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Ensuring supply meets demand is fundamental to ensuring confidence in the wholesale market and promoting the long-term interests of consumers

The most basic requirement of any functioning market is that it matches supply and demand.

A failure to meet this requirement, and/or elevated risk that the market won't be able to match supply and demand, can undermine and threaten confidence in, or the integrity of, the market. Confidence can be particularly threatened where there is sufficient supply capacity to meet demand but the market fails to do so.

Electric Kiwi, Flick Electric and Haast Energy Trading (Haast) and Pulse (the independents) agree with the Authority that "if forced demand curtailment were to reduce confidence in the power supply system, that could have wider flow-on effects. For example, it could hinder the uptake of electric vehicles and New Zealand's decarbonisation programme. The associated cost would be difficult to quantify but could be appreciable".

Process issues

It is not clear the consultation could not have been undertaken earlier. We do not consider it desirable for consultation on an important matter like this to be undertaken: (i) in an abbreviated (3 weeks) time-frame, and/or (ii) without advance notice. Both impacted the extent to which we have been able to engage on the topic.

We are also concerned by the Authority's suggestion subsequent consultation could need to be condensed or limited in scope.

A confluence of factors has contributed to the current situation [Q2]

We consider the role of the transition toward 100% renewables in driving winter peaks has been over-stated in the consultation. There has been a confluence of factors, not reflected in the consultation paper, which heighten the risk supply could fail to meet demand; particularly during periods of peak demand:

- The Authority's recent consultation on ACOT highlights the impact of the changes to the TPM/removal of ACOT payments on peak-demand (hence the step change from mid-2021). The removal of peak-usage signals from transmission pricing/encouragement of demand during peak-periods was a deliberate design choice by the Authority.

- “the relatively thin pipeline for new supply”.[1]

- Issues with market power and economic withholding: The Authority’s 9 August UTS decision removed any meaningful regulatory threat that withholding of generation will lead to enforcement if generation is not offered to the market in tight supply situations. The forward schedules signalled a tight situation as well as they ever have on that day, but the Authority decided enough ambiguity existed that the withholding of the plant was justified.

- Issues with vertical-integration: The 9 August 2021 UTS decision has created a de facto safe-harbour for a generator to decide not to make supply capacity available to meet demand in the market, because the generator considered its supply would be sufficient to meet its own retail customer base demand. The CEO of Genesis Energy was very clear that:[2]

> “[There] was an alert to the market that there was risk. When that happens everyone looks at their own portfolio and says what’s our demand? What do we forecast the risk to be for the evening peak?, and we make sure we have enough units on line … we can’t see the whole market … we manage our own portfolio like everyone else does … When we looked at our portfolio, we knew we could meet our demand …”.
>
> “We looked at our portfolio yesterday and we knew that between all our customer demand and the generation we had online we could meet our customer demand…. We did what we always do and made sure we could meet our customers’ demand … our only accountability is to ensure we can supply our customers.”
>
> “We made a decision on the basis of the information we had … we knew we could meet our own demand.”

Don’t blame retailer incentives for supply issues [Q2, 3, 14 & 20]

We are perturbed by the Authority’s suggestion that an issue about whether generation supply can meet demand during peaks has partially labelled the problem as “potentially misaligned incentives between retailers and end-users if forced load shedding is required”. It is a mis-specification of the problem to suggest an “underlying cause” of the problem is that “the curtailment of demand is likely to lower retailers’ spot energy purchase costs. … It is even possible that a retailer could benefit from load shedding if it became a net seller in the spot market. … they could alter retailers’ contracting incentives at the margin, and hence indirectly affect commitment decisions by operators”.

The Authority’s commentary that “decisions by retailers and industrial users about whether they should obtain additional contract cover to reduce the likelihood of being exposed to high spot prices” does not take into account issues about availability and access to such products.[3]

The supposed benefits are principally a consequence of deficiencies in the contracting market and restrictions on independent retailers access to products to enable full hedging against spot market risk. The suggestion part of the ‘solution’ could be to “Require retailers to make compensation payments to customers affected by forced power cuts” would amount to a form of ‘victim-pays’ or ‘victim-pays-victim’ pricing.

We do not support requiring retailers to compensate consumers because of supposed benefits that retailers could receive from curtailment of demand during periods of high prices. We agree “the option of requiring retailers to make compensation payments to customers affected by forced

[1] Electricity Authority, Information Paper, MARKET MONITORING REVIEW OF STRUCTURE, CONDUCT AND PERFORMANCE IN THE WHOLESALE ELECTRICITY MARKET SINCE THE POHOKURA OUTAGE IN 2018, undated.
[2] https://www.rnz.co.nz/national/programmes/checkpoint/audio/2018807654/power-outages-genesis-ceo-says-energy-ministerscapegoating-but-woods-has-questions
[3] https://www.energynews.co.nz/news/electricity-supply/131013/ea-scoping-winter-2023-risk-management#comments

power cuts should not be explored for Winter 2023" and consider that it should not be considered further at all.

If the Authority is concerned retailer exposure to high spot prices is an underlying problem it is incumbent on the Authority to ensure ALL retailers have access to hedging products to manage spot market risk, including high spot prices during peak period [Q5 & 21]

The Authority's past decisions have contributed heavily to the deficient contracting market. In particular, the Authority has: (i) failed to develop a cap market after deciding that was the preferred approach 2015; (ii) actively encouraged participants to manage profile risk by over-hedging with base-load rather than using profiled products; and (iii) resisted numerous calls to introduce market-making on peak-load products despite the contracts being listed and ready to be used.[4]

The preferred approach should be to create a liquid market for hedging with different products which results in high merit order plants being contracted to a relatively high degree for the critical periods.

Liquidity is not self-sustaining in highly vertically-integrated markets. Market-making regimes in exchange listed products are essential to create liquidity, forward price curves, and equal access. OTC markets can grow much more easily when the key elements of risk are liquid on exchanges.

The New Zealand market lacks an exchange listed capacity or peak product to create liquidity, a price curve, and equal access to this type of risk. The focus of the Authority should be on introducing market making on such a product.

While the Authority has failed to introduce a listed cap on the ASX, we agree that in the medium or longer-term a cap is the most appropriate type of product for capacity risk, and the most complementary to the existing base-load market. If the Authority cannot get such a product listed on an exchange (noting that perhaps the New Zealand market would benefit from the entry of a new exchange like the EEX) it should investigate how products could be sourced and auctioned by the FTR manager.

In the short-term, the best option is to utilise the listed peak products on the ASX. The Authority should introduce an emergency Code amendment which requires the mandatory market-makers to make some markets in the listed peak-load futures. These obligations need not be as large or cover as much of the curve as the base-load market making does. Even some liquidity over the front 18 months will generate a transparent curve and allow more bespoke contracting to happen OTC.

Problems with the ASX market

We note the current disorderly clearing market for ASX listed electricity derivatives means a number of smaller participants lack market access. We believe centrally cleared markets with transparency and equal access, like a well-run futures and options exchange, are essential for dynamic and competitive wholesale energy markets and support a competitive retail market. The Authority should prioritise initiatives towards restoring access to a well-run futures and options market for a wider range of participants.

In our view the ASX has not been a reliable partner for the New Zealand wholesale electricity market. They have not recognised the Authority's role as the primary regulator. The ASX have

[4] Refer, for example, to Electricity Authority, Enhancing trading of hedge products, Decision paper, 8 December 2015, available at: https://www.ea.govt.nz/assets/dms-assets/20/20183Decisions-enhancing-trading-hedges.pdf.

refused to resettle derivatives when price disputes have arisen, they have failed to list a New Zealand cap product despite long indicating they would, and they have failed to foster an orderly clearing market.

We believe the time has come for the Authority to consider actively encouraging another exchange like the EEX to enter the New Zealand market. The listing of a new profiled product could provide a good opportunity to do this.

We remain strongly of the view that a well-run futures and options exchange is critical to thriving wholesale and retail markets, and that OTC markets can only be truly competitive if complemented by the transparency of a healthy listed market. We encourage the Authority to continue to pursue new listed products despite the current clearing issues.

"There is a need to improve opportunities to manage outage and profile risk not covered by baseload products"[5]

We consider that it would be worthwhile for the Authority to revisit its previous decisions (circa 2015) on enhancing trending of hedge products.

In 2015, as with now, the Authority was similarly concerned that "there would be less generation reliably available to meet periods of peak demand".

The Authority's decision was to develop "an electricity price cap derivative (cap product) as a priority" given "There is a need to improve opportunities to manage outage and profile risk not covered by baseload products" and "The benefits of robust and regular pricing of standardised cap products are likely to be significant":

33 The consultation paper put forward the following rationale for pursuing a standardised cap product with robust and regular pricing which would:

(a) Be of direct benefit to a range of physical market participants seeking insurance against the risk of very high spot prices. Specifically, it would provide an avenue for generation (or demand response) assets that only operate occasionally to receive regular income in order to support investment.

(b) Support greater participation by proprietary traders. This would result in more active trading in the products currently available on the ASX NZ market and greater intermediating activity, which would benefit physical market participants seeking to manage electricity spot price risk.

(c) Provide important price signals to the market, because the value placed on the product by market participants would be readily observable. This would provide transparency around:

(i) The market's forward view of capacity conditions and the cost of any shortages. Parties could use this forward view to inform the value of peaking capacity and demand response technology, which would support efficient investment in such capability, and enhance reliability of supply.

(ii) The long 'tail' of the spot market price distribution curve, which participants may not understand well, and thereby reduce any risk premium that may result in the baseload futures prices at times.

[5] Electricity Authority, Enhancing trading of hedge products, Decision paper, 8 December 2015, available at: https://www.ea.govt.nz/assets/dms-assets/20/20183Decisions-enhancing-trading-hedges.pdf

50 The Authority considers that a cap product:

(a) has the potential to provide transparency around the risk of energy scarcity in the medium term, and hence the value of dry year reserve capacity

(b) would provide visibility around the risk of capacity scarcity, which is masked by a monthly or quarterly average price, but would be made more evident by a half-hourly settled cap product.

51 Furthermore, a cap product would provide a source of more reliable income to support investment in dry year reserve or peaking capacity, and firm demand response or load-shedding technology.

52 From discussions it has had with various participants, the Authority is confident that, contrary to comments by some submitters, there is sufficient evidence of demand for a cap product. While trading cap products in the over-the-counter market has historically been quite low, this likely reflects that:

(a) energy security has been supported by large thermal plants which have provided substantial amounts of energy at times of low hydro inflow sequences, which led to parties having reduced incentives to procure hedge cover capacity scarcity has historically been a lower risk for the market than energy scarcity

(b) participation from proprietary traders is a relatively new development, and these parties may be unlikely to purchase bespoke over-the-counter contracts from physical market participants, as the proprietary traders prefer to deal in homogenous products where they have confidence of their ability to efficiently change their positions.

53 The Authority agrees with the suggestion from Mighty River Power that there are no hard barriers preventing the market from developing a cap product of its own accord. However, the Authority considers that, to date, there has not been a strong incentive or urgency for large players in the market to do so. At present the baseload market makers enjoy the benefits of risk management deriving from vertical integration, but a cap product would better enable proprietary traders to contest the baseload product bids and offers posted by the market makers.

54 The Authority has decided that the best means of signalling profile and outage risks is to continue to enhance the efficiency of the spot market, as well as to further develop product choice and performance in the hedge market.[5] In this regard, a cap product is likely to be the most valuable development that the Authority could pursue.

MDAG also highlight the need to deal with hedge/contracting issues

We agree with MDAG that:[6]

- "… achieving public confidence and political confidence is highly influenced by whether there is sufficient competition and whether tools for managing spot risk are properly available, which supports efficient new investment and, in turn, adequacy of supply."

- "Looking ahead we expect the contract market will need to do more heavy lifting to help both risk management and investment. On the risk management front, we expect a significant increase in shorter-term spot price volatility as the share of intermittent supply increases and fossil-fuelled thermal generation declines. Market participants will need access to products to manage the associated spot price risks."

- "… shaped products will become much more important in future, especially those which can provide firming for intermittent generation. However, the supply of these products may become more concentrated."

We do not support options to procure additional resource outside of the spot market [Q17 & 20]

Our reasons are discussed in joint independent retailer submission to MDAG on the transition to 100% renewables.[7]

[6] MDAG, Price discovery in a renewables-based electricity system, OPTIONS PAPER, 2 December 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/MDAG-options-paper-final-2.pdf.

[7] https://www.ea.govt.nz/assets/dms-assets/29/Independent-retailers-MDAG-100RE-issues-submission.pdf

The problem definition has been muddled with the proposed evaluation criteria [Q4]

The adoption of "assessment" or "evaluation" criteria may be useful if it helps the Authority: (i) make decisions which give effect to the purpose in section 15 of the Electricity Industry Act; and (ii) explain its decisions and provide predictability to stakeholders.

We do not consider it helpful to create bespoke evaluation criteria for each individual consultation which appears to be the approach the Authority now takes.

The evaluation criteria the Authority is proposing converts a summary of its view on the problem definition into an evaluation criterion (criteria (a) and (b)) and adds an element of principle 4 from its consultation charter (criteria (d)).

It is valid and appropriate to consider the extent to which policy options would address the underlying problem (regulatory or market failure). This is orthodox but very distinct from using a specific problem definition as a bespoke evaluation criterion. We do not support using the problem definition as an evaluation criterion.

Concluding remarks [Q3]

The independents consider that, while some options (improvement of information available to the market) may have merit in their own right, none of the options the Authority has proposed will help ensure generation plant is made available in tight supply conditions:

- Given the inherent uncertainty of any electricity price forecast, and the Authority's light regulation of trading conduct, it is difficult to see how forecast spot prices will provide any meaningful carrot or stick to ensure plant is made available in tight supply situations. The Authority has created this situation through its own decisions and should not expect a different outcome to 9 August 2021 in a similar situation in winter 2023.

- The retailer compensation scheme option fails to recognise that retailers are not the cause of supply and demand gaps.

- Introducing separate markets like additional ancillary services, because the main contracting market is deficient, adds cost and segregates liquidity. A better approach is to address why contracting is deficient.

- The Authority should consider how to improve contracting regimes so that high merit order plant is incentivised to run.

Yours sincerely,

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