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22<sup>nd</sup> December 2021

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## **EA CONSULTATION PAPER: INEFFICIENT PRICE DISCRIMINATION IN THE WHOLESALE MARKET – ISSUES AND OPTIONS WINSTONE PULP INTERNATIONAL LIMITED’S SUBMISSION**

This is Winstone Pulp International Limited’s (WPI) submission on the “Inefficient Price Discrimination in the Wholesale Electricity Market – Issues and Options, an initial response to the Wholesale Market Review” published 27<sup>th</sup> October 2021.

We support the Major Electricity Users Group’s (MEUG) submission on this paper and submit the following additional points of emphasis and recommended fast track options for consideration.

Overall, we are very disappointed with your Issues and Options Paper. It is too narrowly focused, and lacks well developed options that could address the root causes of the current wholesale electricity market (WEM) dysfunction. In addition, progress towards fixing the underlying WEM problems is simply too slow.

### **1. Dysfunctional state of the wholesale electricity market (WEM)**

WPI shares the view of other major electricity users, as articulated by MEUG, that the current and anticipated wholesale electricity prices are well above levels justified by the underlying Long Run Marginal Cost (LRMC) of available generation technologies, and what could be reasonably expected in a well-functioning WEM.

You have undertaken extensive analysis of how much this problem is costing consumers, as has MEUG<sup>1</sup>, but whatever the level of excess cost, there is no doubt that the market is letting all consumers down, is dysfunctional and needs fixing urgently. We urge you to focus with urgency on pragmatic straight-forward fast-track solutions rather than trying to accurately quantify the problem.

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<sup>1</sup> Your Market Review paper noted an “unexplained upwards shift in average spot prices of almost \$40/MWh from late 2018 to mid-2021,”. The Economic Profit Analysis for Meridian Energy (MEL), that MEUG funded, estimated that Meridian Energy appears to have made excess economic profits of around \$1.5 billion over the last 5 years.

Wholesale prices at current and futures prices are unsustainable for our business, as discussed in the next section. It is our view that, if current and forward WEM price levels persist, there will be irreversible economic damage: New Zealand's major electricity intensive trade exposed primary industries will be unable to compete in their international markets and the high WEM prices will severely hamper the Government's aspirations to drive decarbonisation in the NZ economy by electrification using "abundant low-cost renewable energy".

## **2. Impact on our business**

We operate a pulpmill at Karioi, near Ohakune, that produces over 220,000 tonnes per annum (pa) high grade mechanical pulp for export, and an adjacent sawmill producing over 120,000 m<sup>3</sup> pa sawn timber for export and the domestic market. We process and add value to over 660,000 tonnes of logs and fibre each year. Our business generates over NZD200million/year of revenue with export revenues of over US\$125million/year.

We are a price taker in the international pulp market and we cannot pass on rising domestic input costs. Consequently, to stay internationally competitive, we must aggressively manage our operating costs. Energy is a major component of our input costs.

We currently use around 240,000 MWh/year electricity. We typically hedge around 80% of our demand, but this does not protect us from underlying spot price trends, and since 2019 our average forward price has doubled. It is not rational for us to hedge at prices that are unsustainable for our business.

## **3. Underlying reasons for market dysfunction**

We note that the New Zealand WEM is isolated, complex for its relatively small scale, and has participants who hold concentrations of market power which is exacerbated by supply side vertical integration. These characteristics do not well align with the attributes needed for a successful competitive market and, we believe there has been an overly optimistic trust in the suitability of a lightly regulated approach. We believe that the current market model can not meet its intent without complementary off-market measures that mitigate these core market limitations.

We believe that there are four key underlying problem with the WEM that you should be taking urgent action to address where these are within your mandate, namely:

- (i) Insufficient rate of investment in new low-cost renewable electricity generation, exacerbated by uncertainty about future demand.
- (ii) Insufficient wholesale electricity market competition with potential for the exercise of market power to generate excess economic profits, exacerbated by weak oversight.
- (iii) Rising underlying fuel costs, particularly for gas and ETS charges.

- (iv) Insufficient competition, transparency and liquidity in the gas and the electricity hedge markets, and insufficient demand certainty in the gas market.

We acknowledge the EA has a programme of market development and improvement that is resulting in incremental improvements within the current market framework, but we believe more radical “off market solution” are required.

#### 4. Performance of the Electricity Authority

The Electricity Authority’s statutory objective is *to promote competition in, reliable supply by, and efficient operation of, the electricity industry for the long-term benefit of consumers*. The facts speak for themselves, this objective is not currently being achieved.

Given the WEM competitive weaknesses noted in section 3 above, it is essential that New Zealand has a well-regulated market, with a regulator that is appropriately resourced and focused on achieving its statutory objective.

In our observation over recent years, there has been a trend towards apply a competitive approach to non-core market functions that have questionable cost benefits, further complicate the overall market and divert focus away from core competition in the energy market. We suggest a more focused and pragmatic approach is desirable.

#### 5. Recommended option for EA consideration.

In our view, the EA should be considering options that can be implemented in a one-to-two-year time frame to achieve relatively fast impacts, and there should be much more focus on “off-market” that are outside the core market design. These should have a relatively low risk of unintended consequences and not further complicate the core market design.

The options that we recommend the EA, and wider Government Agencies, consider for fast-track implementation are as follows:

#	Intervention option for consideration	Rationale
1	Tax and accelerated depreciation incentives for new entrants into the generation market – for renewables only <sup>23</sup>	To encourage “additional” low cost RE generation by new entrants into the NZ market.

<sup>2</sup> could also consider whether peaking gas options should be supported as an interim measure to assist the transition away from coal

<sup>3</sup> The Tax Working Group (2019) recommended these options for encouraging targeted investment, including accelerated depreciation, and/or expensing of some CAPEX development and “black hole” cost.

#	Intervention option for consideration	Rationale
2	Increase resourcing for more proactive market monitoring and impose much larger penalties for market manipulation, with a timely process for resolution. In California, market manipulation can result in significant financial penalties (in addition to WEM price reset and resettlement) and, in worst cases of mis-behaviour, forced divestment.	<p>The EA’s market review concludes that some generators have market power, there have been “instances of economic withholding” and “at times offers appear unrelated to supply and demand conditions”.</p> <p>The current framework is very weak: remedies take too long, and penalties are trivial. The risk of market manipulation will be lowered by increasing the consequences of manipulation.</p> <p>Improved UTS and HSOTC Code provisions being implemented by the EA will make compliance more transparent and support this measure</p>
3	Government to set out a clear energy policy for gas as a transitional fuel, and integration of large scale storage into the WEM.	<p>Uncertainty in the gas sector is destabilising the gas market and is a major barrier to upstream investment to maintain the supply balance and enable the conditions for development of green gas alternatives.</p> <p>Similarly, uncertainty as to how the Onslow pump storage scheme (or similar projects) would be integrated into the WEM is disincentivising investment in generation.</p>
4	Provide <u>transitional</u> relief to thermal generators for ETS costs by re-introducing the 1 for 2 surrender obligation (possibly only for gas generation), to be phased out starting from (say) 2025.	<p>To lower the spot price stack until additional lower cost RE capacity is commissioned<sup>4</sup>. Currently, hydro generators must push up spot prices to force thermal generators on, so that they can conserve water storage.</p> <p>A price on carbon, reflected into electricity prices, should incentivise generators to retire fossil fuelled generation and replace it with lower carbon generation, which Gentailers can fund from windfall competitive rents that are resulting from the rising NZU prices. The current market settings are not driving this outcome.</p>
5	Establish a secondary exchange market platform for PPAs and CfDs that would suit large electricity users, IPPs and/or independent retailers. This market would also be supported by option 6 below.	<p>The ASX futures market is not providing the hedge products and liquidity that are needed by these market participants. This is a major barrier to investment by new IPP entrants.</p> <p>This market could also de-risk the option for major electricity users to enter in long term hedges, which can help to underpin investment by generators.</p>

<sup>4</sup> The Climate Change Commission has concluded that the electricity sector (already 80% renewable) would continue to decarbonise without a higher NZU price, because wind and solar (increasingly so) are now far cheaper than fossil fuels.

#	Intervention option for consideration	Rationale
6	Establish a government guaranteed scheme to offer new entrant independent power producers (IPP) long term hedges for RE generation under a competitive reverse auction procurement process, which would also support option 5. IPPs would trade their output on the spot market but would have their investment de-risked. Any hedge profit/loss from the scheme could be funded by Government ETS revenues or managed through a market price levy and rebate mechanism.	<p>This could increase supply side participation and increase the supply of lower cost wind (and potentially solar), leading to a lower spot market offer stack.</p> <p>The threat of this could incentivise incumbent generators to faster action</p> <p>Note – this differs from a single buyer market or the NZ Power proposal which is not currently supported</p>

Thank you for the opportunity to make this submission.

Yours sincerely

David Anderson  
Managing Director