Via email: inefficientpricediscrimination@ea.govt.nz

31 October 2022

Inefficient Price Discrimination in very large electricity contracts

Mercury welcomes the opportunity to provide feedback to the Electricity Authority (the Authority) on its consultation paper *Inefficient Price Discrimination in very large electricity contracts: Proposed Code Amendment*, 18 August 2022.

The Authority is seeking stakeholders' views on a proposed Code amendment that would prohibit certain large contracts between generators and large load users. The proposed Code amendment relates to materially large contracts (MLC) for a net quantity of electricity supplied that would equal or exceed 150 MW consumed at a point in time. The net quantity of electricity is the total MW consumed less any MW consumed from new generation built as a consequence of the contract.

The proposed Code amendment would permit an MLC where the value of the contract to the generator is equal to or exceeds the value of the generator's best alternative, or the contact allows the load user to reduce consumption and on-sell the electricity at no worse terms than if it had consumed the electricity itself. It would require generators to disclose large contracts and supporting information to support the Authority's monitoring and compliance, as well as giving generators opportunities to obtain a clearance for the transaction from the Authority.

Mercury's concern with the proposed Code amendment is that it creates a new regulatory burden and uncertainty that generators must take into consideration when making investment decisions in new generation that is a consequence of large load users. This regulatory burden and uncertainty not only relates to the initial clearance process set out in the proposed Code amendment. It also extends into the future as there is uncertainty about how the Authority might treat new generation assets after they are built when they might no longer be considered "new".

This outcome is not consistent with the Authority's valid concern that it should not create barriers or uncertainty for very large contracts linked to the investment in new generation. Such an unintended consequence could be particularly costly given the imperative to decarbonize and the electrification of the economy[1].

Mercury expands on these concerns here.

Uncertainty of regulatory intervention in the long run may slow investment decisions

Mercury agrees with the Authority that it should be "*mindful that an intervention should not create unnecessary and disproportionate barriers or uncertainty for very large contracts linked to investment in new generation."*[2] This in part recognizes the importance of large load users for promoting investment in new generation.

Mercury submits that a reason large load users are important for investment in new generation is that they allow generators to diversify their customer types, from large load users to consumers, which provides an opportunity to diversify revenue sources and manage risk. Mercury furthermore contends that maintaining this diversity in customer

[1] See consultation paper, paragraphs 1.18, 7.3, 7.13 to 7.16 where the Authority addresses this issue.
[2] Consultation paper, paragraph 1.18

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types is not only important at the time that investments are made in new generation, but over the life of the generation asset.

The proposed Code amendment, however, makes a distinction, which is not defined, between new generation and existing generation. It states that the Code would not apply to new generation built to supply energy to a large user. However, at some point in the future this "new generation" will no longer be new, and so it may then be captured by the Code.[3] This creates uncertainty looking forward as to how large contracts that are linked to new generation now might be allowed to evolve as they come up for renewal and as market conditions change.

This uncertainty may also extend to decisions made by investors in large loads that are new now. The discussion in the consultation report considers whether NZAS might exit New Zealand if the value of the supply contract is equal to or exceeds the value of the generator's best alternative as determined by the Authority. Looking forward, the consultation report therefore raises the prospect that investors in large loads that are new now may be exposed at some future point to the Authority determining a contract value based on the Code that results in asset stranding.

Such an outcome may also be detrimental to the decarbonization of the economy. For example, the risk of stranding the load asset due to the proposed code, as described above, might be a factor considered by investors that influences a decision to choose a less efficient decarbonization pathway over electrification.

To mitigate this general risk and promote investment in new generation and decarbonization, Mercury proposes that the Code amendment only applies to large contracts linked to legacy generation assets as at the time the Code is enacted. This would provide investors with clear transparent test as to the generation assets that would be exposed to the Code.

Drafting of proposed Code amendment clearance and disclosure regime is open ended

Mercury submits that the process for a generator seeking clearance for an MLC as set out in the proposed Code amendment is open ended with respect to:

- the information an applicant must provide in a clearance application;
- the timeframe that the Authority is allowed to make its decision; and
- the lack of definition of large load users as it relates to an MLC.

The resulting uncertainty may slow the process for finalizing an MLC and may require clearance and disclosure for MLCs that are not related to large load users.

Information an applicant must provide in a clearance application

Clause 13.271(2)(d) would require a generator to provide *any information or documents, including any financial modelling, that are in the possession, or under the control, of the generator that discuss or show the impact of the materially large contract on the generator's and its related companies' group-level earnings before interest, taxes, depreciation, amortisation and fair value adjustments or on the generator's and its related companies' broader financial performance and strength.*

The requirement to provide *any information* is excessive and goes beyond the information required to show whether or not the value of an MLC is equal to or exceeds the value of the generator's best alternative. The justification for providing *any information* is not given and the administrative cost of providing it may be significant.

[3] Manapouri Power Station illustrates this point. The Manapouri Power Station was "new generation" when it was built as a consequence of a large load user, as it was originally built to supply power to the Tiwai Point aluminium smelter. However, at this point in time the Authority considers that it is no longer "new generation" and therefore the contract should be regulated under proposed Code amendment.

Mercury considers that the information to be provided set out from clause 13.271(2)(a) to (c) would be sufficient for the Authority to make its decision, as this information should go straight to the question of the value of the generator's best alternative. Therefore, Mercury proposes that Clause 13.271(2)(d) is simply deleted.

Timeframe for the Authority to make its decision

In addition, clauses 13.273(3) and (4) provide no certainty regarding the time the Authority can take to provide a clearance, nor the reason for not providing a clearance. These clauses indicate that the Authority can decline an application for a clearance by simply waiting 45 days from the time the Authority considers it has received the information it requires to make its decision and then not taking any action. This approach does not require the Authority communicate its reason for declining the application.

Even though clause 13.273(3) allows the Authority and the applicant to agree to extend the period for the Authority to make the decision, any agreement to extend the period would be based on the counterfactual that the Authority could do nothing for 45 days and the application would be declined. This means that the Authority could in effect unilaterality decide to extend the period for considering an application if the applicant wanted to continue to pursue it.

Furthermore, Mercury notes that clause 13.273(1) requires the Authority to provide or decline a clearance application by notice. Clause 13.273(4), however, seems to allow the Authority to circumvent this clause by simply waiting 45 days and not approve the application.

Mercury therefore proposes that this clause 13.273(4) should be deleted from the Code amendment, and the clearance process rely on the Authority providing a notice under clause 13.273(1).

Lack of definition of large load users as it relates to MLC

Mercury notes that the discussion in the consultation report states that the Code amendment relates to MLCs between generators and large load users.

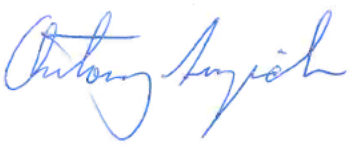
However, Mercury also notes that the drafting of the proposed Code amendment does not specify or limit the MLCs to those between generators and large load users. This may expose any large contract to regulation under the Code, which would be inconsistent with the purpose of the amendment.

Mercury, therefore, submits that the Authority should amend the drafting of the Code amendment so that it clearly states that it only applies to MLCs between generators and large load users.

Mercury considers that given the scope of the issues raised above with the present draft of the proposed Code amendment, the Authority should issue an amended version of the Code amendment for a further round of consultation.

Mercury looks forward to engaging with the Authority and industry stakeholders on finalizing the proposed Code amendment.

Yours sincerely,



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