

Questions for Electricity Authority staff – ahead of 8 Nov 23 MBIE team / EA team discussion

MBIE perspective on policy objective

Effective competition in wholesale markets is critical to ensure prices are no higher than supply costs, as the economy transitions to more renewables.

We recognise the importance of independent (non-vertically integrated) market participant at both wholesale and retail levels of electricity supply:

- Independent wholesalers create more competition in the market for spot and hedged supply to retailers.
- Independent retailers challenge the historic incumbents by bringing more innovation and dynamism (e.g. innovative tariffs) and lowering costs over the longer term., which benefits the long-term interests of consumers.

MBIE perspective on problem statement

We have heard repeated complaints that independent retailers face a price barrier to access, compared to the incumbent gentailers' own retail arms, to hedging contracts that cover peak demand periods. Independent retailers have formally made these complaints to the Commerce Commission.

We have also heard from an independent generator that is struggling to access hedge products to cover firming, as a complement to their own intermittent generation supply. Accessing a firming hedge is necessary if they are to offer firmed PPAs to a large customer.

We're thinking about a mutli-layered possible problem statement:

1. **A physical shortage:**
 - New Zealand has a shortage of peaking, and firming generation (capacity to cover peak demand and when intermittent supply drops), and a shortage of energy storage (to cover dry years).
2. **Potential market power:**
 - Vertically integrated generators that hold peaking and firming capacity, and/or energy storage, may have market power in times of scarcity, and so may be able to lift prices above the long run marginal cost to supply (of the last-dispatched generator).
3. **Potential use of market power:**
 - Vertically integrated generators that hold peaking and firming capacity may be unwilling to offer this to generator-competitors or retailer-competitors, on *terms* and *pricing* equivalent to its own retail arm.

MBIE current thinking is – we are concerned about the higher-level concerns (1) and 2) above):

1. **Physical shortage:** If there is a shortage of peaking, firming and storage, this will challenge the speed and cost of transition to more renewable generation. MBIE recently considered this challenge via its EMM paper, and is currently reviewing submissions, in preparation for providing advice to an incoming government.

2. **Market definition:** before assessing market power, it is necessary (in anti-trust) to define the relevant market. We are considering whether a temporal dimension is appropriate when considering wholesale electricity markets (as, for example, supply from 1-3pm is not a substitute for supply during the 7-9am morning peak; or a baseload supply contract is not a substitute for extra supply needed in dry year periods).
3. **Possible market power:** If market design is such that market power can be exercised (in spot or hedge markets), lower competition will affect dynamic efficiency (innovation) and pricing levels in both wholesale and retail electricity markets – meaning the electricity sector will not be playing its part in New Zealand transitioning to achieve climate targets along a least cost transition pathway.

We are also considering the complaints related to number 3) above - from independent generators and independent retailers. Our current thinking is:

- To date, we have not been presented with persuasive evidence that the complaints do not warrant careful consideration. MBIE is keen to ensure the complaints are appropriately considered, and envisages this may include collaboration, as appropriate, across Comcom and the Authority, with MBIE also collaborating from a policy perspective as appropriate.
- We are concerned that a two-tier market may be developing as independent retailers will be increasingly unable to offer the same retail offer as the gentailers. We are concerned about the potential for retail price increases for electricity supply offerings by independent retailers to end customers, if prices from gentailers to independent retailers also 'bake in' costs that include any market power surplus at the wholesale level. It is not clear that the gentailers face similar upward pressure on retail prices (given that their profits are being made at the wholesale level while their retail arms may be running at a loss).

The role played by price signals in the electricity sector is critical, as electricity is a core input for decarbonization of industry, and transport.

This is why we are also keen to fully understand the Authority's current work programme with respect to competition – following on from its own wholesale market report, in light of the concerns related to ourselves by independent generators and independent retailers, and also in light of the concerns raised in the draft MDAG report (about any wholesale market competition problems amplifying during the transition) – which we expect may be repeated in MDAG's forthcoming final report.

Questions

On the Authority's work programme relating to these matters

1. Does the Authority have a work programme assessing wholesale market competition, following on from its own wholesale market review? If so, what are the aims, scope and component parts of the work programme, and timeframes for analysis, any engagement, then advice to the EA's Board?
2. Yes, see the every second quarterly report. We have also published evaluations of the new trading conduct provisions, and we publish weekly trading conduct reports. These are all spot market based outputs.
3. <https://www.ea.govt.nz/industry/monitoring/>
- 2.4. Note the essence of the trading conduct work is to identify periods where the prices and underlying supply conditions diverge, and then to investigate these.
5. Does the Authority have activity underway to support the Commerce Commission carry out screening-assessment (pre investigation) for the complaints made to the Commission by independent retailers?
- 3.6. We're working closely with the ComCom to access some of their knowledge about competition economics.

More detailed questions on the EA's consideration of these matters

Checking our understanding and your general views-

- 4.7. Our understanding of the contract is market is that participants may agree multiple different hedging products– i.e., some contracts that cover both baseload and peak times, some contracts focussing on baseload, and then separate products for daytime load and for peak times. Is this correct?
 - s9(2)(g)(i)
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8. Do you have a view on the impact (if any) of the appointment of Marex Australia, as a new clearing participant on the ASX, have on the accessibility to hedges for independent retailers?
- 6.9 s9(2)(g)(i)

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Responding to [REDACTED]

22. We note also that [REDACTED] has asked for a response to their proposition that competition from independent retailers is important. MBIE is prepared to make this statement and respond to

[REDACTED] Has the Authority reached a view on whether or how to respond?

13-23. Not my responsibility, but I will follow up on this.

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