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Electricity Authority

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## **Consultation submission: improving prudential security arrangements**

Nova Energy (Nova) appreciates the opportunity to respond to the Electricity Authority's (Authority) consultation on the Clearing Manager's prudential arrangements. However, the Authority's response to earlier submissions does not, in our view, address the significant costs and risks created by the current prudential methodology.

The consultation paper suggests the Authority is prioritising outcomes for small independent retailers over overall market efficiency and competition. In Nova's submission on a level playing field, we provided academic and international evidence that, in volatile electricity markets, the most competitive participants typically operate across both generation and retail. One key reason is that integrated participants generally require less equity capital to manage exposure to uncertain wholesale prices.

Nova has competed with the major gentailers for more than two decades by differentiating its service and managing wholesale spot-price risk primarily through investment in its own dispatchable generation. This has occurred despite detrimental outcomes from UTS rulings in 2019 and 2021 and ongoing unfavourable prudential settings.

### **Prudential methodology**

In response to the Issues and Options Paper, Nova submitted *"The framework also does not recognise the value of dispatchable generation capacity that does not operate during periods of low prices. Nova maintains peaking generation assets so they are available when renewables are not able to generate, yet this firm capacity currently provides no prudential benefit unless it is dispatched."*

Nova has raised this issue with the Authority and the Clearing Manager (CM) for more than five years, but it remains unaddressed. The CM's approach—projecting forward generation using a moving average of recent weeks generation quantities—does not work for dispatchable generation that is intentionally not operating when spot prices are low.

This is compounded by the methodology using historical, forward-looking price projections that can be out of date and, at times, materially different from actual trading conditions. This can penalise participants that use price-responsive dispatchable generation, some financial derivatives, or demand response to manage wholesale price exposure.

In practice, under the current methodology Nova's retail prudential requirements may not reduce when prices are low. At the same time, lower generation revenue during low-price periods can unnecessarily or disproportionately increase Nova's net prudential requirement—sometimes dramatically.

Nova supports prudential security requirements that appropriately reflect the risk of retailer failure. The wholesale spot market is volatile, so some volatility in prudential requirements is expected. The key issue is ensuring the methodology is broadly consistent with the financial risks retailers are actually exposed to.

The Authority stated in its Issues and Options Paper: *“However, since retailers are more prone to default during these periods of high and volatile prices, the increased security would help mitigate the risk of non-payment.”* The latest consultation paper does not explain why this reasoning no longer applies. Short-term volatility can still be moderated, and reasonable notice periods can be applied to changes in prudential requirements, without putting generators at risk of having to cover the default of a retailer.

### **Recommendation**

The methodology should recognise the benefits of dispatchable, price-responsive generation so prudential costs better reflect actual risk.

The current methodology does not include a suitable mechanism for calculating prudential requirements for wholesale market purchasers that accounts for the price-responsive nature of dispatchable generation. This also affects retailers that manage risk through hedges that respond to price (for example, price caps or swaption arrangements, including the Huntly Firming Options (HFO) arrangements entered into by Genesis Energy and Mercury, Meridian, and Contact in 2025. We understand additional HFO quantities will be made available to other parties in due course.

A substantive pro-competitive outcome would be to allow participants that enter into these arrangements with Genesis—or that have equivalent price-responsive generation or demand response—to have those risk mitigations reflected in the calculation of their prudential requirements. This would also better recognise the value of dispatchable, price-responsive capacity and improve the investment case for such resources.

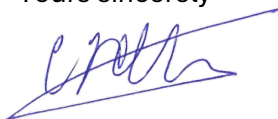
### **Evidence base**

Nova believes any time series analysis of the prudential requirements for Nova compared to monthly settlements will support our views on this matter and demonstrate the degree to which prudential requirements are overstated for Nova. Currently analysis is being prepared, and we will provide that separately in due course under confidentiality.

### **Conclusion**

The Authority has missed an opportunity to implement a sustainable prudential regime that recognises the value of dispatchable, price-responsive generation in a retailer’s prudential requirements. An appropriate mechanism would also support the investment case for such capacity, which is expected to play an increasingly important role in security of supply by firming the output of intermittent renewables and reducing wholesale price volatility over the long term.

Yours sincerely



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