Firstgas Group

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Sent via email: inefficientpricediscrimination@ea.govt.nz

Dear Andrew

Inefficient price discrimination in very large electricity contracts

Firstgas Group welcomes the opportunity to comment on the Electricity Authority's (EA) consultation paper *"Inefficient price discrimination in very large electricity contracts*" released in August 2022. There is no confidential information in this submission.

The EA proposes that very large electricity contracts should be subject to regulatory scrutiny to avoid electricity suppliers agreeing to an artificially low contract price leading to an artificially high wholesale price. We support the aim of efficient wholesale electricity prices. We are interested in this consultation due to our work on Future Fuels, in particular the opportunities for large-scale green hydrogen production from renewable electricity generation. For more information about Firstgas Group's businesses, refer to **Attachment 1**.

We are unconvinced by the EA's evidence of a problem so are not satisfied that any intervention is warranted.

We have identified opportunities to make the proposed intervention better targeted. Without better targeting, we consider the EA's estimation of costs will be too low as we believe the number of contracts subject to the regime will be much higher than the EA expects. We have also identified some minor improvements to the application process and legislative drafting. These detailed comments are set out in **Attachment 2**.

We have reviewed and support the point's raised in the Business Energy Council submission.

Intervention needs to be better targeted

We agree with the EA's objective that its intervention "…should not create unnecessary and disproportionate barriers or uncertainty for very large contracts linked to investment in new generation." The key drafting that gives effect to this objective is within the definition of "materially large contract" as clause 13.268(4). It states, "the net quantity of electricity is the total MW consumed at a point in time (calculated in accordance with subclause (3)) less any MW consumed from new generation built as a consequence of the contract."

We consider the draft Code is unclear and will create considerable uncertainty about which contracts are "materially large". As such, we believe the costs of the proposal are higher than the EA anticipates unless it can provide much better clarity in its drafting.

Unclear what counts as 'built as a consequence of the contract'

The phrase 'generation built as a consequence of the contract' has been designed to describe a concept rather than attempt to define a clear set of parameters. This is understandable but going to lead to significant uncertainty amongst prospective contracting parties. In all but the most clear-cut of circumstances, parties will tend to assume their contract *might* meet the definition of a 'materially large contract' and so be subject to the proposed regulatory scrutiny. If a developer of new generation signs off on its final investment decision without yet having signed contracts with cornerstone load users, the parties would be understandably uncertain whether the generation is a consequence of the contract. This sort of situation is not uncommon, as an EA survey identified.[1]

Recommendation: Replace "built as a consequence of the contract" with "substantially underwritten by the contract" in clause 13.268(4).

Unclear what counts as 'new generation'

Another potential source of uncertainty is the word 'new'. We consider that the EA probably intends that genuine expansion of existing generation should be considered 'new'. There are a variety of uncertainties arising from the reference to 'new generation':

- If a generation developer retires end-of-life generation and replaces it like-for-like, is this considered 'new'?
- If a generation developer retires end-of-life fossil-fuelled thermal generation and replaces it onsite with a biogas- or biomass-fuelled thermal generation, is this considered 'new'? What if it converts an existing generator to be fuelled by an alternative fuel-source?
- If a generation developer replaces end-of-life nacelles and wind turbine blades in an existing wind farm, is this considered 'new'?
- What if the generator itself is all-new, but takes heat away from the geothermal resource used by an existing generator?

Recommendation: Replace "new generation" with "additional generation capacity" in clause 13.268(4)

Firming contracts are an important part of the transition

A mix of contracts with existing and new generation owners will be needed to supply new loads vital to the transition. The EA anticipates this with the existence of clause 13.268(2). However, this will not give effect to the intention with sufficient clarity.

In a hypothetical example, suppose there is a developer of a 300 MW electrolyser farm (party A). Party A signs a PPA for a new 500 MW windfarm with party B. In this example, we assume the contract between party A and party B will not meet the definition of a materially large contract. But party A also signs a contract with party C who owns a portfolio of pre-existing generation plant. That contract provides firming for party A to get high asset utilisation from their electrolysers. The contract between parties A and C allows for a maximum load of 300 MW and since there is no "new generation built as a consequence of the contract" the exclusion in subclause (4) does not apply.[2]

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[1] Source: Slide 22 of the EA's *Generation Investment Survey 2022*. This newfound willingness to take on offtake risk was ascribed to "Experience gained by parties in overseas markets where developers have built projects before securing full sales agreements for a project's output" and "Greater comfort based on market soundings that customers will be willing to enter into contracts once a project is completed."

[2] The drafting of 13.268 is designed to define the circumstances when a contract *does* meet the definition of a materially large contract. It defines the circumstances when more than one contract meets the definition. But if one of the contracts that would jointly fail to meet the definition in subclause (2) meets the definition of subclause (1) by itself, then it is a materially large contract.

Contrast this with another hypothetical example with the same details but where party B and C are the same entity and there is only one contract involved. Because that contract would have 500 MW of new generation built 'as a consequence of the contract', the exclusion applies to the entire contract. The portion of the contract that deals with firming the supply is also subject to the exclusion. This difference in outcomes tilts competition in favour of existing owners of generation plant.

Recommendation: Replace clause 13.268(1) with the following drafting:

"**13.268 Definition of materially large contract**

(1) A **materially large contract** is, subject to subclause (1B), one or more related contracts that—

(a) are not entered into through a derivatives exchange; and
(b) relate to the physical consumption of **electricity**; and
(c) relate to a net quantity of **electricity** that equals or exceeds 150 **MW** consumed at a point in time.

(1A) Two or more contracts are considered related for the purpose of subclause (1) if they comprise—

(a) two or more contracts between a **generator** and a **buyer**; or
(b) at least one contract between a **generator** and a **buyer** and at least one contract between that **generator** or its related company and that **buyer** or its related company; or
(c) at least one contract between a **generator** and a **buyer** and at least one contract involving a second **generator** where the contracts rely on each other or are otherwise interdependent; or
(d) any other arrangement that is substantially of the same kind as that described in any of paragraphs (a)-(c).

(1B) If two or more contracts are considered related for the purpose of subclause (1) but do not collectively meet the conditions in subclauses (1)(a)-(c), each related contract cannot be a **materially large contract**."

Demand response is an important part of the transition

In paragraph 1.18 of the consultation paper, the EA states that it considers "it would be inappropriate for the proposed interventions to apply to contracts such as PPAs which support the transition, to the extent that they result in improved supply of renewable generation, and do not lead to material increases in prices paid by other consumers." By the same reasoning, we consider that a consumer's contract that provides for firm demand response will reduce wholesale price volatility and ttend to be of net benefit to consumers. As such, large contracts that also contain suitable demand response provisions should be excluded from the definition of a materially large contract.

Revisiting our earlier hypothetical example of a contract between a 300 MW electrolyser farm (party A) and a generator with pre-existing generation capacity (party C), party A might be obligated under the contract to reduce its load to zero in response to a real-time price trigger. We consider such a contract should not be a 'materially large contract', provided the trigger price is not excessively high. The EA would need to determine what limit it considers too high.[3] For example, a trigger price higher than two standard deviations above a mean price seems unlikely to make a significant contribution to reducing wholesale price volatility. The EA would need to set a trigger price that is meaningful, easily or automatically updated, and easy for contracting parties to understand.

We also note the drafting of clauses 13.268(3) and (4) could be more concise, as the only content that subclause (3) adds is the use of the word 'maximum'.

[3] Even a trigger as low as the mean wholesale price could be of use for new loads (such as electrolysers producing green hydrogen) to enter the market under a contract with an unprecedentedly low purchase price because it operates only when there is excess renewable generation.

Recommendation: Replace clauses 13.268(3) and (4) with a new 13.268(3) that states:

> "For the purpose of subclause (1)(a)(iii), the net quantity of **electricity** is the maximum **MW** it is possible for the **buyer** to consume under the contract at a point in time, less any **MW**—
>
> (a) that is obligated to immediately or pre-emptively turn off in response to real-time prices less than a threshold published by the **Authority**
> (b) sourced from [*drafting here depends on whether our earlier drafting proposals are accepted*] additional generation capacity substantially underwritten by the contract."

Parties should have the option of seeking agreement a contract is not materially large

Despite the room to improve clarity with the existing proposal, there will still be some significant residual uncertainty for contracting counterparties as to whether their prospective contract would be materially large or not.

This uncertainty will be most felt by those for whom it matters least. Companies concerned with diligently complying with the Code will err on the side of safety and subject themselves (perhaps unnecessarily) to the EA's pre-approval process. Other companies may never bring the contract to the EA's attention.

To minimise unnecessary costs among the diligent companies, the EA should extend its application process to consider whether a set of circumstances is sufficient to conclude a prospective contract appears not to be a materially large contract. This process would be voluntarily initiated by a generator. The generator would need to state the basis on which it considers the contract may not be materially large and provide evidence it considers sufficient to support that argument. The EA would be obligated to consider the argument and evidence provided and determine whether this was sufficient for the EA to conclude the contract appears not to be materially large.

For instance, an applicant might consider the contract is not materially large because the buyer will purchase 40% of the first ten years' output of a brand-new wind farm. The application would provide minimal evidence of the uncontentious question of the wind farm being new, but highlight the circumstances that mean the contract is substantially underwriting its development. A different applicant might be unsure whether the generation in question is genuinely additional capacity in the EA's view, so the detail they provide would focus on that. Another applicant might be concerned about whether two contracts "rely on each other or are otherwise interdependent" as set out in clause 13.268(1)(b)(iii).

Recommendation: Add a new clause 13.272A that enables a generator to seek the EA's agreement that a set of circumstances mean a prospective contract would not be a materially large contract, provided the applicant's information is complete and accurate.

Contact details

Firstgas Group staff are available to meet with EA staff to discuss the points we have raised in our submission. To arrange this meeting or if you have any questions, please contact me on 027 2016600 or via email at callum.mclean@firstgasgroup.co.nz.

Yours sincerely

Callum McLean
Senior Policy & Government Affairs Advisor

Attachment 1 About Firstgas Group

Our vision is to lead the delivery of New Zealand's energy in a changing world. Our mission is to safely and reliably deliver energy that's affordable and accessible to Kiwi families and businesses. We're really proud of this and of the important role we play in Kiwis' lives.

Based in New Plymouth, Firstgas Group is an umbrella brand consisting of Rockgas, Firstgas, Flexgas and Gas Services NZ. Firstgas and Rockgas are consumer brands that supply LPG and natural gas to over 165,000 customers through their gas network of over 2,500 kilometres of high-pressure transmission pipeline and 4,800 kilometres of distribution pipeline in the North Island, 36 local LPG suppliers, and over 180 Refill and Save locations across New Zealand.

Flexgas and Gas Services NZ are energy storage, operations and maintenance brands who make sure gas can be delivered safely and continuously. Flexgas operates the Ahuroa gas storage facility in central Taranaki. Gas Services NZ provides operational and maintenance support to all gas infrastructure owners, including the brands within Firstgas Group.[4]

New Zealand's homes have benefited from the choice of energy sources to meet their household needs. Currently there are over 400,000 homes in New Zealand who enjoy natural gas and LPG in their homes. These homes predominantly use gas for cooking, instant hot water, and heating. There are many benefits of having gas in the home. Hot water heating is currently the most energy. affordable way to heat a home and water.[5] Gas boilers heats water so that it is instantly available. It requires no onsite storage in the home.

Firstgas is investigating opportunities for using our assets in ways that help to reduce New Zealand's carbon emissions. Our gas transmission and distribution networks cover much of the North Island and are ideally placed to support the development, transfer, and use of emerging fuels such as hydrogen and/or biogas.

Firstgas rockgas Flexgas gas services nz

[4] For more information about Firstgas Group, visit www.firstgas.co.nz , www.rockgas.co.nz , www.flexgas.co.nz

[5] Home heating costs in 2020 - Consumer NZ

Attachment 2: Minor improvements to the application process and drafting

Code ref.	Opportunity for improvement	**Recommendation**
Opportunities for improving the application and audit process		
13.273(3)	The Code provides a 'time limit' of 45 business days, but this has virtually no effect as the timeframe can be endlessly reset by the EA seeking more information. In the event the EA fails to make a decision within the 'time limit, clause 13.273(4) means it is automatically declined.	Either: (a) Replace the 45 business day timing with a generic 'as soon as reasonably practical' obligation; or (b) Include an obligation on generators to respond to requests in a specified timeframe (e.g. 10 business days) and amend the EA's timing obligation (which may need to be longer than 45 business days) to kick in from receipt of the original application.
13.274	The Code provides for reconsideration of decisions, but this is superfluous as a generator can always make a new application in relation to the same contract. If they fail to provide new information or reasons, the EA reconsideration will be appropriately brief.	Delete this clause.
13.274	Reconsideration decisions have no timeframe obligation on the EA.	If clause 13.274 is retained, introduce a timing obligation on the EA that mirrors the approach of clause 13.273.
13.275(2)	This clause provides a blanket prohibition on a generator's right to appeal if information was not provided. This is regardless of the significance to the appeal of the information not provided or whether the request was relevant. A generator's appeal might be specifically on the basis of the EA declining the application because of the information not provided. This could be a genuine dispute about relevant considerations for the EA. The EA may have declined the application for multiple reasons (including information not provided) and the appeal might be on the basis of one of the other reasons given for declinature.	Delete 13.275(2). Rely instead on the general incentives that appeals are costly for appellants and, if frivolous or baseless, carry risk of costs being awarded against them. If the EA wishes to further disincentivise poorly-evidenced appeals, it should instead update its Prosecution Policy[6] with a statement about the circumstances under which it will pursue costs from appellants.
13.278	This clause fails to limit the EA's ability to use the confidential information received for unrelated purposes. The current wording of this clause is tantamount to saying that the EA must keep information confidential unless it decides it ought not to (as part of its functions). The EA should not use audits under clause 13.280 as a means of fishing for information for its roles in market monitoring or compliance with the Code (other than subpart 7). Information received under subpart 7 should be used only for purposes related to subpart 7.	Replace 13.278 with: "The **Authority** must keep all information provided to it under this subpart confidential except to the extent that disclosure is required to enable the **Authority** to carry out its obligations and duties in relation to this subpart or disclosure is required by law."
13.281	There is no timeframe in which the EA must consider an audit.	Include an obligation on the EA to consider the audit report under clause 13.281 within two months of receipt.
Opportunities for improving the drafting		

[6] The EA's Prosecution Policy was last approved in March 2017 and overdue for its triennial review.

Code ref.	Opportunity for improvement	**Recommendation**
Contents table at start of Part 13 and heading after clause 13.266	Headings for subparts of the Code name the subpart. The headings for subpart 7 do not.	Add “Subpart 7—” in front of the two instances of the heading.
Use of the defined term “buyer”	The pre-existing defined term “buyer” is somewhat complicated, with three contexts in which it is defined. Two of those (contracts for differences and options contracts) are irrelevant for materially large contracts as they are contracts for financial derivatives rather than physical consumption (which is an essential part of the definition of a materially large contract). Because the three contexts are not comprehensive, the EA has introduced a fourth catch-all part to the definition. The distinction between contract types is irrelevant for subpart 7 as it already defines which contracts it relates to. This complexity could be avoided if instead of “buyer”, subpart 7 referred to “consumer”. “Consumer” is essentially a person supplied with electricity for consumption, which aligns well with subpart 7 that relates only to contracts for physical consumption. No changes would be needed to the definition of “consumer” and amendments to other definitions could be avoided.	Replace instances of “buyer” in subpart 7 with “consumer”. Revoke consequential amendments to defined terms “buyer” and “party”.
Use of the terms “party” and “parties”	The pre-existing defined term “party” (which includes “parties” by extension) is not well suited to the use needed in subpart 7. Using “party” means readers need to investigate the defined term “seller” which is not used at all in subpart 7 (which refers only to “generator” for this role). In the body of subpart 7 “party” is used twice and “parties” five times. All of these instances could be replaced with the undefined term “counterparties” (which is already used once in subpart 7). Using the defined term “party” creates a need for consequential amendments to other definitions.	Replace the two instances of “party” with “a counterparty”. Replace the five instances of “parties” with “counterparties”. Revoke consequential amendments to the defined terms “party”, “seller”, “contract for difference”, and “risk management contract”.
13.274(1)	Uses “is discretion” instead of “its discretion”.	If clause 13.274 is retained, use “its”.
13.275(1) and (2)	Unbolded use of the defined term “party”.	If retained, bold both usages of the defined term.
13.268(1)(b)(ii) and (5)	The term “related company” is used only in 13.268(1)(b)(ii) with a clarifying definition in (5). These can be consolidated to help readers easily and unavoidably be aware of the special meaning.	Either: (a) Include a reference to (5) in (1)(b)(ii) so readers know to look at (5) for the special meaning; or (b) Delete (5) and amend (1)(b)(ii) to read “at least one contract between a **generator** and a **buyer** and at least one contract between that **generator** or its related company and that **buyer** or its related company, where related company has the meaning set out in section 2(3) of the Companies Act 1993”