7 May 2025

Energy Competition Task Force

By email to: taskforce@ea.govt.nz

Tēnā koe

Response to "Level Playing Field measures: Options Paper"

Thank you for the opportunity to respond to the Task Force options paper on level playing field measures.

We recognise the theoretical concern identified by the Task Force, and agree that a principles based regime would help address these concerns. The regime will provide transparency to show that Contact does not, nor ever has engaged in discriminatory practices. This would be a breach of existing competition law, and not a risk that would be acceptable for us to take.

Implementing this regime will be a significant task. We have begun this work, but we are not in a position to comment in the detail of the design of the regime at this time. In this submission we highlight high-level feedback to help shape the regime, and look forward to engaging on the design detail in future consultations.

In summary our view is that:

1. A principles-based non-discrimination regime is proportionate to the evidence.
2. However some tweaks are needed to ensure that the regime does not create new risks, including ensuring market fundamentals are not harmed, explicit recognition that the regime is not intended to regulate credit risk policies, and changes to minimise the impact on end-consumers.
3. The escalation path has material risk of unintended consequences
4. Other options considered are not proportionate to the evidence

We provide further discussion on each of these points below, followed by an assessment of the evidence presented by the Task Force, and responses to the consultation questions.

Please contact me at [redacted] if you wish to discuss further.

A principles based non-discrimination regime is proportionate to the evidence

The Task Force has identified that:

> *integrated gentailers may discriminate in favour of their own retail arms when offering hedge products to third parties, not necessarily by price, but through non-price terms like credit requirements*

We recognise the theoretical concern that independent retailers often consider themselves reliant on hedge products from major generators like Contact Energy, who are also their retail competitors. This provides a prima facie case that there may be incentives for a margin squeeze, where companies like Contact Energy offer themselves better hedge deals than they do for their competitors.

We do not consider that the Task Force has any evidence to support this theoretical concern. However, we also recognise that gathering evidence (both for and against) this practice is very challenging. A principles-based disclosure regime is therefore a proportionate response to provide a more robust evidence base to ease concerns raised.

Contact Energy is not engaging in a margin squeeze

Some parties appear to come to a view that a margin squeeze is occurring because some large generator-retailers (including Contact Energy) are reporting an operating loss on their retail segment. We disagree with this interpretation.

Contact Energy's retail segment remains commercially viable on a stand-alone basis. This is because we have a strong expectation of returning to profitability over the coming years, and we have sufficient balance sheet to cover this challenging period for the market. Accounting rules require us to assess this each year, and record an impairment (and the associated impact on profit) if any segment is not commercially viable. This process is overseen by our Auditors.

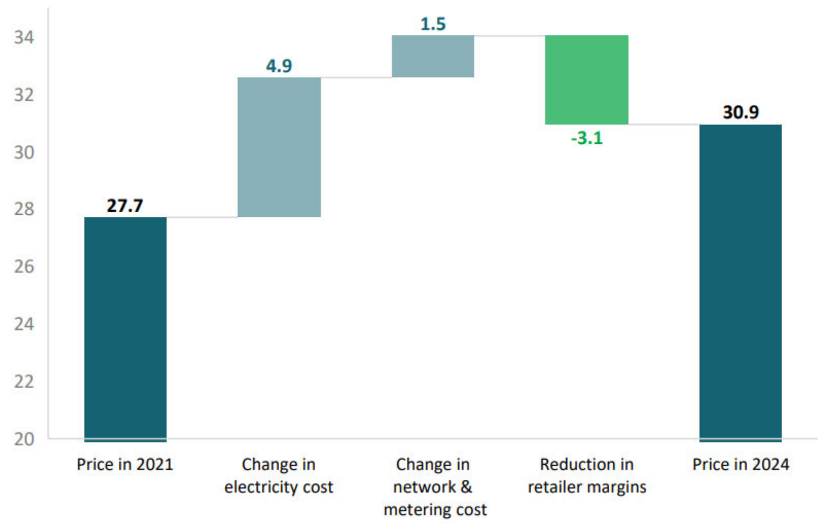
We take a long-term view of the market to support our customers through shorter term fluctuations in the market. However, the operating losses on our retail segment are expected to continue in the short term. This is because:

- the retail market has not kept pace with changes in input costs;
- that any internal transfer price will not be able to perfectly mimic the energy cost Contact's retail arm could achieve if it were a separate entity; and
- we have attempted to mitigate hardship for the highest cost regions.

The retail market has not kept pace with changes in input costs

As recently shown by Sense Partners for MBIE, retail prices have not kept up with increases in input costs since 2021.

Figure 1: Impact of cost increases on retail prices and margins. Approximate effects in cents per kWh[1]



Source: Sense Partners (2024), Phase-out of the Low Fixed Charge regulations: Quantified price effects for the first 3 years

This is likely due to a number of factors, including:

- The heightened regulatory and political attention on the sector over that period has moderated retail price increases which between 2011 and 2024 did not keep up with inflation[2]
- Wholesale electricity increases were initially considered by many to be temporary. Temporary changes in input costs are less likely to be passed through to retail customers. It is increasingly clear that there is a more permanent change in wholesale prices, but retail prices have not yet had time to catch up.

While recent price changes indicate that retail prices are beginning to adjust, this may take several years to mitigate the impact on consumer price shocks and consumer hardship.

Any ITP will be an imperfect estimation of energy costs of a stand-alone retailer

The losses we report are partially a function of our ITP. However, any ITP will only be an approximation of the energy costs that an independent retailer of Contact's scale could achieve. While we intend to consider if a more sophisticated ITP is necessary to be compliant with the proposed non-discrimination regime, we consider that the necessary simplifications of any ITP model will over-estimate energy costs compared to what Contact's retail arm could achieve if it were a stand-alone business.

For example, our current ITP is based on average ASX prices over the three years preceding each period. However, the ASX price for a particular quarter varies significantly over time. For example, it is well known that ASX prices reduce across the board when there are high hydro inflows (regardless of whether the inflows have any impact on the period in question). An independent retailer actively trading on the ASX will be able to take advantage

[1] https://www.mbie.govt.nz/dmsdocument/30583-mid-point-review-of-the-phase-out-of-the-lfc-regulations-pdf, p14.
[2] https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/energy-prices

of this by purchasing more of their hedge cover when ASX prices are low, and therefore systematically out-perform our ITP.

As an illustration, Q1 2024 at Otahuhu was priced at ~$135 in our ITP. However, if we arbitrarily removed the 100 highest trading periods each year, the price drops to ~$126. While such an arbitrary adjustment would be unjustified in a modelled ITP it demonstrates the degree of inaccuracy such a model will produce.

This is further compounded by the fact that our ITP does not take account of the scale of our retail business, and it is proposed that taking account of scale is prohibited under the new regime.

A restriction on considering the cost savings of scale is not reflective of what Contact's retail arm could achieve if it were a stand-alone business. A large retailer would bring a certain degree of buyer power, ultimately reducing costs for consumers.

Some regions have a very low margin, drawing down the average

Contact has the highest ITP of any market participant. This is largely because of the location factor we apply, and the fact that many of our customers are in high-cost regions at the edge of the network. To avoid hardship in these regions the market has for a number of years not passed through the full costs of serving these regions.

There are currently a number of EDB regions where Contact has a negative gross margin. These regions account for roughly half of the total loss recorded on our retail business. Some of these regions are among the most deprived in New Zealand, and therefore price increases have been capped by efforts to minimise price shocks and energy hardship.

The wider evidence base is insufficient to support greater intervention

We disagree with the wider 'evidence' base that the Task Force has presented. This is discussed further in attachment 1, in summary:

- The Task Force has mischaracterised the growth of smaller retailers. Apart from two companies (Nova and Electric Kiwi) collectively other smaller retailers are growing faster than the four largest retailers.
- The gap between LRMC and wholesale prices is exaggerated due to using a very low LRMC number
- The Task Force has found no evidence or logic to support a finding of foreclosure
- The evidence from the Risk Management Review has been materially over-stated
- The international and domestic comparisons largely relate to companies with materially larger market share than Contact's 20%, and materially larger market power. These examples demonstrate why more substantive interventions are not justified on Contact Energy.

The proposed regime can be improved to deliver better outcomes for consumers

To ensure that the regime has the best long-term benefit for end consumers, we recommend that focus is put on three areas:

1. Ensuring that the regime does not undermine market fundamentals
2. Clarify that the regime is not seeking to regulate risk policies
3. Place a greater emphasis on minimising the pricing impact for end-consumers.

The regime must not undermine market fundamentals

We agree with the Task Force that internal transfer prices should be based on “market traded hedges adjusted for internal requirements”. It is critical that hedge prices retain a strong relationship with current and expected spot market prices and ASX futures. Anything that forces hedge prices below market set rates would:

- weaken the incentives to supply shaped hedges by encouraging generators to take greater merchant length, or sell more load via ASX. This would ultimately harm retail competition.
- distort incentives to invest and allocate resources efficiently. This is fundamental to the Electricity Authority’s statutory role.

Other parties contributing to this consultation may be seeking a material reduction in hedge prices below market set rates. The Task Force must resist these attempts to ensure that the fundamentals of the market are not undermined.

To help reduce the risk of a loss in confidence in the ability for the market to set prices, we recommend that the Authority explicitly states that it has no role in setting prices or arbitrating disputes related to pricing.

The regime should not seek to regulate risk policies

The Task Force correctly identifies “risk management” as one of the key benefits of vertical integration. This particularly relates to credit risk, which is central to Contact Energy’s business model, and crucial to financing the substantial generation investment needed to support the transition.

We note that some submissions to the Task Force do not appear to understand the importance of stable and predictable financial returns, emphasising that “the efficiencies that can be derived by the gentailers from vertical integration seem almost entirely financial or risk management based, rather than productive efficiencies”.[3] This misunderstands the relationship between prudential risk and access to low-cost capital to fund investment which in turn improves the efficiency of the market.

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[3] https://comcom.govt.nz/__data/assets/pdf_file/0020/363008/Attachment-to-Electric-Kiwi-submission-Letter-from-Matthews-Law-to-Electricity-Authority-7-August-2024.pdf

Australian research has shown a direct link between credit quality, the cost of capital, and investment. They found that “Lenders and equity investors evidently trade-off gearing, credit spreads and returns on invested capital” based on the credit quality of counterparties.[4]

This also applies to Contact Energy. S&P’s credit rating for Contact Energy specifically calls out vertical integration as one of the key strengths supporting a BBB rating. They note that “Contact's presence in both segments provides a natural hedge, resulting in less volatile earnings when compared with a pure generator or retailer”. We consider that the reference to vertical integration is a proxy for counterparty risk. Undermining this would lead to a higher cost of capital and harm our ability to continue to invest at pace.

This is not a theoretical risk. Last year Prime Energy defaulted on payments to Manawa, contributing to a $35 million earnings forecast downgrade.[5] This sort of volatility has a material impact on investor confidence and access to low-cost capital.

This risk was also highlighted in Ofgem’s ‘Secure and Promote’ regulations, which the proposed non-discrimination regime borrows heavily from. Submitters during that consultation highlighted:

- GDF SUEZ: “We see a significant risk that the subjective nature of assessing credit risk leads to a raft of claims from small suppliers of unfair credit terms being offered by Obligated Parties with no real prospect of being able to determine what 'fair' really looks like”[6]
- SSE: “Effective credit risk management is a key commercial activity –it is imperative that the setting of appropriate credit and collateral arrangements remain the prerogative of the obligated party”[7]
- Centrica: “financial institutions are better placed than energy companies to bear credit risk (due to a larger size, a higher level of diversification, and a better ability to manage this risk through derivatives)”[8]
- EDF Energy: “credit is still the major issue for market participants as it is intrinsically linked to trading activity. The lack of credit is therefore a key driver for the current levels of liquidity”[9]

In response, Ofgem stated in its final decision paper that: ”It is not our intention to regulate proposed S&P licensees’ risk policies”. It is crucial that the Task Force makes a similar acknowledgement so that it is clear that the regime is intended to improve transparency, rather than direct government intervention in credit policies.

We also note that a clear recognition that the regime is not intended to regulate risk policies is consistent with the escalation path. Step three in the path is to trade all contracts through

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4 https://www.researchgate.net/publication/358161274_Renewable_entry_costs_project_finance_and_the_role_of_revenue_quality_in_Australia's_National_Electricity_Market
5 https://www.nzherald.co.nz/business/markets/commodities/prime-energy-named-as-electricity-retailer-who-defaulted-on-payment-to-manawa/ODK2HRFAZBERDHYU4Y2RPIZPRI/
6 gdf_suez_response.pdf
7 Microsoft Word - 2013-02-15 SSE_Secure and Promote_cover letter.doc
8 centrica_response_163-12_0.pdf
9 https://www.ofgem.gov.uk/sites/default/files/docs/2013/03/edf_energy_response_163-12_0.pdf

a regulated market, which would inevitably require substantial credit requirements to protect the platform and brokers, in a similar way as currently required on the ASX.

The impact on consumers should be minimised

We are concerned that the proposed drafting of the regime may lead to material price increases for consumers. This risk was recognised by the Task Force in the options paper:

> *Any Level Playing Field measure runs some risk of a short-term increase in retail prices, to the extent that Gentailers may not be currently passing through the full extent of wholesale price increases over recent years. That is the trade-off for longer term competition benefits.*[10]

We consider greater weight should be given to the impact on consumers in the design of this policy. It is not clear to us that there is a material countervailing benefit to consumers to offset the risk of price increases in the short term.

Contact Energy does not have market power, so it is a price-taker in both the wholesale and retail markets. We, therefore, do not have any certainty over how the market would react to these new rules. However, we are concerned that the market may react in a way that is not in consumers interests.

For example, the proposed clause 17 requires that all of Contact's business units are commercially viable on a stand-alone basis. We consider the correct interpretation of this clause is similar to the test we currently carry out to assess if an impairment is necessary, and therefore would not have been breached to date. However, it is possible that the market interprets this as a requirement to not show any operating loss in any year, except under exceptional circumstances.

A more sophisticated ITP may make Contact's retail segment appear more profitable, however, this can only go so far while maintaining a relationship to market fundamentals (as required under the proposed clause 15a). It is possible that an updated ITP will be insufficient to quickly overcome the gap between retail and wholesale prices. This may lead the market to make a sudden correction, resulting in consumer price shocks and hardship. We note that this is most likely to occur in regions with the lowest margins, which as covered above are some of the most economically vulnerable parts of New Zealand.

This risk is further compounded by not allowing Contact to take account of scale when setting its ITPs. This means that even a more sophisticated ITP will be artificially high, making consumers worse off.

We note that the license condition in the UK that this regime is based off explicitly highlights scale as one of the cost-based factors that can be taken into account. Similar rules in the USA, also do not prohibit scale as a cost-based factor.[11] The consultation paper has no justification for this very significant design choice, and it is not clear to us that it is in the long-term interests of consumers.

To mitigate the risks to consumers we recommend that the Task Force:

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[10] Para 5.12
[11] https://www.law.cornell.edu/uscode/text/16/824d,

- remove the proposed clause 13 that restricts gentailers from taking account of volume, this unfairly denies consumers the benefits of scale, and may lead to inefficient market structures.
- removes the proposed clause 17 requiring all internal business units to be commercially viable on a standalone basis. There is already sufficient incentive to avoid this outcome to avoid recording an impairment. The requirement in the Code may lead to a market over-reaction to the detriment of consumers.
- work with MSD and other support agencies to support consumers that may face price shocks and hardship as a result of this regime.

Risks of the escalation path

We consider that there are material risks of unintended consequences of the escalation path that are not justified by the evidence before the Task Force. We recognise that these escalations have been put in place to give an incentive to robustly implement the principles based non-discrimination regime. However, the substantial risks of these options are causing undue policy uncertainty, and may themselves be undermining investment cases.

Prescribed non-discrimination requirements risk dampening competition

Prescriptive rules governing the interactions between Contact and certain buyers of hedge products would likely dampen competition. Much of the Task Force's analysis appears to assume that Contact, Meridian, Mercury and Genesis act as one collective unit. This is incorrect. Each of the four major competitors have different portfolios, and strategies. This provides competition in the market to the benefit of consumers.

Prescriptive rules risk creating a self-fulfilling prophecy. The act of making the four major competitors trade in the same way, with the same underlying rules would likely in itself create a level of coordination, and stifle the emergence of innovative contracting practices.

For example, under a prescribed model the hedges made available may converge on those set by the regulator for the ITP, rather than products developed as part of a competitive negotiation that would better suit the needs of the contracting parties. There may be little to no competition over these standardised hedges as the derived price for them would be set by rules overseen by the regulator, and there would be no reason for any supplier to deviate from that. In effect it could create the conditions akin to market power to a much greater extent than present in the market today.

A regulator prescribing matters such as risk policies could also harm access to capital and investment incentives. Part of the original rationale for separating Contact, Meridian, Mercury and Genesis from Government was that private companies are better placed to manage such risks than government. It should require a significant evidence base to overturn that consensus.

Mandatory trading may lead to uncertain outcomes

There is a very high degree of uncertainty over the outcome of mandatory trading. Significant further research, and possibly smaller scale trials would be required to ensure that there are no unintended consequences. Such an exercise would only be justified in the face of overwhelming evidence, which is not currently the case.

For example, we are concerned about the impact that the capital requirements of such a regime would have on the market. Any exchange traded scheme would require substantial capital requirements, such as margin calls, to minimise risk for the platform and brokers. This would tie up millions of dollars that could otherwise be deployed into generation investments, and may also harm the ability for smaller retailers to compete in the market.

Other options considered are not proportionate to the evidence

As covered above the Task Force has a thin evidence base to justify interventions. While a relatively low-cost intervention like a principles-based non-discrimination regime is a proportionate response, some of the other options are major interventions that risk a major misallocation of resource if not well justified by the evidence. In particular, we do not consider that options 3 (negotiate arbitrate regulation) or option 4 (corporate separation) are proportionate to the evidence available.

Negotiate arbitrate regulation

Negotiate arbitrate regulation is already a legislative regulatory option available under Part 4 of the Commerce Act 1986. To activate this form of regulation the Task Force would need to trigger an inquiry to assess if the sector met the criteria under s52G as set out below:

52G When goods or services may be regulated

(1) Goods or services may be regulated under this Part only if—

- (a) the goods or services are supplied in a market where there is both—
  - (i) little or no competition; and
  - (ii) little or no likelihood of a substantial increase in competition; and
- (b) there is scope for the exercise of substantial market power in relation to the goods or services, taking into account the effectiveness of existing regulation or arrangements (including ownership arrangements); and
- (c) the benefits of regulating the goods or services in meeting the purpose of this Part materially exceed the costs of regulation.

(2) In any consideration of this test, the part of the test in subsection (1)(c) need not be considered unless the parts of the test in subsection (1)(a) and (b) are satisfied.

The inquiry findings must then be presented to the Minister for consideration under s52L, and if a sector is deemed to meet this test then the Minister can recommend under s52M to impose regulations, including negotiate arbitrate regulation.

We consider it important for the Task Force to not override clear legislative processes. Parliament clearly considered specific tests that are necessary before negotiate arbitrate regulation would be a justified intervention. We do not consider that the Task Force has the mandate to circumvent this. We also consider it unlikely that the electricity sector with four major competitors, and a long tail of generation and retail competitors would meet the test under s52G.

Corporate Separation

Corporate separation is a major intervention that would occupy significant resource across the industry at a time when we should be focusing on investment, and addressing the capacity scarcity the industry is facing.

For the Task Force to be confident that such a major intervention is justified it must be confident that the benefits outweigh the costs. In this case we do not consider that corporate separation would address the theoretical problems identified by the Task Force. If Contact's retail arm were a stand-alone business it would continue to be a good counterparty, and likely be a first-choice partner for stand-alone generators. There is nothing about this structure that suggests more hedging would be made available to independent retailers.

As covered in attachment 1, the overwhelming evidence is that corporate separation results in higher prices for consumers, and reduced investment. We are unsure what countervailing benefit would outweigh these significant costs.

Ngā Mihi

[redacted]

Brett Woods

Head of Regulatory and Government Relations

Contact Energy.

Attachment 1: Response to evidence presented by the Task Force

In this attachment we respond to the evidence presented by the Task Force in support of the proposed interventions. We find that there is a very weak evidence base. However, we recognise the theoretical concern and consider that a principles-based non-discrimination regime is proportionate to address this.

Growth of independent retailers

At paragraph 3.13 the Task Force states:

> *The Gentailers have sustained high retail market shares, while growth of competing retailers has been stagnant*

This is misleading. This statement relies on treating all smaller retailers together as one, however, when looking closer it can be seen that some smaller retailers are flourishing, while others are reducing market share. For example, since the start of 2022 2degrees has grown by more than 30%, and Flick by more than 70%.

In fact, a substantial part of the 'stagnation' identified by the Task Force is related to a decline in customer numbers for two companies: NOVA – who is an integrated gentailer with access to a similar amount of flexible thermal generation as Contact Energy (following TCC's retirement), and Electric Kiwi, whose reduction in customer numbers may be related to the strategy of its related trading arm (Haast Trading). Apart from these two retailers the other smaller retailers have grown by 16% since 2021, a materially faster rate than gentailers combined 6%.

Gap between LRMC and wholesale prices

At paragraph 3.41 the Task Force points to a gap between LRMC and wholesale contract prices. We consider that the LRMC figure quoted by the Task Force is materially below the cost of new build. Contact Energy has indicated a long-term baseload market price of around $120 at Otahuhu in 2024 dollars.[12] This price will be higher if market or retail shape is taken into account.

A more realistic value of LRMC is still less than average baseload prices since 2021, however, the wider challenges of the market must also be acknowledged, including demand uncertainty due to Tiwai, policy uncertainty, and the sudden decline in the gas market. While a number of these issues are now resolved (or realised), the market will take time to adjust to the new realities.

Relationship between ITP and retail prices

At paragraph 3.45 the Task Force notes that there is a disconnect between retail pricing and gentailer ITPs. While we recognise that this has occurred we also note:

- Contact Energy does and will continue to use its ITP as a critical input into informing our retail pricing. We noted in the last consultation that "the ITP is not on its own

[12] https://businessdesk.co.nz/article/markets/contact-energy-thinks-it-knows-where-power-prices-are-going#:~:text=The%20price%20of%20wholesale%20electricity%20is%20likely,as%20generators%20absorb%20the%20increasing%20cost%20of

determinative of retail prices". This appears to have been mis-interpreted by the Task Force who concluded that "there was consensus from all parties who provided feedback that the current ITPs are not a useful measure for any assessment that is seeking to better understand competition in the retail electricity market". We disagree with this conclusion. Our ITP is an important input into retail pricing, but we must also take account of other input costs, and the market price, given we are a price taker.

- As covered above, there are reasons why the retail market has not kept up with the wholesale market, including regulatory attention, and mis-forecasting the permanence of the wholesale price changes.
- We strongly disagree with the assertion that our retail arm is not exposed to hedge cover risk. Our retail arm has to operate within strict volume budgets, reflective of our wholesale capacity. That is why our retail arm has focussed on growth without increasing the volume of electricity consumed, by branching out into innovative time of use plans, and multi-product bundling.

Foreclosure

At paragraph 3.51(a) the Task Force states:

> *Gentailers have the opportunity and incentive to restrict generation and retail competition because of their control of the flexible generation base, and therefore of the firming/hedging input their competitors need (at least in the short to medium term).*

And further at paragraph 4.16 that gentailers "have incentives to favour their own internal business units (primarily their own retail arms) over other parties"

We disagree with these assertions. The Task Force has not established either the ability nor incentive to engage in foreclosure.

The ability to foreclosure only occurs when there is market power. Without market power, attempts to engage in foreclosure would result in buyers switching to other providers, or alternative technologies. As we have shown in previous submissions, there is substantial evidence against market power:

- The Task Force appears at times to refer to the gentailers together as one entity, and does not appropriately recognise that there are four major gentailers competing on a nationwide basis. This level of competition is the envy of many other capital intensive sectors in New Zealand.[13]
- The Task Force itself has not found evidence of coordination, and therefore market power must be assessed at an individual company level.
- Contact Energy has roughly 20% market share of total generation, and only 10-14% of the flexible generation capacity.[14] We do not consider it reasonable to assume that these modest market shares are reflective of market power.
- There is substantial investment across the sector, including investments that would increase capacity during super peak periods. Investment of this nature would not be occurring if there were market power.

[13] https://comcom.govt.nz/__data/assets/pdf_file/0035/273779/Coriolis-Ltd-Post-conference-submission-on-Market-study-into-grocery-sector-18-November-2021.pdf
[14] https://comcom.govt.nz/__data/assets/pdf_file/0037/364789/Contact-Energy-Submission-on-Contact-and-Manawa-Statement-of-Issues-9-March-2025.pdf

- The Task Force's own analysis shows that there are substitutes capable of constraining prices. Since the Task Force came to this view more and more investments have been announced, particularly for grid scale batteries.

The incentive to engage in foreclosure has also not been established. For example:

- As shown in our previous submission, engaging in foreclosure requires a generator increasing exposure to the spot market, this is inconsistent with our incentives.
- There is no financial incentive to engage in foreclosure. The Commerce Commission recently found that foreclosing the supply of shaped hedges would cost Contact Energy three to five times more than any benefit.[15]
- Previously the Commission has also noted that the incentive to engage in foreclosure: "appears to rely on the gentailers being able to raise prices post-exit without either attracting new entry in the retail market, and without being undercut by the other gentailers. Consequently, this theory is likely to rely on a reasonable degree of coordination between gentailers, most likely in the form of parallel accommodating conduct during the recoupment phase."[16] We reiterate that no evidence of coordination has been found.

Evidence from the Risk Management Review

At paragraph 3.51(b) the Task Force states:

> *The evidence, particularly from the Risk Management Review, raises genuine concerns that this risk may be playing out — withholding of supply, overpricing, favouring supply to internal channels over external competitors.*

We disagree with this assertion. The risk management review found that there is a premium on the pricing of super-peak contracts. We agree with the Task Force that there is a strong rationale for why there should be a premium. But we do not agree that the difficulty of quantifying this premium should be interpreted as a problem with the market.

As noted above, Contact Energy clearly does not have market power, and is therefore a price taker in the market. Because we do not set prices we are no better placed than the Task Force to determine the exact quantification of the super peak premium. Further we note that since the introduction of the standardised super peak product, the pricing of super peaks appears to be increasing, possibly settling on a price that would justify new generation investment. As we suggested in our previous submission, this may be a better metric of a well-functioning market.

The examples given are not a good comparison to Contact Energy

We disagree that the set of international and domestic examples highlighted by the Task Force demonstrate that "Non-discrimination obligations are common in sectors characterised by large vertically integrated incumbent firms".[17] These examples are not comparable to Contact Energy, or the wider New Zealand electricity market. Most of the examples highlighted by the Task Force relate to monopolies or near monopolies, compared to

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[15] Ibid.
[16] Commerce Commission, *Memorandum: s36 complaint – preliminary assessment*, 10 July 2023, released under Official Information Act request.
[17] Para 4.19.

Contact Energy's 20% market share of generation assets, and roughly 14% of flexible generation assets. The Task Force has directly compared Contact Energy to:

- A requirement to offer contracts on the government owned Hydro Tasmania with around 75% market share[18]
- The reforms in California that led to the Enron scandal.
- A behavioural undertaking on EDF France for a merger that brought them up to around 95% market share.
- Conditions placed on Endesa and Iberdrola in Spain to auction VPP rights. This applied to less than 6% of Endesa's generation, and less than 5% for Iberdrola.[19] These obligations were revoked by the EU in 2011.[20]
- A behavioural undertaking that Nuon agreed to as part of a merger in the Netherlands
- The Farm Gate Milk Price disclosure regime on Fonterra, who has around 79% market share
- The price-quality regulation of local fibre broadband monopolies
- The break-up of the government owned ECNZ monopoly.

We do not consider any of these to be reasonable comparators. They all relate to sectors with substantially higher market concentration, or related to merger conditions. This highlights that the sort of regulations considered by the Task Force are extremely rare for a company of Contact Energy's size and market influence.

The one example that may hold some relevance is Texas. Texas has imposed very extensive restrictions on company size, and vertical integration. However, subsequent analysis has shown that this has resulted in consumers in Texas being considerably worse off than consumers in markets where vertical integration was not restricted.[21]

We also note that Texas faces a major investment challenge, and suffered severe outages in during a cold snap in 2021, resulting in the death of at least 246 people.[22] It therefore does not appear to be a good guide for how to overcome the capacity scarcity underlying the concerns raised by independent retailers and the Task Force.

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[18] https://www.hydro.com.au/docs/default-source/about-us/our-governance/annual-reports/hydro-tasmania-annual-report-2024.pdf?sfvrsn=6ad6929_1
[19] Competition and Regulation in the Spanish Gas and Electricity Markets
[20] https://www.economist.com/business/2008/06/26/price-shock
[21] https://www.wsj.com/business/energy-oil/texas-electric-bills-were-28-billion-higher-under-deregulation-11614162780
[22] https://www.texasstandard.org/stories/texas-freeze-winter-storm-2021-death-count/

Attachment 2: Response to Consultation Questions

<table>
<tr><th>Question</th><th>Contact Energy Response</th></tr>
<tr><td colspan="2">Problem definition — competition concerns from Gentailer vertical integration</td></tr>
<tr><td>Q1. What are the benefits of vertical integration between generation and retail? Do you have any evidence to better specify and quantify these benefits? In particular, we are interested in benefits that would be realised by New Zealand’s electricity consumers.</td><td>We agree with the benefits identified.

We would like to emphasise the importance of risk management. Having access to a low-risk route to market is key to accessing low-cost capital to support our investment pipeline. In the last four years Contact has invested more than $2.3b in new generation, even a small increase in the cost of capital may have added millions to the cost of these projects, and made the business cases just that much harder to get across the line.

There are also two further benefits not considered by the Task Force:

• As shown by international and domestic studies vertical integration leads to lower prices at both the wholesale and retail level. Some of these studies are highlighted below.

• Vertical integration also mitigates generation risks. Contact Energy can instruct its retail arm to change volumes in response to market or physical risks. For example, if we were to suffer a major outage at one of our generation plants that took it out of use for a sustained period, we may instruct our retail arm to reduce volumes to reduce the impact of this risk. This provides a material risk mitigation benefit that may be difficult to contract for.

There is abundant evidence to support these benefits, for example:

• James Bushnell et.al. who found that regulatory intervention to prevent vertical integration increases prices by around 45%[23]

• Frontier Economics who found that “vertically integrated generators in fact behave more competitively on average than when they were operating as stand-alone generators.”[24]</td></tr>
</table>

[23] https://bushnell.ucdavis.edu/uploads/7/6/9/5/76951361/vertical-arrangements.pdf
[24] https://www.accc.gov.au/system/files/AGL%20%28Frontier%20report%29.pdf

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	• CEG found that vertical integration is the most efficient/least cost form of economic organisation. [25] • NERA who found that "vertical integration may strengthen competition. Competing firms adopt vertical integration to gain an advantage over their rivals; standalone firms stay in business by finding some other source of efficiency, such as a lower cost way of providing customer service. Overall, therefore, vertical integration tends to drive down costs and prices to consumers."[26] • Professor Paul Simshauser, who highlights that the "weight of theoretical and empirical evidence" points to vertical integration reducing transaction costs, volatility of earnings, and a material improvement in credit quality.[27] • Brown and Sappington, who found that vertical integration in the electricity sector "often reduces retail prices and increases industry capacity investment, consumer surplus, and total welfare"[28] • Dr Richard Mead who found that vertical integration leads to less volatile spot prices, and lower costs for consumers.[29]
Q2. Do you agree with our description of the competition concerns that can arise from the combination of Gentailer vertical integration and market power? Why/why not? Do	We consider these concerns are highly theoretical and materially outweighed by the benefits to end consumers. We are unaware of any robust evidence to support the assertions made by the Task Force.

[25] https://www.accc.gov.au/system/files/Origin%20Energy%20%28Attachment%29.pdf

[26] https://www.accc.gov.au/system/files/AGL%20%28supplementary%20submission%29_0.pdf?ref=0&download=y

[27] https://www.researchgate.net/publication/341327402_Merchant_utilities_and_boundaries_of_the_firm_vertical_integration_in_energy-only_markets

[28] https://bear.warrington.ufl.edu/centers/purc/docs/papers/2201_Sappington_vertical_integration_capacity_investment.pdf#:~:text=We%20%C3%96nd%20that%20vertical%20integration,Unilateral%20vertical%20integration%20often%20is

[29] https://www.cognitus.co.nz/_files/ugd/022795_d6c22b27cf87427cb50f890774f21da3.pdf

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you have any evidence to better specify and quantify the competition risks of vertical integration?	
Q3. To what extent does vertical integration of smaller gentailers, such as Nova and Pulse, raise competition concerns? Should these smaller gentailers be subject to any proposed Level Playing Field measures?	Nova has a similar amount of access to thermal peaking as Contact Energy (following the retirement of TCC). It would be inconsistent to exclude them. Pioneer has a diverse portfolio of hydro assets. To the extent that there are concerns about access to generation capacity, we consider they should also be included. The Task Force should also consider including in the regime vertically integrated trading houses and retail arms, such as Haast and Electric Kiwi. A vertically integrated trading arm provides many of the same benefits as a generation portfolio. Further if trading arms are excluded it may be difficult to unpick gentailers portfolio separating out the volumes related to trading activities, and volumes directly related to generation plant. As noted by Castalia during a similar review in Australia, vertically integrated firms typically are not well matched between their generation and retail portfolios, so a substantial part of the shape of a gentailers book is due to trading, in much the same way as dedicated trading houses.[30]
Q4. Are there other specific areas (other than access to hedges) where Gentailer market power and vertical integration are causing competition concerns?	We reiterate that no proof has been provided to establish market power. This question is unfairly biased.
Q5. Do you agree with our preliminary view that the evidence indicates	We recognise the theoretical concerns, and agree that a principles based regime will help improve transparency, and may encourage greater trading if there are pockets where discriminatory practices are occurring.

[30] https://castalia-advisors.com/review-of-vertical-integration-between-generation-and-retail-in-the-electricity-market-australia/

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there may be good reasons to introduce a proportionate Level Playing Field measure to address the competition risks in relation to hedging/firming? Why/why not?	
Level Playing Field options we have identified	
Q6. Have we focused on the right Level Playing Field options? Are there other options that we should add or remove to the list in paragraph 4.1?	We consider options 3 (negotiate arbitrate) and option 4 (corporate separation) are disproportionate to the evidence. We discuss this further above. Raising these options may only be serving to reduce confidence in the market.
Q7. Are there any other important factors we should consider when identifying options (see paragraphs 4.2 to 4.5)?	As covered above, the Task Force should take account of existing legislative tests for interventions considered, such as Part 4 of the Commerce Act.
Q8. Are there other key features, pros or cons we should consider in our description of the four Level Playing Field options?	
Our assessment of Level Playing Field options	
Q9. Have we identified the right criteria for assessing Level Playing Field options (Figure 6)? Is there anything we	The criteria should also consider the financial impact on end-consumers. As noted above, there is a risk of a market over-reaction to these rules that may lead to a sudden price correction. This risk was recognised by the Task Force, but we recommend it is included as a specific criteria when assessing options.

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should add or remove?	
Q10. Do you agree with our application of the assessment criteria (Table 5)? Are changes needed to the colour coding or reasoning?	***Impact of credit risk in investment*** We consider that the risks to generation investment have been underplayed. Unless it is more explicitly acknowledged that the Task Force is not seeking to regulate credit risk policies, this regime may result in a material change in our credit rating, and therefore our ability to finance new projects. ***Impact on incentives to invest in new generation*** We consider that this regime risks disincentivising investment in new flexible generation, or demand response. This should be considered as 'negative' across options 2, 3 and 4. The paper states that: "Gentailer retail arms expected to face stronger incentives to invest in flexibility, due to reduced ability to hedge internally". However, the volume of flexible assets in the market is a function of expected returns on these assets, not to maintain retail market share for its own sake. If the Task Force's view were correct there would already be material investment in flexible generation by independent retailers who claim they currently cannot get enough of these products from the market. We note that no evidence, or even theoretical barriers have been identified to investment in new flexible generation, except for factors that apply equally to new entrants and incumbents. Rather than support these investment decisions, there is a material risk that this regime provides a basis for regulatory or political interference on the ultimate pricing of flexibility services. In numerous places the Task Force has indicated it will be the judge on whether prices are 'fair' rather than left to market forces. Investors are likely to see this as a risk of counterparties being able to successfully lobby government to reduce prices, and undermine a fair return on their capital. An explicit recognition from the Authority that it will not, and can not interfere in market pricing would help mitigate this risk and make this criteria neutral for all options. ***Implementation costs*** We consider that the costs and timing of the proposed regime have been materially underplayed. Determining an accurate set of internal hedge products, robust cost allocation, and cost based reasons will take time and careful consideration. The

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	regime also implies an auditing regime may need to be established. We expect that this will be time consuming and expensive to establish and maintain.
Q11. Are there any other material benefits or risks that should be considered (but are currently not) in our assessment of options?	As above, we consider a criteria should be added regarding the impact on ultimate pricing for consumers. This should be rated as 'negative' for options 2, 3 and 4 due to the risk of a market over-reaction to show profitability of retail segments in most years. We also recommend assessing the potential risks on wholesale market prices due to these proposals. As noted above much of the literature on vertical integration suggests a substantial downward effect on wholesale prices. The Task Force should consider if the proposed changes would change this outcome.
Q12. Do you agree with our selection of non-discrimination obligations as our preferred Level Playing Field measure? Why/why not?	We agree that a principles-based non-discrimination regime is proportionate to the evidence before the Task Force. Other options considered are a material over-reach for a competitive industry.
Roadmap for implementing non-discrimination obligations	
Q13. What are your views on our proposed roadmap for the implementation of non-discrimination obligations?	We do not support the escalation path, as there are material risks of unintended consequences as covered above.
Q14. Which products should any non - discrimination obligations apply to? Should all hedge contracts be captured, or should the rules be focused on super -peak hedges only? Are there are other interactions between	We do not consider that obligations should apply to baseload hedges. These are highly liquid on the ASX, and are subject to market making obligations. We do not consider it reasonable to assert that there is any ability to foreclose on these products, or for gentailers to individually set prices. Applying non-discrimination obligations to baseload products may encourage other parties to seek political or regulatory influence to circumvent the necessary credit conditions of the ASX. This would lead to providers of baseload services taking on a greater level of risk, which as covered above, would materially impact on our ability to invest to meet future demand.

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Gentailers and their competitors which would benefit from non -discrimination rules?	
Q15. Do you have any feedback on the indicative draft non -discrimination principles (and guidance) set out in Appendix B? Without limiting your feedback, we would be particularly interested in your views on the following questions: a. Have we got the level of detail/prescription right? For example, do you consider that the principles and guidance will lead to economically meaningful Gentailer ITPs being put in place? What would be the costs and benefits of instead applying a more prescriptive ITP methodology? b. How far should the allowance in the principles for different treatment where there is a "cost -based, objectively justifiable reason" extend? Do you agree with the guidance that this	We expect to be able to provide further feedback on this as we step through the implementation steps. However, at this stage we have identified the following matters for the Task Force to consider: • There is insufficient recognition that the choice of credit policy should remain at each company's discretion. Without more explicit recognition of this, the regime may materially harm our ability to access low-cost capital to support our investment pipeline. • Clause 13 should be removed. There is no rationale given for not allowing consideration of volume, and this would deny consumers the benefit of scale efficiency. • Clause 17 should be removed. There is already sufficient incentive to ensure business segments are profitable to avoid an impairment. Clause 17 creates a material risk of a market over-reaction to the detriment of end consumers. • We note the desire to have as much information as possible publicly disclosed. However, we operate in a competitive market, and therefore substantial parts of this information will be commercially sensitive. For example there is substantial risk of gaming if we disclose the method we use to allocate scarce resources.

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allowance should not be extended to volume (at paragraph 13 of Appendix B)?	
Q16. Do you agree that escalation options are needed if principles - based non -discrimination obligations are implemented initially? Why/why not?	No, we consider that the escalations would materially harm the competitive outcomes of the market for consumers. The escalations risk treating a competitive industry in a similar way to an industry with substantial market power. In doing so it may mute the level of competition by specifying how each competitor must price, and set its products. In other words a more prescriptive regime may become a self-fulfilling prophecy, creating an outcome akin to coordination that currently does not exist.
Q17. Are prescribed non - discrimination requirements and mandatory trading of Gentailer hedges via a common platform suitable escalations given the liquidity, competitive pricing and even - handedness outcomes we are seeking? Why/why not? What alternatives would you suggest (if any)?	No, as above, we consider that these escalations would materially harm competition, and outcomes for end consumers. Another option to consider to improve liquidity of the market is an increased set of standardised products. The recently established standardised super-peak product has been very successful in providing more options to parties seeking peak capacity cover, and improving price discovery. Continuing this to other products may be a better way of addressing the concerns of the Task Force.
Q18. What costs and benefits are likely to be involved in setting more prescriptive regulatory accounting rules which detail how ITPs should be calculated? What would be appropriate triggers for introducing more prescriptive	We consider that there is material risk of harming competitive tension between Contact Energy, Meridian, Mercury and Genesis, resulting in a worse competitive outcome for consumers.

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requirements for ITPs?	
Q19. Do you have any views on how the non-discrimination requirements should best be implemented to ensure that Gentailers are no longer able to allocate uncontracted hedge volumes to their own retail function in preference to third parties? What are the key issues and trade-offs?	Contact Energy does not preference our own retail arm ahead of other buyers. We prioritise good quality counterparties to support our business model, and investment pipeline. If well implemented this regime will help improve transparency. However, as there is no strong evidence of an existing problem, care should be given that the proposed regime does not create issues itself, such as distorting market price signals, harming credit policies and access to capital, or driving significant increases in retail prices for consumers.
Q20. Do you have any views on the triggers for implementing the stronger regulation proposed in our roadmap?	We do not consider that the escalations should be further considered given the material risks of unintended consequences.
Our current thinking on virtual disaggregation	
Q21. Does our proposed approach to implementing non-discrimination obligations (as set out in the roadmap in Figure 7) sufficiently address the underlying issue that originally led to MDAG recommending virtual disaggregation?	We believe that the paper materially mis-represents what MDAG intended with virtual disaggregation. It describes the problem differently to MDAG, who were focussed on the potentially for an increase in the volatility of volatility, and what that does to new entrant generators. The paper also indicates this solution will be implemented well ahead of finding market power, which was a key feature of MDAGs report.
Q22. Do you have any views on whether virtual disaggregation	The concept of virtual disaggregation was intended to solve a different problem than the theoretical concern raised by the Task Force in this paper.

Question	Contact Energy Response
provides a useful response to the competition risks we have identified (relative to the proposed roadmap) and, if it does, how it should be best applied?	