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The Electricity Authority
Wellington

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Re: Submission of Level Playing Field measures – Options paper

Thank you for this paper and the opportunity to comment at this stage when the Authority is considering options. The opportunity to engage direct with the Authority is appreciated. It has helped with understanding.

We find the context section particularly valuable in that it captures issues with the current market. Many of these points have been made from within the Industry for a number of years. Key issues are identified in para 2.10 of the option paper¹. Having these issues set out by the Authority validates the call for urgent action to prevent on-going harm to the economic and social well-being of New Zealand.

Where there is doubt as to cause and effect, it is time to place the emphasis on the demand side rather than supply. The long-term benefit of consumers seems to always be an arms-length (or more) away.

The key issue relates to affordability. This requires change to ensure a workably competitive market, and will involve:

- a. improved liquidity,
- b. addressing the significant hedge premium that extends out some years (ASX), and
- c. decreased futures prices, while
- d. encouraging new generation, in particular firming.

We agree timeliness of implementing changes that will make a difference for independent retailers and customers exposed to the spot and futures markets, is a key requirement. A pragmatic approach will be required by all involved – at least at stage one. For this to be achieved we agree with 4.2 of the paper, that a primary focus should be on measures within the Authority's existing powers.

With regard to the specific options:

- Consideration of corporate separation (option 4) should be a stream of work, including ownership separation, but not where the current focus should be. More urgent initiatives are required.

¹ But we question the suggestion prices out to FY2027 are trending downwards given the unrealistic starting point for that assertion.

- Option 3 is not going to be quick or easy to implement. An arbitration approach will need a process of its own and not lead to quick decisions. We are not confident this option will lead to the necessary outcomes.
- Option 1 may bring added scrutiny but we doubt any real impact or certainly, and not quickly.
- By default option 2, non-discrimination obligations, has a level of validation.

However, Option 2:

- Step 1 is still largely based on gentailers working within guidelines and reporting (Section 6.18(c) – (e)). How will this drive down futures prices and encourage new generation build?
- Step 2 has a ring of more bureaucracy
- Step 3, mandatory trading, has a ring of independence and hence an attraction. However, on deeper consideration raises prospects of unintended consequences that stem from current deficiencies with the market.

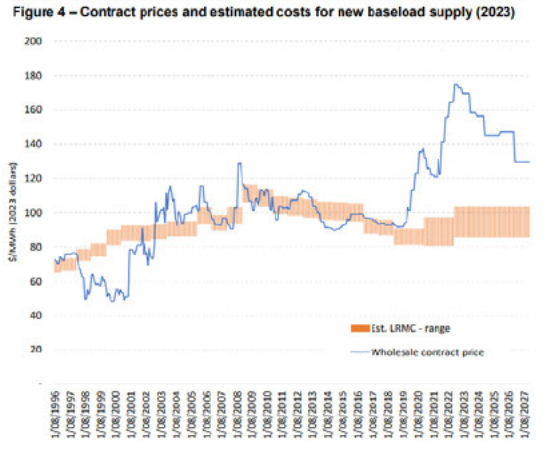
The paper has articulated many of the current issues with the market, but no evidence is presented that the proposed non-discrimination initiatives will address these issues – in fact they may exacerbate the affordability situation. Core issues underlying risk premiums and lack of investment in firming generation need to be addressed ahead of, or in conjunction with, level playing field measures.

The paper questions if non-discrimination initiatives should be limited to specific products (para 6.6-6.11). This raises concern re limited application, and discounts potential benefit to consumers reliant on base load.

Our more detailed comments follow in Attachment E, the submissions form.

We will be happy to engage further with the Authority on this important matter.

Appendix E Format for submissions

Submitter	New Zealand Steel Limited
Questions	Comments
Problem definition — competition concerns from Gentailer vertical integration	
Q1. What are the benefits of vertical integration between generation and retail? Do you have any evidence to better specify and quantify these benefits? In particular, we are interested in benefits that would be realised by New Zealand's electricity consumers.	<p>There are to key benefits to a combined generation and retail business:</p> <ol style="list-style-type: none"> 1. A natural hedge for retail (as per para 3.9, 3.23(a)) 2. A customer base for generation. <p>Benefits for consumers are expected when</p> <ol style="list-style-type: none"> 1. There is a fully functioning competitive market with generation able to firm retail requirements. <p>OR</p> <ol style="list-style-type: none"> 2. Generator / Retailer businesses are efficiently run with New Zealand Inc objectives in mind. <p>However, New Zealand does not have a functioning competitive market (refer 2.10 of the paper).</p> <p>Also, NZ is still largely reliant on the generation built 50+ years ago with hydro backed by thermal. Except 25 years ago that generation was split to compete within a tight group (para 3.30). Now tightened supply introduces unacceptable risk premiums (inferred in para 3.32).</p>
Q2. Do you agree with our description of the competition concerns that can arise from the combination of Gentailer vertical integration and market power? Why/why not? Do you have any evidence to better specify and quantify the competition risks of vertical integration?	<p>Yes. Summarised in para 3.41 with reference to Figure 4 and the gap between the futures curve and LRMC.</p> <p>Figure 4 – Contract prices and estimated costs for new baseload supply (2023)</p>  <p>Source: Concept Consulting²⁸</p>

Q3. To what extent does vertical integration of smaller gentailers, such as Nova and Pulse, raise competition concerns? Should these smaller gentailers be subject to any proposed Level Playing Field measures?	Vertical Integration pe se is not the issue. It is market power that leads to the core issue. (as per para 3.22)
Q4. Are there other specific areas (other than access to hedges) where Gentailer market power and vertical integration are causing competition concerns?	Refer response to question 1. Given New Zealand's isolation from supporting grids, it is the split of generation assets and expecting the core assets to compete when there are limitations on fuel, that is at the heart of the issue.
Q5. Do you agree with our preliminary view that the evidence indicates there may be good reasons to introduce a proportionate Level Playing Field measure to address the competition risks in relation to hedging/firming? Why/why not?	We commend the Authority on bringing together information confirming what a number in the industry have been saying for some years ie NZ does not have a properly functioning market. The extent of intervention required is a key question.
Level Playing Field options we have identified	
Q6. Have we focused on the right Level Playing Field options? Are there other options that we should add or remove to the list in paragraph 4.1?	No. Options 1 – 4 focus on the mechanics within defined boundaries. The starting point should be identifying the key outcomes required for consumers and NZ Inc.
Q7. Are there any other important factors we should consider when identifying options (see paragraphs 4.2 to 4.5)?	How will the proposed changes lead to prices that reflect the cost of supply in a properly functioning market? We fail to see what is proposed will address the current risk premium issue and encourage more generation build and firming.
Q8. Are there other key features, pros or cons we should consider in our description of the four Level Playing Field options?	
Our assessment of Level Playing Field options	

<p>Q9. Have we identified the right criteria for assessing Level Playing Field options (Figure 6)? Is there anything we should add or remove?</p>	<p>Impact on independent retailers and independent generators is mentioned, but the impact on direct market participants on the demand side needs to be added.</p> <p>We also draw attention to Authority's statutory objective and the (now out-of-date) February 2011 paper. The proposed criteria for assessing level playing field options should draw more closely on these obligations. In particular criteria for <u>objective (ie quantifiable) assessment</u> of the long-term benefit for consumers, and <u>specific measures</u> for a workably competitive market.</p> <p>A subjective assessment that one option may be superior to another does nothing to establish that either will move the dial in an appreciable way. The key question is, are any of the options going to make a noticeable difference for consumers in a timely manner? We don't have confidence the process or assessment factors are going to achieve this outcome.</p>
<p>Q10. Do you agree with our application of the assessment criteria (Table 5)? Are changes needed to the colour coding or reasoning?</p>	<p>The concept of the table is good. Refer response to Q9 relating to contents.</p>
<p>Q11. Are there any other material benefits or risks that should be considered (but are currently not) in our assessment of options?</p>	<p>As per our response to Q7, how will the proposed changes lead to prices that reflect the cost of supply in a properly functioning market? We fail to see what is proposed will address the current risk premium issue and encourage more generation build and firming.</p>
<p>Q12. Do you agree with our selection of non-discrimination obligations as our preferred Level Playing Field measure? Why/why not?</p>	<p>We agree with criteria that provide for timely change. This dictates a speedy path to implementation and within existing legislative powers. However, there may be a conflict between objectives and practicalities - the result needs to be appreciable change in pricing for consumers or is for little/no avail.</p> <p>Our initial assessment was Option 2 would best meet these criteria, but after much consideration we are not confident any of the options will bring appreciable change - Just be more reporting and monitoring, and more time elapsed without the real issues being addressed.</p> <p>As identified in para 5.12 there is actual risk that the measures proposed may increase prices.</p>
<p>Roadmap for implementing non-discrimination obligations</p>	

<p>Q13. What are your views on our proposed roadmap for the implementation of non-discrimination obligations?</p>	<p>The concept of a stepped approach has appeal, but the key question relates to achieving the required changes. Each of the steps has limitations and raises other issues, but more importantly none of these address the underlying issues around lack of firming generation and risk premiums. Some options will likely negatively impact prices.</p>
<p>Q14. Which products should any non-discrimination obligations apply to? Should all hedge contracts be captured, or should the rules be focused on super-peak hedges only? Are there are other interactions between Gentailers and their competitors which would benefit from non-discrimination rules?</p>	<p>For NZ Steel we cannot see any value in restricting application to certain financial instruments. Base-load products need to be included (refer para 6.8 of the paper).</p>
<p>Q15. Do you have any feedback on the indicative draft non-discrimination principles (and guidance) set out in Appendix B? Without limiting your feedback, we would be particularly interested in your views on the following questions:</p> <p>a. Have we got the level of detail/prescription right? For example, do you consider that the principles and guidance will lead to economically meaningful Gentailer ITPs being put in place? What would be the costs and benefits of instead applying a more prescriptive ITP methodology?</p> <p>b. How far should the allowance in the principles for different treatment where there is a “cost-based, objectively justifiable reason” extend? Do you agree with the guidance that this allowance should not be extended to volume (at paragraph 13 of Appendix B)?</p>	<p>We bring no particular experience in answering this question, but make the following points:</p> <ol style="list-style-type: none"> 1. 15.d. How would this apply? Presumably unallocated contract capacity is what is traded on the spot market through the RTP process? 2. The guideline seems to assume structured periodic bi-lateral trades. How does this work for a more dynamic daily / hourly trade situation, including the ASX? 3. Where does market-making fit-in? 4. Compulsory volume offers may impact the creditworthiness of the overall gentailer entity. How may this impact credit worthiness assessment of/by 3rd parties? 5. Credit terms should be transparent separating transactional risk (ie the 30 minute S&P price) and contract risk (ie withdrawal from the contract) 6. Requirements and conditions around HSAs should be spelt-out.
<p>Q16. Do you agree that escalation options are needed if principles-based non-discrimination obligations are implemented initially? Why/why not?</p>	<p>Early and game-changing implementation is essential. So long as the Authority is prepared to move quickly from step to step, an escalation approach would assist manage the risk of unintended consequences.</p>

<p>Q17. Are prescribed non-discrimination requirements and mandatory trading of Gentailer hedges via a common platform suitable escalations given the liquidity, competitive pricing and even-handedness outcomes we are seeking? Why/why not? What alternatives would you suggest (if any)?</p>	<p>At first look this approach seems attractive. However, this requires a properly functioning market, and para 2.10 of the paper records what many in the industry has said for some time, ie there are significant issues with 'the market' that have gone unaddressed.</p> <p>NZ is still largely reliant on the generation built 50+ years ago with hydro backed by thermal. Except 25 years ago that generation was split to compete within a tight group (para 3.30). Now tightened supply introduces unacceptable risk premiums (inferred in para 3.32).</p> <p>Compulsory trading may in fact increase the risk premiums and cost to consumers.</p> <p>This approach may also inhibit more be-spoke and innovative hedging products.</p>
<p>Q18. What costs and benefits are likely to be involved in setting more prescriptive regulatory accounting rules which detail how ITPs should be calculated? What would be appropriate triggers for introducing more prescriptive requirements for ITPs?</p>	
<p>Q19. Do you have any views on how the non-discrimination requirements should best be implemented to ensure that Gentailers are no longer able to allocate uncontracted hedge volumes to their own retail function in preference to third parties? What are the key issues and trade-offs?</p>	<p>The base to the question appears to be, how to prevent genailers benefiting from their natural hedge (of own generation). Again, this seems attractive on the surface but could lead to unintended consequences.</p>
<p>Q20. Do you have any views on the triggers for implementing the stronger regulation proposed in our roadmap?</p>	<p>As has been outlined, NZ Steel has not been convinced the steps proposed will make any appreciable difference where it matters – ie improved liquidity with prices more aligned to LRMC. We also have concern that some of the proposals will lead to increased risk premiums and cost pass through.</p>
<p>Our current thinking on virtual disaggregation</p>	
<p>Q21. Does our proposed approach to implementing non-discrimination obligations (as set out in the roadmap in Figure 7) sufficiently address the underlying issue that originally led to MDAG recommending virtual disaggregation?</p>	<p>No.</p>

Q22. Do you have any views on whether virtual disaggregation provides a useful response to the competition risks we have identified (relative to the proposed roadmap) and, if it does, how it should be best applied?

We have outlined above our concerns with the current market and that of the non-discrimination proposals. Options involving virtual disaggregation and a minimum volume of traded generation, including firmed, should be further pursued.