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Submissions
Electricity Authority

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Feedback on Level Playing Field measures

Nova Energy (Nova) welcomes the opportunity to provide feedback on the Electricity Authority's (the Authority) consultation into Level Playing Field Measures. Nova supports well-designed policy that promotes competition and efficiency in the electricity sector. The current market stress is the result of broader structural factors rather than a failure of the vertically integrated business model.

The recent tight market conditions have primarily been driven by external and transitional influences—including global fuel supply and other disruptions from COVID-19, constrained domestic gas reserves, contractual uncertainty around Tiwai Point, and government policy targets for 100% renewable electricity amongst others. These conditions—not the presence or structure of gentailers—have created challenges in the market, regardless of the number of competitive gentailers or retailers.

Economic evidence supports vertical integration as an as an efficient business model in competitive markets that provides long term benefits for consumers, particularly in capital-intensive industries like electricity. It enables better risk management, supports long-term investment, and contributes to lower costs for consumers through reduced costs of capital. These benefits are not just anecdotal but well supported by academic literature and economic research which Nova references in this submission.

In essence, regulating for a level playing field between vertically integrated gentailers and independent generators and retailers would result in a higher cost of electricity for consumers rather than lower.

The real issue to be addressed is the increasing concentration of ownership in dispatchable renewable generation. The ability for thermal generators to compete and maintain downwards pressure on price is being reduced due to both reducing fuel availability and decarbonisation policies. This was one of the important conclusions of the MDAG in the 2022 Price discovery under 100% renewable electricity supply paper. Since 2022 the environment for new dispatchable generation options has deteriorated with fuel shortages for gas fired generation in particular such that there is reduced ability for that capacity to provide competition and contestability to the large hydro based providers.

Ensuring fair and competitive access to dispatchable generation resources—rather than targeting the gentailer model—will better serve competition and consumer outcomes. In Nova's view the focus should be on identifying and ensuring the barriers to development are low for investment in new and existing sources of dispatchable generation. Phased, proportionate measures, such as super-peak contracting obligations, where the amount of super-peak power is ideally tied to the actual flexibility available to each of the relevant parties, can support market confidence through a proportionate allocation, without disrupting the fundamentals that enable investment.

Thank you for considering Nova's feedback. Nova looks forward to continuing contributing to the Energy Competition Task Force initiatives.

Yours sincerely

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Nova submission: Feedback on level playing field measures

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>Vertical integration is increasingly recognised as a preferred business model in deregulated electricity markets. This trend should not come as a surprise—it has been observed in other markets such as Australia, UK, parts of the USA and across Europe amongst others. Nova reminds the Authority of the case of Australia, where the market began with separated generation and retail functions, but commercial drivers (cost of capital) naturally led the market to reintegrate over time. As academic literature supports (see below), vertical integration reduces investment risk and enables firms to access capital more efficiently. This is particularly important in capital-intensive industries like electricity generation, where only firms with sufficiently deep financial resources can participate effectively. While this raises some competition concerns—since larger players are better positioned to invest in new generation capacity—the overall market dynamics are driven by efficiency and capital structure advantages that favour vertical integration.</p> <p>Nova refers the Authority to the following study: “Vertical Integration in energy only electricity markets”¹ and an earlier paper on “Vertical Integration and Market Power in Electricity Markets”².</p> <p>To quote from the abstract for the first paper:</p> <p>“In this article we model a Pure Play Retailer, a Pure Play Generator, and a Vertically Integrated Firm (‘Gen-tailer’) in Australia’s energy-only electricity market using market data over a 10-year period to 2013/14. We find Pure Play businesses are unable to sustain investment-grade credit metrics whereas the Vertical Firm does in all years, despite the wild commodity price cycle contained within our data set. The starting premise of industrial organisation is that vertical arrangements are an organisational form of last resort. Our findings explain why vertical reintegration of retail and</p>

¹ Simshauser, P., Tian, Y., & Whish-Wilson, P. (2015). Vertical integration in energy-only electricity markets. *Energy Economics*, 52, 114–127. <https://www.sciencedirect.com/science/article/abs/pii/S0313592615000272#preview-section-references>

² Hogan, S., & Meade, R. (2007, February 18). *Vertical integration and market power in electricity markets* [Working paper]. New Zealand Institute for the Study of Competition and Regulation. <https://ir.wqtn.ac.nz/server/api/core/bitstreams/9e9b4c32-6440-4010-bd5f-42b72ea7009b/content>

	<p>generation became an enduring trend from the mid-2000s.”</p> <p>In the second: “Vertical separation of generation from electricity retailing has often been required as a condition of electricity market liberalisation. A well-developed and liquid contracts market is similarly suggested as necessary to manage the resulting wholesale market risks, which risks are further exacerbated by competition. Such contracts markets are rare, however, and increasingly evidence is emerging that vertical integration is associated not just with improved wholesale market risk management but also reduced wholesale market power. This paper develops a theoretical model showing that non-vertically integrated generators will over-report their inverse supply curves, with the incentive to over-report increasing with the firm’s share of generating capacity. Conversely, in a vertically integrated industry, no over-reporting occurs when integrated firms have balanced shares in wholesale and retail markets.”</p> <p>The primary benefit of vertical integration between generation is that it reduces the volatility of returns on investment. That reduction in volatility allows the business to minimise its total capital requirement, and hold a higher leverage on its equity capital, i.e. hold more debt. The direct result is that in a market dominated by competition between the four large gentailers, it is not surprising that independent generators and retailers find it difficult to compete and earn an adequate return on capital.</p> <p>Electricity consumers benefit directly from the competition between the vertically integrated gentailers, including Nova Energy. Independent generators and retailers need to compete based on differentiated offerings, specialist expertise or operating in niche areas that the vertically integrated gentailers are not as competitive in.</p>
<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</p>	<p>No.</p> <p>The Market Development Advisory Group (MDAG) identified that in a 100% renewables market there was likely to be a limited quantity of flexible generation available, and this flexibility is currently controlled, to varying degrees, by the four largest gentailers plus Manawa Energy. Control over a limited amount of flexible generation could lead to market power in the electricity spot market.</p> <p>MDAG did not identify vertical integration as being a problem for market competition, and Nova does</p>

<p>evidence to better specify and quantify the competition risks of vertical integration?</p>	<p>not believe the Authority has provided sufficient evidence to support that premise.</p> <p>As per the response above, true competition in the electricity market arises from competition between the gentailers. Empirical findings found in an Italian academic article defend that Gentailer vertical integration can moderate the market power of generators, leading to lower bid prices in wholesale markets.³ Independent generators and retailers are at a disadvantage to the vertically integrated parties due to the need for greater capital to cover pricing risk. The independents have a useful role to play as niche participants, innovators and disrupters, but priority must be to ensure the gentailers are effectively competing. The lack of market share held by the independents is not due to market failure, but rather a reflection of the weakness of the independent business model.</p> <p>The issue of access to and control of flexible generation resources is however still key to the continuing competition in the market among the gentailers. The development of Pulse from its purely retail beginnings to integrated generator/retailer, and Nova's growth on the back of its gas resources are a useful case study into the benefits of integration and ability to compete on that basis. Neither Pulse nor Nova has to date secured an adequately diverse generation base to seriously challenge the major gentailers, but with adequate capital and opportunities to build on their existing flexible generation assets they may be able to grow their portfolios and provide greater levels of competition in the future.</p>
<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?</p>	<p>The key competition consideration with Nova Energy is whether it can sustain capital growth and expand its generation base, particularly by securing access to flexible, dispatchable generation. Nova's degree of vertical integration enabled it to deliver the competitive pricing among independent participants, providing a sustainable, low-cost alternative to the major gentailers through different economic conditions and investment cycles.</p> <p>Increased participation by vertically integrated players like Nova is a positive development for the sector, as it supports greater retail competition while also offering the economic benefit of a lower cost of capital, as noted in Q1. Nova did develop a strong customer base as a result of its generation capability. However, Nova is currently disadvantaged by its reliance on gas-fired peakers for firming</p>

³ Bosco, B., Parisio, L., & Pelagatti, M. (2013). Optimal pricing behavior of vertically integrated utilities: Theory and evidence from the Italian electricity wholesale market. In *Proceedings of the 10th International Conference on the European Energy Market (EEM)*.
https://www.researchgate.net/publication/261169344_Optimal_pricing_behavior_of_vertically_integrated_utilities_Theory_and_evidence_from_the_Italian_electricity_wholesale_market

	<p>capacity, especially given the increasing scarcity of gas. For example, Nova has had to defer its plans for investment in new peaking generation at its consented site near Otorohanga due to the increased uncertainty regarding access to fuel. If thermal options are constrained, the current market offers limited alternatives for firming, which in turn restricts the ability of independents to scale competitively. This is a core concern—not just the ability to build generation, but the ability to firm it and sell it competitively, whether directly to consumers or through other independent retailers, as noted in the MDAG paper.</p> <p>Imposing additional regulatory obligations, such as non-discriminatory pricing between generation and retail, would place further burdens on parties building generation to support a retail base. These measures risk undermining the very competition the Authority intends to encourage and limit their growth.</p>
Q4. Are there other specific areas (other than access to hedges) where Gentailer market power and vertical integration are causing competition concerns?	<p>Not particularly. Nova's view is the opposite—vertical integration among retailers enhances competition. However, ideally the market would see five or more vertically integrated participants rather than four.</p> <p>One potential concern to competition is the proposed merger between Contact and Manawa. This could reduce competition by removing an independent generator from the market and shrinking overall market flexibility. A pro-competitive pathway would be if Manawa were instead to partner with or merge into an independent retailer, creating an additional vertically integrated player to the market.</p>
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?	<p>There is insufficient evidence to support a view that introducing regulation to directly support independent generators and retailers will be beneficial for consumers. There is, however, sufficient concern over access to and the pricing of flexible generation resources to create a market for pricing that resource. Similarly, if the Authority has reason to believe that the four major gentailers do not compete actively enough and there needs to be greater retail competition, then it should consider initiatives that enable the smaller gentailers to compete more effectively.</p>

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?

Forcing separation upon vertically integrated entities, whether by accounting separation or corporate separation (Options 1 & 4) will only have the effect of reducing efficiency, increasing costs and capital requirements, and thereby create an increase in consumer prices.

The independent retailers favour those options for that specific reason, i.e. the retail playing field moves to a price level where they can compete, which is a higher price than the status quo.

Instead of focussing on the vertically integrated model, the Authority should examine more closely the availability and ownership of the increasingly limited sources of flexible generation capacity, the rules and restrictions being applied to hydro operations under the Resource Management Act and if those conditions may be relaxed so as to increase the supply of dispatchable generation, and how and the means by which the access to flexible dispatchable capacity can and should be allocated efficiently through competitive market mechanisms. The super peak hedging initiative is an example of such a measure.

If Option 4 is to be considered seriously, then the Authority could consider corporate separation of one entity only: the Gentailer with the greatest level of hydro flexibility, i.e. Meridian Energy. The separation could go as far as separating Meridian's residential and commercial customers but leaving its existing large industrial customers. That would leave a viable business model with capacity to supply both independent retailers and the smaller gentailers. (While this amendment would make Option 4 more viable, Nova does not believe such a change is necessary or desirable.)

As an example of a change that could improve access to flexible generation, Nova proposed to MDAG that the conditions on the System Operator's gate closure be relaxed for its Peaker units so that they could respond more quickly to generator outages or rapid falls in wind generation. That would increase the competitiveness of the Peaker units and reduce the impact of spikes in prices due to the steep offer curves submitted by the hydro generators. Given this option was highly specific to a particular generation set and some parties expressed reservations, it did not make the final set of recommended actions. This option could be reconsidered.

It remains to be seen if the new grid connected BESS projects make a difference to the short-term

	spot price volatility.
Q7. Are there any other important factors we should consider when identifying options (see paragraphs 4.2 to 4.5)?	<p>Internal transfer prices (ITP) are a function of a number of elements, but most importantly the impact of changes in retail pricing on consumers. It is the role of the retailer to isolate the consumer from price volatility and where possible ensure that their utilities bill is not something they need to give much regard to, unless there is an unexpected spike in usage. As an example, in the early 2000's there was a cost reflective shift in retail prices from commercial customers to residential customers, unwinding the pricing structures that were politically determined prior to 1999. The gentailers progressively increased residential prices and reduced commercial prices, but competition between the gentailers meant the residential increases were mostly less than 10% each year to avoid losing residential customers.</p> <p>As an approximation, Nova would expect the ITP to reflect a five-year moving average of wholesale prices. This is based on an average customer churn rate of a 20% p.a. On that assumption a gentailer or independent retailer would hold a hedge book with a weighted average duration of around 2.5 years, which is achievable by purchasing 5-year hedges to cover 20% of the retailers expected demand on a rolling basis each year.</p> <p>On this basis, the Authority should assume that each year the gentailers retail book is covered by internal hedges (in a nominal sense, or potentially actual). As such, under conditions of a Level Playing Field, gentailers should only be expected to offer to the market a maximum of 20% of their expected flexible generation capacity each year for contracts of a 5-year duration. (Traders may purchase those contracts and easily divide those into smaller tranches and time periods to suit independent retailers.)</p> <p>Nova has performed some modelling of this, and the results show that it is (unsurprisingly) consistent with the internal transfer prices published by the EA for the major gentailers. A summary of the modelling is attached in the Appendix to this submission.</p> <p>Given that the concern with market power is focussed on flexibility contracts, the Level Playing Field Options should also only cover flexibility contracts. This is a version of the "Compelled contracting"</p>

	<p>proposed by Vector and rejected by the Authority⁴.</p> <p>Parties exposed to intermittent generation output (being either the generator or buyer of a PPA) need to hold significant levels of share capital to avoid insolvency under adverse generation and pricing conditions. With the growth in generation output expected to come from wind and solar PV farms there will be an increase in demand for both flexibility contracts and capital. It is important that under the Level Playing Field that the parties providing flexibility are adequately compensated for the additional capital reserves they need to hold to support those contracts.</p> <p>There is a fundamental issue for gentailers when they build new generation in that they rely on maintaining their retail base for at least the first 7 years or so (and in most cases for longer periods of time depending on how much debt is used) . That is necessary because they need to have confidence in steady cash flows to support the capital cost and debt obligations associated with building new generation.</p> <p>The trend has been that independent retailers are only interested in shorter term contracts, typically around 3 years because of the risk of being ‘out of the money’ and the capital they need to underwrite longer term hedges or PPAs. If the gentailers are required to sell hedges on equal terms, then independent retailers must be prepared to sign 5-to-7-year hedges and hold adequate capital to support those.</p> <p>The impact of this effect is well described by Simhauser¹ in a paper reviewing the financing of OCGT Peaker Plants in the Australian electricity market, published in 2021.</p> <p><i>“Results reveal the canonical merchant peaking plant remains too risky as a stand-alone project financing, but vertical integration and energy retailer incentives to commit to on-balance sheet peaking plant remains strong, with transaction cost synergies of 13% and investment grade credit quality being contingent on integration.”</i></p>
<p>Q8. Are there other key features, pros or cons we should consider</p>	<p>If Gentailers make 5% of their flexible generation capacity available on a quarterly basis (20% p.a.) under a closed tender basis, and are free to make offers to purchase, then there is no need for “Option 3: Negotiate-arbitrate regulation” we can expect trading houses to recognise the opportunity</p>

⁴ Paragraph 4.34 of the Consultation Paper.

<p>in our description of the four Level Playing Field options?</p>	<p>to purchase tranches and repackage those for interested parties, or resell those contracts in subsequent tenders. If the independent operators do not purchase the contracts the Gentailers can be expected to purchase them. It is unlikely that there would be collusion on those trades.</p> <p>This number is also somewhat arbitrary however as each gentailer has a different quantity of hydro flexibility and as a proportion of total generation available to it.</p>
<p>Our assessment of Level Playing Field options</p>	
<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>The Authority's focus on the ability of independent generators and retailers to enter or expand is misplaced, unless the Authority is of the view that retail prices should be increased to the level where more independent operators are profitable.</p> <p>Based on the market evidence and academic papers referenced in this submission, it appears that the vertically integrated gentailers have the most efficient business model and as such actively compete for market share and growth.</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>In Nova's view, with option 1 there is no straightforward way to determine whether a particular ITP is "appropriate" or not since internal transfer prices (ITPs) are, by design, intended to reflect a long-term moving average of wholesale prices—and that each gentailer has a different customer and contracts mix, and internal structure. Industrial and large commercial customers typically focus on hedge prices available at each contract renewal, while residential pricing tends to be smoothed over longer timeframes - often five years or more.</p> <p>Nova agrees with the general conclusions under Option 2.</p> <p>Option 3 is unnecessary. Intermediary traders may be expected to compete away opportunities for arbitrage.</p> <p>Under Option 4, not only would there be significant costs, but there would be no gain to consumers from lower prices. It would also likely damage confidence in New Zealand's capital markets unless the separation was discounted out to 10+ years away.</p>

Q11. Are there any other material benefits or risks that should be considered (but are currently not) in our assessment of options?	As stated above, the issue to be addressed is the limited ownership and control of renewable flexible generation. Vertical integrated gentailers are capital efficient and there is active competition between the parties.
Q12. Do you agree with our selection of non-discrimination obligations as our preferred Level Playing Field measure? Why/why not?	<p>No.</p> <p>The solution to managing the limited availability of flexible hydro generation needs to focus on how that generation is offered into the spot market and its pricing. The pricing of super-peak hedges, or any other contract design to provide retailers with a tool to manage exposure to very high prices when available generation capacity is constrained, will always link back to prices experienced in the spot market.</p> <p>The appropriate way to manage that is through the trading conduct rules, i.e. section 13.5A of the Code 'Conduct in relation to generators' offers and ancillary service agents' reserve offers'.</p> <p>It is also important that flexibility generation is not underpriced in the market. Over the longer-term under-pricing flexible generation would result in a lack of investment in alternative sources of flexible demand or generation, e.g. BESS, thermal generation based on biofuels, geothermal flexibility, demand flex and other potential sources of peak flexibility.</p>
Roadmap for implementing non-discrimination obligations	
Q13. What are your views on our proposed roadmap for the implementation of non-discrimination obligations?	Nova agrees with the concept of the roadmap, but if this is adopted, Step 3 should be a gradual phase-in over 5 years with only a proportion (a maximum of 20% of total exposure) should be required to be on offer in each year. The gentailers internal hedge book would be progressively built up over that same time for reporting purposes. This is because gentailers already have notional hedges in place between generation and retail, even if these are not specific in anyway, supporting the continuation of their retail book at the ITP.

<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>Nova believes the focus should be on super-peak contracts (or similar) only as it is the flexibility capability that has been identified as a potential source of market power once the thermal generators retire.</p> <p>Even with the non-discrimination obligations in place, Nova expects the independent retailers will find it difficult to be consistently competitive across the board given their need for greater proportion of equity than the gentailers, and smaller scale of operations. They will still find niche opportunities, however.</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>The risk of the model is that the regulations, by their nature, force all retailers to respond more quickly to shifts in wholesale prices, e.g. Clause 17 of Appendix B.</p> <p>Given its small size, the NZ electricity market has a track record of going through extended periods of relatively high and low prices. The low wholesale prices in the years before 2018 were highly attractive to independent retailers, which in itself contributed to the gentailers holding off from building new generation capacity as they were losing market share. While wholesale prices then increased rapidly for several reasons, gentailers only increased retail prices slowly for residential consumers. While this was at a short-term cost to the gentailers, it helps preserve the brand and minimises customer losses in anticipation of lower future prices and utilises the overheads in running customer servicing teams. If gentailers are required to adjust their ITPs rapidly in response to market conditions, then retail prices could be expected to move by more than 10% - 15% on a regular basis. That would have a negative impact on consumers and require them to be continually alert for price difference between retailers.</p> <p>It will also make it more difficult for the gentailers to underwrite investments in new generation as they will by definition have a shorter duration in their hedge/retail book. This will lead to a higher hurdle for new investments or a requirement for increased equity capital. Either way, it will flow through to higher wholesale prices in the long term.</p> <p>The most critical element for a gentailer contracting with an independent retailer is determining if the</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>retailer has adequate financial resources to back their obligations, particularly for contracts beyond 3 years. The pricing of any form of commercial risk is complex and volatile over time. Any form of regulation that dictates the terms of market contracts will have a value impact for the parties involved. Such requirements are unlikely to lead to lower electricity prices.</p> <p>It is also reasonable for the gentailer to link flexibility contracts to the specific performance of one or more of its power stations. While this may be a standard operating risk for the gentailer in supporting its retail arm, an independent retailer may be overexposed to that single risk and fail if that power station has an extended outage. Examples can include transformer failures (Manapouri) or extended low hydro inflows (Tokaanu). In those circumstances the gentailer should not be expected to incur the cost of the retailer’s capital requirements to cover risk, or in the extreme, insolvency.</p>
<p>Q16. Do you agree that escalation options are needed if principles-based non-discrimination obligations are implemented initially? Why/why not?</p>	<p>While it makes sense to outline the potential escalation options, they should not be ‘locked and loaded’ or implemented without further discussion. As per the examples and discussion above, there are a range of issues that are likely to arise as the initial regulations are implemented, and these can only be addressed in the context of what is learnt in the interim.</p> <p>As Nova contends in this submission, there is a risk that too much emphasis is being given to supporting independent retailers at the cost of promoting increased competition between the existing (and preferably additional) vertically integrated gentailers.</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>Nova supports the use of a common trading platform, provided that adequate credit risk protections are in place. For example, ensuring that counterparties to the gentailers have sufficient capital or appropriate third-party guarantees to mitigate default risk and avoid unintended exposure for gentailers.</p> <p>Trading exchanges have a very long history and highly developed rules and systems to ensure that market participants are not exposed to counter-party risk. While the concept of a trading platform seems simple enough, it will be necessary for participants to have visibility on the proposed counterparty to each trade if contracts are to be priced appropriately.</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>Setting prescriptive regulatory accounting rules which detail how ITPs should be calculated is likely to be highly disruptive to the market. Retailer's do not have the same generic mix of customers, and each customer group responds to price changes in a different way. Furthermore, ITP's are a function of customer acquisition costs, capacity in its customer service centre, the retailer's intent to increase or decrease its retail load to match its generation and hedge portfolio and their views on alternatives to managing wholesale price by buying or selling hedges instead. The gentailer may also choose to hold or change its ITP in anticipation of wholesale price moves in the following year, perhaps even associated with new generation being commissioned.</p> <p>Another form of disruption will be the potential for parties that are required to have ITP's constrain their innovation regarding pricing and product development which would be an unfortunate but nevertheless a possible unintended consequence.</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>If the gentailer has spare servicing capacity in its own retail business and can enhance its offering to target customers with the uncontracted hedge volume, then retaining the volume in-house may be of greater value to it than selling the same volume to a 3rd-party retailer or intermediary. By deduction, it would also be value-adding for consumers.</p> <p>A potential solution to that would be for the gentailer's retail unit to retain the equivalent or similar to a "right of first refusal" for any volume required to be made available for 3rd-party offers.</p>
<p>Q20. Do you have any views on the triggers for implementing the stronger regulation proposed in our roadmap?</p>	<p>Given the intent of MDAG's recommendations was focussed on the market power inherent in a limited supply of flexible generation, Step 3 should not be triggered before retirement of the next major thermal generation closure after TCC. The Authority should review the total capacity of flexible generation in ratio to the level of flexibility required in the market. While the assumptions inherent in such a calculation are somewhat subjective, it will provide a measure of the risk of market power being exercised in the flexibility market. A study of the offer volumes and prices in the spot market will help determine if market power is being abused and if further action is required.</p>

	Noting that the Level Playing Field options proposed do not actually prevent an abuse of market power in of themselves.
Our current thinking on virtual disaggregation	
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>The MDAG recommendation was focussing on the limited availability of flexible generation resources once the thermal power stations are retired. It must be remembered that the context of the MDAG review was that of a 100% renewable market given Government policies at that time. As such it was concerned that the owners of such flexible generation, almost entirely hydro power stations with storage, could exercise market power and earn a premium and restrict effective competition through that resource.</p> <p>The approach taken in this proposal makes a number of assumptions that are inconsistent with the MDAG work:</p> <ul style="list-style-type: none"> • The 4 large gentailers will control all of the flexible generation. <ul style="list-style-type: none"> ◦ MDAG was focussing on the largest owners of hydro generation and how control of that might be disaggregated to ensure a competitive market for flexible hydro generation, i.e. primarily Meridian Energy and Mercury Energy. • The gentailers have market power and will exercise that. <ul style="list-style-type: none"> ◦ That was not a conclusion reached by MDAG. • The gentailers each have a similar proportion of flexible hydro in the generation fleets. <ul style="list-style-type: none"> ◦ The facts do not support this. • The owners of flexible hydro generation should not be able to realise a gain on the increased value of that resource as it becomes more valuable to the market. <ul style="list-style-type: none"> ◦ That is inconsistent with other markets, such as where owners of strategic parcels of land are entitled to make a capital gain on that resource. • The Huntly power station will be retired, and if not, continue to be fully integrated into Genesis' generation fleet. <ul style="list-style-type: none"> ◦ The potential for this outcome appears to be receding and in any case there may be other options for maintaining the availability of Huntly for the benefit of the market as a whole, which will continue to have a role in hydro firming.

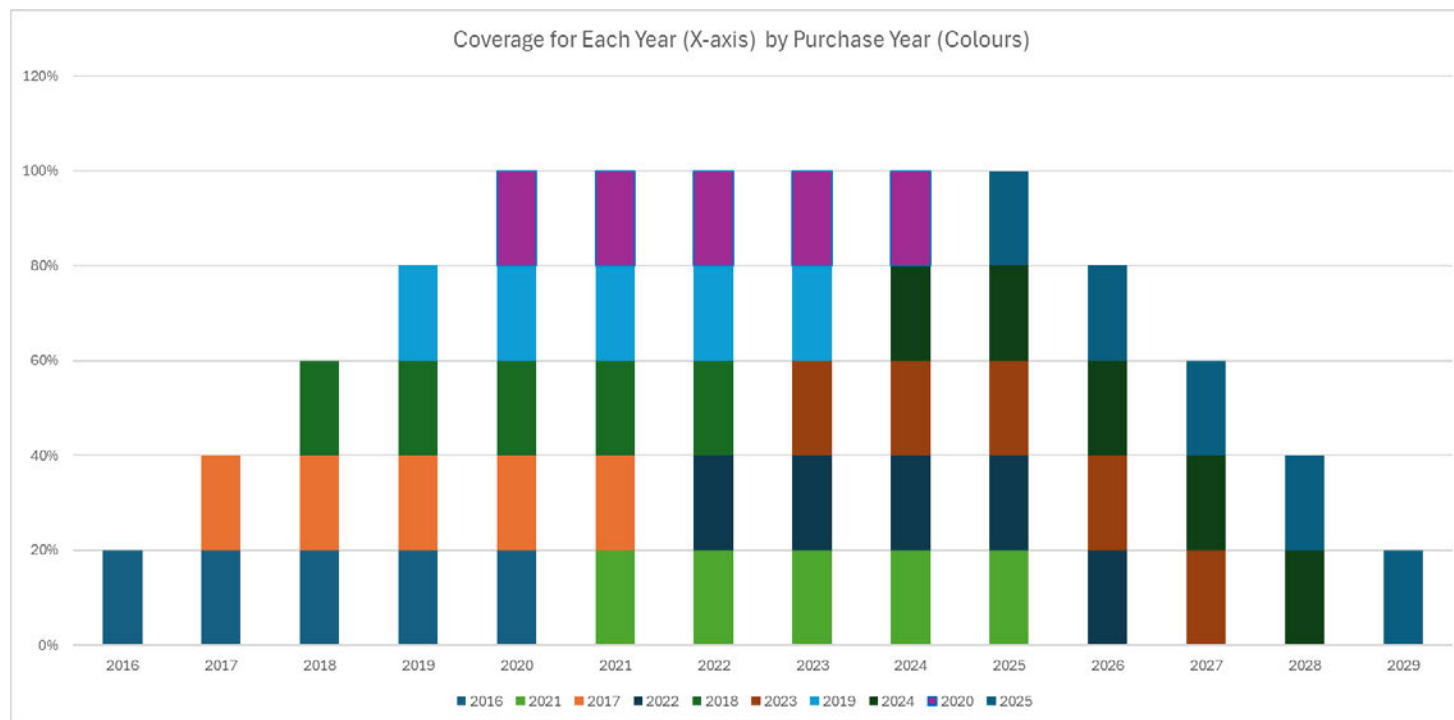
	<ul style="list-style-type: none"> • MDAG assumed there would continue to be some form of thermal generation available for peaking or firming based on bio-fuels in the longer term. <ul style="list-style-type: none"> ◦ Grid scale batteries (BESS) are also being built much sooner than might have been envisaged by MDAG. There are also minimal regulatory barriers to independent retailers or generators building BESS or contracting with 3rd parties for BESS services.
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?	<p>The approach taken is expected to have the effect of ensuring that the benefits of ownership of flexible hydro generation resources are evenly shared between the vertically integrated gentailers and independent retailers. While that may level the playing field in terms of hedge costs, it does not have an impact on the value ascribed to flexible generation, i.e. it just ensures that both gentailers and independent retailers are passing on the same higher costs to consumers.</p> <p>A more straightforward approach would be to require the Gentailers to sell PPA's for a proportion of their major hydro schemes, such as those with an aggregate capacity of over 200MW. This would enable 3rd-parties to build their own virtual portfolio of hydro generation and package hedges, or retail offerings based on that. The Authority would still need to actively monitor the offer prices for hydro generation in the spot market to minimise the exercise of market power.</p> <p>However, while structural reforms like PPA access and improved hedge availability can help support long-term competition, it's important to recognise that many of the challenges in the past two years were not due to market design flaws. In Nova's view, the core issues have primarily been driven by external factors—including the COVID-19 pandemic, global fuel price volatility, and domestic gas shortages. The only significant internal factor was the uncertainty caused by the Tiwai Point smelter decision, which disrupted investment planning and market confidence.</p>

Appendix: Comparing internal transfer prices with a rolling portfolio of 5-year ASX futures contracts

1. Constructing a portfolio of CFD's/futures from the Wholesale market to provide a basis for ITP's

- ASX prices are taken mid reporting year (December 31st) on a rolling basis where 20% of volume is covered using baseload ASX OTA prices adjusted to central a north island node (BPE2201).
- Prices are weighted by quarterly load, and
- 4-year out ASX prices are double-weighted as ASX prices do not go out 5 years.

The following chart just to illustrate how the price each year is a construct of the previous years' 5-year baseload hedge contracts

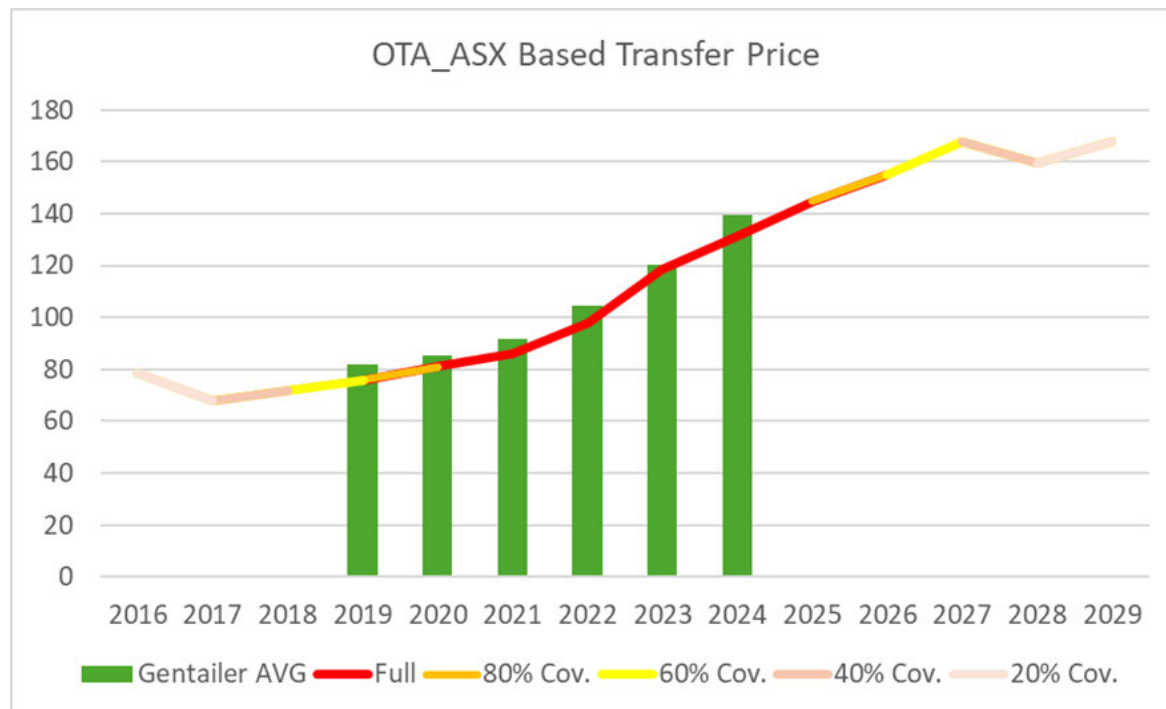


- “t” refers to contracts purchased for the coming year (purchased on December 31st of 2024 for 2025 calendar year, “t-1” refers to contracts purchased a year prior, etc. as it would take 5 years to build up the hedge book, 5 years of data is required before we have full coverage. Therefore, the price path begins in 2020 and ends in 2025 (2026 has 80% coverage and the rest will be realized on December 31st of 2025).

2. Gentailer published ITP's vs hedge portfolio

The following chart illustrates that a 5-year rolling portfolio of ASX electricity futures provides a reasonable match with the Internal Transfer Prices (ITPs) published by Contact Energy, Genesis Energy, Mercury Energy and Meridian Energy. This suggests that the ITPs are consistent with the hedge market as OTC hedges prices also tend to be consistent with the ASX market.

The retailing arm of the gentailers will likely not always adjust their retail pricing in line with the change in the ITPs as that may depend on a number of internal factors.



Notes to the chart:

- The gentailer ITP data is acquired from the ITP benchmark Tableau dashboard provided by the EA
- '2024' here represents the value provided for 2023/24)
- 2024-dated 'Gentailer AVG' includes the numbers provided by Meridian and Genesis in their respective integrated annual reports as they are clearly presented.

¹ [Vertical integration, peaking plant commitments and the role of credit quality in energy-only markets - ScienceDirect](#)