

Review of risk management in retail electricity

Board meeting – 21 November 2023

Planning a review of risk management

We are concerned about poor outcomes for consumers if independent retailers do not have the ability to access risk management products in the form, or at the price, needed to be competitive.

Staff have begun planning a review of risk management in the electricity market.

This presentation is to:

- Keep you informed
- Provide advanced notice of future decisions that will be needed to progress this work
- Provide detail on the first phase of the project



Review of risk management in the electricity retail market

Interested in the ASX and OTC contract markets to better understand:

- The availability and accessibility of risk management solutions to independent retailers
- The pricing relationship between the ASX and OTC market
- The supply and pricing of shaped solutions
- The interaction of contract markets with the retail market.

Key research and policy questions are:

- How accessible are hedge products and the contract market?
- What determines price differentials between ASX and OTC?
- What other mechanisms are relevant for risk management?
- How does the contract market affect competition in the retail market?
- ...more detail on these questions later



Why?

Supporting market competition:

- Changing situation warrants renewed attention – need for shape products as more volatile spot prices.
- The Authority has looked at the wholesale spot market and is increasing its monitoring of retail – this leaves the risk management market.

Prompted by:

- OTC now a necessity for retailers – due to ASX limitations and the transition
- Increasing importance of importance of other avenues for risk management in the transition
- Complaints to Commerce Commission
- Issues raised during MBIEs consultation on *advancing New Zealand's energy transition* – organisational risk for the Authority
- MDAG – likely to have recommendations on improving hedge market



Scope

Inclusions

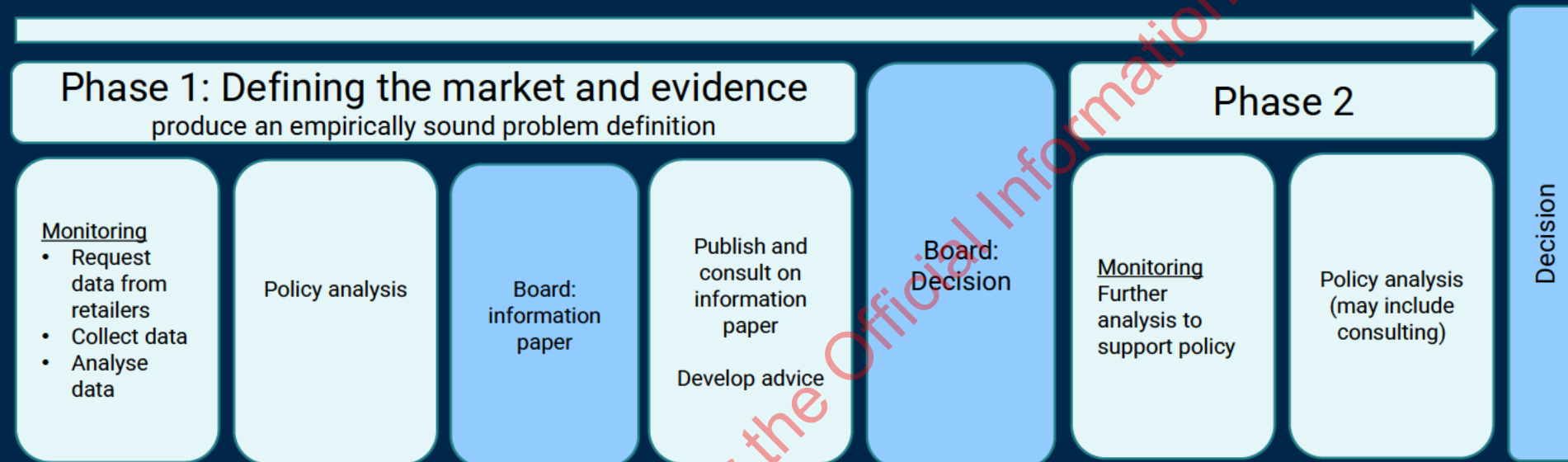
- Risk management products
 - OTC market
 - PPAs
 - ASX exchange traded electricity derivations and options
 - Other mechanisms such as demand response and batteries
- Monitoring of OTC code of conduct
- Outcome of the ITP/RGM PIR

Exclusions

- The market for financial transmission rights.
- Spot market (was covered in the WMR)
- Retail market competition



Phases and indicative timing



s18(d)

Programme governance

SLT

Steering committee

Programme manager

Project team: monitoring

Project team: policy

Programme support



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Connected work

- Review of wholesale market competition (completed)
- OTC code of conduct working group (code of conduct complete – monitoring being established)
- Post implementation review of ITP/RGM
- Improving the hedge disclosure obligations
- Market Development Advisory Group (MDAG)
- Retail data project



Commerce Commission

- Commerce Commission staff are providing input at project team level
- Technical assistance
- It has received 4 x complaints from independent retailers under misuse of market powers legislation
- Our communications staff are liaising with the Commerce Commission about public communications about the project.



Questions

Do you have any comments before we move on to the details of phase 1 of this project?

Would you like more detail on the scope of the project?

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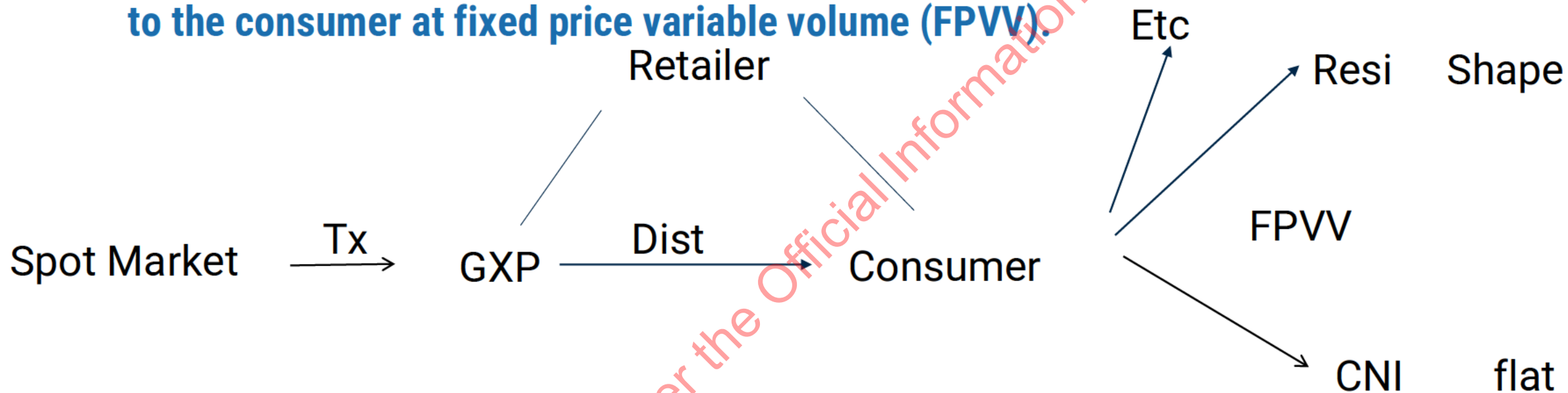


Phase 1: Defining the market and evidence

The objective is to produce an empirically sound problem definition

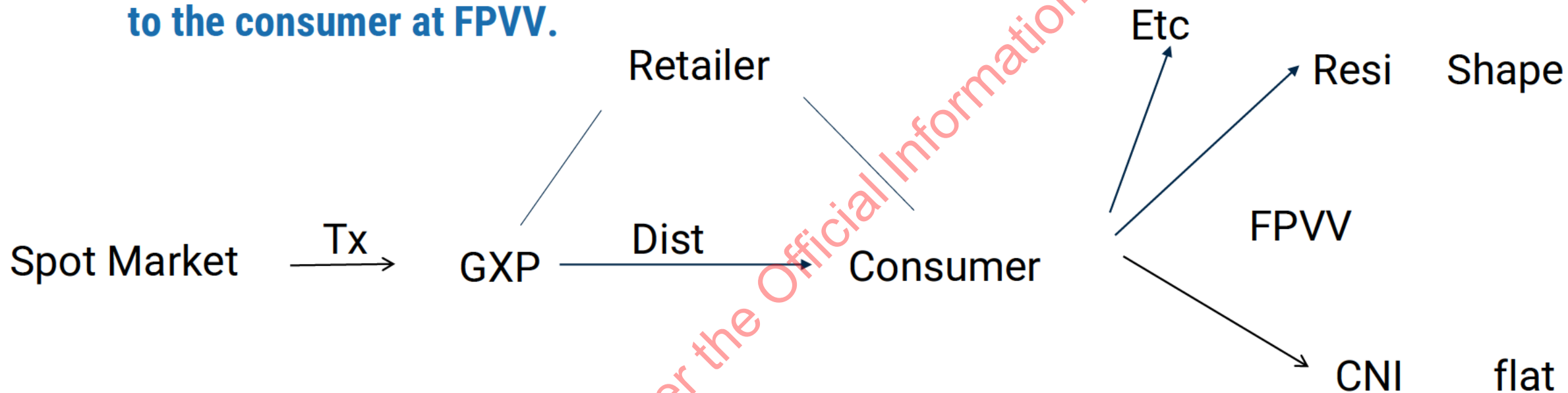
Physically: electricity flows from the grid exit point (GXP) to the consumer via the distribution network.

Economically: retailer buys electricity at the GXP on the spot market, then sells to the consumer at fixed price variable volume (FPVV).



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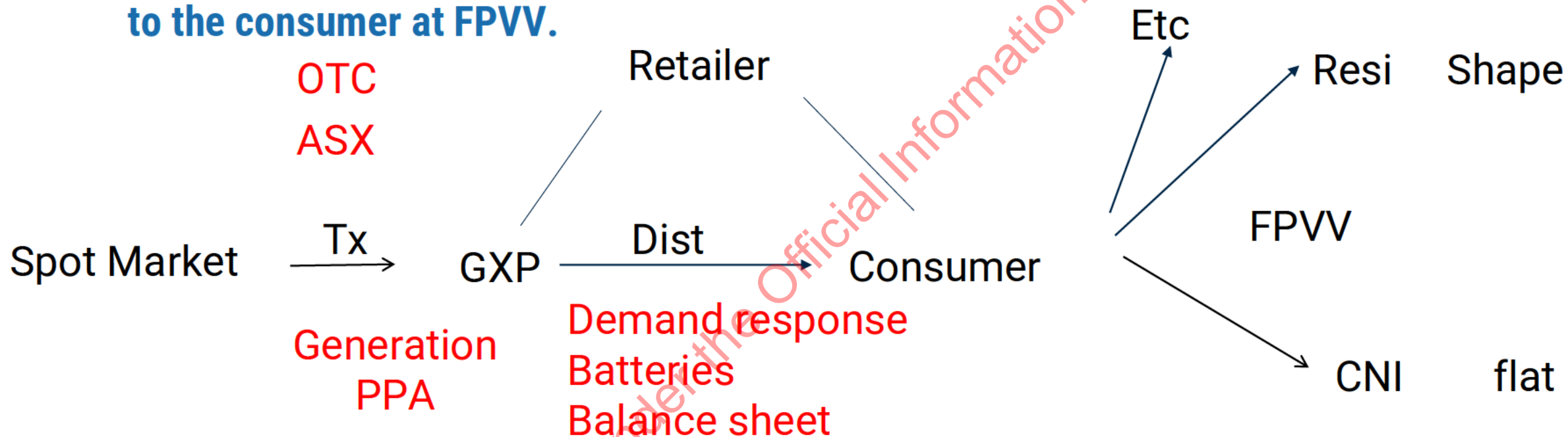
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So a retail business stands between a volatile spot price and the convention of FPVV for consumers. The issue is the mechanisms available to manage this risk.

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Different approaches to get estimates to compare with ASX prices

Think about this as premiums on top of the ASX price for:

- Shape (if not baseload)
- Illiquidity (bespoke OTC more difficult to trade out of a position)
- Credit risk (ASX settles daily with margin calls, almost eliminating the risk of non-payment)

And as pricing to the next best alternative:

- Over hedging on the ASX
- Generation/quasi integration/PPA
- Demand response
- Battery
- Financing spot/residual spot exposure

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Information request on hold until announced

From independents:

- Details of RFPs and tenders received
- Details of investigations into other avenues to manage spot price risk: PPAs, demand response, etc

From gentailers

- Credit risk assessment frameworks
- Past credit risk assessments
- Evidence of responses to RFPs and pricing methods
- Trades between gentailers

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Any questions?

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