



31 October 2022

Electricity Authority (EA)

Submitted via email: inefficientpricediscrimination@ea.govt.nz

Proposed Code Amendment Consultation: 'Inefficient price discrimination in very large electricity contracts'

Fortescue Future Industries (FFI) is a global green energy company committed to producing green hydrogen from 100 percent renewable energy. FFI is currently establishing a global portfolio of green hydrogen production and manufacturing projects. Our New Zealand based team is growing, with a keen focus on building green hydrogen projects and eco-systems to support the decarbonisation transition.

FFI is a subsidiary of Fortescue Metals Group (Fortescue), an Australian company recognised for industry leading development of infrastructure and mining assets. Fortescue has recently announced a world-leading heavy industry decarbonisation strategy, aiming to eliminate fossil fuel use and achieve real zero terrestrial emissions (Scope 1 and 2) across its iron ore operations by 2030. This investment plan will eliminate Fortescue's fossil fuel risk profile and enable it to supply its customers with a carbon-free product.

We welcome the opportunity to provide comment on the EA's consultation, given that our future projects will have large electricity requirements, and we will ultimately be one of the parties impacted by the proposed changes.

FFI appreciate the analysis and thought that has gone into this consultation paper. Reviewing this at a principles level, we propose that the intended outcomes could be met with a simpler and more direct solution – *requiring all contracts (of all sizes) to allow for on-selling of energy as the default position*, with any proposed deviation to be individually approved by the EA (which could have full authority over such decisions). Outside of the portfolio benefit that is being addressed in this consultation paper, we have not identified good reasons for a participant to want to avoid the on-selling clause, and so do not believe that this would create an undue workload for the EA.

Our submission is provided below in the requested table format. If you would like to discuss any comments raised in our submission, please contact David Kemshall at david.kemshall@fmgl.com.au, or myself on the below contact information.

Yours sincerely,

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Attached: Submission from Fortescue Future Industries (FFI)

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| | QUESTION | COMMENT |
| 1 | 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? | <p>Yes. The most direct answer would be that the sale of the energy is higher than the short run marginal cost to produce, and that there would be insufficient demand to consume the energy otherwise. In simple maths, it is better to sell the full volume at half price than a quarter of the volume at full price. When building new plant, the incremental cost of additional MWhs is also often substantially lower than the project cost. Therefore finding a customer that can increase demand can often be efficiently served at a lower price.</p> <p>It is also possible that it is in the interest of the economy and/or community to keep a business operating. The net benefit of the continued operation may be more beneficial than the subsidised cost.</p> |
| 2 | Do you agree that restrictions on reselling by large users are primarily of benefit to the generator where the expected overall value of the contract to the generator is less than the best alternative value in the absence of the contract, taking into account any credible threat to consumption by the load user? | <p>Agree. Stopping the on-selling of a product only makes sense in two ways:</p> <p>(1) To inflate price and avoid competition. (2) To avoid scalping - which typically only relates to a finite product.</p> <p>Conceptually, new energy projects should be able to be built, so holding onto product to drive up demand and scalp the market should not theoretically occur. It is considered that (2) is a competition issue and would be managed through monitoring and enforcement of trading conduct.</p> <p>Since (1) is not good for the market and (2) is considered highly unlikely, stopping on-selling of power is unlikely to be good for the market. This supports our principle position that all contracts should allow for on-selling.</p> |
| 3 | Do you agree with the problem definition? If not, why not? | <p>Broadly yes. We understand that the problem definition is addressing non-competitive contracts that are not in the interest of the market. On a principle level, this could be addressed by increasing competition and allowing on-selling of the power.</p> <p>Much of this paper is highlighting potential concerns regarding pricing of a contract and arguably this may be considered part of the problem definition. When considering the details, we need to ensure that the problem is assessed against the bigger picture. If there is a need to assess the market value of the offer, it needs to be assessed against both the price and the volume. It shouldn't just be the price.</p> |
| 4 | 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 | <p>Generally yes. The principles should be the same regardless of size. However, in practical terms, generators are unlikely to offer under market value deals to small customers since they won't move the market.</p> |

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| | <p>shift market prices for other consumers), they will be inefficient if:</p> <p>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</p> <p>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?</p> | <p>Nevertheless, taking a simple principle-based position can simplify the definition of thresholds and minimise additional workload.</p> |
| <p>5</p> | <p>Do you agree with the principles:</p> <p>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?</p> <p>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?</p> <p>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?</p> <p>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?</p> | <p>Broadly yes. The following details are provided for context. If the simpler approach of allowing on-selling in all contracts were to be adopted, the consequences of these details may not be necessary to understand since they will be addressed through competition forces.</p> <p>(a) Yes, although the definition of the counterfactual value is key to this principle. The NZAS case study used throughout the document provides an easy-to-understand example. The following points will illustrate several definitions of the counterfactual.</p> <ul style="list-style-type: none"> i. Using price in the market observed while Tiwai was in the market is not a viable measure of the counterfactual value. A large load is sufficient to influence market price (the whole point of this consultation) and removing the load would substantially reduce the market price, meaning that the alternative market price would be much lower and the energy should be assigned a lower value. ii. Using price in the market projected if Tiwai was not in the market is a good start to establishing a viable measure of the counterfactual value. The market would likely be in oversupply, suppressing price. This alternative price that may be achieved would be a reasonable measure of value. The portfolio benefit to the generator would not be assessed in this analysis. iii. Considering transmission constraints slightly complicates point (ii) above. If the energy is curtailed at times and unable to reach the market, this should be considered as lost revenue. To ensure equity for the generator, the volume that can be sold is just as relevant as the price at which it is sold. iv. Finally, an additional complication of market changes or asset development also needs to be considered. If there is an alternative customer that may not yet be in the market, the potential inclusion of that customer as an alternative source of demand needs to be considered. |

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| | | <p>Ideally, the potential contracts would need to be compared and assessed as part of the alternative pricing calculation. Similarly, additional asset investment (such as transmission expansion or storage) may also affect the volumes and market. Trying to accommodate potential future projects may also require views on risk and likelihood of completion.</p> <p>Needless to say – trying to establish a counterfactual value based on alternative price and volume is complex and challenging. Adopting an option to default to on-selling in all contracts could avoid the need for this analysis and increase clarity in the market.</p> <p>(b) Absolutely yes. This is critical if the value of the contract is being scrutinised. It gives demand response (including ‘dry year’ mechanisms) a clear option to be executed efficiently and effectively in the market.</p> <p>(c) Agree. This may be hard to enforce and would preferably be avoided if on-selling was used as default. The challenge with this analysis is that if the volume is not sold, then the market is in oversupply and this may be an unrealistic hurdle to jump. Sometimes a generator will need to contract volume at a lower price to avoid loss. However, if the contract is assessed individually rather than against a market price curve, then that would likely work.</p> <p>(d) Agreed. Some level of forecasting is reasonable and an artificially suppressed (or inflated) price curve is not in keeping with the intent of this paper. Therefore, the information needs to consider risk as well. i.e. Very high short-term prices do not mean high long-term prices (and vice versa). Considering that forecasts are uncertain by nature, this may result in numerous challenges. Defaulting to on-selling in all contracts would allow for this to be managed in the competitive market.</p> |
| 6 | Do you agree with focusing on contracts related to the physical consumption of electricity? | <p>Conceptually no. If there were to be a large purchase of power for a trading portfolio this would still be relevant. However, purchase of energy for a trading portfolio would only be possible if there was the option to onsell, thereby resolving the competition issue.</p> <p>We recognise a risk that pure trading of energy may result in stockpiling and “scalping” of energy trading for profit and limited benefit to the market. We expect that this would be addressed by the EA’s monitoring and enforcement of trading conduct to manage of competition.</p> |

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| 7 | Do you agree the threshold for a Materially Large Contract should be the equivalent of net 150MW? | <p>Nominal thresholds are always challenging to set and can create market discontinuities. A much simpler alternative would be to adopt a solution that could apply to all contracts, regardless of scale. We believe that adopting a default of on-selling in all contracts is easy to implement, easy to monitor and enforce and does not require a nominal threshold.</p> <p>Creating a fixed quantity threshold (i.e 150MW) may result in bad practise of forming many smaller deals to try and avoid thresholds. i.e. Contracting individual portions of a plant.</p> <p>If it is decided that a threshold is still required, an alternative would be to apply a more flexible or interpretable value, for example a threshold could related to [2%] of the total system demand. Conceptually, 150MW currently seems like it would be of the right magnitude (if required).</p> |
| 8 | Do you think the threshold should be set in MW or the equivalent MWh set over a 12 month period? e.g. in the case of a net 150 MW the threshold could be defined as either: <ul style="list-style-type: none"> • net 150 MW • net 1,314,000 MWh over any 12-month period | <p>As noted above, any nominal threshold would be preferable to avoid with a simpler all-encompassing change. If it is determined that a threshold is still required, establishing a volume-based (MWh) threshold would likely provide a better relationship to the energy market and pricing impacts. However, at times a high capacity, low volume trade could also result in adverse market outcomes meaning that both thresholds may need to be used.</p> <p>Moreover, this raises a further complication of aggregated contracts. Is a single site consuming 150MW really any different to 15 sites each consuming 10MW? It seems that an aggregated view of the contracts is more relevant. However, what if the 15 sites were not all built or contracted at once, but expanded over time and passed the threshold – potentially rendering earlier agreements void? This may be a disincentive to grow and a clear discontinuity in the market competitiveness.</p> <p>As noted previously, it would be recommended that a default ruling is applied to all [new] contracts allowing for on-selling of the energy. This simple approach could avoid these complications.</p> |
| 9 | Do you consider that the proposed provisions to ensure the intent of the Code changes are not undermined by contract structures are sufficient? | <p>Somewhat yes. However, it is worth noting (as outlined in Question 8 above) that aggregation of the contracts may not be straightforward and may have unintended consequences.</p> <p>We would prefer a change which can be applied more broadly to avoid the risk of undermining and avoid the complications that the additional provisions cause.</p> |
| 10 | Do you agree with focusing on whether the net value to the contract to the generator is positive? | <p>Yes and no. Firstly, it is preferred that this is not required at all and a simpler default position for all contracts be implemented to allow for on-selling. This would negate</p> |

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| | | the need for assessing the net value at all. However, if there is a need to assess the net value, we would agree on assessing if the net value of the contract to the generator is positive with the provision that the generator can look at the contract volume, tenor and contracting cost - not just the energy price per unit. |
| 11 | Do you agree with focusing on contracts which restrict on-selling? | Yes. This is central to our preferred position. |
| 12 | Should the Authority consider other criteria to determine which contracts the proposed Code amendment should apply to? | Yes. Fundamentally, a change to default all contracts to allow for on-selling would be preferred. It is understood that small customers may not practically be able to implement this trading, but having the option does not mean that it has to be executed. This also somewhat future-proofs contracts against potential future developments. |
| 13 | Do you agree with a code amendment prohibiting MLCs unless generators can show that the overall value of the contract to the generator is positive, or the contract does not restrict on-selling to a third party? | Yes. Our primary preference would be to focus on the on-selling restrictions. However, if the net value needs to be assessed, it is reasonable that the contract value to the generator should be positive. It is worth noting that this question is somewhat unclear - for example: If the SRMC of hydro is \$7/MWh and the contract value is \$35/MWh that is a positive value. Conversely, if the alternative market price for the total volume is \$70/MWh, then the contract may have positive value, but not as positive as other options? |
| 14 | Do you agree with requiring generators to disclose to the Authority all MLC contracts and supporting information within 5 working days of signing? | Yes. This may still require some definition of a threshold for an MLC contract, even if the simpler default on-selling approach is endorsed. However, since this is a simple disclosure requirement, the disincentives from the threshold should not impact the market. |
| 15 | Do you agree with the list of information to be disclosed which constitutes the supporting information? Is there other information you think the Authority should require from generators? Is the current list of supporting information too extensive? Is it reasonable to assume the marginal cost of producing this information is low? | It depends on the solution adopted. Some of the information listed is suitable for the net value analysis, but may be considered onerous for a standardised contract that allows for on-selling. |
| 16 | What challenges do you envisage for a generator demonstrating the net value of the contract is positive? What implications might these have on the Authority's enforcements and merits of the proposal? What alternatives does the Authority have to prevent inefficient | Potential challenges we see include: <ul style="list-style-type: none"> • a risk of long-term harm to a generator if this is not handled carefully. • a risk of actually stifling development and investment too. <i>For example:</i> if a new generation company was formed, with the sole purpose of supplying power to a new or existing |

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| | price discrimination of the type being addressed here, given the potential for severe harm to the long-term interests of consumers? | <p>load, and was intending on supplying power on a cost or cost-plus basis. If this is at a lower price than market prices, will this be impacted? This issue could potentially be avoided with a simple on-selling clause</p> <ul style="list-style-type: none"> it is critical that any measures do not impact the ability of new generation sources (e.g. wind or solar) to enter the market and secure long-term offtakes to underpin their finance. A developer may be willing to sign contracts for some or all of their generation at below market rates in order to secure an offtake. |
| 17 | In the event of a generator entering an MLC, under what circumstances would a generator choose to show the net value of the contract is positive instead of showing that the contract does not restrict on-selling? | As outlined above our view is that on-selling should be the base case, and we are unclear of a reason as to why generators would restrict this unless the customer was intending to stockpile energy and try to scalp the market. This is more of a competition issue. |
| 18 | Do you support the voluntary clearance regime? | No comment provided. |
| 19 | Do the proposed timeframes for the Authority to arrive at a clearance decision offer a reasonable balance between the time necessary to make a good decision and timeliness for commercial decisions? | Provided that the process is known and adhered to. These are large decisions which will typically require extended periods of negotiation – however, once a contract has been agreed there may be significant time pressure. |
| 20 | Does providing the parties to the contract with 20 days to sign the contract after obtaining clearance provide the parties with sufficient time to finalise the contract, yet not so long that the parties effectively have a free option to strike a deal if and when prevailing prices fall below the value of the best alternative? | This seems reasonable. We note that 20 days is quite tight, but if the process is known, the application would only be made late in the stages of the agreement. This may be costly if it is rejected. However, if the rules are sufficiently clear, the outcome should be understood beforehand. |
| 21 | Does requiring the generator to disclose a signed contract to the Authority within 5 business days seem reasonable? | This seems reasonable. |
| 22 | Do you agree that the proposed amendment is preferable to the status quo? | Generally yes. However, an amendment that introduces the requirement to provide the ability to on-sell power would likely be simpler and still effective. |
| 23 | Do you support the drafting of the proposed Code changes in appendix A? | No comment provided. |
| 24 | Do you have any recommendations on how the drafting of the proposed Code | No comment provided. |



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| | changes could be improved? If so, how? | |
| 25 | Do you agree with the Authority's assessment of the benefits and costs of the proposed amendment? If not, why not? | No comment provided. |

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