

9 August 2023

Andrew Millar
General Manager, Market Policy
Electricity Authority
Wellington

By e-mail: WholesaleConsultation@ea.govt.nz

The independent retailers support reform of the hedge market disclosure obligations

2degrees, Electric Kiwi, Flick Electric and Pulse Energy (the independent retailers) welcome the Electricity Authority's review of the hedge market disclosure obligations (HDO). We support reform of the HDO requirements. A well-functioning hedge market is critical for a successful, highly competitive electricity market and energy transition. In parallel with disclosure reform, we reiterate:¹

- “Development and provision of risk management tools which enable independent operators to compete on a level playing field is an essential pre-requisite for a competitive market.”
- “Hedge market development needs to be prioritised and fast-tracked. Our lived experience is that the problems in the contract market stem from the actions and market power of the incumbent, vertical-integrated gentailers. One of the Authority's main priorities should be rapid evolution and development of hedge market arrangements and availability of new products, as part of mandated market-making requirements, including shaped and capped products.”

The HDO are out-of-date and not fit-for-purpose

Hedge market arrangements have moved on considerably since the disclosure obligations were introduced in 2009 by the then Electricity Commission. We agree with the Authority's principal observations that:

- “The HDO requirements do not accommodate the growing diversity in OTC risk management contracts”
- The “Current information on OTC contracts” inhibit evaluation of “market efficiency”
- “The current HDO System delivers poor user-experience and low quality data”
- “Improving the HDO requirements aligns with recommendations from industry reports”
- “Improving the HDO requirements supports the Authority's statutory objective”.

¹ 2degrees, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast) and Pulse Energy, There is a substantial 'risk of unintended consequences' if the transition to greater reliance on renewables isn't well managed, 3 March 2023, available at: https://www.ea.govt.nz/documents/2519/Haast_Independent_retailers_-_MDAG_submission_-_100RE_Options_-_2023_03_03_FINAL.pdf.

We support broadening both the scope of the information collected and the range of risk management contracts covered

We consider improved transparency will help the Authority monitor what is happening in the market/identify evidence of the scale of market failure.

We consider that recording RFP participation and responses is particularly important for encouraging positive OTC market behaviours and/or evidence of market power issues. This is because the largest market power issues are often not within the successful offer (if there is a successful offer) but with those not bidding, pricing high, not pricing what is requested etc.

We agree with the Authority that “collecting information about pre-negotiation bids and offers [would] allow for greater monitoring and oversight of both the contracts market and the wider electricity market” and:

... Access to this information is timely given the Authority’s need to have greater visibility of the contracts market, especially with the increasing share of renewable generation in electricity supply. The need for greater transparency of hedge information was further highlighted in correspondence from market participants to the Authority in November 2022, following disruptions to exchanged-traded futures.

Information on bidding processes helps to identify competitive constraints. It will be possible to observe behaviour of participants in terms of how frequently they face each other and potential new participants, and whether they do not bid to supply certain customers. This will assist the Authority with its statutory functions in terms of industry and market monitoring.

There will be a lot of technical design work required to develop new enhanced disclosure requirements, and it is likely there will be diversity of views about what the disclosure requirements should look like (regardless of whether parties support reform or not). We consider the design work is something the Authority should work through collaboratively with a series of stakeholder workshops and such like.

It is important to be explicit about the underlying market failures

The independents consider that the consultation paper does a good job of setting out why the HDO requirements should be reviewed (the disclosure requirements are not out-of-date, there have been material changes to the hedge market etc). It is important the Authority develop a clear problem definition/specification of the market failure as part of the next stage of the policy development.

While we agree an increase in the share of intermittent renewables may result in increased spot price volatility and heighten the importance of hedging arrangements (para 3.6) this is not the underlying market failure we are concerned about.

The independents consider it important to recognise the market failure is a market power/competition problem. Improving information and transparency will help provide information about the nature of the underlying market power/competition problem but won’t fix barriers to access to hedging arrangements resulting from incumbent vertical-integration and resulting incentives to limit access to risk management products by competitors. The Authority’s reference to risk of “anti-competitive effects” alludes to there being a market power problem.

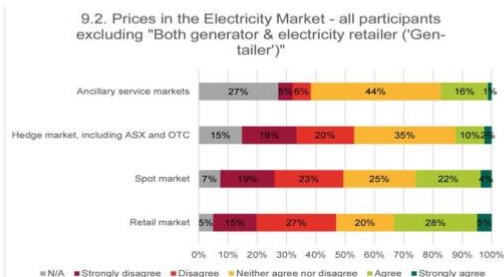
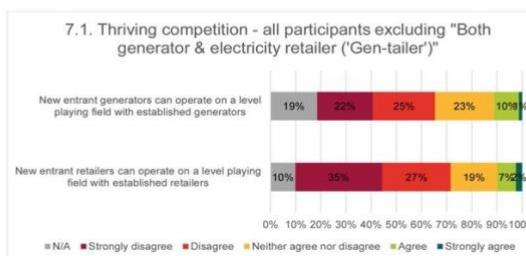
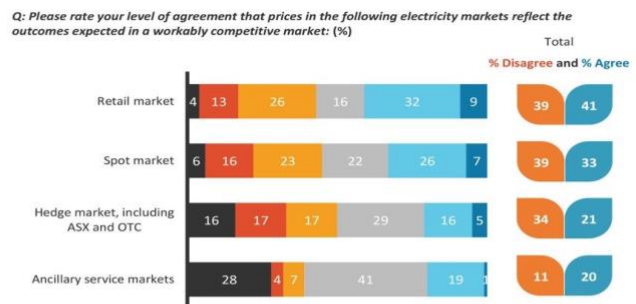
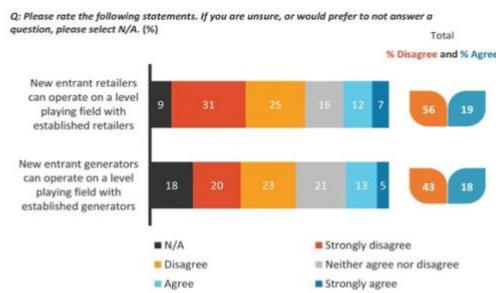
The Authority should ensure disclosure requirements help provide it with evidence to identify problems in the electricity market

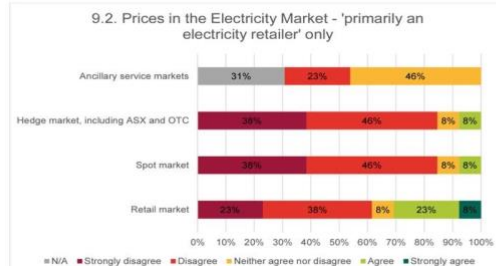
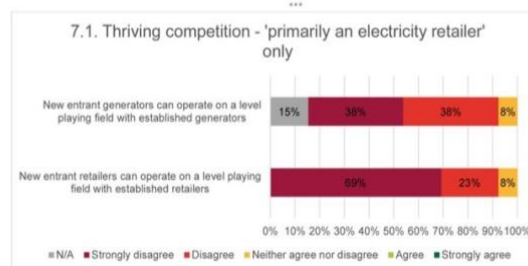
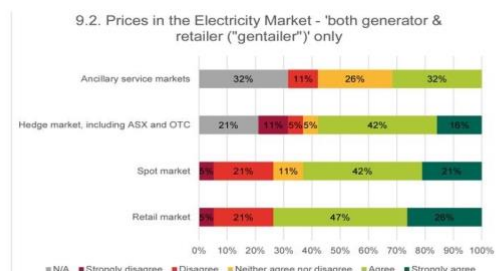
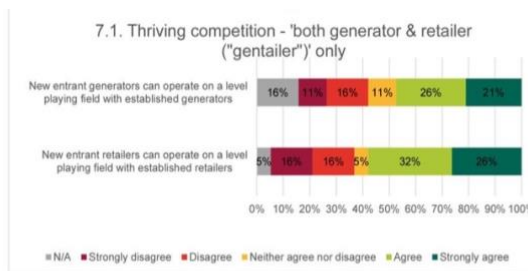
One of the Authority’s recurring themes, in relation to problems in/barriers to competition caused by current hedge market arrangements, is lack of what it considers sufficient evidence to determine whether there is a problem and the size of the problem. The Authority should tailor its HDO reforms around the kind of evidence it would need to satisfy itself there is a problem e.g. evidence of price squeezes and (undue) price discrimination.

By way of illustration, Mercury and Meridian’s internal transfer prices are within the Authority’s benchmark range principally because the range includes an implausible “Minimum of monthly hedge prices (overall minimum)” benchmark, and a backward looking “Average hedge prices for 12 quarters to the quarter prior to the target financial year”. Improved disclosure could assist the Authority to determine realistic benchmarks to compare incumbent gentailers against independent retailers.

While the Authority has not yet been able to satisfy itself about the problems in the hedge market/barriers to competition for independent suppliers, its market participant surveys paint a very different story e.g. the following extracts from the SOI survey highlights only 19% of all market participants agree there is a level playing field for independent retailers, and this result is skewed upwards by the gentailers. When the gentailer views are excluded, the result drops to just 9% of market participants agreeing there is a level playing field. These results reinforce the need for a focus on identifying (and eliminating) barriers to (retail) competition, in tandem with the WMR, and there is a long way to go for “ensuring a level playing field”.

The concerns about how well competition is functioning in the hedge market is also clearly highlighted by the high degree of concern that prices in the hedge market, including ASX and OTC, do not reflect workably competitive market outcomes.





Anti-competitive behaviour risk

The consultation paper raises the prospect that a potential cost of greater transparency could be anti-competitive behaviour. We appreciate the Authority’s clarification that “Anti-competitive effects in this context could potentially happen through either directly facilitating collusion among competitors or, particularly with respect to prices, providing them with focal points, which may be used by firms to align their behaviour. ...”²

To the extent the Authority is concerned about collusion or tacit collusion, this should be reflected in its market monitoring activity.

The likelihood or prospect of collusion is a function of market structure and how competitive the market is. There is a lower risk of collusion if the market is highly competitive and a higher risk if the market is concentrated.

If there is a risk of anti-competitive collusion then the risk of other anti-competitive conduct (which does not rely on information about what other market participants/suppliers are doing) such as refusal to supply would also threaten the achievement of the outcomes the Authority discusses in the consultation paper e.g. better enabling risk management/enabling increased competition and market entry/growth.

Concluding remarks

The contracts market and regulatory settings for the contracts market are a crucial determinant of barriers to competition in the electricity market and the extent to which competition is promoted for the long-term benefit of consumers.

The required arrangements for a successful, highly competitive market will and are evolving over-time. We agree “As the sector transitions [closer] to 100% renewable generation and becomes more complex, market participants will need to use a wider range of risk management contracts to manage their exposure to high price volatility” (para 3.9). We have been clear about our views on this in response, for example, to the MDAG consultations.

The independents remain of the view reform of the hedge market, including both access

² From an e-mail exchange with the Authority seeking clarification on this point.

arrangements and disclosure requirements, should be fast-tracked and treated as one of the Authority's highest priorities.

Yours sincerely,

<p>Emma-Kate Greer Chief Corporate Affairs Officer Emma-Kate.Greer@2degrees.nz</p> 	<p>Luke Blincoe Chief Executive luke.blincoe@electrickiwi.co.nz</p> 
<p>Sunil Unka Chief Executive sunil.unka@flickelectric.co.nz</p> 	<p>Sharnie Warren Chief Executive sharnie.warren@pulseenergy.co.nz</p> 