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Inefficient price discrimination in very large contracts – consultation paper

ETNZ - The Energy Trusts Association - represents the trust owners of electricity distribution businesses throughout New Zealand.

As the organisation representing consumer and community owners of EDBs, ETNZ has both an asset owner and a consumer perspective in making this submission.

Our position summarised

We have responded below to the five higher level questions raised in the discussion paper, focussing in particular on consumer outcomes.

Responses to the questions raised

Q1 Are there plausible reasons for why major generators with no commercial contract with NZAS would be willing to subsidise them staying, other than because of the impact NZAS's exit would have on aggregate prices facing all generators?

The overwhelming consideration for such generators would be the implied major drop in wholesale prices. However, a related consideration is the investment uncertainty created by the possibility of such a price drop, meaning that an uncontracted generator might be prepared to support a subsidy provided that it was linked to a guarantee of forward investment certainty. Some form of underwriting might provide such a guarantee (perhaps underwriting by the Government, as it was past governments that entered into the original aluminium smelter contracts).

Q2 Do you agree that where there are restrictions on reselling by large users who are in a position to threaten exit, the Authority should have a concern to

examine whether the expected overall value of the contract to the generator is less than the best alternative value in the absence of the contract?

From the point of view of our consumer and community beneficiaries, energy trusts would be likely to support the avoidance of restrictions on re-selling electricity that has been purchased at favourable rates by large users. Such re-selling could be expected to increase competition and place downward pressure on wholesale and retail prices.

However we recognise that the absence of restrictions could create scope for a large user to threaten re-selling unless additional concessions are granted, and this could be at the expense of other consumers. Accordingly we believe that the best outcome would involve the EA overseeing any adjustments to contracts with a view to achieving the best commercial outcomes for other consumers.

Q3 Do you agree with the problem definition? If not, why not?

We agree with the problem definition but would add the following to the list of inefficient price discrimination outcomes:

(d) Given the extensive Crown investment in major generators and in Transpower, there is a risk of government pressures on those entities to enter into large contracts where favoured large users are being encouraged to invest in New Zealand. This has been a familiar pattern in the past, and is also a familiar pattern in other countries.

Inadequate transparency in such situations would have a compounding effect.

Q4 Do you agree that for the types of contracts the Authority is interested in ensuring the efficiency of (very large contracts which have the potential to shift market prices for other consumers), they will prima facie be inefficient if:

a) the value of the contract to the generator is below the generator's best alternative value taking into account any credible threat to consumption and

b) the large load user is not able to on-sell any consumption under the contract it forgoes and remain subject to the same terms as if it consumed the electricity itself?

We agree.

Q5. Do you agree with the principles:

a) the relevant counterfactual against which to assess the value of the contract to the generator is the best alternative value taking into account any credible threat to consumption?

b) direct value components of the contract including and in addition to the contract price should be recognised and taken into account when assessing the value of the contract to the generator, so long as the generator can value them in a transparent and credible manner?

c) the value to the generator from increases in prices to other consumers as a consequence of the contract should be excluded from the assessments of the value of the contract to the generator?

d) the assessment should be made at the time the offer was made (or extended or renegotiated by the generator) on the basis of information in the immediate lead up to the generator signing the offer or contract?

In general we agree. However, principle *c) the value to the generator from increases in prices to other consumers as a consequence of the contract should be excluded from the assessments of the value of the contract to the generator?* is disquieting. In our view an efficient market would prevent other consumers being required to cross-subsidise major contracts. If resultant increases are a realistic possibility then options for sequestering the wider wholesale market from the impacts of special deals with major users should be urgently investigated.

Finally, we support the continued development of Transpower's proposed "Assumptions book" that is supposedly going to give some level of transparency to transmission arrangements that facilitate major energy contracts. It would be useful to see consistency in that project with the principles that the EA is developing.

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