

Fonterra Submission on Electricity Authority's "Wholesale market competition review" consultation papers

Submitted 21st December 2021

INTRODUCTION

1. Fonterra welcomes the opportunity to submit feedback to the Electricity Authority (EA) on the consultation papers for the "Wholesale market competition review" (the Review).
2. Fonterra is a co-operative owned and operated by around 9,000 New Zealand farming families. We are New Zealand's largest exporter and have 27 manufacturing sites spread across New Zealand, in addition to science and innovation centres and distribution facilities which are integral to the business.
3. Our farmers businesses, as well as our manufacturing sites and distribution facilities use a large amount of electricity each year. Last season, our site and distribution facilities used approximately 1,100 GWh of electricity, of which approximately 800 GWh was from the grid and the remainder was from industrial co-generation plants supplying four of our sites. Fonterra Commodities Limited (a subsidiary of Fonterra) are an active user of the ASX hedge market to manage electricity spot price exposure.
4. As a large industrial company with significant energy requirements, as well as one of New Zealand's largest employers, we are supportive of actions to ensure the electricity market achieves all three elements of the energy trilemma for electricity supply being secure, sustainable, and economic – which requires the market to be both competitive and efficient.
5. Looking toward the future, we consider a well-functioning and competitively priced electricity market as critical to New Zealand's successful transition to a low-emissions economy.

GENERAL COMMENTS

6. The Review notes that the average spot price between 2009 and the Pohukura outage in 2018 was \$67/MWh, while prices since that time have been on average >\$100/MWh. Once underlying demand, water values, gas, and other fuel costs/factors are accounted for, some of these price increases remain unexplained by the EA.
7. While none of the individual factors unequivocally prove uncompetitive pricing has occurred, together the Review notes "*there is some evidence that suggests prices may not be being determined in a competitive environment*". Furthermore, it observes "*some offers do not reflect underlying conditions*", "*...increased incentive and ability to economically withhold*" and subdued price differences between the islands during times of high storage suggests some generators may have been economically withholding.

8. Fonterra closely follows the electricity market and requires the market to have integrity with efficient spot and futures prices. In recent years, we observe that the market has suffered several sub-optimal outcomes such as reduced confidence in both the spot and futures market, some participants choosing not to engage with the futures market, loss of industrial businesses which unsustainable energy costs (inclusive of carbon) contributed towards¹, independent retailers delaying investment and growth plans², and an estimated wealth transfer of ~\$1.96Bn in the last five years from manufacturers to electricity companies³. For Fonterra, over the last three years our costs for electricity have also materially increased.
9. While we acknowledge and understand the EA's interest in the Tiwai contract which is perhaps clearer cut – this does not address the more serious issues regarding pricing conditions in the wholesale market which have been a concern for a full two years prior to the renewed Tiwai contract and which gave rise to the need for this Review. In our view, the EA's focus on the Tiwai contract should be a secondary priority to the EA focusing on ensuring security of supply, improving competition, pricing efficiency, and confidence in the electricity market.
10. Fonterra notes that there is insufficient new generation build underway, ahead of accelerating demand and the potential loss of fossil fuel thermal generation from the market – this is also summarised in the Information Report paragraphs 5.187 and 5.188. It would be beneficial if the EA could understand the hurdles for this and what is required to address the challenge.
11. Looking forward, as the amount of renewable electricity generation surpasses 90%, traditional pricing volatility should reduce or flatten, and instead we are likely to see periods of stress in the market becoming more acute and of shorter duration, resulting in shorter-term high price periods⁴. This will signal to the market to build assets that can deal with the short-term high price periods and reflect the value that an asset can bring to provide the market with security of supply.
12. The Review highlights an unexplained uplift in average spot prices of \$40/MWh over the review period. It would be beneficial for the EA to understand and address the drivers of this uplift. This is core to restoring confidence in efficient pricing in the wholesale market. Concept Consulting comment:
“We regard the regression analysis as among the most potentially informative evidence in the review because it allows diverse data to be assessed in an integrated way. Putting aside the underlying cause of the apparent shift for now, it is striking that the analysis points to an unexplained upwards shift in average spot prices of almost \$40/MWh from late 2018 to mid-2021.”
13. Within the context of sustained high spot prices, we are also seeing long dated futures prices which are not reflective of the long run marginal cost to produce.

¹ For example, the Norske Skog Tasman Paper mill closure. <https://www.nzherald.co.nz/business/the-last-days-of-the-norske-skog-tasman-mill/XD2EQJGH5DWI74DOPVEJ3WSUWI/>

² For example, EnergyNews report on Electric Kiwi investing in Australia rather than New Zealand <https://www.energynews.co.nz/news/electricity/100405/electric-kiwi-shift-20m-oz-perverse-nz-market>; and Octopus Energy delaying entering the New Zealand market until conditions improve: <https://www.energynews.co.nz/news/electricity/105967/market-concerns-delay-octopus-retail-push>

³ As summarised in the MEUG economic profit analysis [MEUG MEL EPA Findings Media Release 12PM 24 AUGUST 2021.pdf](#)

⁴ Baringa Partners presentation to MDAG on Page 7 demonstrates this: [PowerPoint Presentation \(ea.govt.nz\)](#); and the Independent Electricity Generator Association presentation on pages 6&7: <https://www.ea.govt.nz/assets/dms-assets/29/IEGA-presentation.pdf>

14. Below are some suggestions from Fonterra's perspective for the EA to consider when addressing wholesale market improvements:
- a) We encourage the EA to engage with other Government departments, including the Gas Industry Company, to ensure energy security of supply, address hurdles for decarbonisation, and the regulatory regimes that are changing within NZ that may impact the energy sector. This is important to ensure the development of energy systems which is a foundation for a secure, sustainable, and economic electricity system.
 - b) Further development of demand response financial incentives to enable demand to participate in response to high electricity prices. For example, process heat users could potentially install electrode boilers and dual fuel sites to switch in periods of high price or low electricity generation (assuming the transmission capital investment hurdle was addressed).
 - c) Review the hurdles for developing, renewing, or modifying new or existing resource consent for renewable electricity generation, and opportunities to ensure this process is efficient and therefore low cost which will flow through to all electricity users.
 - d) Ensure that access to the grid and networks, and associated pricing, is open, robust, and supportive of renewable electricity developments.
15. If there are any clarifications, or if there is any further information that would be of use to the EA, please do not hesitate to contact us.