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## **Wholesale Electricity Market Review and Inefficient Price Discrimination**

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Genesis Energy Limited (**Genesis**) welcomes the opportunity to provide feedback on the Electricity Authority's (**Authority**) discussion documents: *Market Monitoring Review of Structure, Conduct, and Performance in the Wholesale Electricity Market - Information Paper* and *Inefficient Price Discrimination in the Wholesale Electricity Market - Issues and Options* dated October 2021.

The Authority's review of competition in the wholesale electricity market covered the period since the Pohokura unplanned outage in the spring of 2018, focussing on the question of whether spot electricity prices over the period reflected underlying market conditions.

These papers set out the outcome of the Authority's review, and feedback from a survey of market participants undertaken by Concept Consulting on the investment environment for new electricity generation.

The Authority found that, generally, offer prices reflected underlying conditions and that generators operated within the spot market conduct rules. The Authority observed, however, that: some offer prices did not reflect underlying conditions; there may have been economic withholding of generation by some generators; and that the January 2021 contract between Meridian, Contact and NZ Aluminium smelters (**Tiwai contracts**) may have given rise to inefficient price discrimination.

In light of these observations, the Authority has sought feedback on potential regulatory intervention options to address the risk of inefficient price discrimination in the wholesale market.

### **Regulatory intervention must be appropriate, measured and support investment in new generation**

Genesis' diverse portfolio of assets performs a critical role in ensuring energy security for the market and we are committed to empowering New Zealand's sustainable future.

To this end, Genesis has:

- Accelerated the transformation of our business as we play our role in leading New Zealand's transition to a low carbon future.
- Supported the work of the Climate Change Commission, and advocated for a 30-year national energy strategy that takes into account the interconnectedness of the energy system and enables the right sequencing and prioritisation of actions to avoid unintended consequences.
- Committed to removing 1.2 million tonnes of carbon emissions before 2025 tied to the internationally recognised benchmark of limiting global warming to below 1.5°C of pre- industrial temperatures.<sup>1</sup> These targets have been verified by the Science Based Targets initiative and Genesis was the first New Zealand gentailer to commit to 1.5°C with them.

Our Future-gen strategy is how we will meet our science based targets. Our objective is to economically displace baseload thermal generation with 2,650 GWh of new renewable generation, sufficient to power 380,000 households a year. This will be delivered in different ways, including as a developer and through long term power purchase agreements (**PPAs**).

We have been executing our strategy and are well on the way to delivering on those goals:

- **March 2021:** The Waipipi wind farm was commissioned, underpinned by a 20-year power purchase agreement (**PPA**) with Tilt Renewables for all of the electricity generated from the farm. The Waipipi windfarm produced 222GWh of renewable generation for Genesis in FY21 mitigating the required thermal backup, and is expected to produce 430GWh of renewable energy annually.
- **August 2021:** Entered a PPA with Tilt Renewables for the Kaiwaikawe wind farm to be built in Northland by early 2024. This is expected to provide 230GWh of renewable energy and was the first agreement from an RFP process we ran as part of the Future-gen strategy.
- **August 2021:** Entered a PPA with Contact to support the development of 1.3 TWh of geothermal plant. Genesis has contracted 41% of the output capacity for the first 10 years.
- **November 2021:** Genesis selected FRV Australia as its joint venture partner to co-develop 500MW of solar generation capacity over the next five years. This is expected to generate about 750GWh of energy annually – enough to power 100,000 households or 185,000 electric vehicles per year.

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<sup>1</sup> This supports New Zealand's commitments under the 2015 Paris Agreement.

New Zealand, and as we have outlined above, Genesis, has ambitious climate targets. The electricity sector, including investments in new renewable generation, will play a key role in achieving these targets.

A competitive wholesale electricity market is important to ensure that price signals for new generation investment (and other) decisions, are not distorted, and that capital and resources are allocated efficiently. It is important, therefore, that regulatory intervention and market design changes, are data driven, targeted, and support, rather than hinder, the development and investment in new generation.

As a general principle, we support market participants being free to reach a commercial agreement, having regard to their respective strategic objectives and risk appetites, and to do so using a range of instruments. This framework should result in better capital allocation and pricing decisions relative to alternatives that, for example:

- (a) require approval by third parties who are not resourced or incentivised to manage risk and achieve commercial outcomes;
- (b) give rise to the risk that the regulatory process is used by:
  - (i) disaffected counterparties renegotiate contracts;
  - (ii) unsuccessful parties to an RFP process, to delay contracts such as PPAs or large derivative contracts.

In relation to the consultation papers, we observe that:

- (a) The Authority has not determined that the Tiwai contracts constitute inefficient price discrimination and appears to have proceeded on the assumption that the Tiwai contracts are indicative of widespread inefficient price discrimination in wholesale contracts. However, no compelling evidence has been provided support this assumption. The options proposed therefore strike us as unmerited and disproportionate.
- (b) Several of the options proposed would prohibit parties from accessing valuable and well-established mechanisms such as OTC derivatives and PPAs to manage risk or to support new generation. These options raise the prospect of adverse or unintended consequences, including inefficient hedging, reduced dry year risk cover options and hindering investment in new generation. In addition, there is no analysis provided that compares the potential financial impact of such consequences with the benefits of addressing the alleged inefficient pricing discrimination.
- (c) A significant amount of new renewable generation is being built under the current market design. Options which essentially give the Authority a veto right over the price struck by parties in arms length commercial transactions are more likely to hinder rather than facilitate investment in new generation.

- (d) The Overseas Investment Office and Commerce Commission (merger) approval processes are not comparable. They do not regulate the price of the relevant transactions.

Accordingly, while we would support exploring improvements to wholesale contract disclosures to increase transparency and build a data set that could provide an indication of whether inefficient price discrimination is occurring, we would not support changes of the scale proposed in the consultation papers.

Regulatory intervention aimed at addressing a particular risk, should be grounded in credible evidence and analysis, targeted and measured, and in the context of the wholesale electricity market and New Zealand's journey to a low transition economy, facilitate generation investment decisions.

Our detailed feedback on the consultation questions is set out in the **Schedule** to this letter.

Please don't hesitate to contact me should you wish to discuss our response further.

Yours sincerely



Warwick Williams  
Senior Regulatory Counsel and Group Insurance Manager

## CONSULTATION QUESTIONS

	Question	Response
1	<p>NZAS has a number of unique attributes as a consumer of electricity, including size, location, the related potential for stranded water, and capacity to provide demand response. Do you agree that these factors support a discount relative to Benmore prices (as the reference South Island node)? Are there other relevant factors and how might one determine an appropriate level of discount?</p>	<p>Other than what has been published by the parties, we are not aware of the commercial terms of the Tiwai contract. We expect that the pricing mechanism and price agreed between NZAS and Meridian, reflect their respective commercial imperatives, bargaining power and risk appetites and the nature of the contract and circumstances (such as the transmission constraints that limit the flow of that energy to the North Island).</p>
2	<p>Do you have any additional feedback or information on the efficiency of the existing Tiwai contractual arrangements and their consequences?</p>	<p>No.</p>
3	<p>Do you agree that the Authority should investigate price discrimination in relation to wholesale contracts?</p>	<p>Yes, if there is compelling evidence to suggest that inefficient price discrimination (whether through discounts or premiums) exists in wholesale contracts generally. No such evidence has been presented. We have supported the standardised disclosure of transfer prices by gentailers and consider that the transparency and trends over time, should alleviate concerns relating to alleged inefficient discriminatory pricing by gentailers. Similarly, we would support proposals that explore improvements to wholesale contract disclosures to increase</p>

		transparency and build a data set that could provide an indication of whether inefficient price discrimination is occurring. We would not support changes of the scale proposed in the consultation papers.
4	Should the Authority's consideration of policy implications from price discrimination practices extend to situations where electricity is supplied both at discounts and premiums to market prices?	See response to question 3.
5	Do you agree these baseline assumptions are reasonable? What other assumptions should be tested?	It is unclear why NZAS consumption is assumed at the maximum contracted amount and the Rest of NZ annual consumption based on annual 2019 demand. Should actual consumption be used for both assumptions and perhaps based on an average (e.g. 5 years)? It is also unclear how: (a) transmission costs (which have an impact on "willingness to pay") and (b) the demand response capability in the Tiwai contract, have been dealt with.
6	Do you agree that any investment issues raised by the Tiwai contracts are best addressed through a review of barriers to new investment more generally, as the Authority intends to undertake in 2022?	Yes, a holistic approach should be preferred. To the extent that the Tiwai contracts raise issues for investment in new renewable generation, this approach would reduce the risk of policy decisions being unduly influenced by the Tiwai contracts relative to other factors such as resource consenting, transmission and carbon prices.

		<p>For example, as we have discussed with the Authority previously, while the electricity sector is a key enabler of New Zealand's transition to a low emissions economy, there is a balance to be struck. Forecast wholesale electricity prices need to be sufficient to support investment in new generation. The impact of material increases in carbon prices on wholesale electricity prices may, however, hinder the electrification of high emission industries such as the transport and industrial process heat sectors.</p>
7	<p>Beyond the Tiwai context, do you consider discriminatory pricing or discriminatory terms and conditions are adversely affecting efficiency and competition in the electricity system? If so, please provide evidence.</p>	<p>We have not observed evidence of this.</p>
8	<p>The following is a list of options the Authority considers could address concerns about inefficient price discrimination, which are discussed below.</p> <ol style="list-style-type: none"> <li>1. Status quo</li> <li>2. Prohibit use-it-or-lose-it clauses</li> <li>3. Electricity Authority pre-approval of large contracts</li> <li>4. Require public offering of all (or some percentage of) hedge contracts</li> <li>5. Require large hedges to be traded publicly</li> </ol>	

	<p>6. Extend trading conduct provisions beyond the spot market to hedge markets</p> <p>7. Non-discriminatory pricing rules</p> <p>8. Hybrid of non-discriminatory pricing and pre-approval of contracts.</p> <p>Are there other options the Authority could implement to mitigate inefficient price discrimination?</p>	
	<p><b>Option 2: Prohibit 'use-it-or-lose-it' clauses</b></p>	
9	<p>What are the pros and cons of the status quo?</p>	<p>A competitive wholesale electricity market is important to ensure that price signals for new generation investment (and other) decisions, are not distorted, and that capital and resources are allocated efficiently. It is important, therefore, that regulatory intervention and market design changes, are data driven, targeted, and support, rather than hinder, the development and investment in new generation.</p> <p>As a general principle, we support market participants being free to reach a commercial agreement, having regard to their respective strategic objectives and risk appetites, and to do so using a range of instruments. This is what the status quo provides.</p>



		<p>This framework should result in better capital allocation and pricing decisions relative to alternatives that, for example:</p> <ul style="list-style-type: none"><li>(a) require approval by third parties who are not resourced or incentivised to manage risk and achieve commercial outcomes;</li><li>(b) give rise to the risk that the regulatory process is used by:<ul style="list-style-type: none"><li>(i) disaffected counterparties renegotiate contracts;</li><li>(ii) unsuccessful parties to an RFP process, to delay contracts such as PPAs or large derivative contracts.</li></ul></li></ul> <p>While the paper sets out a range of pros and cons of the status quo, we query whether the status quo necessarily leads to certain cons. For example:</p> <p><i>“Maintains demand for electricity and associated high prices, delaying decommissioning of high cost, high carbon-emitting thermal.”</i> [emphasis added]</p>
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		<p>This is at odds with the acknowledgement at paragraph 5.36 of the paper that higher prices support the maintenance of higher cost thermal generation to support reliability.</p> <p>As the Authority is aware:</p> <p>(a) thermal base load generation will be required, notwithstanding the new and anticipated renewable generation being built, to ensure the security and resilience of the energy system as we transition to a low emissions economy;</p> <p>(b) companies like Genesis are executing generation strategies - within the status quo - to displace their thermal generation with new renewable generation. Genesis intends to displace 2,200 GWh p.a. of <u>baseload thermal</u> with renewable generation by 2030 (1,350 GWh p.a. by 2025);</p> <p>(c) there are other drivers of high electricity prices, which include rising carbon prices and a tighter gas supply market.</p>
10	Do you consider that the status quo addresses the problem identified?	The Authority recognises in the consultation paper that the status quo is dynamic.

11	Do use-it-or-lose-it clauses have a legitimate commercial role? What would the effect be of prohibiting them in wholesale electricity markets?	<p>We can understand the commercial rationale and the certainty that such clause might provide. However, this clause appears to be bespoke to the Tiwai contracts.</p> <p>We have not seen it used in other derivatives and so a prohibition would seem unlikely to have an impact on contracting structures. However, to the extent that the Tiwai contracts resulted in inefficient price discrimination, it is unclear whether the absence of such a clause would have resulted in a different outcome, given amongst other things, the transmission constraints that restrict energy supplied to Tiwai flowing North. Accordingly, we query whether these clauses should be prohibited.</p>
12	Which contracts (e.g., minimum size) should be subject to a prohibition on a use-it- or-lose-it clause?	Please see the response to question 11.
13	What are the pros and cons of prohibiting use-it-or-lose it clauses?	Please see the response to question 11.
14	Do you consider that prohibiting use-it-or-lose it clauses addresses the problem identified?	Please see the response to question 11.
	<b>Option 3: Electricity Authority pre-approval of large contracts</b>	
15	Should this option be limited to pre-approval of contracts or extended to apply to offers that one party considers are discriminatory?	As discussed in our response to question 9, market participants should be free to reach agreement, having regard to their objectives and

		<p>risk appetites. This should result in better capital allocation and pricing decisions relative to alternatives that, for example, require approval by third parties who are not incentivised to manage risk and achieve commercial outcomes.</p> <p>We agree with the cons set out in the paper, including the impact on commercial decision making. We query, however, the comparison to the Overseas Investment Office and Commerce Commission approval processes. Those operate under distinct regimes with different policy objectives. Further, those processes do not involve the regulator approving prices. Under this proposal, the Authority would effectively be regulating the price of these contracts. Accordingly, we would not support the pre-approval option.</p>
16	What criteria should the Authority consider in pre-approving large contracts?	Please see the response to question 11.
17	What should the MW or dollar threshold be for contracts requiring pre-approval?	Please see the response to question 11.
18	What are the pros and cons of Authority pre-approval?	Please see the response to question 11.
19	Do you consider that pre-approval of large contracts addresses the problem identified?	No, for the reasons set out above.

	<p><b>Option 4: Require public offering of all (or some percentage of) hedge contracts</b></p>	
<p>20</p>	<p>Would greater reliance on exchange-traded derivatives provide as much risk mitigation as current arrangements that also encompass over-the-counter risk products? Please explain your reasoning.</p>	<p>It is important that market participants have access to a range of instruments to:</p> <ul style="list-style-type: none"> <li>(a) manage risk effectively, such as through tailored OTC derivatives;</li> <li>(b) support investment in new renewable generation, such as PPAs.</li> </ul> <p>As the options paper highlights, a greater reliance on exchange traded derivatives reduces the ability of participants to enter into contracts suited to their risk management needs.</p> <p>An ASX futures contract, for example, may not be suitable for a customer wanting to hedge its exposure to a particular shaped load at a specific GXP or for a short period (e.g. intraday or for certain days/trading periods in a week).</p> <p>We also note that:</p> <ul style="list-style-type: none"> <li>(a) The costs (such as margin requirements) of using centralised platforms like the ASX prevents some participants from accessing exchange traded derivatives.</li> </ul>

		<p>(b) Participants already use public tenders under the status quo to sell or buy energy, or to develop new renewable generation. The obligation to do so should not be imposed on them.</p> <p>(c) Exchange traded contracts are not suited to: (i) PPAs which are long term contracts with bespoke terms and conditions arising from the relevant project; (ii) demand response arrangements; (iii) dry year risk management products like swaptions.</p>
21	What products would you want to be offered in addition to the existing publicly traded hedge products?	There is a sufficient range of OTC and exchange traded derivatives available to market participants. The Authority could consider, however, whether there are opportunities to reduce the costs to participants accessing exchange traded derivatives. For example, lowering margin requirements or netting of collateral held with the NZX and ASX.
22	What percentage of hedge contracts should be offered publicly?	Please see the response to question 20.
23	What are the pros and cons of public offering of hedge contracts?	In addition to the pros and cons identified in the paper, a public tender process can take time and may not be suitable for participants who require cover quickly. For example, for an unplanned outage or a transmission constraint which an

		exchange traded derivative or FTR is not suitable for.
24	Do you consider that public offering of hedge contracts addresses the problem identified?	No, for the reasons set out above. The Authority may wish to consider whether improvements to the hedge disclosure regime could provide better transparency on pricing and conditions.
25	How should 'large' hedges be defined?	Please see the response to question 20.
26	What are the pros and cons of this option?	Please see the response to question 20.
	<b>Option 6: Extend trading conduct provisions beyond the spot market to hedge markets</b>	
27	Do you consider that the option addresses the problem identified?	No. This option requires that any hedge price offered was one that could be maintained if there was competition for that contract. Given the nature of the Tiwai contract and, among other things, the well traversed grid constraint issues, it seems to us that the parties best placed to contract were Meridian and NZAS. Further, no information has been presented in the paper that the <i>offer behaviour</i> of either party (or the behaviour of other parties to derivative contracts or PPAs more generally) gives cause for concern. It is not clear why perceived issues with the Tiwai contracts, leads to the conclusion that

		<p>there are conduct or price discrimination issues with other wholesale contracts generally.</p>
28	<p>Which types of contracts should be covered by trading conduct-type provisions?</p>	<p>As noted above, no information has been presented that OTC contracts or PPAs that have been entered into (or the associated offer behaviour), requires regulation of the nature proposed. The fact that a counterparty does not sign does not mean there is anti-competitive behaviour. Often the parties simply cannot reach agreement on price or the credit support arrangements. In some cases, a commercial decision may have been taken not to hedge and when this is revisited when market conditions or its risk appetite has changed, the prices and terms reflect the heightened risk. Similarly, it is difficult to see how agreements such as long term PPAs, which can have plant dispatch and operational decisions incorporated, would operate under such a regime.</p> <p>We would add to the drawbacks identified by the Authority with this option, the increased risk of spurious objections or use of the conduct rules by parties who simply do not like the price and commercial terms, or wish to renegotiate through a regulatory process. Similarly, there would be a risk that disgruntled parties could use the process to delay PPA agreements and hedges</p>



		with the consequential impact on plant construction and commissioning.
29	<p>How would trading conduct-type provisions be monitored:</p> <p>Where a party to an offer or contract believes they are being disadvantaged?</p> <p>Where the parties being harmed are not a party to the contract?</p> <p>Where no offer was received?</p>	See the response to questions 27 and 28.
30	What are the pros and cons of extending trading conduct-type provisions?	See the response to question 28.
31	Do you consider that extending trading-conduct provisions to hedge contracts would address the problem identified?	See the response to questions 27 and 28.
	<b>Option 7 Non-discriminatory pricing rules</b>	
32	What attributes of a contract should be permitted reasons for price discrimination? What attributes should be expressly precluded?	<p>Policy should, so far as possible, be data driven so that regulatory intervention is targeted and appropriate.</p> <p>This question, and the following questions, proceed on the basis that there is discriminatory pricing in wholesale contracts generally. However, no evidence presented that this is in fact the case.</p> <p>Further, as the paper sets out, the disadvantages with this option out number and outweigh the benefits. These include the complexity that arises</p>

		with such a regime, including assessing tailored provisions (negotiated by the parties on commercial arm's length terms) such as demand response, counter party risk and provisions related to plant operating conditions (e.g. notice periods and force majeure events). Excluding such terms from an assessment is problematic as they are often key elements of the commercial bargain struck by the parties.
33	What remedies would be appropriate if discriminatory pricing was found?	Please see the response to question 32.
34	Are the current penalties under the Electricity Industry Act 2010 sufficient to deter inefficient price discrimination of the scale potentially associated with the Tiwai contracts?	Please see the response to question 32.
35	What are the pros and cons of non-discriminatory pricing rules?	Please see the response to question 32.
36	Do you consider that non-discriminatory pricing rules would address the problem identified?	Please see the response to question 32.
	<b>Option 8: Hybrid of non-discriminatory pricing and pre-approval of contracts</b>	
37	What are the biggest risks of implementing this hybrid combination of non-discriminatory pricing and pre-approval of contracts?	As discussed above, there is no compelling evidence that merits regulatory intervention of this nature. The advantages and disadvantages of the non-discriminatory pricing and pre-approval options would apply here. The biggest

		risk is that a hybrid options exacerbates the complexity and disadvantages.
38	What are the pros and cons of this hybrid option?	Please see the response to question 32.
39	Do you consider that this hybrid option would address the problem identified?	Please see the response to question 32.
40	Is inefficient price discrimination best addressed through an amendment to the Electricity Industry Participation Code 2010 or through structural options that would involve other parts of government?	The appropriate option to address inefficient price discrimination should be assessed once there is clarity on the existence and extent of any inefficient price discrimination. We note that the case for intervention through proposed Code amendments has not been made out. It is premature therefore to consider structural options such as forced divestment of assets that have far reaching implications, including for shareholders and other stakeholders.
41	Which structural options do you think should be considered further? Please explain your reasoning.	Please see the response to question 40.
42	Do you agree with the criteria proposed to assess the options? If not, what additional criteria should be used to evaluate policy options?	Please see the response to question 40.