million	$4,223.2 million
Percentage of total	28%	14%	42%	16%	100%

It is a company's choice to decide how it distributes and invests capital, and companies must weigh up long and short-term priorities. However while electricity companies trade in the private market, there are clear social and environmental implications in the way they operate. The mixed ownership model under which Genesis, Mercury and Meridian operate is a concession to this idea. The state maintains a majority public shareholding to balance public and private objectives. This data suggests a consistent failure in the ability of the model to deliver on its long-term social and environmental objectives.

CUMULATIVE GENTAILER EBITDAF MARGIN ($ 000)



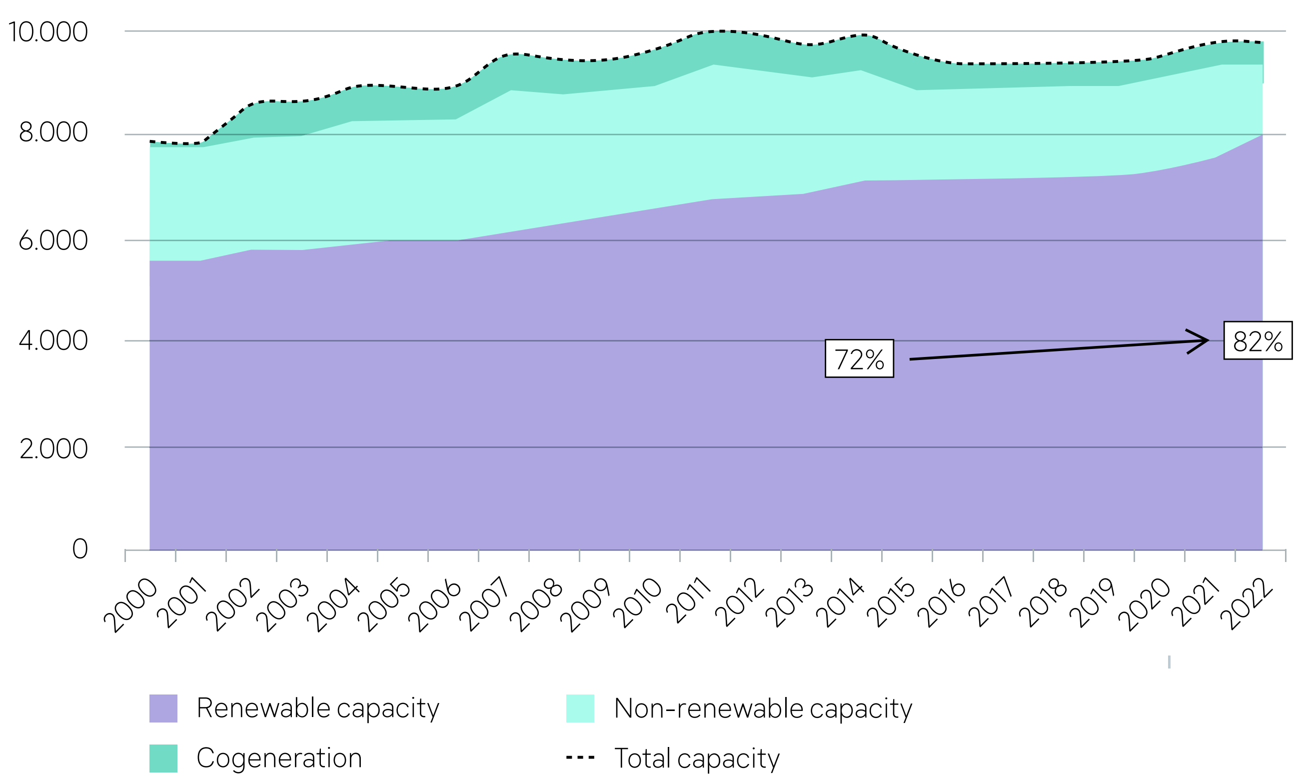
INVESTMENTS TOP DIVIDENDS IN 2023

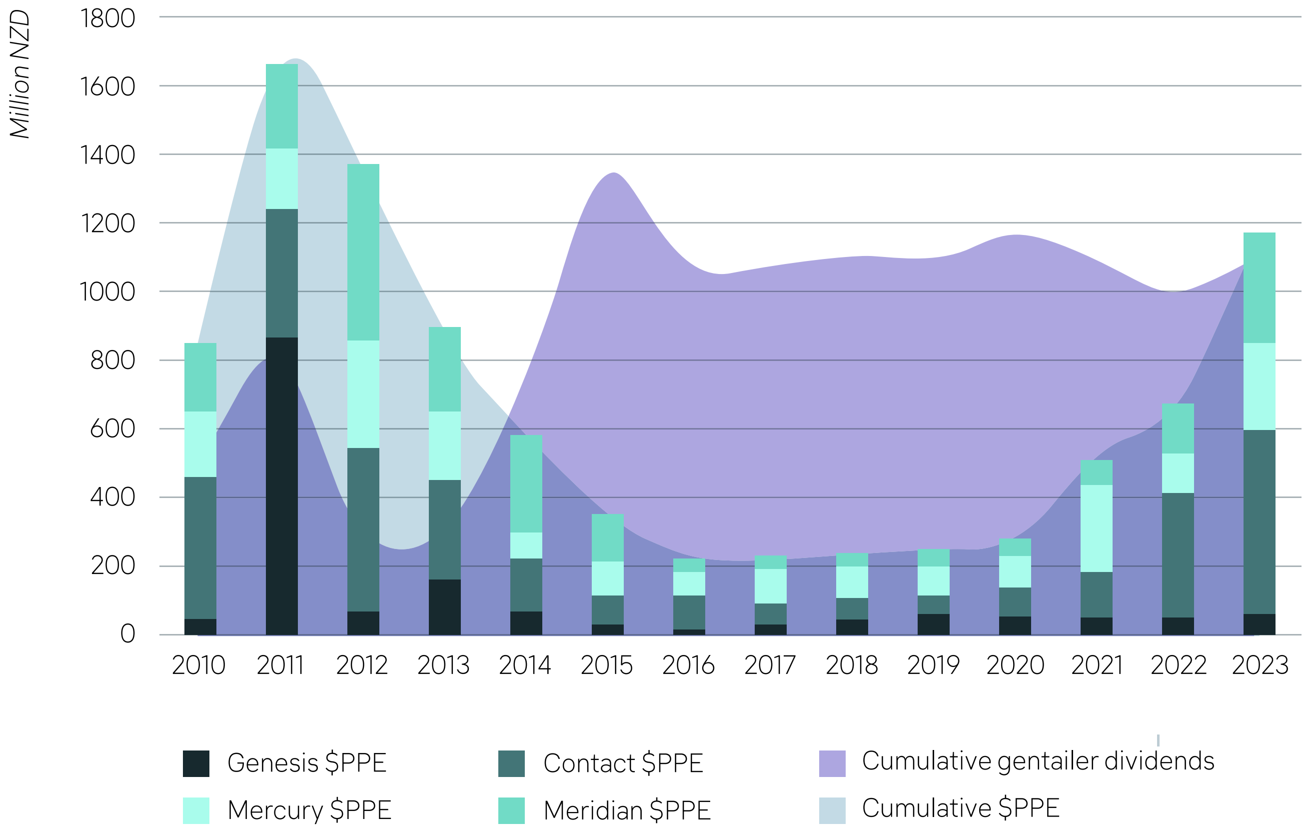
Decarbonising the industrial and transport sectors in the coming decades will require a significant increase in renewable electricity generation. The industry insists this is already happening. "We're ploughing earnings back into developments," said ERANZ chief executive Bridget Abernethy. "Market analysts estimate we'll invest around $4 billion in renewable generation in the next five or six years."[17] However while the last two years show a positive trend, the decade since partial-privatisation has shown weak patterns of investment overall. We need to ensure that the trend for the coming decades reflects the last two years rather than the previous eight, however the need to return dividends to private investors militates against the likelihood of this.

As noted above, the last two financial years have shown a positive trend. From 2021 to 2023, cumulative gentailer investment in plant, property and equipment has increased 128 percent, surging from

17 *See* Note 6.

OPERATIONAL CAPACITY (MW)





$513 million in 2021 to $1,168 million in 2023. That is $60 million higher than the dividends distributed that year, meaning that 2023 is the first year since 2013 that cumulative investment in plant, property and equipment has been higher than cumulative dividends.

This appears to represent a break from the previous period when investment in plant, property and equipment collapsed in the wake of partial privatisation. The policy was unpopular when initially proposed in the early 2010s, causing uncertainty which likely discouraged further investment. The asset sales themselves proved underwhelming, with total earnings reaching only $4.7 billion, falling short of the $5 – 7 billion sum projected by the Government. In the years that followed it seems that gentailer management focused disproportionately on rewarding investors that had bought shares. From 2016 to 2020, cumulative gentailer investment in plant, property and equipment ran at less than $300 million per year, while dividends consistently topped a billion dollars a year.

These trends are reflected in MBIE's electricity generation capacity data. Over the 2016 to 2020 period total generating capacity increased by only 124 MW to 9,537 MW, a mere one percent increase (made up of a 164 MW increase in renewable capacity, a 12 MW increase in non-renewable capacity and a 40 MW reduction in cogeneration capacity). Contrasting this with the last two years shows an apparent changing trend. While 2023 data isn't yet available (the dataset uses the calendar year, not the financial year)

"[F]rom 2013 to 2022, total generating capacity has increased by only one percent, 104MW."

in 2021 and 2022 generating capacity increased by 315 MW, with a notable 670MW increase in renewable capacity and a 356 MW reduction in non-renewable capacity.

The combined impact of these changing patterns of investment, and the reduction of non-renewable generating and co-generation capacity, means that from 2013 to 2022, total generating capacity has increased by only one percent, 104MW. Despite this negligible increase, cumulative gentailer borrowings have increased by 34 percent ($1.6 billion), to $6.2 billion, 58 percent of cumulative revenue.

The replacement of non-renewable capacity means the proportion of renewable capacity in the generating mix has now risen from 72 percent of total operational capacity to 82%. Wind-powered generating capacity has increased by 312 MW to 994 MW, a 46 percent increase. More impressive has been the increase in solar capacity, from a mere 24 MW of installed capacity in 2014 to 284 MW in 2022, a 1105 percent increase. The exclusion of small-scale distributed generating capacity – particularly home solar – means this figure is likely undercounted.

Ultra-low interest rates during the pandemic may well have been a factor supporting higher rates of investment in the last two years. The sharp rise in interest rates since October 2021 likely militates

RISING RATES INCREASE BORROWING COSTS

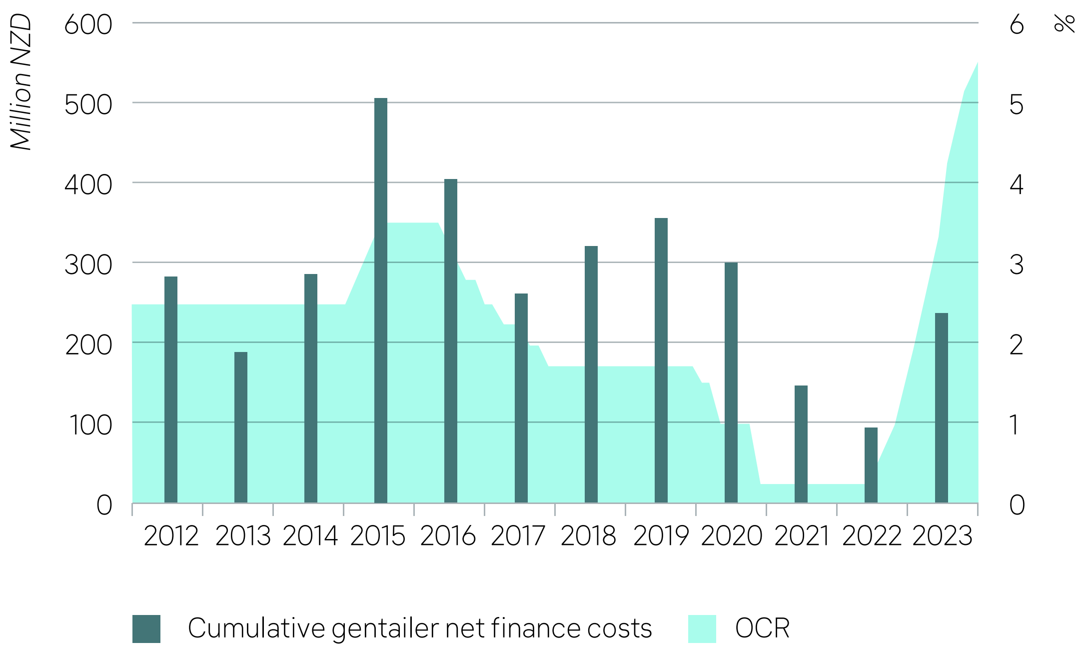


Photo by: Rebecca McMillan

against sustaining the investment momentum of the past two years. Gentailer finance costs rebounded from record lows in the 2022 financial year, increasing 158 percent to $234 million in 2023. The OCR is currently projected to stay above 5 percent until the beginning of the 2026 financial year,[18] keeping debt servicing costs high and discouraging further investment. The elevated cost of debt servicing over this period should be considered alongside the question of whether renewable electricity development is cranking upwards, and whether our policy settings are fit for purpose.

So is renewable electricity development turning a corner? Transpower's new connection dashboard currently includes proposals for another 39,053 MW in capacity across 367 enquiries, with Waikato and the Central North Island alone account for a third of proposed capacity.[19] NZ Wind Energy Association currently lists 1,102MW of consented wind capacity.[20] The proposed Taranaki offshore wind partnership between the Superfund and Copenhagen Offshore Partners could add as much as a gigawatt to the national grid, while looking further up the coast for other possible opportunities.[21] It is worth noting that

18 "OCR projections" (29 November 2023) Reserve Bank of New Zealand. https://www.rbnz.govt.nz/hub/publications/monetary-policy-statement/2023/monetary-policy-statement-november-2023#cw2tu6hKBkON4QacZk0DEg

19 "New Connection Enquiries" (updated 4 November 2023) Transpower. https://experience.arcgis.com/experience/97d4604079b545448280423f9269b9ea/page/Dashboard/

20 New Zealand Wind Energy Association "Consented Wind Farms". https://www.windenergy.org.nz/consented-wind-farms

21 Jamie Gray "Danish renewables developer shifts offshore focus to Waikato" (25 September 2023) NZ Herald. https://www.nzherald.co.nz/business/danish-renewables-developer-shifts-offshore-focus-to-waikato/WUIV5FPDAREIFI7WFBANTKQ3OM/

DIVIDENDS VS INVESTMENT, 2014 TO 2023

	Contact	Genesis	Mercury	Meridian	TOTAL
Dividends	$2,607 million	$1,483 million	$2,359 million	$4,372 million	$10,821 million
Investment	$1,606 million	$478 million	$1,268 million	$1,143 million	$4,496 million
Investment as a % of dividends	46%	32%	53%	26%	42%

there is serious environmental impact to some of these proposals from groups like Climate Justice Taranaki, noting the impact on seabirds and endangered species of marine mammal like blue whales and Maui dolphin while questioning the logic of using domestic renewable electricity to develop a green hydrogen export industry.[22] In the far North, generation is expected to begin at the country's largest solar installation in Kaitaia in late 2023, and owner Lodestone Energy plans to deliver a further four plants by the end of 2026.[23] The relatively significant increase in renewable generating capacity in the past two years does show that where investments are made, renewable operational capacity can increase relatively quickly. It is unclear at this stage the extent to which additional capacity is being added by gentailers or by other emerging players. Meridian have talked up their 4.7 GW deep pipeline (to 2050), however in the shorter term they are focused on seven grid-scale projects in the seven years to 2030, beginning with the 176 MW Harapaki wind farm.[24] Contact claims to have $1.2 billion of renewable generation currently under construction, including building 380Gwh of grid-scale solar generation by 2026.[25] While the Onslow Battery project was expected to reduce the gentailer control of the market, the cancelation of that project will likely moderate that reduction.

The distribution of gentailer dividends have come at significant cost, with the better part of a decade of stagnant investment. Historical investments in state hydropower and progressive deindustrialisation has enabled successive New Zealand Governments to shirk responsibility for questions of future electricity supply, outsourcing the question to the private sector (in which it is the primary shareholder). Projected future demand scenarios suggest a stepchange in supply is required. The last two years suggest that the sector has the capacity to make the necessary investments and boost supply, provided investment is forthcoming.

The biggest barrier to that investment taking place, however, is the scale of dividends distributed since partial-privatisation. It significantly raises the cost of investments in new renewable electricity capacity, and keeps electricity prices unnecessarily high for households struggling with the cost-of-living crisis. Greater (and cheaper) electricity supply would enable greater investment in a range of green manufacturing industries, to support green job creation and new streams of revenue for communities. This would also help reduce the complexity and scale of our supply chains, and support our economic resilience.

22 Catherine Cheung "Caution needed in the rush to embrace wind farm solutions to climate change" (17 June 2022) Stuff.co.nz. https://www.stuff.co.nz/environment/climate-news/300612324/caution-needed-in-the-rush-to-embrace-wind-farm-solutions-to-climate-change

23 "Powering a first mover in solar electricity" Jarden. https://www.jarden.co.nz/our-work/lodestone-energy/

24 Meridian annual report 2023, pp 26, 45, 69. https://www.meridianenergy.co.nz/public/Investors/Reports-and-presentations/Annual-results-and-reports/2023/Meridian-Integrated-Report-June-2023.pdf

25 Contact annual report 2023, p8, 27. https://contact.co.nz/-/media/contact/mediacentre/annual-and-half-year-reports/2023-integrated-report.ashx?la=en

UNDERSTANDING TOMORROW'S ELECTRICITY SECTOR

The 2023 BlackRock announcement was premised on the idea that the NZ Government had set a target of reaching 100% renewable electricity generation by 2030. Coalition agreements have announced the repeal of that target, along with the repeal of the offshore oil and gas ban and the cancellation of the Lake Onslow pumped hydro project. Amidst this regulatory uncertainty, we expect asset managers like BlackRock to play a significant role in the transition. This section looks at the possible impacts of the new coalition Government's reforms on the electricity sector, and gives some reflections on the rise of asset managers based on international experience.

The coalition Government's electricity sector direction

With ink now drying on coalition agreements, we can start to get a sense of what the future policy direction we can expect from the incoming Government. The National-Act coalition agreement commits to repealing the ban on offshore oil and gas exploration, cancelling the Lake Onslow Pumped Hydro and amending the Resource Management Act to make it easier to consent new infrastructure "including renewable energy".[26] The National NZ First coalition agreement includes a commitment to "Deliver Net Zero by 2050 including by doubling New Zealand's renewable electricity and supporting new technology to reduce agricultural emissions", echoing some similar language in the Act agreement. The parties also agreeing to "require the electricity regulator to implement regulations such that there is sufficient electricity infrastructure to ensure security of supply and avoid excessive prices."[27]

National's 100 Day Action Plan gives some indication on phasing of these commitments. It commits to "Begin efforts to double renewable energy production, including work to issue a National Policy Statement for Renewable Electricity Generation"- more of a statement of intent that carries no concrete timeline or policy changes, and the more straightforward "Stop work on Labour's

26 "Coalition Agreement: New Zealand National Party & Act New Zealand" https://assets.nationbuilder.com/nationalparty/pages/18466/attachments/original/1700778592/National_ACT_Agreement.pdf?1700778592

27 "The National-NZ First coalition agreement in full" (24 November 2023) The Post. https://www.thepost.co.nz/politics/350118190/national-nz-first-coalition-agreement-full

Photo by: Pavel Sevtov

Lake Onslow pumped hydro scheme."[28] On 3 December Energy Minister Simeon Brown told Newshub that he had received confirmation from the Ministry of Business, Innovation and Employment confirmed that "all work on the scheme has ceased and decommissioning is set to begin."[29]

Satisfying the commitment to "[b]egin efforts to double renewable energy production" presumably relies only on beginning work on the development of the new National Policy Statement for Renewable Electricity Generation. The current National Policy Statement was issued in 2011 under the Resource Management Act. It highlights growing energy demand amongst the need to respond to climate change while delivering secure and affordable energy, and commits to the "strategic target that 90 percent of electricity generated in New Zealand should be derived from renewable energy sources by 2025."[30] The document is largely silent to the question of the role of the private sector in the supply of electricity and the development of new generating capacity. It is interesting to consider whether and how these questions will be explicitly addressed in the National Policy Statement.

---

28 "National's 100 Day Action Plan" NZ National Party. https://assets.nationbuilder.com/nationalparty/pages/18431/attachments/original/1696107664/100_Day_Action_Plan.pdf?1696107664

29 "Government scraps Lake Onslow hydro scheme" (3 December 2023) Newshub. https://www.newshub.co.nz/home/politics/2023/12/government-scraps-lake-onslow-hydro-scheme.html

30 "National Policy Statement for Renewable Electricity Generation 2011" New Zealand Government. https://environment.govt.nz/assets/Publications/Files/nps-reg-2011.pdf

The National-NZ First coalition agreement also includes the commitment to amend the Resource Management Act make it easier to consent new renewable energy projects, alongside a number of other energy-related commitments. Of note is a commitment requiring the regulator to ensure electricity infrastructure guarantees security of supply to avoid excessive prices. Little detail is provided on what this means, and in the absence of clarifying language, it could be read to prolong the operation of older non-renewable capacity or support the expansion or new development of non-renewable electricity generation. The language is a softening of the NZ First manifesto promise to replace the Electricity Authority with a Ministry of Energy,[31] which was abolished in December 1989 and had its policy and regulatory roles transferred into the Energy and Resources Division of the then-Ministry of Commerce (now the Ministry of Business, Innovation and Employment).[32]

All coalition partners agree on the need to reform the Resource Management Act to make it easier to consent new renewable projects. This is supported by the 100 days commitment to "repeal Labour's RMA2.0 legislation and introduce a fast-track consenting regime". It will certainly take longer for such a regime to undergo the consultation process and enter into force, and longer still to start influencing investor behaviour. Whether there is any material impact on renewable electricity development during the next three years remains to be seen.

The commitment to double NZ's renewable electricity by 2050 needs a coherent strategy behind it to make it workable. Without a change in incentives, large investors will continue to operate in much the same way as they already do, disproportionately rewarding shareholders while drip-feeding investment. The next section looks at how the emerging global trend of private sector investment – through the asset management industry – is increasingly shaping the priorities and decision-making of the sector.

BlackRock and the rise of the asset managers

Renewable electricity infrastructure is becoming an increasingly important asset class for asset managers like BlackRock, as both the public and private sector become more concerned with the need for a transition to a renewable energy order. The 2023 Blackrock fund was premised on the 100% renewable energy policy agenda, but we believe it will persist regardless of what happens to that policy. In our view, however, reliance on the asset management sector to ensure a just transition has serious risks that need to be considered.

BlackRock is the world's largest asset management firm, with more than $9 trillion in assets under management. In 2022 it had revenue

31 "New Zealand First 2023 Policies". https://www.nzfirst.nz/2023_policies

32 "Chronology of New Zealand Electricity Reform" (August 2015) Ministry of Economic Development. https://www.mbie.govt.nz/dmsdocument/178-chronology-of-nz-electricity-reform-pdf

Photo by: 350 Aotearoa

of US $17.8 billion and net income of $5.2 trillion.[33] It is the largest of the so-called "new permanent universal owners", who – alongside Vanguard and State Street – together manage 80-90 percent of all assets under management in US passive equity funds.[34] The three new permanent universal owners are "invested indefinitely in thousands of firms that are members of international stock indexes".[35]

Detail on the fund remains limited. "The New Zealand Net Zero Fund will look to crowd in investment from Crown companies and entities, including superannuation funds, and private sector funds to accelerate New Zealand's transition to 100% renewable electricity", said then-Prime Minister Chris Hipkins.[36] The next day

33 "BlackRock Reports Full Year 2022 Diluted EPS of $33.97, or $35.36 as adjusted Fourth Quarter 2022 Diluted EPS of $8.29, or $8.93 as adjusted" (13 January 2023) BlackRock. https://s24.q4cdn.com/856567660/files/doc_financials/2022/Q4/BLK-4Q22-Earnings-Release.pdf

34 Fichtner, J., Heemskerk, E. M. & Garcia-Bernardo, J. (2017). Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk. Business and Politics, 19(2), 298–326. https://www.cambridge.org/core/journals/business-and-politics/article/hidden-power-of-the-big-three-passive-index-funds-reconcentration-of-corporate-ownership-and-new-financial-risk/30AD689509AAD62F5B677E916C28C4B6

35 Jan Fichtner and Eelke M Heemskerk (2020) "The New Permanent Universal Owners: Index funds, patient capital, and the distinction between feeble and forceful stewardship" Economy and Society 49(4). https://www.tandfonline.com/doi/full/10.1080/03085147.2020.1781417

36 Michael Neilson "BlackRock fund for clean energy: NZ bid to be first in world with 100 per cent renewable electricity" (8 August 2023) NZ Herald. https://www.nzherald.co.nz/nz/politics/climate-change-nz-bid-to-be-first-in-world-with-100-per-cent-renewable-energy-government-aims-for-2b-fund-with-blackrock-investor/L5SAOAKXIRFBZN5JJIEWLGJIEA/

the Government announced consultations on a five related streams of energy policy – including gas industry transition, an interim hydrogen roadmap, offshore energy regulations.[37]

At the time of writing, Blackrock already held $710.4 million in gentailer shares. This is a clear reduction in the size of their exposure to the NZ electricity market. In September 2022 BlackRock also acquired SolarZero, a leading player in the solar and smart battery sector in a deal worth more than $100 million.[38]

There is evidence that the large positions taken by asset managers like BlackRock have the capacity to influence share prices. For example, in early 2021 a BlackRock clean energy exchange-traded fund modeled on the S&P Dow Jones Global Clean Energy Index – that included Meridian and Contact shares – experienced a surge of interest while NZ traders were still largely on summer vacation. BlackRock's Contact shareholding swelled to 14 percent, while their Meridian holding reached 7 percent. When S&P realised the impact that the ETFs were having on stock prices they redesigned the index, triggering a mass exodus from the Contact and Meridian shares.[39]

Asset managers active in other jurisdictions have not hesitated to throw their weight around. Asset manager Brookfield has recently written to the Colombian Government, indicating that it is considering its legal options with regard to regulations passed to reduce residential electricity prices during the cost-of-

37 "Empowering Kiwis to have a say in the energy transition" (9 August 2023) Beehive. https://www.beehive.govt.nz/release/empowering-kiwis-have-say-energy-transition

38 "solarZero Announces Acquistion by BlackRock Real Assets" (14 September 2022) solarZero. https://www.solarzero.co.nz/blog/solarzero-announces-acquisition-by-blackrock-real-assets

39 Dan Brunskill "Blackrock dumps $1 billion stake in Meridian and Contact" (16 April 2021) Businessdesk. https://businessdesk.co.nz/article/markets/blackrock-dumps-1-billion-stake-in-meridian-and-contact

BLACKROCK GENTAILER SHAREHOLDINGS

Share holder #	Gentailer	% of shares	Market value ($ million)
4	Contact	6.191	381.9
4	Meridian	1.715	221.8
5	Mercury	1.274	105.8
17	Genesis	0.035	0.9
		TOTAL	710.4

living crisis.[40] In 2016 Brookfield purchased ISAGEN, a privatised electricity company that produced between a fifth and a quarter of Colombia's electricity, mostly from hydropower stations. Brookfield is dual-listed in Toronto and New York and has the option to file investor-state proceedings under the Colombia's US and Canadian free trade agreements. A fund managed by Brookfield currently owns just over one million shares in Mercury Energy.[41]

In Australia, Brookfield's offer to purchase Origin Energy, the country's largest energy retailer/generator, has just been rejected by shareholders.[42] Brookfield had been publicly trumpeting their proposed investment of $20 – 30 billion in renewables, however as former PM Paul Keating pointed out in a recent op-ed in the Australian Financial Review, this is to be fully funded by Origin's cash flow.[43] In other words, the deep pockets of asset managers like Brookfield, Blackrock and others in reality add little capital to the pool for new renewable investments.

It is likely that the same approach – funding new developments from cash flow, in competition with shareholder returns – would also prevail in New Zealand. And if regulation impedes profitability then similar courses of action are likely available to asset managers like Brookfield or Blackrock through NZ's international trade and investment agreements. This might include regulation aiming to regulate household electricity prices or to require minimum profit reinvestment targets.

40 Letter available at https://twitter.com/ricarospina/status/1709710946153726330

41 Brookfield Real Assets Income Fund Inc.

42 Scott Murdoch and Lewis Jackson "Origin investors reject $10.6 billion Brookfield bid, company open to other funding" (4 December 2023) Reuters. https://www.reuters.com/markets/deals/origin-investors-reject-brookfields-106-bln-bid-proxy-votes-2023-12-04/

43 Paul Keating "Brookfield taking 'suckers for a ride' in Origin play: Keating" (30 November 2023) Australian Financial Review. https://www.afr.com/companies/energy/brookfield-taking-suckers-for-a-ride-in-origin-play-keating-20231129-p5enuf

CONCLUSION

A decade of data shows the ongoing costs of partial-privatisation in the electricity sector. For every dollar of investment over that decade, gentailers have paid out $2.41 in shareholder dividends. Since 2014, the gentailers have distributed $4.2 billion in excess dividends, putting shareholders ahead of households, communities and the environment. While investment in 2023 has topped shareholder dividends for the first time in more than a decade, high interest rates and an uncertain regulatory environment threaten that progress.

The authors of this report stand by the recommendations made in the previous Generating Scarcity report, with some minor changes:

- Setting minimum profit reinvestment targets requiring gentailers to invest in new renewable generating capacity or into other activities that provide greater energy security and affordability for New Zealanders and New Zealand businesses. Targets should be determined with reference to the need for new generating capacity and the cost of financing.
- Any dividends distributed to the Government from their gentailer shareholders be used to buy back shares of the gentailers. The ownership of any gentailer shares shall be placed in a special purpose vehicle, co-governed by the relevant local Maori entity (hapū or iwi), whose objective would be "stable, sustainable, and affordable electricity". It would submit shareholder motions at AGMs to this end, and require the companies to demonstrate publicly how this is being achieved. Becoming a signatory to the inaugural NZ Stewardship Code could further embed social and environmental objectives.[44]
- That the Government purchases the remaining fossil fuel generating facilities across the country, ringfencing them for strictly non-commercial use to ensure national energy security as the electricity network undergoes its full decarbonisation process.
- That financing at least equivalent to the Government's share of excess dividends distributed over the 2014 to 2023 period – $1.54 billion – be invested into household and community-owned and operated electricity generation schemes, including through the MBIE Community Renewable Energy Fund,

44 See https://stewardshipcode.nz/ for further information.

between now and 2030 to reduce reliance on the gentailers and support low-income households.

- That a windfall tax is levied against these gentailers, set against the value that has been generated through the excessive use of thermal generation. The value of that windfall tax would be used to insulate homes across Aotearoa, and to reduce emissions from industrial heat processes.

The dominant view of the new Government seems to be that excessive regulation stands in the way of our renewable energy targets. However, the gentailer experience of the last decade shows that reinvesting profits into new generation is a distant second to excess dividend distribution. While the decision to cancel Onslow will probably reinforce gentailer influence in the market, other private sector players look set to dilute gentailer influence in the longer-term. In the New Zealand context, is excess dividend distribution a gentailer issue or a private sector issue more broadly?

There remains a compelling case in favour of public sector investment in the sector. The public sector can generally borrow at lower rates than the private sector. At the same time, lower or no dividends means there is significantly more capital available for reinvestment in new renewable generating capacity. Government policy can target objectives beyond simple profit maximisation, and coordinate across agencies and Ministries to support those objectives. It can build decent work and stronger communities in the process.

That said, investors can play an important role in developing an electricity industry that serves people and planet. There remains a space for ESG investors with gentailer shareholdings to put forward minimum profit reinvestment resolutions, and collaborate with Government to develop a more expansive renewable energy development agenda. While many of today's existing legacy hydro projects might struggle to get consented under today's rules, operating them responsibly is crucial.

The electricity industry should serve as a warning for other areas of the economy in which privatisation is being promoted as an option. The global surge in interest rates has served to increase the global wealth divide, and vast swathes of capital are looking for new profitable investment opportunities. Historically public sector spheres of activity like electricity and health are ranking at the top of these lists. Private sector innovations can help improve the cost and efficiency of delivering of public services, but it is crucial that those control of those services remain in public hands. This will ensure the benefits of greater efficiency help us in the process of achieving a just transition that supports the interests of people and planet.

GENERATING SCARCITY 2023 UPDATE

A joint report by 350 Aotearoa, the NZ Council of Trade Unions, and FIRST Union