

22 June 2021

Tom Georg
Electricity Authority
By email to wholesaleconsultation@ea.govt.nz

Dear Tom

Consultation Paper - Commercial market-making scheme: levy consultation

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority consultation paper "Levy consultation: Commercial Market-Making Scheme," 25th May 2021.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may make separate submissions.
3. This submission addresses question 1 in the consultation paper: What is your view on the Authority's proposed 2021/22 commercial market-making (MM) appropriation amount of \$14.4m? MEUG's response is:

- a) MEUG supports trialling a commercial MM regime.
- b) The proposed \$14.4m cap for a trial commercial MM service provider is a material increase on the EA appropriation for 2021/22, i.e., $\$14.4m/\$78.157m = +18.4\%$.

The most important policy question facing the sector, in our view, is whether there is evidence of sustained market power by some or all the large suppliers by way of sustained excess economic profits. This is not a trivial exercise to analyse. The Electricity Price Review used a partial analysis, that is partial in so far as capital costs were not included and the approach was not the usual economic profit analysis (EPA) that is, in our view, best practice.² The final report of the Electricity Price Review concluded, with text underlined by MEUG for emphasis, "We found no evidence of generator-retailers making excessive profits, although data limitations mean we cannot be definitive in this assessment."³

¹ Document URL <https://www.ea.govt.nz/assets/dms-assets/28/Levy-consultation-Commercial-Market-Making-Scheme-Consultation-paper.pdf> at <https://www.ea.govt.nz/development/work-programme/risk-management/hedge-market-development/consultations/#c18887>.

² Sometimes the EPA methodology is referred to as Economic Value Added (EVA).

³ Electricity Price Review final report, dated 21 May 2019, published October 2019, p41, refer <https://www.mbie.govt.nz/assets/electricity-price-review-final-report.pdf>.

We are unsure what data limitations the final EPR report refers. Had the Electricity Price Review chosen to use the EPA methodology there would have been no data limitations as EPA uses publicly available audited accounting information. Rather the usual barrier to using EPA is the complexity of adjusting accounting information into economic terms to then apply the EPA methodology. Hence it is a non-trivial and resource intensive exercise; but superior to the approach used by the Electricity Price Review.

If an increase in the EA levies is to be implemented this year, then work on robustly assessing economic profit analysis would, in our view, have a higher benefit than trialling a commercial MM regime. It is not a case of either or, rather EPA should be funded first and then a trial of an initial commercial MM service provider.

- c) Thank you for the advice on how the performance of the commercial MM arrangement will be monitored and is tied to the payment for the service. At the conclusion of the inaugural commercial MM contract, consideration should be given to including public consultation and possibly an external expert peer review, ahead of deciding next steps.
 - d) We have no view on the initial proposed cap of \$14.4m and hence have not answered questions 2 to 4, apart from the comments in b) above. The Electricity Authority should exercise its judgement subject to having a transparent and inclusive assessment after the conclusion of the initial trial arrangement as discussed in c) above. Having clarity and agreement by all parties on what constitutes a robust assessment process before a commercial MM is entered into is, in our view, a necessary requirement to create the best incentives on the EA to optimally design and execute an agreement.
 - e) Thank you for providing information to assist clarify the definition of how an increase in the levy on purchasers and generators would apply for large scale co-generation and embedded generation. We are still reviewing that information and will advise the Authority if further clarification is needed.
4. In summary we are supportive of making progress on commencing commercial MM arrangements to supplement the existing mandatory arrangements on large suppliers subject to a comprehensive review on next steps once the inaugural contract ends. However, MEUG does not support seeking an appropriation in the supplementary estimates round this year unless there is also a higher priority bid for appropriation to allow the Authority to implement a robust economic profit analysis to answer the question of whether there has been sustained excess economic profits earned by some or all the large vertically integrated suppliers.

Yours sincerely



Ralph Matthes
Executive Director