

Not in scope

From: Rob Bernau [Section 9(2)(a) Privacy]
Sent: Wednesday, January 17, 2024 3:22 PM
To: Ritchie Hutton [Section 9(2)(a) Privacy]
Subject: RE: EA project - risk management review

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Thanks Ritchie – I'll send through a meeting request for next week. Feel free to forward to Luke or anyone else you want to be in the meeting – I'm not intending to exclude anyone, but just want to talk through what's realistic/most useful in terms of Commission involvement.

Ngā mihi
Rob

From: Ritchie Hutton [Section 9(2)(a) Privacy]
Sent: Wednesday, January 17, 2024 9:30 AM
To: Rob Bernau [Section 9(2)(a) Privacy]
Subject: RE: EA project - risk management review

Hi Rob

Thaks for making contact. It would be good to have a chat about our involvement. It is a good time to be planning meeting as I am free all next week after 1pm except for Thursday.

Thanks

Ritchie

Ritchie Hutton

Head of Competition Investigations | Competition Branch
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44 The Terrace | PO Box 2351 | Wellington 6140 | New Zealand
DDI [Section 9(2)(a) Privacy]

From: Rob Bernau [Section 9(2)(a) Privacy]
Sent: Friday, January 12, 2024 2:01 PM
To: Ritchie Hutton [Section 9(2)(a) Privacy]
Subject: EA project - risk management review

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Tēnā koe Ritchie

Happy new year – I hope that you had a relaxing break.

I've joined the Authority team that is responsible for this work, and am overseeing it end to end, ie, from the analysis that Doug's team is leading, through to developing and implementing any subsequent policy response.

I'd appreciate the chance to talk to you once you are back in the office to better understand how we might work with the Commission on this matter, and get the most benefit from your team's expertise. The two teams have been communicating really well to date, but we are now in detailed planning mode so are looking to firm up exactly how we engage with Luke, Reuben and Jenna on the various workstreams that sit under this programme.

Can you please suggest a couple of times when you'd be free to talk? As I'm based in a different timezone, ideally they'd be after 1pm NZ time.

I look forward to talking soon.

Ngā mihi

Rob

From: Luke Archer [Section 9(2)(a) Privacy]
Sent: Monday, December 4, 2023 12:13 PM
To: Doug Watt [Section 9(2)(a) Privacy]
Cc: Julia Hall [Section 9(2)(a) Privacy]; Jenna Bernstein [Section 9(2)(a) Privacy]; Reuben Irvine [Section 9(2)(a) Privacy]; Ritchie Hutton [Section 9(2)(a) Privacy]
Subject: RE: EA project [CCNZ-IMANAGE.FID371436]

Hi Doug

Sorry, we've been discussing this internally but I just realised we never confirmed receipt! So – we have this and are considering it. Do let us know if/when there is:

- an updated version of the below that your legal team has reviewed; and
- a draft Terms of Reference (or similar) that might sit behind any public messaging when the project is announced.

Our comms team (Charlotte) has also been in touch with your comms team (Sean) and I understand we are going to come up with some text agreed by both agencies to describe our (Commission) involvement in this work. We also understand that the potential ETA for an announcement might be next week (w/c 11 Dec) to align with the next stage of MDAG's work?

Thanks

Luke and team

From: Doug Watt [Section 9(2)(a) Privacy]
Sent: Wednesday, November 29, 2023 8:19 AM
To: Luke Archer [Section 9(2)(a) Privacy]; Ritchie Hutton
[Section 9(2)(a) Privacy]
Cc: Julia Hall [Section 9(2)(a) Privacy]
Subject: EA project

Hi Richie and Luke.

Sorry this has taken so long. [Section 9(2)(h) Legal privilege] So with that caveat... :

We appreciate the support you can provide for this project.

We are happy to be able to access the Commission's competition expertise, and we are not expecting the Commission to give formal comments.

My team have a mix of backgrounds, some of which touch on competition, but our main skill set is industry expertise and quantitative analysis. So this is really a part answer to your second question—the expertise we would hope to get help with is around competition economics. But a bit more on this below.

Market definition

The basics of the market is that retailers purchase from the spot market and sell to consumers. The spot market is volatile, and the convention is that consumers are on fixed-price-variable-volume contracts, although this is not ubiquitous, especially for non-residential consumers. The retailer's business is providing this swap (selling certainty and managing uncertainty), so it is doing risk management on behalf of the consumers. Retailers in turn manage their exposure to the spot price in a range of ways:

- Owning generation
- Having a quasi-integrated relationship with a generator
- Financial contracts (CFDs) either exchange traded or over the counter
- Demand response
- Batteries
- Balance sheet (basically self-insuring)

This set of risk management options is our market definition. The project will look at the costs of these relative to the costs being paid in the over-the-counter CfD market.

Research questions

Our overall research questions are:

- Is the ASX an unbiased predictor of the spot price? This is necessary as we will look at the actual prices being paid in the OTC market as being composed of the ASX, plus premia for shape, credit risk, illiquidity risk.
- What are the prices of the risk management products that are traded now? So distinguishing shaped contracts from baseload etc. There is also some suggestion from industry that mid-level retail FPV schedule prices would be worth looking at for a comparison.
- Are these prices rational? Can we create an arbitrage free price from market prices and compare actual prices with these? This may mean that we have a residual that represents

credit and illiquidity risk for example, if we can't independently estimate these. Then we will be in a world of asking whether this is a reasonable residual.

- Are independent retailers being treated fairly in the OTC market? For example, are any prudential requirements, credit risk premiums, simple refusals to trade commensurate with the actual default risk?

So our project will ask for data on:

- Over the counter CfDs
- Investigations that independent have made into demand response, arrangements with generators, etc

From this will be able to understand the prices being paid for OTC CfDs, and the efforts that independents have made to access alternative risk management mechanisms. We already have a comprehensive set of ASX data.

From gentailers we will get:

- Credit risk assessment frameworks (most likely policy and procedure documents)
- Past examples of credit risk assessments
- Evidence of responses to RfPs (both successful and unsuccessful)
- Evidence of trades between gentailers.

This set of data will help us understand whether independent retailers are being treated in an unbiased and consistent way.

What is above is what we will start with in terms of scope. Mostly when we embark on these sorts of exercises we discover things as we travel, so we don't put a lot of effort into planning beyond understanding the questions we need to answer. This might not be enough for you, but I suggest we discuss.

We will not investigate the structure, conduct and performance of the retail market. That is, we are not looking at competition in the retail market, but rather the impact a lack of competition in the risk management market may have on the retail market. This therefore excludes looking at indicators such as:

- Concentration measures in the retail market
- Product differentiation in the retail market
- Retail pricing practices
- Innovation in the retail market
- Profitability of retailers

However, things such as barriers to entry will be touched on insofar as these arise from risk management. For example, do access issues to risk management products create a barrier to entering the electricity retail market. Product differentiation of risk management products will also be explored (ie, the range and types of contracts being offered), but not the range and type of retail products being offered.

As mentioned above, it is competition economics where we would be looking for some support. Below are a couple of questions that would be good to discuss. I expect more will come up during the course of our work.

One question is around pricing of risk management products. So if a gentailer has a stock of plant and equipment that can be used to manage its own spot price risk, or sold to manage other's spot price risk, how should this be priced? If the gentailer is building more plant and equipment that can be used to manage spot price risk, then should this be sold at the marginal or average price?

Another question is the temporal dimension to the market definition. Demand changes through time, and for residential consumers demand is high in the morning and evenings. To a certain extent demand can be shifted between these periods. Sometimes this is consumers responding to time-of-use tariffs but more commonly this is lines companies using ripple control to shift water heating load away from peak times. On top of this, fixed-price-variable-volume contracts don't provide consumers the incentive to shift load. At the other end of the scale, we are seeing large contracts between gentailers and industrial load starting to include demand response. Having said all this, spot price risk is ubiquitous, so there seems little to separate time periods from a price perspective.

We have been in contact with MBIE about this.

Doug

Section 9(2)(g)(i) Free and frank opinion

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