Institute for Energy Economics and Financial Analysis

Fact Sheet:

Electricity networks have been receiving billions in supernormal profits

As monopolies, electricity network prices are regulated by the Australian Energy Regulator (AER), to avoid excessive network prices and profits (returns). IEEFA analysed the actual profits of network service providers and found they were materially higher than allowed profits over the last decade, leading to supernormal profits of:

$11bn over FY14-FY22

– on top of $16bn allowed profits. Total profits were 1.7 times allowed profits.

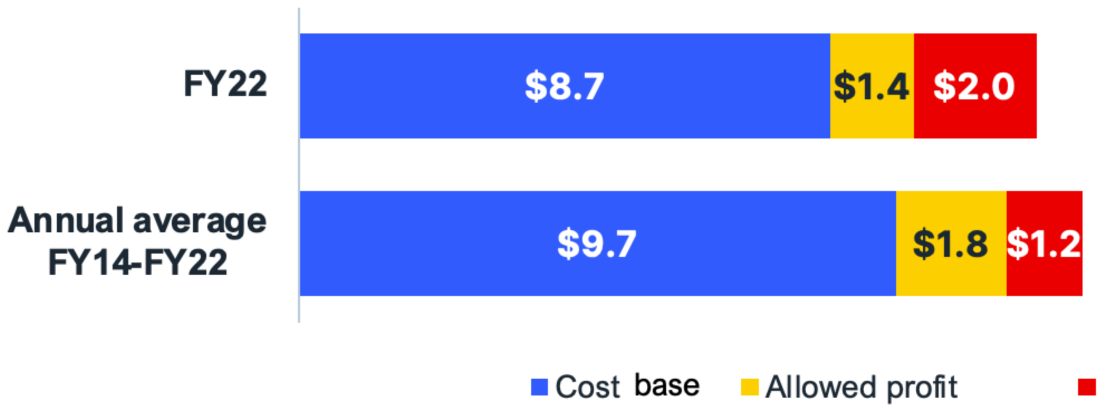
$2bn in FY22

– on top of $1.4bn allowed profits. This means total profits were 2.5 times allowed profits.

More than half of the profit outcomes are more than **1.3 times allowed profits**, the maximum ratio expected under effective incentive regulation.

With more detailed financial data from networks, AER calculated **$9.7bn in supernormal profits** over FY14-FY22.

Annual profit outcomes ($bn)



Supernormal profit as % of cost plus allowed profit

20%

11%

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Power prices can be fairer and more afforable

Reducing supernormal profits would ease the cost of living crisis and mitigate inflation:

- Supernormal profits of the level experienced in FY22 result in $80-$400 of unnecessary bill costs per consumer (including very large consumers), depending on their location

- If excessive supernormal profits were addressed, regulated network prices would be lower, and 14%-69% of the 2023 retail reference (VDO & DMO) price rises could be avoided

The cause of supernormal profits in FY22 is that all network costs were overestimated by AER:

- Financial costs were overestimated – lower cost of debt than expected, and more debt than expected

- Operational costs and capital costs were overestimated

- Inflation was different to forecast levels, leading to higher supernormal profits.

We found that higher profits cannot be explained by productivity improvements.

An independent inquiry should be established to test IEEAF's analysis and evaluate possible solutions

IEEFA recommends two parallel sets of corrective actions to ensure the current incentive regulations work properly:

Amend parameters to reduce supernormal profits as soon as possible:

- Amend the rate of return instrument to better reflect actual financing costs
- Introduce a 'feedback loop' to ensure other cost estimates are accurate
- Revise incentive schemes to ensure they don't 'double up'

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Make structural adjustments to improve governance:

- Disclose networks' actual net profit after tax for transparency
- Improve performance evaluation of AER in regard to price and profit outcomes
- Introduce a safeguard mechanism to return excessive supernormal profits to consumers

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