

26 February 2024

Andrew Millar  
General Manager Market Policy  
Electricity Authority  
Wellington

By e-mail: [OperationsConsult@ea.govt.nz](mailto:OperationsConsult@ea.govt.nz)

## Market-making obligations should be enhanced by including flexibility products

2degrees, Electric Kiwi, Flick Electric and Pulse Energy (the independent retailers) welcome the Electricity Authority's consultation on peak capacity issues and the related review of risk management options available to electricity retailers. It will be critical to the Authority and the electricity market's success that tangible reforms come out of this work.

We agree there is a heightened risk outages or demand curtailment could occur during (winter) peaks compared to past/recent experience. This should be of concern to industry regulators, market participants and consumers. Information provided by Transpower/the System Operator shows the electricity industry has been lucky so far with benign winter conditions mitigating supply risk. It would not be prudent or efficient for the Authority and/or market participants to assume or rely on our luck continuing.

The most basic requirement of any functioning market is that it matches supply and demand. A failure to meet this requirement, and/or elevated risk the market won't be able to match supply and demand, can undermine and threaten confidence in, or the integrity of, the market.

Confidence is particularly likely to be undermined where there is sufficient supply (generation) capacity, but not enough generation is released to match demand.<sup>1</sup>

The focus of our submission is on section 6 of the consultation paper, though we note we have previously expressed concern about options for procuring additional resources/services outside the wholesale market. We agree with the Authority's assessment such options could add costs for consumers without necessarily improving system security and this assessment is supported by overseas experience. We had previously commented more work would be needed before it could be determined whether such options should be adopted, and that the "CEO Forum" treated the justification for its proposals as axiomatic.

Our submission to the Authority in response to its 2024/25 appropriations consultation,<sup>2</sup> and to MBIE in relation to its Energy Transition omnibus<sup>3</sup> canvass matters relevant to the Authority's peak capacity issues consultation and are part of this submission.

---

<sup>1</sup> The corollary of which is that confidence in the market is undermined when there is unnecessary or deliberate dumping of electricity/spill of hydro water.

<sup>2</sup> The submission details that addressing competition problems (in particular, by fast-tracking hedge market reform) should be prioritised and fast-tracked by the Authority.

<sup>3</sup> The submission details problems in the retail and hedge markets, and the importance of reform of risk management/hedge products.

## **The Authority can draw on overseas work**

At various times we have referenced (favourably) the work the ACCC is doing on the inquiry into the Australian national electricity market (NEM). The most recent December 2023 report<sup>4</sup> and the previous November 2022 report<sup>5</sup> should be particularly useful for consideration of reform of market-making obligations/addition of flexibility (hedge) products. The Authority can improve its efficiency and limit the extent to which it ‘reinvents the wheel’ by drawing on work of other regulators.

## **It is important to be clear about the underlying market or regulatory failure**

A lot of the focus in the consultation paper is on symptoms and potential adverse outcomes (risk that supply won’t be sufficient to meet demand), but this raises a fundamental question about whether the Authority considers underlying problem to be temporary/transitional or reflects a systematic problem resulting in less or slower investment than would be expected in a workably competitive market? The Authority’s comment that the underlying issue “is an investment timing issue” leaves its position on this question unclear.

The more competitive a market is the greater amount of the goods or services that will be supplied while, at the other end of the spectrum, service providers with market power are able to raise prices by constraining supply which some commentators have suggested is what is happening in the electricity market. This highlights that a focus on promoting a stronger, more competitive, wholesale electricity market should be seen as part of the longer-term and enduring solutions to the issues raised in the consultation paper.

There are signs the issues raised in the consultation could manifest for longer than may be hoped.<sup>6</sup> For example, the reports Transpower has released are very clear resolution of the current generation shortfall is contingent on the extent to which consented new electricity generation goes ahead – which is far from guaranteed. The Authority should be focused on solutions that have an enduring positive impact on market outcomes regardless of how long tight supply situations persist.

## **Q.6: We consider the review of risk management options available to electricity retailers should be the Authority’s single biggest priority for resolution this calendar year**

We consider hedge market development and regulation should be fast-tracked for resolution within the 2024 calendar year. This fast track would be analogous – but far simpler and less onerous – to the Authority requiring Transpower to develop a new TPM and then implement it, each within around 12 months.

We consider that this would provide ample time for the review – and would not require a quality-time trade-off – as long as the project is adequately managed and resourced.

Problems in the hedge/contract market have held competition back for far too long and need to be resolved. It will be important, if the review is to be successful, that the Authority is able to reach a clear problem definition, rather than that the extent of problems is “uncertain” (as per the wholesale market review), matched by tangible market reforms.

---

<sup>4</sup> [https://www.accc.gov.au/system/files/accc-inquiry-national-electricity-market-december-2023-report\\_0.pdf](https://www.accc.gov.au/system/files/accc-inquiry-national-electricity-market-december-2023-report_0.pdf)

<sup>5</sup> <https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20-%20November%202022%20report.pdf>

<sup>6</sup> See Concept Consulting’s report for the Electricity Authority 2023 update on Generation Investment Survey.

Hedging plays a key role in the wholesale market effecting generator offer behaviour, plant availability, generation investment decisions and effects spot price volatility through volume-price-risk based offer behaviour. Current issues are being made worse because of the lack of hedging offered in the part of the wholesale market where competition is least workable. It is therefore critical the Authority intervenes to ensure hedging is made available in the super peaks to incentivise physical supply availability and to minimise potential for non-orderly outcomes.<sup>7</sup>

We support the Authority's intention to develop a standard product for financial 'super peak' hedges. In the context of the MDAG final report, market-making for flexibility products (including shape and cap products) (Recommendation 24) should be treated as the Authority's single most important priority for implementation as part of Recommendation 8 in 2024. We do not support MDAG's recommendation that it be: (i) treated as a tranche 2 action, and (ii) "contingent on assessing whether previous measures are sufficiently effective".<sup>8</sup> The light-handed voluntary approach to market regulation has been a failure which, based on the Authority's recent decision to mandate the Consumer Care Guidelines,<sup>9</sup> the Authority is becoming wary of.

Development of these products would assist in managing potential tight supply situations (or periods with peak electricity capacity issues) as well as improve competition for the long-term in the wholesale and retail markets. Developing these products is a no regrets initiative that would benefit consumers whether or not tight supply situations persist.

Our position on fast-tracking extension of mandatory market-making is supported by the risks the Authority has raised in terms of ensuring the electricity system is able to meet peak electricity/winter demand and avoid 9 August 2021 type outages. The Authority has recognised the importance of flexibility products for allowing flexible supply and demand "to participants in the forward price discovery process and obtain more certain revenues while supporting the management of peak demand."<sup>10</sup>

### **An efficient hedge market is a key pillar for a well-functioning wholesale market**

The MDAG final report makes it very clear one of the key pillars, which needs to be "beefed up", for a well-functioning wholesale market, is that "market participants need tools to efficiently manage their risks. These tools can be physical options (e.g. an ability to increase supply or reduce demand) or financial arrangements where parties contract with others who can manage the underlying risk at a lower cost." MDAG is very clear if access to flexibility products (including shape and cap products) is not adequately resolved it "could tear at the fabric of the broader market" and "undermine competition in the retail and new investment market".<sup>11</sup>

We agree with MDAG that:

"The importance of flexibility contracts to the electricity system is expected to increase even further in future as the proportion of supply from intermittent sources rises. Indeed, we think flexibility contracts will become the market's 'secret sauce' – enabling a range of wholesale market processes to function effectively."

"... the contract market must be strengthened so it can do more of the heavy lifting in future. In particular, the market for 'flexibility contracts' needs to develop significantly."

---

<sup>7</sup> A major concern of the independents is the labelling of current super peak issues as a capacity issue only. By doing so the Authority is under playing the significance of the interdependence of wholesale market behaviour and the hedge market. Independent retailers are simply not being offered adequate super peak hedge products with an increasing tendency for gentailers to withhold hedging albeit there generally remains sufficient generation to supply super peak demand.

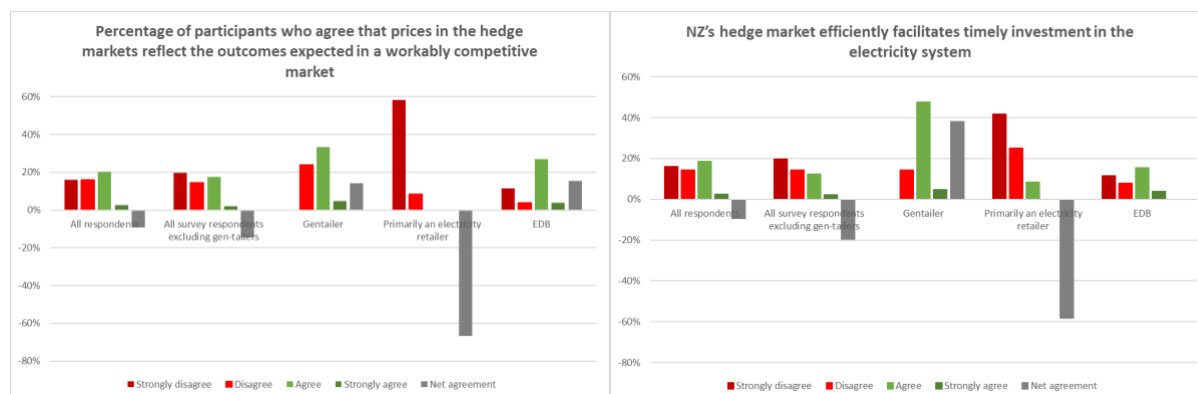
<sup>8</sup> MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

<sup>9</sup> [https://www.ea.govt.nz/documents/4436/Preferred\\_option\\_to\\_update\\_and\\_strengthen\\_the\\_Consumer\\_Care\\_Guidelines\\_-\\_decis\\_PYcdexB.pdf](https://www.ea.govt.nz/documents/4436/Preferred_option_to_update_and_strengthen_the_Consumer_Care_Guidelines_-_decis_PYcdexB.pdf)

<sup>10</sup> Electricity Authority, Potential solutions for peak electricity capacity issues, 12 January 2024.

<sup>11</sup> MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

There is very low confidence amongst market participants (other than gentailers) about how well the hedge market is working.



### An efficient market requires that independent suppliers can compete on a level-playing field

We consider that measures should be adopted to improve liquidity in contract markets and to limit generator market power being used in retail markets. The independent retailers consider one of the primary pre-requisites for a well-functioning, competitive electricity market that can support the energy transition and delivery of affordable electricity is that independent retailers have access to flexible hedge contracts on terms equivalent to a gentailers’ retail arms. The risk premiums gentailers add to products they sell on the ASX or OTC markets should also be paid by the gentailer’s retail arm – especially as the fixed price variable volume (FPVV) product sold to this retailer includes ‘shape’ and a ‘cap’ and is higher risk than a base-load product. Essentially, the incumbent gentailers’ generation businesses should be indifferent between selling to their related retail business or any third party.<sup>12</sup>

We consider that a wholesale access regime should be developed, in which the regulator determines the (minimum) risk/hedge products the incumbent gentailers must provide. The principles of “non-discrimination” and “equivalence of inputs” – contained in the Telecommunications Act – are key principles that should be adopted to regulation of access of hedge products. The Grocery Industry Competition (Grocery Supply Code) Amendment Regulations 2023 also includes universal good-faith and non-discrimination obligations.<sup>13</sup>

Regulation of access services in vertically-integrated industries where there is monopoly or market power is an orthodox part of competition law internationally and should not be seen as a significant intervention.

### Q.5: The evaluation criteria should be reassessed

The adoption of “assessment” or “evaluation” criteria may be useful if it helps the Authority: (i) make decisions which give effect to the purpose in section 15 of the Electricity Industry Act; and (ii) explain its decisions and provide predictability to stakeholders.

<sup>12</sup> Our understanding is that this may be Contact Energy’s current approach.

<sup>13</sup> The Code includes useful requirements such as good faith dealing obligations (with a highly prescriptive definition) and related requirements to avoid unreasonable discrimination or distinction between suppliers: <https://legislation.govt.nz/regulation/public/2023/0220/latest/096be8ed81db0c51.pdf>.

We do not consider it helpful to create bespoke evaluation criteria for each individual consultation which seems to be the approach the Authority has been taking. We do not support the latest formulation of the evaluation criteria. The concerns we previously expressed remain. There are a number of problems with the evaluation criteria:<sup>14</sup>

- Criteria (a) is a high-level composite/muddling of problem definition and description of a policy option, not an evaluation criteria.
- Criteria (b) essentially repeats part of what the Authority discusses as issues or problems in its consultation paper. It would be better to elevate and generalise the evaluation criteria to how well the solution addresses the problems the Authority has identified. We reiterate “It is valid and appropriate to consider the extent to which policy options would address the underlying problem (regulatory or market failure). This is orthodox but very distinct from using a specific problem definition as a bespoke evaluation criterion. We do not support using the problem definition as an evaluation criterion.”

It is not appropriate or good regulatory practice to blur the evaluation criteria with, or include in the evaluation criteria, either elements of the problem definition and/or policy options.

- In relation to criteria (c), it is important to understand there can be risks of unintended consequences or side-effects from doing nothing, and letting problems continue or get worse. It is important that if this principle is applied it is not used as a status quo bias.

The Authority should have at front and centre of its policy development the risk of unintended consequences and outcomes from policy inertia and delay. Doing nothing is not a risk-free option.

- Criteria (d) adds an element of principle 4 from the Authority’s Consultation Charter. It is unclear why this particular criterion has been singled out over others in the Charter. If the Authority is going to use select principles from the Charter we would like to see “Principle 5 – Preference for Greater Competition” included. This would be consistent with the Authority’s statement that one of its policy objectives is to “Maximise the benefits of competition in electricity supply for consumers”.<sup>15</sup>
- The evaluation criteria should be used to help the Authority to determine whether policy options would meet the Authority’s statutory objective. It is circular to include the statutory objective in criteria to help determine whether an option would meet the statutory objective. The Authority also has not provided any ranking of importance of the different criteria so it appears that criteria (a) – (f) have the same status and importance as meeting the Authority’s statutory objective (criteria (g)) which would clearly be inappropriate.

## Concluding remarks

The independent retailers consider there is a need to improve opportunities to manage wholesale market risk (including retailer customer profits risk) not covered by current baseload products.

We agree with the Authority that “the forward price curve for baseload contracts represents a market assessment of future average prices, taking into account the full range of outcomes,

---

<sup>14</sup> Electric Kiwi, Flick Electric, Haast Energy Trading and Pulse Energy, Ensuring supply meets demand is fundamental to ensuring confidence in the wholesale market and promoting the long-term interests of consumers, 16 December 2022.





<sup>15</sup> Electricity Authority, Options to support consumer plan comparison and switching, Consultation paper, 1 February 2024.

including high inflows, low inflows, and possible power station and transmission outages. It provides little ability to distinguish between the components of price representing energy and capacity risk within the forward price. It is therefore unclear to what extent the baseload futures prices represent a perceived risk of energy scarcity and capacity scarcity.”<sup>16</sup>

We consider there would be wide-ranging benefits from evolution and enhancement of the (financial) hedge market. Reforms that improve access to risk management products would help:

- support more active trading and help build confidence in the electricity market;
- provide a more level playing field that enables independent suppliers to compete against incumbent gentailers; and
- provide improved price signals to assist parties in making efficient investment decisions.

Yours sincerely,

<p>Emma-Kate Greer Chief Corporate Affairs Officer <a href="mailto:Emma-Kate.Greer@2degrees.nz">Emma-Kate.Greer@2degrees.nz</a></p> 	<p>Luke Blincoe Chief Executive <a href="mailto:luke.blincoe@thecollective.energy">luke.blincoe@thecollective.energy</a></p> 
<p>Pavan Vyas Chief Executive <a href="mailto:pavan.vyas@flickelectric.co.nz">pavan.vyas@flickelectric.co.nz</a></p> 	<p>Sharnie Warren Chief Executive <a href="mailto:sharnie.warren@pulseenergy.co.nz">sharnie.warren@pulseenergy.co.nz</a></p> 

<sup>16</sup> Electricity Authority, Enhancing trading of hedge products, Decision paper, 8 December 2015.