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Andy Doube, General Manager Market Policy
Electricity Authority
By email to reviewconsultation2022@ea.govt.nz

Dear Andy

WHOLESALE MARKET COMPETITION REVIEW - WPI SUBMISSION

This is Winstone Pulp International Limited's (WPI) submission on the Electricity Authority (EA) consultation paper "*Promoting competition in the wholesale electricity market in the transition toward 100% renewable electricity*," issued on 12th October 2022.

We support the Major Electricity Users Group's (MEUG) submission and NZIER report on this consultation paper and submit the following additional comments.

Importance of economically efficient electricity prices for our business
We operate a pulpmill at Karioi, near Ohakune and an adjacent sawmill, with most of our production exported into competitive international markets where we are a price taker. Consequently, we cannot pass on rising domestic input costs and electricity is a major component of our input costs.

We currently use around 240,000 MWh/year electricity. We aim to prudently hedge our demand, but this does not protect us from underlying price trends, and since 2019 our average forward price has doubled. This is harming our economic viability: it is not rational for us to hedge at prices that are unstainable for our business, but it is not prudent to operate our business without risk management in place.

There is sufficient evidence to warrant urgent action
We note that our last submission on wholesale electricity market competition problems was on 22nd December 2021, almost exactly a year ago, but we have observed little progress since then in addressing the market dysfunction that is evident.

We do not share the EA's faith in the current market design and structure, and consider there is sufficient evidence to warrant more urgent and meaningful action.

We observe a wholesale market where:

- There is insufficient rate of investment and no new generator entrants are gaining scale. Since its establishment around 1996, the market has not needed, or demonstrated a capacity to foster timely investment in new generation at scale.
- Large generators have market power and appear to be making profits in excess of industry norms.
- Supply security margins are steadily eroding, which results in increasing generator's market power, hydrological price volatility and the need for operational interventions by the system operator
- Government ETS policy designed to promote decarbonisation in other sectors of the economy are driving up electricity prices despite their already being sufficient economic drivers to incentivise more low-cost renewable electricity. This is resulting in wealth transfer from consumers to owners of renewable generation, but without the intended benefit.
- Market uncertainty is being significantly increased by Government ETS price settings and their promotion of the Onslow pumped storage scheme.

We consider this sufficiently is demonstrates a need for urgent and meaningful action.

Strong price signals alone are not sufficient to accelerate investment
The EA paper suggests that the current market design, structure and conduct arrangements require only modest changes to promote competition and accommodate the transition towards 100% renewable electricity. We disagree: high wholesale prices have been present since 2018, and the forward market price curve indicates these high prices will persist for at least another 3 to 4 years. A market which has not responded to very high price signals after a seven-year lag (at least) is dysfunctional and indicates that reliance on economic market theory with light handed regulation is not working in the New Zealand market.

We believe that the EA need to change its decision-making paradigm <u>from</u>:

> *understanding root causes and establishing supporting evidence to these, and then adjusting settings within the current market and function*; <u>to</u>
>
> *taking action to lower prices, if necessary through off market mechanisms, wherever the risk of unintended consequences is less than the risk doing nothing*.

Market uncertainty created by Government policy

Market uncertainty remains a fundamental barrier to private sector investment and the Government is currently one of the primary causes of this uncertainty.

Promotion of the Onslow pump storage proposal as a silver bullet without any clarity as to how it would be integrated into the WEM is creating major uncertainty. To date we are not aware of a sound evidenced based rationale for this proposal or industry stakeholder support. Distributed energy storage using a range of technologies appears to be a much sounder way forward for the market outcomes needed.

Lack of clarity as to whether the Government will adopt or modify the proposed increases in ETS price settings recommended by the Climate Change Commission is also creating elevated wholesale price expectation. If they are adopted, they will result in further increases in wholesale electricity prices and wealth transfer.

Urgent need for interim measures

We are concerned about the lack of interim measures to address the current market disfunction, which is hurting the industrial and manufacturing sector, including our business. We have made numerous submissions on this issue.

We encourage you to considering interim options that can be implemented in a one-to-two-year time frame to achieve relatively fast impacts, and to consider more "off-market" option that are outside the core market design. These may have a relatively low risk of unintended consequences and not further complicate the core market design.

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

- Tax and accelerated depreciation incentives for new entrants into the generation market – for renewables only[1]
- Abandon the Lake Onslow proposal and quickly establish a clear policy and market framework for private sector investment in energy storage
- Provide transitional relief to thermal generators for ETS costs by re-introducing the 1 for 2 surrender obligation.

[1] 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.

- Establish a Government backed reverse auction scheme for promoting investment by new entrants in renewable electricity. For example, the Government could offer 15-year Power Purchase Agreements (PPA) to the lowest bidders for defined capacities and locations. Independent Power Producers (IPP) would trade their output on the spot market but would have their investment de-risked. Any hedge loss from the scheme could be funded by Government ETS revenues, but a gain is equally possible.

We look forward to 2023 being your year for decisive action.

Yours sincerely

Glenn Whiting
Chief Financial Officer