

16 June 2020

Submissions
Electricity Authority
P O Box 10041
Wellington 6143

By email: HME.feedback@ea.govt.nz

Dear Andy and Tom,

Re: Consultation paper – Hedge Market Enhancements

Pulse Energy (Pulse) and Pioneer Energy (Pioneer) welcome the opportunity to make submissions on the Electricity Authority's (Authority's) options for an enduring market making approach. We appreciated the opportunity to discuss our views with you during the consultation period and, as discussed, this submission includes that feedback.

Pulse is also a signatory to the joint submission by ourselves, Ecotricity, energyclubnz, Electric Kiwi, Flick Electric and Vocus.

The Authority has established that a key measure of success from establishing an enduring market making solution is improving confidence in the exchange traded futures market – currently run by the ASX. From our perspective that confidence must be held by both independent retailers and independent generators.

Confidence in the ASX market from independent retailers

Pulse is not confident that the prices available on the ASX are the real prices. This is confirmed by Pioneer's experience of gentailers underbidding ASX prices to commercial consumers when they are long generation – such that Pioneer is in the process of exiting this customer segment.

ASX price and volume information is used to price Over-the-Counter (OTC) contracts. Timely and accurate information about OTC contracts is also very important to ensure a robust future price curve.

Another factor that impacts our participation on the ASX is the size and volatility of margin calls – real cash is required to meet these margin calls.

In our view, availability of and calls on cash is a significant barrier to growth of non-vertically integrated retailers. Margins for these retailers are slim. The market share held by independent retailers is basically the same as the increase in the number of new ICPs over time. The incumbent vertically integrated retailers have tolerated independent retailers taking these customers during the last few years when they didn't need to have a larger customer base to underwrite new investment in generation capacity.

Generation volumes from independent generators is less than the volumes sold by independent retailers. Independent retailers therefore have to rely on vertically integrated generators offering their discretionary volumes on the wholesale markets after supplying their retail book.

As you know, the product of electricity is homogeneous – independent retailers and retail competition ensures consumers experience innovate, differentiation and choose.

The Authority must consider whether the current wholesale market construct (spot and hedge markets) has evolved to support the current level of retail competition or even promotes competition as required by its statutory objective. Our view is that the wholesale market construct does not promote competition and is no longer fit-for-purpose.

Confidence in the ASX market from independent generators

Independent generators hold numerous options for new generation capacity. At the moment it is very hard to get new generation into the market. Long-dated Power Purchase Agreements (5-7 years) are only available from vertically integrated gentailers – whom independent generators compete with and this impacts the price and terms of these agreements.

We suggest the Authority does not know if consumers are getting access to the best generation. In our view, there are significant opportunities for improvements in efficiency and competition if independent generators' view of the regulatory regime, including the ASX market, means new investment in generation capacity is made. For example:

- increases in reliability and security of supply, especially if this generation capacity is close to load
- increases in diversity in decision making about the timing of new investment
- improved dynamic efficiency as these new generation options can have a lower long run marginal cost than options held by vertically integrated generators (for example, there are economies in civil costs when constructing smaller scale plant)
- environmental and visual impacts can be lower while social engagement and buy-in can be higher for independent generators than for utility scale generating plant.

Our recommended solution to build both independent retailers and independent generators confidence in the ASX

Our recommendation is that all generation output must be sold into a market: spot, OTC and ASX markets. That is, all generators must transact at arms-length on a non-discriminatory basis to sell their electricity.

The benefits of this solution are:

- this is virtual separation of vertically integrated gentailers without the complication of corporate or financial separation
- a significant increase in liquidity on these markets – with a likely consequent reduction in the cost of operating the ASX for the benefit of all players (eg all players would be incentivised to call for a change to the margin call methodology reducing the costs for everyone)
- the increased volumes traded would result in a reduction in the risks market makers are potentially exposed to increasing the reliability of this service
- increased competition in the market for selling electricity as everyone competes to sell to retailers (and no-one has access to an internal retail hedge) ensuring the least cost generation is on the market

- prices are established at arms-length by market interactions (as opposed to internal hedge arrangements)
- enabling more competition in retail as all retailers are buying off the same markets and face the same wholesale input costs
- everyone would still be incentivised to manage their future price risks but this would be done with a third party in a non-discriminatory manner
- building confidence that the spot, hedge and retail markets are efficient
- improving the robustness of the forward price curve
- facilitating new independent generation investment that can participate in the wholesale market on the same terms as all other generation
- improve competition in the market for new generation investment ensuring the best cost generation is constructed

Overall, this would create real markets¹: generators would be competing for retail customers and all retailers would be competing for customers on a level playing field as they are all exposed to the market tested and determined prices when buying off the same markets. This would improve competition in the markets of generation dispatch, new generation investment and electricity retailing. What's fair is fair for everyone, ultimately providing a long-term benefit to consumers.

Pioneer, as well as Pulse, support this solution.

We would welcome the opportunity to discuss this submission with you in more detail.

Yours truly



Fraser Jonker
Chief Executive

¹ We note that the function of markets to improve efficiency is the only focus of how the Authority is assessing its market making options against the statutory objective.

