Meridian submission

“Level Playing Field measures: Options Paper” proposing virtual disaggregation and non-discrimination obligations for Meridian, Genesis, Contact and Mercury

7 May 2025

This submission by Meridian Energy Limited (**Meridian**) responds to the Electricity Authority's (**Authority's**) "Level Playing Field measures: Options Paper" (**Options Paper**) proposing virtual disaggregation and non-discrimination obligations for Meridian, Genesis, Contact and Mercury.

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Executive Summary

This submission addresses the Electricity Authority's "Level Playing Field measures: Options Paper" which proposes the virtual disaggregation of and non-discrimination obligations for Meridian, Genesis, Contact, and Mercury.

Meridian supports an efficient, competitive and reliable electricity market. Competition in both the retail and wholesale markets helps drive efficient prices, high standards of customer service and the development of innovative products. We therefore support the Authority's goal of promoting greater competition in retail and wholesale markets to deliver long-term benefits to consumers. We will do our best to assist the Authority in the development and implementation of any proposed reforms to ensure they maximise benefits to consumers.

However, we believe the Authority needs to proceed with caution with respect to the proposed Level Playing Field measures. Meridian and our expert advisors – Carl Hansen (Capital Strategic Advisors) and NERA – have identified several potential risks with the Authority's proposal, including:

- higher electricity prices for households and businesses;
- net welfare losses for consumers; and
- dampened incentives to invest in new generation and flexibility.

If the Authority continues with its current proposal, we suggest several design details which we believe will need to be adopted to ensure these risks are minimised. These include:

- allowing generator-retailers to assume the notional internal hedge books they put in place have been built up over time;
- assessing the viability of a generator-retailer's internal business units over a commercially realistic timeframe; and
- providing for the non-discrimination obligations to apply only to actual physical participants in the New Zealand electricity market (as opposed to offshore speculators, traders or others).

We also believe, in deciding whether to progress this proposal, the Authority needs to consider the merits of vertical integration and how these have served – and continue to serve – the interests of New Zealand consumers. We have sought to highlight these merits in our submission.

Lastly, we would like to stress the importance of the Authority (as well as other regulators and policymakers) recognising and responding to the demise of New Zealand's gas sector in recent years. This has been the key driver of recent market constraints, including the events of Winter 2024, which set New Zealand on the current path of regulatory change. Preserving incentives for investment in new generation and flexible resources will also be critical to bring down wholesale prices and maintain security of supply through New Zealand's electricity sector transition.

Meridian appreciates the opportunity to comment on the Authority's proposal at this stage and we remain committed to working with the Authority to develop and implement changes that will benefit all electricity consumers.

1 Introduction

1.1 Meridian supports a competitive, dynamic and innovative electricity market

As indicated in our initial feedback to the Authority on its level playing field workstream, Meridian supports a retail market with a multitude of diverse parties competing intensely to win and retain consumers.[1] Such a market is most likely to drive efficient prices, high standards of customer service, the development of innovative products and, ultimately, value to consumers. As a major retailer, Meridian's experience is that the New Zealand electricity retail market is highly competitive and is delivering on these outcomes for kiwi households and businesses.

We also support a competitive wholesale market. We strongly agree with the Government Policy Statement on Electricity (**GPS**) that New Zealand's electricity system is best served by:

> *"…an efficient wholesale electricity market with many different wholesale buyers and sellers of electricity, managing their own risks, responding to competitive pressures and accurate price signals, continually looking for ways to serve their current and potential customers more effectively than their competitors".*[2]

In particular, a well-functioning wholesale market is critical for delivering investment. New Zealand needs 5 GW of additional renewable generation capacity each decade through to 2050 to deliver on our decarbonisation goals.[3] Meridian's own analysis indicates that the energy system also needs to add 200 MW of new flexible capacity each year for the next 25 years.[4] It is critical that both existing and new market participants have the confidence to invest to ensure that this additional capacity is delivered. Under current settings, both incumbents and new entrants are actively investigating, developing and commissioning new generation across the country. Care is needed not to dampen investment signals and create future security and affordability challenges, the costs of which would ultimately be borne by New Zealand consumers. We elaborate on our views on the functioning of both the retail and wholesale markets in Section 2.3.

1.2 The Authority's proposal must avoid adversely affecting investment or driving poor pricing outcomes for consumers

We understand the Authority is trying to achieve greater competition in wholesale and retail markets and, through this, deliver long-term benefits to consumers. We have commissioned analysis from two expert advisors: Carl Hansen (Capital Strategic Advisors or **CSA**) and NERA. Both have identified concerns with the Authority's proposal. In particular, they are concerned the proposal will:

(a) Drive increases in household electricity prices in the short term, generating a net welfare loss for consumers; and

(b) Dampen incentives to invest in new generation and/or flexibility.

[1] Meridian response to request for feedback on level playing field measures, November 2024, link
[2] Government Policy Statement on Electricity, October 2024, link
[3] The Future Is Electric report, BCG, October 2022, link
[4] Flexible capacity might include batteries, new thermal (local or imported gas), new large scale demand response, biofuels (i.e., Bio-Rankine), new hydro storage etc.

The expert reports are attached as **Appendix D** and **Appendix E** and are referenced throughout this submission.

Meridian shares the concerns of our expert advisors. We consider there to be a risk of higher and more volatile retail prices as a result of the proposal, and for critical investment to be discouraged. We detail these concerns in Section 4.

1.3 We will do our best to make any intervention work for consumers

We acknowledge this is an initial proposal from the Authority.[5] We are grateful for the Authority's willingness to engage with us and other stakeholders on the proposal during the consultation period and we welcome the opportunity to provide feedback at this stage.

In Meridian's opinion, if the Authority intends to develop this proposal further, several changes are necessary to improve its workability and mitigate the risk of unintended consequences and costs to consumers. Meridian's suggestions are set out in Section 4.8.

We also consider that there are a number of alternative interventions or approaches which could help address the Authority's underlying concerns while avoiding the risks outlined above. Both Carl Hansen and NERA have proposed such alternatives. These are discussed in Section 5. We think these alternatives warrant careful consideration to ensure the path the Authority ultimately pursues delivers on the outcomes the Authority is seeking. We would be happy to engage with the Authority further on the development of these alternatives.

Ultimately, Meridian wants to see a well-functioning, efficient and competitive electricity market that is delivering for New Zealand consumers. That is best for Meridian, best for the sector, and best for New Zealand. We will continue to work with the Authority as it develops its proposals and will continue to provide our frank assessment of the likely outcomes of any interventions proposed. Once any intervention is finalised, we will work to implement any changes in a way that delivers the best outcomes for consumers.

2 Explanatory context

Before addressing directly the Authority's proposal, this section sets out some explanatory context that we believe is directly relevant. It discusses the reasons for the prevalence of vertical integration in the New Zealand electricity sector and describes the competition and investment that has occurred within the current market construct. It goes on to discuss the Authority's problem diagnosis in the wake of Winter 2024 and considers the relevance, if any, of the Authority's underlying assumption of an unlevel playing field to what transpired over Winter 2024. Finally, it reflects on lessons that might be drawn from regulatory measures pursued in the United Kingdom in recent years which were similarly intended to promote competition in the electricity retail market.

2.1 Benefits of vertical integration in the New Zealand electricity sector

The advantages of adopting a vertically integrated structure to manage volatility in wholesale electricity markets have been well canvassed in New Zealand and around the world.

[5] We acknowledge in particular the Authority has indicated that the proposal has had less opportunity for input from industry given the Authority determined it was 'price sensitive' and has therefore largely developed the proposal in isolation.

Appendix B sets out conclusions from recent academic and regulatory considerations of this issue, including the Authority's own assessments. In short, there is a wealth of evidence – in New Zealand and globally – that vertical integration is an efficient business model that delivers significant consumer benefits while, in contrast, vertical separation would work to the detriment of consumers.

The benefits of vertical integration are also discussed extensively in our expert reports from Carl Hansen and NERA.[6]

2.2 Meridian's approach to portfolio management

Appendix C provides a description of how Meridian's approach to portfolio management has evolved and details some of the relevant considerations and trade-offs that we are continually required to make. In the context of the Authority's proposal, key points of note include:

(a) The balance Meridian has achieved as a vertically integrated business has not happened by accident: we have spent years efficiently managing and investing in our existing hydro and wind assets, creating new generation and new flexibility assets, securing a large pipeline of new generation and flexibility options, establishing and evolving a carefully considered hedge portfolio, and building up a large, diverse retail and customer base including a number of formalised demand-response agreements.

(b) The success or otherwise of our commercial decisions are only determined in the fullness of time, when market conditions reveal whether any particular decision was a good idea or not. That is the nature of the significant market and investment risk that Meridian and other participants face.

(c) Any party – including independent retailers or new entrant generators – could adopt a similar approach to Meridian to managing their wholesale market risk. Indeed, Lodestone Energy has recently taken such a step.[7] It just requires long-term commitment, investment, and the balancing of risk and reward to be at the centre of their decisions.

2.3 The current market structure has delivered significant investment and strong competition

New Zealand's wholesale market has gone through several supply and demand cycles since its inception in 1996. At various times, regulatory and market uncertainty have also impacted incentives to invest. Despite this, investment in the sector has been considerable. Over $10 billion has been invested in new generation in the last 15 years with much of this occurring during low or flat demand growth periods.

And this investment is continuing. As set out in Table 1 and Table 2 below, 3.1 TWh of new generation production has been delivered in the last 24 months (7.2% of current demand) and a further 2.2 TWh is under construction (5.1% of current demand).[8]

[6] Refer, for example, Sections 2 and 3 of Carl Hansen's report and Section 3 of NERA's report.
[7] https://lodestoneenergy.co.nz/lodestone-becomes-an-energy-retailer/
[8] We note this doesn't include recently announced Meridian projects, such as Ruakākā Solar Farm (see link) and Mt Munro Wind Farm (see link).

Table 1: Energy projects delivered over the previous 24 months

Project	Fuel	Developer	Commissioning Year	Annual Production (GWh)	% of 2023 Elec. Demand
Kaiwera Downs Stage 1	Wind	Mercury	2023	147	0.3%
Turitea	Wind	Mercury	2023	370	0.9%
Kohirā	Solar	Lodestone	2023	56	0.1%
Harapaki	Wind	Meridian	2024	542	1.2%
Tauhara	Geothermal	Contact Energy	2024	1450	3.3%
Rangitaiki	Solar	Lodestone	2024	54	0.1%
Te Herenga o Te Rā	Solar	Lodestone	2024	69	0.2%
Te Huka 3	Geothermal	Contact Energy	2025	430	1.0%
				3118	7.2%

Table 2: Energy projects under construction

Project	Fuel	Developer	Commissioning Year	Annual Production (GWh)	% of 2023 Elec. Demand
Lauriston	Solar	Genesis / FRV Aus.	2025	100	0.2%
Ngā Tamariki OEC5	Geothermal	Mercury	2025	395	0.9%
Topp2	Geothermal	Eastland Generation	2025	407	0.9%
Pāmu Rā ki Whitianga	Solar	Lodestone	2025	50	0.1%
Tauhei	Solar	Harmony Energy	2026	258	0.6%
Kaiwaikawe	Wind	Mercury	2026	221	0.5%
Kaiwera Downs Stage 2	Wind	Mercury	2026	525	1.2%
Kōwhai Park	Solar	Contact / Lightsource bp	2026	275	0.6%
				2231	5.1%

It is worth noting that around a third of generation under construction is being led by independent generators.[9] Carl Hansen similarly noted that the Authority's own investment pipeline shows that 51% of investments (measured in GW) committed for the period to December 2028 were driven by parties other than "NZ integrated", that is, other than generator-retailers.[10] For actively pursued projects, the generator-retailer share is only 23%.[11]

Figure 1: Committed, actively pursued and other generaton projects by developer type

Source: Electricity Authority

This evidence makes clear that not only is the electricity market delivering investment, but it is delivering investment by a diverse range of parties. The Authority seemed to previously acknowledge this in its May 2023 paper 'Promoting competition in the wholesale electricity market in the transition toward a renewables-based electricity system – Decision Paper' (**Decision Paper**) when it concluded:[12]

[9] Projects led by Eastland, Lodestone and Harmony total 715 GWh or 32% of total generation under construction.
[10] CSA, Section 2.1
[11] See https://public.tableau.com/app/profile/electricity.authority/viz/Investmentpipeline/Investmentpipeline
[12] Promoting competition in the wholesale electricity market in the transition toward a renewables-based electricity system – Decision Paper, Electricity Authority, May 2023, link

> *"The Authority considers that the current pipeline of investment (including a very significant portion from non-incumbents) is not consistent with anti-competitive behaviour holding back entry."*

It is unclear what has changed since 2023 such that the Authority now considers competition for investment in new generation to be a significant concern.

Meridian also considers the current settings have driven a highly competitive retail market. With around 40 retailers, New Zealand has almost double the number of electricity retailers per capita as Australia and over 20 times the electricity retailers per capita as the United Kingdom. Market concentration measures for New Zealand's electricity retail sector have declined consistently over the last 20 years.[13] The Ministry of Business, Innovation and Employment's (MBIE) electricity price data shows that household electricity costs have *declined* in real terms over the last ten years.[14] Taking an international perspective, New Zealand's domestic electricity prices rank seventh cheapest amongst IEA countries.[15] These are not indicators of a market with weak competitive forces.

Carl Hansen reaches a similar conclusion when considering the Authority's concerns about retail competition, noting that the real cost of the energy component of New Zealand household electricity prices has declined since 2020, "which does not support concerns that retail market competition is weak".[16]

Mr Hansen also observes that competition is delivering innovation in the retail market and that gentailers are often the drivers of that innovation:[17]

> *"It is a mistake to think that [Non-Integrated Retailers] are the primary drivers of innovation. Some will be, some of the time. But my understanding is that several gentailers have been revamping their retail divisions and introducing more technology to reach and retain customers during this period of allegedly stalled competition."*

2.4 The decline of the gas sector in New Zealand is central to the trends the Authority has observed, including wholesale prices in Winter 2024

Meridian notes that this proposal is the product of the 'Energy Competition Task Force' a collaboration between the Authority and the Commerce Commission involving both operating to some extent outside their traditional roles in an effort to increase competition in the energy sector. The Task Force was set up in September 2024 seemingly in response to the high prices observed in August 2024. While Meridian welcomes initiatives that increase competition, the events of August 2024 were not the result of any lack of competition in New Zealand's energy sector – they were the result of gas shortages. In our view, the more appropriate response to the events of Winter 2024 would have been to set up a Gas Sector Task Force.

We have observed an unfortunate regulatory pattern of overlooking problems in New Zealand's gas sector. In Meridian's view, the Authority, other regulators and officials have consistently not placed sufficient weight on the demise of the gas sector in New Zealand and more broadly have not placed sufficient weight on the importance of the gas sector in terms of its impact on the electricity market and on electricity prices.

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[13] https://www.emi.ea.govt.nz/Retail/Reports/R_HHI_C?_si=v|3
[14] Household sales-based electricity cost data, MBIE, December 2024, link
[15] https://www.gov.uk/government/statistical-data-sets/international-domestic-energy-prices
[16] CSA, Section 2.3
[17] CSA, Section 2.3

This has meant the Authority has not put in place measures that would ensure there was better disclosure of material information by the gas sector. In Meridian's view, this came to a head in August 2024 when the Authority, Meridian and the broader sector were caught by surprise by the lack of gas available for electricity generation.

Instead, the Authority has tried to explain the wholesale electricity price increases seen since the first Pohokura gas outages of 2018 in terms of supposed abuse or exercise of market power. While it is entirely right for a regulator to be alert to the possible presence of such issues, the Authority's persistence in looking for a 'market power' explanation despite the lack of evidence to support it and despite the more obvious explanations relating to gas issues, has meant, in our view, that the Authority has incorrectly diagnosed the problem.

For example, during the short period of high prices in August 2024, which it is now clear were the result of gas shortages, the Authority issued a press release which strongly implied that some kind of abuse of market power was taking place:[18]

> *"The Electricity Authority is not comfortable with the current high prices and we have moved swiftly to make sure the market is working properly. We are using all our powers to drill into why prices are so volatile and so high. We monitor market behaviour every week but this work goes even further. From next week we will be publishing new analysis to see what lies behind the current prices as the fuel shortage that we're experiencing can only explain so much. We will be testing to see if the prices are justifiable in the circumstances, which is why we are digging deeper and making the companies give us more information, so everyone can see exactly who is making what and to shine a light on the current situation."*

The new analysis referenced in that press release – which culminated in the publication of the Authority's Winter 2024 Review – ultimately revealed nothing untoward was going on and prices were found to be justifiable in the circumstances. In fact, it clearly identified gas shortages as the driver of high electricity prices:[19]

> *"…thermal generators did not have gas available to run at full capacity, and increased offer prices to prevent running out of thermal fuels. This fuel shortage resulted in a dramatic price increase."*

Quite appropriately the Authority Chair reportedly advised Parliament's Select Committee recently that "…the real issue last year was that gas supply declined faster than expected".[20]

In the Options Paper, the Authority references its May 2023 Decision Paper on the Review of Competition in the Wholesale Market and says that paper found that prices between January 2019 and mid 2021:[21]

> *"…to some extent…reflected underlying supply and demand conditions, but we noted that generators may have been exercising market power in the wholesale market in that period."*

The reality is that the May 2023 Decision Paper made no such finding. Instead, it referenced an earlier Authority paper, its October 2021 Information Paper titled 'Market monitoring review of structure, conduct and performance in the wholesale market', where it claimed such a finding was made.[22]

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[18] What we're doing about the electricity price spike, Electricity Authority, August 2024, link
[19] Review of Winter 2024, Electricity Authority, April 2025, link
[20] https://www.energynews.co.nz/news/electricity-supply/816534/ea-seeks-more-power-require-information
[21] Options Paper, para 2.10
[22] Market monitoring review of structure, conduct and performance in the wholesale market – Information Paper, Electricity Authority, October 2021, link

Again, the reality is that earlier paper made no such finding. The key findings from the Information Paper appear on pages 3 to 4 and are reproduced in full below (emphasis added):

> *"2.1 Since the Pohokura outage in 2018, the spot market has experienced high prices, higher demand, continuing uncertainty surrounding future gas supply from Pohokura and other fields, and high gas spot prices. The climate has also generally been drier, with periods of quite low storage. The cost of carbon emissions has also increased significantly.*
>
> *2.2 During the review period, changes in underlying market fundamentals have been reflected in spot price movements. This is confirmed by our regression analysis (see Appendix A for details). Table 1 sets out the underlying conditions for different months from January 2019 to June 2021.*
>
> *2.3 While spot price movements appear to have reflected underlying conditions, there has been an overall increase in the level of spot prices above the level explained by the market fundamentals in the regression. The regression analysis shows that there has been a sustained upwards shift in prices after the Pohokura outage in October 2018. Since then, the market has continued to experience uncertainty around gas supply from Pohokura and other fields.*
>
> *2.4 This sustained upwards shift is indicated by the statistically significant coefficient for a dummy variable in the regression analysis. The dummy variable equals zero before the 2018 Pohokura outage, and one from October 2018 onwards. Since other underlying fundamentals are controlled for in this regression analysis, the significant dummy variable shows that the price is higher for other reasons.* ***However, what the regression analysis does not show is whether this upwards shift is due to the uncertainty surrounding gas supply from Pohokura and other fields (above that reflected in the gas spot price) or if there is some other reason for the upwards shift, such as the exercise of market power****."*

This was the Authority's actual finding i.e. that the Authority's regression analysis was inconclusive as to whether the upwards shift in price was due to uncertainty about gas supply (in relation to which the Pohokura outage was the first taste of the issues which have since weighed heavily on the sector for a number of years) or whether it was due to other reasons.

This actual finding was then distorted by the Authority's own quotation of itself which placed less and less emphasis on gas issues and the gas sector, and more and more emphasis on unsubstantiated speculation about the exercise of market power.

For example, the Authority's related 'Summary Paper' summarised the Information Paper and, while still recognising that there might be benign explanations for the price increases, made the first suggestion that prices might not be being determined in a competitive environment:[23]

> *"Prices over the review period have, at least to some extent, reflected underlying supply and demand conditions, which is a sign of a competitive market. Over the review period, demand has been higher; hydro inflows and storage have been low; there have been a number of gas production outages; and all fuel costs — including the value of stored water and the cost associated with carbon dioxide emissions — have been rising. These have all affected electricity spot prices.*
>
> *However, some of the price increases since the Pohokura outage appear to be unexplained by these underlying conditions. For example, prices tend to increase as the duration of low storage increases. However, in 2019 there was low storage for only about 4 percent of the year but an average yearly price of above $100/MWh (see Figure 4 in the main review paper). This could be because, given*

[23] Market monitoring review of structure, conduct and performance in the wholesale market – Summary Paper, Electricity Authority, October 2021, link

the data available to the Authority, it is difficult to account perfectly for all underlying conditions, or it could be because prices are not being determined in a competitive environment."

The Authority's website commentary related to the above documents and a webcast presentation made at the time by the Authority's then Chief Executive (both still on the Authority's website) took the mischaracterisation further and claimed the Authority found actual evidence of manipulation of market prices. The website commentary for example says:[24]

"Our review found out that higher prices over the review period did not always match the relative supply and demand conditions. There was also some evidence that generators may have manipulated prices by manipulating levels of supply and demand."

It is important that a regulator like the Authority accurately quotes and does not distort its findings. Consumers, Meridian and market participants more generally, place great store on what the Authority says. However, the bigger issue, as indicated above, is that the Authority's 'market power' explanation for much of the price increases seen in the last seven years has meant it has not adequately scrutinised, warned about, or used its regulatory powers in respect of the emerging demise of the gas sector. We, like the Authority in its recently released Winter 2024 Review, consider that these gas shortages alongside the drought were the drivers of the events of August 2024. The parties that were initially considered to have exercised market power, made less, not more money as a result of the events of 2024. One can reasonably assume that had market power actually been exercised, that would not have been the outcome.

2.5 The Authority's concept of a level playing field seems to deny that market participants should face the consequences of their own strategic choices

The Authority's proposed intervention is premised on the idea that the current "playing field" between generator-retailers and independent generators and retailers is not level. It is not clear to Meridian how that is the case.

Different retailers have adopted different approaches to managing wholesale market risk and to developing offerings that will appeal to New Zealand consumers. These are choices which every retailer is free to make. Some participants, such as Meridian, have chosen to vertically integrate to manage wholesale market risk on behalf of their customers – as detailed in Appendix B, there are clear strategic reasons for making such a decision. Other retailers have opted to operate without generation support but instead utilise the options available on the hedge market to manage this risk. Again, this is a deliberate and strategic choice.

Some of the independent retailers that operate in New Zealand also participate in electricity markets overseas and have adopted a vertical integration strategy in those locations. Retailers are free to commit their resources to adopt a vertical integration strategy in New Zealand too if this is what they consider is best for their shareholders and their customers.[25]

There is an important distinction to be made in seeking a level playing field in order to ensure that all participants can enter a market and make decisions on how they would like to compete,

[24] https://www.ea.govt.nz/projects/all/review-of-wholesale-market-competition/consultation/review-of-structure-conduct-and-performance-in-the-wholesale-electricity-market/

[25] Meridian itself adopted a vertically integrated structure when it entered the Australian electricity retail market, owning three small hydro stations and two wind farms and amassing a customer base of nearly 200,000 customers at the time the Meridian Energy Australia business was sold to Shell Energy and Infrastructure Capital in 2022.

versus seeking to curtail the competitive advantages (or nullify the competitive disadvantages) that firms are experiencing as a result of their strategic decisions.

This distinction was discussed previously by NERA in a report prepared for Meridian:[26]

> *"The…aim to ensure independent retailers can compete on a level playing field appears on its face to be an uncontroversial objective. However, there is an economic difference between "levelling the playing field":*
>
> > *a. Before firms make their business model and investment decisions; and*
> >
> > *b. After firms make their business model and investment decisions.*
>
> *There is a risk that "levelling the playing field" after firms make their business model and investment decisions effectively amounts to "changing the rules of the game" in favour of one business model over another. In respect of electricity supply, risk management is fundamental to competing, and is a cost of doing business, incurred by both incumbents and entrants. Some firms choose to manage risk by vertically integrating (i.e., investing in generation) and others choose not to. Care is needed that any attempts to "level the playing field" do not:*
>
> > *a. Undermine the efficiencies the vertically integrated firms anticipated when making their investments, as this would deter future investment; or*
> >
> > *b. Give a "leg up" to firms that have opted not to make the investments, if "giving a leg up" could result in social costs (e.g., deterred investment that would have been efficient)."*

These considerations remain relevant in the current context: in contemplating the need to 'level the playing field' the Authority should not prefer one business model over another or seek to advantage one type of participant over another. This critical point was also observed by Carl Hansen:[27]

> *"For many years I have viewed the entry of non-integrated retailers as a contest between business models: a contest between gentailers with their large customer base and long-lived generation assets versus the nimbleness of new entrants with new technology and marketing ideas. When I was a regulator, it was never a case of viewing one model as better than the other, or that the absence of one signalled the market wasn't working. It was up to the market to decide whether one model wins, or they coexist."*

We agree with Mr Hansen's view: it is the choice of each new entrant and each incumbent how to best manage risk, compete with their rivals, and win customers. And it is up to the market to determine which approach ultimately succeeds. Ultimately, it can only result in greater costs for consumers if New Zealand were to subsidise or support inefficient business models.

2.6 Experience in the United Kingdon suggests fixating on retailer entry can ultimately cost consumers

NERA have drawn on their experience in the United Kingdom's electricity market to identify potential lessons for the current New Zealand context. The United Kingdom experience is particularly relevant as they have also adopted 'non-discrimination measures' in their pursuit

[26] Problem definition underlying "Internal transfer prices and segmented profitability reporting" consultation paper – memo, NERA, May 2021, link
[27] CSA, Section 6

of retail market competition. A detailed description of the United Kingdom's experience of retail market regulation is set out in Section 7 of NERA's report.

The key lessons that NERA draws from this experience are:

(a) The availability of hedging products is correlated to higher retailer entry, but at a cost to the parties mandated to make products available;

(b) Without regulatory oversight, new entrant retailers have incentives to adopt risky short-term hedging strategies to compete on price with incumbents; and

(c) Fixating on retailer entry without ensuring sustainability in new entrant business models may end up creating more costs for customers than the benefits of competition and innovation that new entrants may drive.

NERA notes that, following the exit of 29 retailers from the market in 2021, United Kingdom regulator Ofgem conducted a review of its historical policy of promoting growth in retail competition, concluding:[28]

> *"The focus on expanding competition and promoting choice, while benefitting consumers through lower prices, ultimately led to low financial barriers to entry and light regulation of financial risks. The energy crisis exposed problems with this retail market model, leading to a large number of supplier failures towards the end of last year, ultimately costing all consumers through higher bills."*

While the United Kingdom context differs from New Zealand, this experience suggests a single-minded focus on promoting new entrants can ultimately cause significant costs for consumers if other risks are not properly considered.

3 Issues with the Authority's problem definition and evidence base

This section sets out our view on the Authority's problem definition and the evidence underlying its proposal. We recognise that, to date, the Authority has developed its proposal under tight timeframes and with limited input from wider stakeholders. Nevertheless, our view is that a well-considered problem definition remains a critical part of a robust regulatory development process.

3.1 The Authority's problem definition is unclear and is not well evidenced

Section 3 of the Options Paper discusses a number of concerns the Authority has identified under the heading 'Problem Definition'. These include:

(a) Concerns about the impact of vertical integration on competition;

(b) Concerns about the availability of and access to flexible resources;

(c) Concerns about the gap between ASX futures prices and the long-term cost of new build; and

(d) Concerns about the disconnect between Internal Transfer Prices (ITPs) and retail pricing.

[28] Statutory Consultation: Strengthening Financial Resilience, Ofgem, November 2022

It is not particularly clear from the Authority's description how these concerns are related or which specific concerns the Authority is setting out to address. We discuss each of these concerns in turn below.

3.1.1 Concerns about the impact of vertical integration on competition

The Authority notes at the outset of Section 3 that it "is investigating level playing field measures to address risks to competition arising from Gentailer vertical integration".[29] This section goes on to make a number of observations about competition in the electricity market (emphasis added):

(a) The generator-retailers have sustained high retail market shares, while growth of competing retailers has been stagnant since 2021;[30]

(b) The four generator-retailers have continued to have high market shares for generation and there have been recent attempts to consolidate;[31]

(c) The limited growth of competing retailers and generators **suggests** there may be barriers to entry and/or expansion in retail and generation;[32]

(d) While efficiencies may arise from vertical integration, these **could be** outweighed by conditions or conduct that compromise the ability of non-integrated generators and retailers to compete;[33]

(e) **Where [risks to competition from vertical integration] are observed in practice**, hedge contract buyers (especially independent retailers and generators) cannot be confident that the shaped hedges they need will be available (liquidity), will be competitively priced, or that they will be treated even-handedly;[34] and

(f) These risks of vertical integration **may** persist absent a change in market structure or introduction of Level Playing Field measures.[35]

We note that much of the Authority's reasoning on these matters (as highlighted by the emphasised wording) is observational or speculative in nature. The Authority has not attempted to robustly understand or evidence the actual drivers of current market dynamics or the presence of any genuine barriers to competition. Rather, it has identified some general competition concerns or risks based on a few high-level indicators and appears content to move forward on this basis.

Carl Hansen draws attention to the Authority's lack of rigour in seeking to understand the problem. On the matter of generator-retailers seeking to restrict retail competition, Mr Hansen noted:[36]

> *"Surprisingly, the Options paper makes no effort to explain why gentailer opportunities and incentives (supposedly) changed suddenly in or around 2020 and offers no evidence regarding opportunities and incentives."*

[29] Options Paper, para 3.1
[30] Options Paper, para 3.13
[31] Options Paper, para 3.14
[32] Options Paper, para 3.15
[33] Options Paper, para 3.21
[34] Options Paper, para 3.24
[35] Options Paper, para 3.25
[36] CSA, Section 2.3

Mr Hansen undertakes his own analysis of this issue. He identifies that the trajectory of real household energy prices in recent years is not consistent with a sudden weakening of retail competition from 2020 (as suggested at para 3.15 of the Options Paper). He goes on to present an alternative explanation for why non-integrated retailers have recently found it difficult to compete effectively, which is to do with weaknesses in their business model. This is discussed in detail in Section 3 of Mr Hansen's expert report.

In summary, Mr Hansen considers the key issue is that non-integrated retailers are poorly placed to offer long-term price smoothing services to consumers as they do not own assets or have capital structures that enable them to 'ride through' a supercycle. Mr Hansen notes this explanation is consistent with non-integrated retailers being able to compete effectively before 2020 and weakly since then. We consider Mr Hansen's expert analysis makes clear that there are valid alternative explanations for the trends the Authority has observed.

3.1.2 Concerns about the availability of and access to flexible resources

The Authority goes on to say it has identified specific concerns in the New Zealand market around availability of flexible resources.[37] The subsequent discussion in the Options Paper appears to be largely based on the findings of MDAG. In discussing access to flexibility, the Authority notes some of the concerns it raises "have both a scarcity and a competition risk component to them, and it has been difficult to draw an exact line between the two".[38]

Again, this seems to be an acknowledgement that the Authority has not clearly identified the extent of the competition concern and whether there might be alternative explanations for limited availability in the supply of hedge products backed by flexible resources. It nevertheless goes on to say *if* it considers that the sharing of flexible resources is occurring in a manner that is harming competition it can use regulation to recalibrate how this is occurring.[39]

The Authority then goes on to describe the findings of its Risk Management Review.[40] We will not repeat the full list of findings here; rather we highlight three of the key findings and discuss each of these in turn:

Key finding 1: Prices for OTC baseload and peak hedge contracts are likely to be competitive

We agree.

Key finding 2: It is not clear that pricing for OTC super peak products is competitive as they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape

Our expert advisors NERA further examined this conclusion. NERA note that, in comparing offered prices for super peak hedges with a calculated 'competitive' super peak price, the Authority was only able to quantify two of the six potential risk premium adjustments they had identified. As pointed out by NERA, the Authority repeatedly notes that the result of this is that the 'competitive' OTC prices (against which they compare offered super peak prices) will likely be underestimated.[41]

[37] Options Paper, para 3.27
[38] Options Paper, para 3.34
[39] Options Paper, para 3.35
[40] Options Paper, para 3.39
[41] Reviewing risk management options for electricity retailers – Issues Paper: Appendix A, Electricity Authority, November 2024, link, paras 4.11, 4.16, 4.18 and 4.21

The Authority also notes that these unquantified risk premia “could have a big impact on super-peak contract prices” with this impact likely to be increasing over time.[42] As a result, NERA observes that rather than being “exhaustive but inconclusive”, the Authority’s analysis is simply “incomplete”.[43]

NERA concludes:[44]

> *“Given the uncertainty of the nature and scale of the drivers of these concerns, the EA should ensure that any interventions are appropriately targeted and proportionate, and thus do not create unintended consequences that may exacerbate the problems they seek to solve.”*

Carl Hansen also examined the Authority’s conclusions with respect to the pricing of super peak products. He notes that analysis in the Authority’s paper ‘Reviewing risk management options for electricity retailers – Issues Paper’ (**RMR Issues Paper**) reveals there is little practical difference in terms of risk management benefits from hedging with baseload and peak products (both of which the Authority concludes are competitively priced) versus hedging with baseload, peak and super peak products. In Mr Hansen’s own words:[45]

> *“…the Issues paper shows that adding a super-peak hedge to a portfolio of baseload and peak hedges provides minimal additional cover for a [non-integrated retailer].”*

Mr Hansen also argues that, if any party firmly believed that super peak hedges are materially over-priced, there would be nothing to stop them from selling those products and reaping the benefits when spot prices during super peak periods turn out lower than their hedge price. Mr Hansen considers it is not credible for the Authority to believe it has identified opportunities for excess profits, publicised them, and yet speculative activity has not reduced the gap. As a result, he goes on to conclude:[46]

> *“…the concerns about super peak prices are neither material nor credible”.*

Considering these factors, with respect to the key finding of the Risk Management Review (that it is not clear that pricing for OTC super peak products is competitive) we can conclude:

(a) The Authority has not been able to confirm that pricing of super peak products is uncompetitive as it has not undertaken the analysis to quantify all the potential risk premia which would be reflected in those prices;

(b) The lack of speculative activity to reduce the gap of any over-pricing of super peak products suggests they may, in fact, be competitively priced; and

(c) Regardless of the competitiveness of super peak pricing, independent retailers have access to hedge products (baseload and peak) which:

   (i) The Authority has confirmed are likely to be competitively priced; and

[42] Reviewing risk management options for electricity retailers – Issues Paper, Electricity Authority, November 2024, link, para 2.7

[43] These conclusions are similarly supported by the findings of Sapere in their expert report for Contact to the Authority’s Risk Management Review. Sapere found “very strong evidence that the current challenges in the supply of super peak products are driven by reduced firm capacity in the market relative to demand, and little evidence to support the hypothesis of market power”. See link

[44] NERA, Section 2.1

[45] CSA, Section 2.2

[46] CSA, Section 2.2

(ii) The Authority's own analysis suggests would offer substantially the same risk management benefits as a portfolio which incorporates super peak products.

Key finding 3: While the evidence points to fuel or capacity scarcity being the driver behind the current thin and illiquid market for shaped hedge cover "there is also a plausible driver that has competition implications (for example, refusing to supply products on appropriate terms to counterparties who are downstream competitors), indicating that some level of market power could have been in play."

The Authority is again deriving a conclusion based on speculation rather than on clear evidence. The Authority revisited its conclusions on this matter in 'Reviewing risk management options for electricity retailers: Update paper following submissions' (**Update Paper**) where it found:[47]

> *…no evidence has been provided that causes us to definitively conclude that the exercise of market power to reduce competition is occurring. However, the risk that market power is being exercised remains clear. While some submitters argued that scarcity is the primary driver, the presence of scarcity does, in itself, not exclude the possibility of market power being exercised – both may exist.*

This statement makes it clear the Authority does not have evidence that the exercise of market power is occurring. It is merely speculating that this is possible.

We note also the Authority provides an example of generator-retailers "refusing to supply products on appropriate terms to counterparties who are downstream competitors" as a potential driver of the thin market for shaped hedge products. Little evidence is provided of such behaviour except (from what we can tell) in a footnote in the RMR Issues Paper which cites generator-retailers choosing not to respond to particular RFPs due to limited commercial interest or because they considered they were unlikely to offer a competitive price.[48] For our part, Meridian's practice is always to respond to RFPs from independent retailers. As such, the Authority's claim is inconsistent with our experience.

In the same paragraph in the RMR Issues Paper the Authority also acknowledges that generator-retailers' decisions not to respond to RFPs:

> *"…could be due to location factors, our nodal market, geographically concentrated generators, or the inability to get the necessary financial transmission rights within the RFP timeline".*

Again, the Authority has not reached a firm conclusion here and freely acknowledges there may be non-competition-related reasons for the behaviour it observes. Despite this, the Options Paper goes on to cite "withholding of supply" along with other matters (which we would also dispute) as part of the evidence from the Risk Management Review:[49]

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

This statement seems to mischaracterise the findings of the Risk Management Review, presenting inconclusive analysis and speculation as evidence.

[47] Reviewing risk management options for electricity retailers: Update paper following submissions, Electricity Authority, February 2025, link
[48] RMR Issues Paper, para 5.3(b) of Chapter 7
[49] Options Paper, para 3.51(b)

3.1.3 Concerns about the gap between ASX futures prices and the long-term cost of new build

The Options Paper also refers to an ongoing gap between the forward curve derived from ASX hedge prices and the cost of new generation build and notes that some parties have concluded from this that there are barriers impacting the extent or effectiveness of new entry or expansion that would close the gap.[50] The Authority does not identify who those parties are or whether the Authority itself shares this view. It goes on to note that there may be a range of alternative factors which explain this gap including material market uncertainties at various points (for example, gas supply uncertainty, whether the Tiwai Pt aluminium smelter would continue to operate, the previous Government's proposed Lake Onslow pumped hydro scheme), and investment lag.

Meridian agrees that all these alternative factors are likely relevant to the observed gap between ASX prices and new build cost. Meridian also reminds the Authority of its previous conclusions in its May 2023 Decision Paper stating that:[51]

> *"Over time, it is anticipated that investment in new renewable generation will bring prices back down to the cost of new supply. The Authority set out in the Issues Paper how the observed lag between price signals and new investment is in part linked to the time it takes to build infrastructure and factors such as consenting requirements, COVID-related supply chain issues, and cost escalation. But it is also linked to investment-impeding uncertainty around the NZ Battery project, the Gas Transition Plan, and the Energy Strategy, and insufficient commercially-viable renewable solutions to firm intermittent supply. Having considered submissions, the Authority is satisfied with this explanation of the observed lag..."*

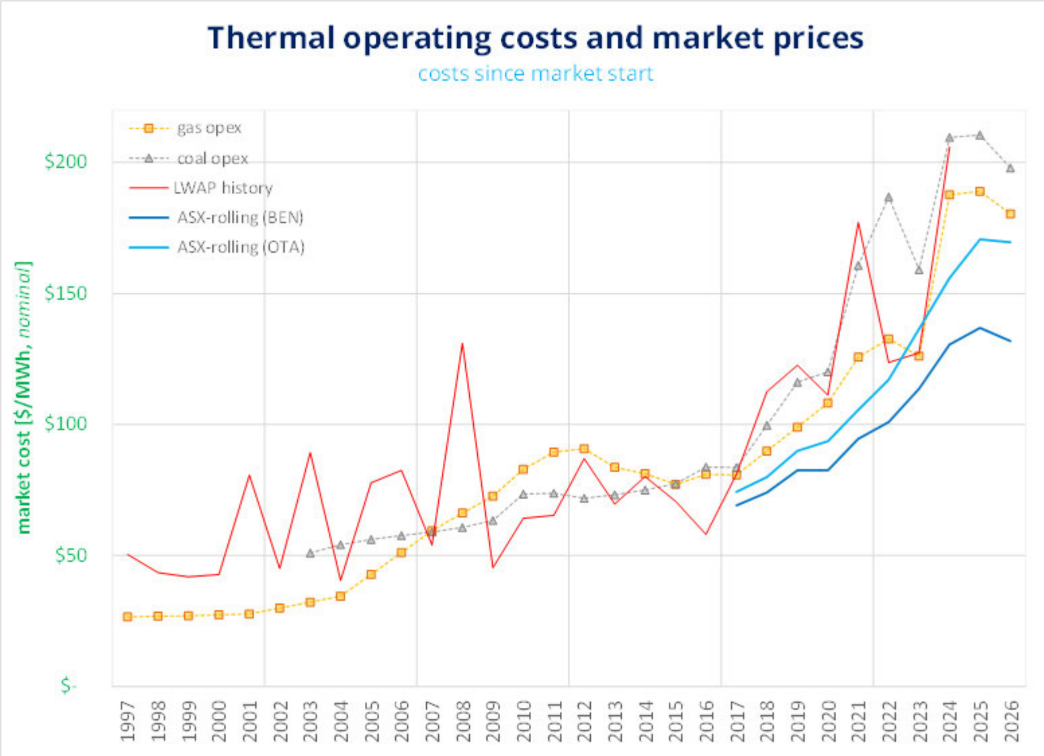
Gas market uncertainty – beginning with the Pohukura outage in 2018 and continuing until the present day – has had as significant an impact on ASX prices as it has on wholesale electricity prices.[52] This can be readily seen by examining the correlation between gas costs and electricity prices, as set out in Figure 2. There is evidently a strong correlation between thermal fuel costs and electricity prices, suggesting higher fuel costs are the primary driver of recent elevated ASX prices rather than any underlying competition issues in the wholesale market.

[50] Options Paper, para 3.41

[51] Promoting competition in the wholesale electricity market in the transition toward a renewables-based electricity system – Decision Paper, Electricity Authority, May 2023, link

[52] https://www.mbie.govt.nz/about/news/natural-gas-production-continues-to-decline

Figure 2: Relationship between thermal fuel costs and electricity prices



Source: Meridian

Carl Hansen also examines the implicit comparison contained in Figure 4 of the Options Paper and concludes that this comparison is not being made on a like-for-like basis:[53]

> *"The chart shows hedge prices peaking in 2023, at about 75% higher than the upper estimate of cost, declining to about 30% by August 2027. However, these price-cost margins must be interpreted carefully because the hedge prices are only for 2-4 years ahead, whereas the LRMC estimates are the average cost of energy over a plant's entire life. For example, solar and wind plants last 25-35 years, and many baseload plants last far longer. In essence, the chart is comparing 'apples and oranges."*

It is not entirely clear from the Options Paper what weight the Authority has placed on its observation regarding the gap between ASX prices and the cost of new build or how this has factored into its thinking regarding the level playing field proposal. But the fact that the Authority has chosen to refer to this in the Options Paper suggests it at least considers it relevant. Meridian's view is that a more robust consideration of the drivers of recent ASX prices and how they relate to new generation build costs is needed before inferring any competition concerns from this comparison.

3.1.4 Concerns about the disconnect between ITPs and retail pricing

The Options Paper goes on to discuss generator-retailer ITPs, noting there is an underlying issue that they are not currently set on a basis that would allow the Authority to make a meaningful comparison between how generator-retailers treat themselves compared to how

[53] CSA, Section 2.1

they treat third parties. The Authority notes "this disconnect between the ITPs and retail pricing suggests there may be an uneven playing field".[54]

Again, the Authority frames its concern here as a suggestion and it is not clear what the specific market failure might be. It is true, as the Authority suggests, that:[55]

> *"…gentailers' vertical integration means their retail arms may not be exposed to the same choices, risks and costs faced by non-integrated retailers."*

This is a consequence of the strategic decision that generator-retailers have made to vertically integrate and, in contrast, the decision that non-integrated retailers have made not to do so. This in itself is not a reason for intervention.

The Authority goes on to say that these risk management benefits are "an understandable driver of the decision to vertically integrate" but "when that integration then aggravates competition concerns, it necessarily invites closer regulatory consideration".[56] The Authority is again referring to general competition concerns without defining this further or providing specific evidence.

3.1.5 Overall views on the Authority's problem definition

The Authority has not provided a clear, singular problem definition statement. It has discussed a range of general competition concerns relating to generator-retailer structure and ultimately concluded that "the competition risk is clear".[57] We disagree. We do not consider that the Authority has adequately defined the problem.

Many of the Authority's concerns are speculative and appear to be based on a hunch or the views of "some parties". It is clear in a number of cases that the Authority has not been able to differentiate between genuine competition concerns and other factors (such as scarcity, fuel shortages, policy uncertainty, and investment lag). The Authority also appears to have ignored – or at least has not sought to understand:

(a) potential alternative explanations for the high-level trends it has observed e.g. the fact that non-integrated retailers have poor long-run price-smoothing capabilities relative to incumbent generator-retailers; or

(b) evidence that is not consistent with its competition concerns e.g. the decline in real terms in the cost of the energy component of energy bills since 2020.

The Authority has mischaracterised the findings of its own Risk Management Review, noting concerns such as "withholding of supply, over-pricing, favouring supply to internal channels over external competitors" when, in fact, the Risk Management Review:

(a) Determined pricing of baseload and peak products was likely to be competitive;

(b) Determined it is *not clear* that pricing for OTC super peak products is competitive; and

(c) Did not reach firm conclusions on the existence of withholding, noting that a lack of responses to some super peak RFPs "could be due to physical withholding" or "could be due to location factors, our nodal market, geographically

[54] Options Paper, para 3.45
[55] Options Paper, para 3.45
[56] Options Paper, para 3.45
[57] Options Paper, para 3.51

concentrated generators, or the inability to get the necessary financial transmission rights within the RFP timeline."[58]

Meridian's view is that the Authority's problem definition is vague, lacks robust evidence and is, at times, misleading. It does not establish a convincing basis for subsequent intervention.

The Authority states in the Executive Summary of the Options Paper that "while evidence of Gentailers exercising market power is not clear-cut, the liquidity and pricing risks are clear". It is concerning that the Authority appears to acknowledge a lack of compelling evidence but seems prepared to move forward on the grounds that there are 'risks'.[59]

The potential impacts of proceeding on this basis are set out starkly by Carl Hansen (emphasis added):[60]

> *"I am very concerned the Task Force has mis-diagnosed the problem confronting non-integrated retailers and does not appear to have fully considered important factors, such as asymmetries between the hedge and retail markets and retail pricing in the face of repeated adverse supply shocks, that were thought more temporary than has turned out to be the case.* ***In my view, this is leading the Authority to propose options that are likely to materially increase prices for households and businesses.*** *It could also harm non-integrated retailers in the long run. Both are unnecessary."*

3.2 It is not clear that Meridian's submitted evidence has been considered

The Authority notes at various points in the Options Paper that it has not been presented with evidence which has caused it to reconsider the conclusions it reached in its Risk Management Review. For example:[61]

> *"While submitters put forward a range of views for and against these findings, parties that disagreed did not present further data or specific evidence to support these views, despite having the best access to relevant information."*

While Meridian did not submit additional evidence with its submission on the Risk Management Review, this was primarily because we had provided substantial evidence on our approach to offering and pricing hedge contracts to the Authority during the information gathering phase of the review.

This included:

(a) A Word document setting out a detailed description of our methodology for pricing shaped products to independent retailers;

(d) An Excel document setting out a worked example of a specific, recent real-world implementation of the above methodology, including the historical price series which fed into the calculation.

We were therefore somewhat surprised by the Authority's statements about not receiving specific evidence and sent a query to the Authority on 1 April 2025 asking what further

[58] RMR Issues Paper, para 5.3

[59] It is also concerning that in some cases the Authority appears to acknowledge that particular issues are only "alleged" but nevertheless appears to draw conclusions on these matters. For example, paragraph 3.40 of the Options Paper notes that "the Risk Management Review issues paper did not make any preliminary findings regarding whether there is a margin squeeze (as alleged by independent retailers)" while paragraph 3.46 goes on to conclude "In an environment where level playing field and margin squeeze concerns have been raised, the existing approach to ITPs is not fit for purpose".

[60] CSA, Section 1

[61] Options Paper, para 3.47

evidence the Authority had hoped to receive. The Authority wrote back to us on 17 April 2025 noting that the further evidence it was seeking was "anything to further elucidate/clarify the other premia" that was discussed in Appendix A of the RMR Issues Paper.

It is not clear to us whether this is the first time the Authority has engaged with the particular evidence that Meridian has previously provided. We would agree that it is important for the Authority to understand the potential composition and magnitude of the various risk premia that apply to shaped products. This point was well made by our expert advisors NERA, as described above in Section 3.1.2. If the Authority has not understood the various risk premia that are likely to be factored into the pricing of a shaped hedge product, it is not possible to robustly draw conclusions on the competitiveness of any market pricing.[62] This is particularly important where a subsequently proposed intervention is based on the conclusions formed from this analysis – as is the case here.

We are concerned that the Authority is still gathering and analysing evidence on the nature and extent of the problem of the competitiveness (or otherwise) of the market for super peak products yet, at the same time, has moved rapidly down the path of proposing an intervention which will have wide-ranging implications and brings significant risk of unintended consequences.

Due to the limited time available between the Authority's response to our query and the closing of submissions, we have not sought to attach any additional 'evidence' to this submission. However, we remain happy to work with the Authority to provide any relevant information on our approach to offering and pricing hedge contracts if it will help inform the Authority's assessment of these issues.

3.3 The decision to intervene now appears rushed and is inconsistent with MDAG's recommendations

The Authority views its proposed staged approach to level playing field measures as incorporating (or "subsuming") a version of virtual disaggregation, an intervention originally conceived of by MDAG.[63] More specifically, MDAG had recommended that virtual disaggregation be developed as a backstop measure – to be 'put in the drawer' ready for use if other measures are not effective. In the Authority's own words, virtual disaggregation was intended to address "a specific future market power concern".[64] MDAG's Options Paper envisioned that such a measure could be in place by 2029.[65]

The Energy Competition Task Force initially took a similar view to MDAG, with its early call for feedback on level playing field measures noting that they were to be used "as a regulatory backstop if earlier steps are not effective".[66] However, the Option Paper notes that rather than treating level playing field measures as a future backstop option, the Authority is now proposing an immediate staged introduction of level playing field measures in the form of non-

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[62] For example, it is not possible for us to determine at this stage which of the various hedge prices offered by Meridian and included in the new analysis shared by the Authority in its 17 April response to us were offered at a time when Meridian was capacity or energy constrained. This would influence our approach to pricing specific hedges and may explain higher prices observed in the Authority's data.
[63] Options Paper, para 2.33
[64] Options Paper, para 2.31(b)
[65] Price discovery in a renewables-based electricity system – Options Paper, MDAG, December 2022, link, p26
[66] https://www.ea.govt.nz/news/general-news/energy-competition-task-force-request-for-level-playing-field-measures/

discrimination obligations.[67] The Authority notes in this same paragraph that it discusses "the reasons for this change in approach in detail in Chapter 6 of this paper".

It is not clear to us where this discussion is located in Chapter 6, other than a brief further description that the Authority's "current view is that there are good reasons to consider introducing a proportionate Level Playing Field measure in addition to the standardised flexibility product and PPA initiatives".[68]

It is also not clear to us what has changed between MDAG's conclusions and the Task Force's current consideration of level playing field measures which warrants this accelerated timetable – or indeed what has changed since the inception of the Task Force (when such measures were still intended to be a 'regulatory backstop') and now. In addition to the lack of evidence discussed in Section 3.1 above, it appears this decision is being rushed. Our view is this risks falling short of a robust regulatory development process.

There are also wider developments which may have consequences for the timing and suitability of the Authority's proposal. As the Authority is aware, the Government has commissioned a wide-ranging review of the sector which will include the following as particular matters to be addressed:[69]

(a) How does business ownership, structure or design of markets affect incentives or opportunities to invest in generation, storage, transmission and distribution?

(b) What is the impact of market design and market rules on competition, market entry and expansion?

Both of these questions could feasibly include consideration of the merits of vertical integration and are likely to take a wider view of this matter than the competition-focused perspective adopted by the Task Force. The review is currently expected to report in June. As this is just a matter of months away – and given the potential consequences and impacts of progressing an intervention such as that proposed by the Authority – it would seem sensible to await the findings of the Government Review to determine if the respective recommended courses of action are aligned before committing to a particular path.

3.4 The proposed solution is more wide-ranging than is justified by the evidence in the Risk Management Review

As noted in Section 3.1 above, the key findings of the Authority's Risk Management Review included:

(a) prices for OTC baseload and peak hedge contracts are likely to be competitive; and

(b) the same conclusion could not be reached for OTC super-peak hedge contract prices as they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape.

In concluding the second point, the Authority noted that "the evidence does point to scarcity being a driver" but said:[70]

[67] Options Paper, para 2.34
[68] Options Paper, para 6.2
[69] Terms of reference for a review of electricity market performance, MBIE, February 2025, link
[70] Options Paper, para 3.39

> *"…there is also a plausible driver that has competition implications, eg, refusing to supply products on appropriate terms to counterparties who are downstream competitors, indicating that some level of market power could have been in play."*

We have already discussed the speculative nature of this conclusion in Section 3.1 above but – ignoring this for the moment – it is clear from the Risk Management Review findings that the *only* concern the Authority has identified is in relation to the pricing of super peak products. However, the Authority's proposal as currently written will capture *all* hedge contracts offered by generator-retailers, including those the Authority has confirmed are likely to be trading competitively.

The Authority notes in the Options Paper that "it would be more effective for any non-discrimination obligations to cover all hedge contracts", citing risks of discriminatory behaviour for the remaining hedge products.[71] The brief subsequent discussion on this point underplays the fact that the Authority's proposal is a significant departure from its conclusions on the scale and nature of the problem as set out in the Risk Management Review. Our expert advisor Carl Hansen made a similar observation, noting "it seemed odd the Authority was proposing a wide-ranging intervention to address a narrow hedge market issue" identified in the Risk Management Review.[72]

In our view, this significant broadening of the scope of the intervention is inconsistent with a robust regulatory development process and only heightens the risk of unintended consequences without any underlying justification. If the Authority is confident that the analysis in its Risk Management Review remains robust, then a more proportionate and reasonable response would be to focus its intervention on ensuring a competitive and liquid market for super peak products. Such an alternative is discussed further in Section 5 of this submission.

4 Our views on the proposal

4.1 The proposal will effectively deliver vertical separation or disaggregation

The Options Paper states:[73]

> *"We respect the right of businesses to choose their own structure and form their own view of the benefits of different structural options. We prefer to not unnecessarily restrict this choice."*

The Authority also frames its preference for principles-based non-discrimination obligations as "the lower end of potential interventions".[74] However, as discussed by NERA in their expert report, the proposal would deliver the effects of virtual vertical separation.[75]

Virtual vertical separation would be a significant intervention given the benefits of vertical integration discussed in Appendix B of this submission and the consistent conclusions in the academic literature that where vertically integrated firms are forcibly separated, there is solid evidence from a variety of sectors around the world that this harms consumers.

The Authority's proposed principles would not be structural separation, but they would erode several of the key benefits to consumers associated with vertical integration. Most notably:

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[71] Options Paper, para 6.7
[72] CSA, Section 1
[73] Options Paper, para 3.19
[74] Options Paper, para 3.51(e)
[75] NERA, Section 4

(a) generator-retailers will incur transaction and compliance costs to put in place a portfolio of notional internal hedges that are less efficient than the absence of such arrangements under vertical integration; and

(b) those notional contracts will decrease the stability of the retail segment of each generator-retailer and lead to more volatile retail prices and less retail competition (as discussed further below).

Carl Hansen made a similar and related point:[76]

> *"Although the paper states that the Authority respects the right of businesses to choose their own structure and prefers to not unnecessarily restrict those choices (3.19), it is in fact proposing very significant restrictions. Although it may not think so, the Task Force is effectively requiring gentailers to take a short-term approach; that is, to adopt the inherent limitations of the non-integrated model. It is overturning the key feature of integration, which is that it displaces the contractual approach to managing price supercycles."*

4.2 There is already a level playing field

The Authority proposes "level playing field measures". In summary, the proposal would require generator-retailers to pretend they have internal contracts and base those implicit contracts on observable market rates for comparable contracts.[77] The Authority is also requiring these implicit internal contracts to be priced at levels that avoid any cross-subsidy such that internal business units must be commercially viable on a standalone basis.[78] [79]

As discussed in Section 2.5 above, in Meridian's opinion, no level playing field measures are needed because the playing field is already level. It is open to any electricity retailer to pursue a capital-intensive vertically integrated business model, or a thinly-capitalised retail-only business model. There are pros and cons associated with each business model and no barriers to adopting either one.

Rather than a level *playing field*, the Authority's proposal seems to be aimed at achieving level *outcomes* by requiring that either:

(a) all businesses enjoy the benefits of vertical integration (even those who have chosen not to invest the capital to become vertically integrated); or

(b) no businesses enjoy the benefits of vertical integration (regardless of investments made to date in that business model).

We explore each of these scenarios further below but note the Authority's proposed principles do not specify one or the other, with implementation left to the discretion of generator-retailers.

These scenarios reflect the discussion in Carl Hansen's paper that picks up on the supposed disconnect between ITPs and retail pricing identified in the Options Paper and the Authority's conclusion that the existing approach to ITPs *is not fit for purpose* in an environment where level playing field and margin squeeze concerns have been raised.[80]

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[76] CSA, Section 2.5
[77] Options Paper, Appendix B, para 15a
[78] Options Paper, Appendix B, para 17
[79] We are adopting the Authority's language of a 'cross-subsidy' here. However, we believe this term mischaracterises the ability of generator-retailers to undertake long-term price smoothing, which in fact is welfare enhancing for consumers. What might be viewed as a cross-subsidy during the current phase of the market supercycle (a supply constraint) would become the opposite during the inverse phase (a supply surplus). It is the ability of generator-retailers to maintain price stability through these supercycles that consumers value.
[80] Options Paper, para 3.46

Mr Hansen notes that the Options Paper is vague regarding where the mis-pricing lies, i.e. is it on the retail or generation side of the business?[81] If the mispricing is on the retail side of the business then all retailers should price off ASX and other market prices meaning no retailers enjoy the benefits of vertical integration. If the mispricing is on the generation side, then hedges should be cheaper such that everyone enjoys the benefits of vertical integration (without making associated capital investments).

4.3 Implications if the benefits of vertical integration must be shared with all retailers

The proposed principles would lead to the sharing of the benefits of vertical integration if a generator-retailer decides to comply by putting in place a series of long-term notional contracts that attempt to capture the benefits of the vertically integrated business model.

The principles would then require the generator-retailer to make the same contract terms available to third parties – for example, as volumes roll off existing notional internal hedges and need to be renewed. In Meridian's opinion, this would amount to a 'leg up' for non-integrated firms rather than a level playing field since they would have access to the benefits of long-term hedges associated with investment in capital intensive assets but without putting any capital at risk.

The implications if the Authority expects the proposed principles to require the sharing of the benefits of vertical integration with all retailers, include:

(a) arbitrage risks to the extent any generator-retailers may need to sell hedges below prevailing market rates to make this implementation approach work in practice;

(b) gradual retail price rises for any generator-retailer implementing the principles in this way due to the inability of notional internal contracts to fully reflect the benefits of vertical integration;

(c) distortions to retail competition to the extent generator-retailers have less flexibility to respond to changing market conditions;

(d) potential uneven impacts on generator-retailers if buyers identify one generator-retailer as having the most appealing contracts for cherry picking; and

(e) chilling of generation investment.

We discuss each of these implications in turn.

4.3.1 Arbitrage risks

Generators cannot offer contracts to non-integrated retailers at prices materially below market prices without risking being arbitraged on the ASX futures market. To the extent that notional internal hedge contracts that seek to replicate the benefits of vertical integration are lower priced than ASX futures contracts then arbitrage becomes a real risk when sale of those "vertical integration replicating" contracts to others is mandated.

It is noteworthy that the Authority's proposal extends the non-discrimination obligation to cover all buyers of hedges including, it seems, banks and trading houses and other parties that have no involvement in the New Zealand energy sector except as buyers of hedges. The proposal

[81] CSA, Section 2.3

as it stands could therefore expose New Zealand businesses to arbitrage by large global financial institutions and reduce the amount of hedge cover potentially available to independent retailers.

4.3.2 Implications for household electricity prices

As described by NERA, it will not be possible for a generator-retailer to build its implicit contract portfolio using market traded hedges, without changing the implicit contract itself:[82]

> *"This is because the implicit contract is based on a very complicated relationship between the cost of its assets over their remaining lives, its long-term expectation of its customer base and expected retail tariff levels, the flexible nature of its generation fleet and customer base (e.g. demand side response), climate conditions, the known and unknown shape of demand, etc. Resolving this complexity implicitly is one of the benefits of vertical integration..."*

Vertical integration is efficient because it avoids the need to identify contracts to cover these complex and related risks. Notional internal hedges would inevitably capture the benefits of vertical integration imperfectly and over time it should be expected that vertically integrated retailers will need to increase retail prices based on these less efficient implicit internal hedges.

4.3.3 Distortions to competition in the retail market

In addition, implementation of the proposed principles in this manner could prevent generator-retailers from competing aggressively at times. Attempting to identify and lock in longer-term hedge positions that reflect the integrated business model could risk locking in the period of elevated wholesale prices since 2019. If the wholesale market reaches the end of the current super-cycle and prices begin to fall as a result of new generation investment, an integrated firm would need to continue to offer retail prices based on its long-term notional contract position meaning its retail prices would be slow to fall and there would be opportunities for non-integrated (or small integrated) retailers to win market share. Under the proposed principles, generator-retailers would have limited ability to compete on price at these times.

4.3.4 Potentially uneven impacts on generator-retailers

The relative differences in implementation across generator-retailers could also distort competition. Non-integrated retailers could seek to identify which generator-retailer had captured the most benefits of vertical integration in their implicit contract portfolio and could target purchases of those relatively more appealing contracts. Such cherry picking could result in significant competitive disadvantage to any generator-retailer that is an outlier and is targeted – particularly if an opportunity for arbitrage is identified. Any cherry-picked generator-retailer could be forced to sell a significant portion of its capacity and would need to look elsewhere for hedges to support its retail business at higher prices, accept spot risks, or shrink its retail business.

4.3.5 Chilling of investment

If the proposed principles are implemented, there will be less incentive for non-integrated retailers to invest in generation since they will have rights to access the benefits of owning generation without putting capital at risk.

Generator-retailers may also have reduced incentives to invest to the extent that new generation increases capacity headroom and necessitates further hedge volume be offered

[82] NERA, Section 4.1

to other parties. When a generator-retailer builds a flexible asset, it may do so in part to protect the retail arm from price volatility. The Authority's proposal is that generator-retailers:[83]

> *"…would no longer be able to prioritise allocation of available shaped hedges to their own retail functions as they are currently able to. Instead, they would be required to make those hedges available to all potential buyers".*

As discussed by NERA in their expert report, if a generator-retailer is unable to fully use flexible generation to offset retail risks, and does not capture the full value of the insurance it provides because it is forced to sell hedges to other firms, then this takes away a substantial portion of the value of building the generation asset, and hence reduces the incentive to build it.[84]

4.4 Implications if the benefits of vertical integration should not be enjoyed by anyone

This would be the outcome if generator-retailers decided to comply with the principles by putting in place a series of short-term notional contracts. This seems to be the implication of the Authority's statement that "internal transfer prices should be based on observable market rates for comparable risk management contracts, including baseload, peak and super-peak contracts (such as the standardised flexibility product)" given these contracts are only for around three years in duration.[85] If this is the only implementation pathway that the Authority has in mind, then it needs to urgently provide that clarification.

The arbitrage risks associated with this option are likely to be less given the availability of reference prices in the ASX New Zealand Electricity Futures market and via hedge disclosures for peak, and super peak contracts (including the new standardised product). Making contracts available to other buyers based on these reference prices would be relatively low risk. However, the implications of this implementation method are more significant in other respects, including:

(a) implications for household electricity prices which would no longer benefit from longer-term price smoothing; and

(b) distortions to retail competition related to the above; and

(c) chilling of generation investment.

4.4.1 Implications for household electricity prices

In this implementation scenario, the retail prices offered by integrated firms would need to be based on short-term contracts and would therefore be far more volatile and would immediately be higher priced than the status quo. This should be unsurprising given:

(a) price smoothing by generator-retailers has kept household electricity prices substantially lower than what would otherwise have occurred since the energy component of average residential costs has declined in real terms since 2020,[86] while ASX prices over the same period have increased; and

[83] Options Paper, para 6.40
[84] NERA, Section 6.1
[85] Options Paper, Appendix B, para 17
[86] Household sales-based electricity cost data, MBIE, December 2024, link

(b) transparent segment reporting by the vertically integrated firms shows negative retail segment EBITDAF in recent years based on internal transfer prices that, we understand, are all linked to some form of rolling baseload ASX prices.[87]

The ability of generator-retailers to offer long term price smoothing to end customers is one of the key benefits of vertical integration. It can be seen as particularly valuable during the current phase of the market supercycle (i.e. a supply constraint). There is a high risk that the Authority's proposal will erode or eliminate this benefit, driving retail prices to be higher and more volatile. While independent retailers may benefit from these changes, consumers will lose.

Carl Hansen's expert report estimates that without generator-retailer price smoothing, prices would have been 21-26% higher in December 2024, or $460-570 higher per year (in a scenario where retail businesses need to be commercially viable in any given individual year). Mr Hansen concludes that the short-term retail price risks associated with the proposal are "likely to be material for households and small businesses".[88]

The extent of immediate retail price rises by generator-retailers would be greater if it is the Authority's expectation that integrated firms implied internal hedges are matched to retail load shape using peak and super peak products (compared to the status quo of ITPs based on ASX baseload prices).

There is significant uncertainty in the Authority's proposal regarding what would amount to a cross-subsidy where a retail business is deemed not commercially viable on a standalone basis. In Meridian's opinion, if a business that has a strong enough balance sheet to ride through a commodity cycle, then commercial viability should be viewed over the long term rather than profitability in any given year. Shareholders will have varying tolerance for the duration over which a retail business should be commercially viable and the amount of short-term pain that will be acceptable. The Authority needs to urgently clarify its expectation in this regard.

4.4.2 Distortions to retail market competition

Impacts on retail market competition under this implementation scenario would likely be significant. Generator-retailers would need to increase retail prices and would expect to lose market share through switching over time. Non-integrated and smaller integrated retailers could either:

(a) gain market share (especially smaller integrated retailers like Nova, Pulse and Loadstone who are not proposed to be captured by the principles since they could continue to price smooth over a longer period and pass on the benefits of vertical integration); or

(b) raise their prices as well, since they could do so and remain competitive with generator-retailers, meaning they would likely experience less growth in market share but more revenue in the short term.

Either way, this would be a significant wealth transfer in favour of non-integrated and smaller vertically integrated retailers. This may be why there has been such strong advocacy by non-integrated retailers for rules of this kind. However, it is far from clear to Meridian that consumers would benefit.

[87] See for example Meridian Energy Limited Annual Report 2024 page 129
[88] CSA, Section 5

4.4.3 Chilling of investment

As noted in NERA's expert report, unwinding long-term retail price smoothing and forcing the adoption of more volatile retail prices would mean revenue uncertainty for generator-retailers and reduced access to finance for new generation investments.[89] Revenue reliability is critical to support investment in significant infrastructure with a long pay-back period.

4.5 A chaotic implementation is more likely than either of the above scenarios

Generator-retailers could decide to implement the Authority's proposed principles in either of the ways described above or do something in between (or do something completely different like sell their retail business).[90] A chaotic implementation is likely, and it is not clear whether implementation would result in the outcomes the Authority intends.

In Meridian's opinion, there is a high likelihood of significant distortion to the free trading of risk and unintended consequences should be expected. We cannot see how consumers would benefit.

The incentives on each generator-retailer are to develop an implied hedge portfolio that strikes a balance between implied internal contract prices that:

(a) keep their retail segment input cost low enough to avoid retail price rises; and

(b) avoid or minimise arbitrage risks by using notional contract prices that are equivalent to prevailing market rates.

Meridian sees no way to do both. There is a trade-off to be made, and each generator-retailer will implement the principles differently.

4.6 Small vertically integrated firms will have a significant competitive advantage

Regardless of how the proposed principles might be implemented, we would expect small vertically integrated firms to have a significant competitive advantage.

Assuming the proposed principles only apply to Meridian, Mercury, Contact and Genesis, smaller generator-retailers like Nova, Pulse, and Lodestone would have a competitive advantage because they would be able to continue to offer longer-term price smoothing based on their generation investments and deliver the benefits of their chosen business model to end consumers.

There is no justification for applying any proposed principles selectively to vertically integrated firms above a certain scale.

4.7 Implementation of the proposed principles would be challenging and costly

While the Authority may consider a set of six principles (and an associated compliance obligation) to be a relatively simple form of intervention, our view is that this will be a highly complex solution to implement. Complexities are likely to arise in multiple ways:

[89] NERA, Section 6.2

[90] Current business structures are not necessarily static – the Authority need only look to the Trustpower sale of its retail business or Lodestone's announcement that it intends to vertically integrate.

(a) Determining a reasonable portfolio of internal hedges, including duration, shape, quantity and price (with reference to undefined ‘observable market rates’, which do not exist for longer-term risk management based on physical assets);

(b) Identifying an objective measure of capacity headroom, which will vary significantly over time based on expected retail portfolio, contract position, generation investments and outages (both planned and unplanned);

(c) Establishing a mechanism through which to offer available capacity to internal and external parties, including frequency, format, any objectively justifiable price adjustments for external buyers, and a method for allocating volume when oversubscribed;

(d) Determining how the principles apply to new generation investments and other sources of flexible capacity (for example batteries, demand response services and virtual power plants);

(e) Assessing independent commercial viability of internal business units;

(f) Managing information flows so as to ensure equal access to internal and external parties, including managing commercially sensitive information; and

(g) Instituting a Board certification process (and associated Board reporting).

Such complexities will entail high compliance costs, risk unintended consequences, and may be less likely to achieve the Authority’s desired outcomes.

If the Authority proceeds with its proposed approach, it must do more to enable implementation and clarify its expectations. This should include the development of far more detailed guidance for generator-retailers, with worked examples of how the proposed principles could be implemented in practice. The drafting of the principles and associated guidance should also address the workability concerns that Meridian has identified in the following section.

4.8 If the Authority intends to develop this proposal further, several changes are necessary to improve its workability

In Meridian’s opinion, to make the proposal workable, the changes set out in this section would be necessary at a minimum. These changes could make the proposal more prescriptive, but they would also clarify the Authority’s intentions. That clarity would in turn enable easier implementation and proper consideration of the costs and benefits associated with the proposal.

4.8.1 Clearly specify that the standalone commercial viability of a retail segment should be assessed over several years

To assess compliance with the no cross-subsidy principle, the standalone commercial viability of a retail segment should be measured over the long term and the Authority should acknowledge this in the drafting of the principles and associated guidance. This should reflect the strength of a business’ balance sheet to ride through a commodity cycle and be profitable over the long run.

We also note that, in assessing commercial viability, different retailers are likely to have different risk tolerances. Variation can be expected in both their accepted risk tolerance with respect to spot price exposure and their approach to analysing this risk (whether this is through regular detailed modelling or some other means). This further illustrates the point that ‘commercial viability’ is not a straightforward analytical exercise and that generator-retailers should not be unduly constrained in making this assessment.

4.8.2 Better define the term “observable market rates”

The Authority’s draft guidance states that generator-retailers should establish an economically meaningful portfolio of internal hedges and that “prices should be based on observable market rates for comparable risk management contracts, including baseload, peak and super-peak contracts (such as the standardised flexibility product)”.[91] In Meridian’s opinion the term “observable market rates” needs to be more formally and broadly defined. The definition should enable prices to be based on, for example, LCOE of generation assets (or other measures that would approximate the long-term price certainty that can be achieved using physical assets), PPA prices, OTC prices, the price of demand response options, and modelled long-term wholesale prices. Not all of these will be readily “observable” in the sense that they are publicly listed on an exchange or hedge disclosure platform. Therefore, a more suitable term may be “objectively justifiable market rates”. If the term is not more broadly defined then there is a high risk that integrated firms will need to adopt ASX prices and standardized super-peak prices for their notional internal hedges, limiting price smoothing to the duration of the forward curve for those products and resulting in increased volatility in retail pricing and higher retail prices in the near term (reflecting recent ASX prices).

4.8.3 Limit “buyers” to New Zealand wholesale participants

The draft guidance developed by the Authority states that a “gentailer is required to deal or offer to deal with buyers on substantially the same price and non-price terms and conditions (including quality, reliability and timeliness of service) as those made available (either expressly or implicitly) to the gentailer’s internal business units and other buyers.”[92] The term “buyer” is defined to mean:[93]

> *“a person who is –*
>
> - *specified as the buyer in a risk management contract with a gentailer; has otherwise obtained; or*
> - *is obtaining, a risk management contract from a gentailer; or*
> - *has indicated to a gentailer a desire to obtain risk management contracts from the gentailer*
>
> *and includes non-integrated retailers, non-integrated generators, or other gentailers but does not include a gentailer’s own internal business units.”*

This definition is extremely broad and means a buyer is any potential counterparty to a risk management contract with a gentailer, including international financial institutions. There may be a policy rationale for enabling New Zealand wholesale market participants to be buyers under the proposal as they need to manage spot price risks. However, there is no possible policy justification for granting non-participants the same rights. Doing so could require generator retailers to sell significant volumes to offshore speculators who would only be looking to sell back to New Zealand wholesale participants at a premium. This could cost New Zealand market participants and ultimately consumers. The risks associated with international

[91] Options Paper, Appendix B, para 15
[92] Options Paper, Appendix B, para 7
[93] Options Paper, Appendix B, Definitions

financial institutions becoming buyers under the proposal would also be greatly pronounced if arbitrage opportunities arise due to the proposal.

4.8.4 Explicitly enable notional hedge portfolios to grandparent in historic prices

To be workable, the drafting of the proposed principles and guidance should state explicitly that in establishing an economically meaningful portfolio of internal hedges, generator-retailers may grandparent in notional contract positions that in effect assume a retail segment had been transacting hedge agreements over several years in the past. This explicit acknowledgement is necessary to avoid the implication that a generator-retailer's notional hedge portfolio would begin on the first day that any proposal took effect and would therefore be based on current prices rather than a forward view of prices locked in at some point in the past.

If generator-retailers cannot grandparent in notional historic hedges this way, then immediate retail price rises would be necessary to comply with the no cross-subsidy principle.

4.8.5 Specify how generator-retailers should quantify "uncontracted risk management contract capacity"

The Authority's draft guidance states that a gentailer should "allocate its uncontracted risk management contract capacity on a non-discriminatory basis, such that the gentailer is unable to prioritise supplying its internal business units over buyers".[94] It is not clear to Meridian how this concept would be applied and interpreted in practice. As discussed in Appendix C, Meridian continuously tries to balance its portfolio to ensure adequate returns against a reasonable level of financial risk. Meridian's internal processes identify an optimal contract portfolio quarterly into the future that will best achieve this balance, and the contract book is constantly adjusted to achieve that optimal position. Real-time portfolio adjustments are also necessary to account for hydrology and factors such as planned and unplanned generation outages. Viewed through this lens there is often no 'spare' capacity waiting to be released into the market. This means that mandated hedge purchases by others would push a generator-retailer's portfolio to be over-subscribed and necessitate either:

(a) back-to-back hedge purchases by the generator-retailer to maintain its optimal contract portfolio; or

(b) shrinking of its retail market share to maintain the optimal contract portfolio.

It may be that the Authority intends that the volume of load consumed by a generator-retailer's mass market retail customers (i.e. the volume of notional internal hedges to cover that mass market retail position) should be the volume that is also made available to other buyers. However, it is far from clear whether that is the intention or if the Authority has something else in mind when it uses the term "uncontracted risk management contract capacity". Further guidance would aid implementation.

4.8.6 Specify how the proposal applies to new generation and flexibility investments

In Meridian's opinion, to make the proposal workable, the Authority would also need to specify how this concept of "uncontracted risk management capacity" applies to new generation and flexibility investments. If new investments are deemed to increase "uncontracted risk management capacity" and therefore increase the volumes that a gentailer must make available to buyers, then this would have a chilling effect on investment by gentailers.

[94] Options Paper, Appendix B, para 15

The Authority should consider explicitly excluding new investment after a specified date to avoid weakening investment incentives. In conversations with Authority staff it was suggested to Meridian that a retail segment could notionally be the party undertaking investments. It is unclear to us how this would work in practice and a clear exclusion in any Codified principles and guidance would be far preferable.

4.8.7 Ensure volume can be considered in credit and collateral arrangements with buyers

The draft guidance at paragraph 13 states that consideration should not be given to volume when applying proposed principles 1 and 3.[95] In Meridian's opinion, it is critical that volume can be considered in respect of principle 3 so that credit terms and collateral arrangements can reflect an objective assessment of the risk of trading with a buyer. If gentailers are prevented from considering volume for credit requirements they could not ask for additional bank guarantees, letters of credit, or similar from a buyer that wanted 1,000 GWh of cover compared to a buyer that only wanted 0.1 GWh of cover. Credit risks are directly related to volume and sellers must be able to ensure they are not exposed to undue credit risks in respect of higher volumes.

4.9 It is not clear how the Authority would monitor and enforce the proposed principles in the Code

As currently drafted, the proposed principles and guidance are vague, poorly defined, and open to a wide range of interpretations. We consider it will be extremely challenging for the Authority to monitor and enforce compliance with the proposed principles and equally challenging for generator-retailers to demonstrate their compliance.

If these principles are incorporated into the Code, both the Authority's Compliance Team and the Rulings Panel need to be able to enforce them. The proposal appears to be a break from the norm of drafting Code that the Rulings Panel can enforce. Rather than allege a breach, it seems likely the Authority would instead make assessments in future of whether the implementation by generator-retailers delivers the Authority's desired outcomes.[96] If not, the Authority has already identified potential steps 2 and 3 that could be taken to intervene further. However, the Authority has not said how or when it would make those assessments and decide if further steps are necessary. The criteria upon which those assessments would be made are also unclear at this stage.

Writing Code that is not able to be enforced but stating that the Authority will continue to intervene if it does not see certain undisclosed outcomes, sets up generator-retailers to fail and risks reputational harm to the companies involved and the industry in general. In Carl Hansen's expert report, he states:[97]

> *"In my view, the Authority's proposal will inevitably result in more intrusive interventions and needlessly harm the reputation of the retail electricity market."*

Reputational harm can be very costly. The Authority should mitigate this risk by specifying the conditions that would trigger further consideration of intervention as well as the process and decision-making criteria it would apply to assess the need to consider further interventions. This would increase certainty for industry and help generator-retailers to implement the

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[95] Options Paper, Appendix B, para 13
[96] This assumption is supported by the Authority's response to a question on this issue, as set out at the link here.
[97] CSA, Section 1

proposal in a way that delivers the outcomes sought by the Authority and avoids further intervention and reputational harm.

4.10 The Authority needs to quantify the expected net benefits to consumers (if any)

The Authority's proposal inherently involves trade-offs. For example, the Options Paper notes that "any Level Playing Field measure runs some risk of a short-term increase in retail prices".[98] The Authority appears to reach a conclusion on this trade-off when it states the costs of non-discrimination principles are likely to be outweighed by benefits to consumers arising from greater competition, particularly over the longer-term.[99]

However, the Authority does not appear to have undertaken any quantification of costs and benefits to identify whether its proposal will result in a net benefit for consumers. We acknowledge the Authority will need to undertake a cost-benefit analysis at the next stage if it decides to proceed. However, some rough quantification of the expected net benefits (or otherwise) of each of the options assessed would have been helpful at this stage to provide guidance to both the Authority and submitters.

As noted by CSA, we would "hope to see a numerical cost-benefit assessment of the proposal rather a high-level qualitative assessment of the competition, reliability, efficiency and other effects of the proposal" in any next stage of this work.[100] This is critical considering:

(a) the high likelihood of retail price rises and consumer detriment in the near-term;

(b) the likely chilling of investment that would occur;

(c) the potential for significant disruption to the efficient free trading of risk;

(d) the potential distortions to competition including uneven impacts on generator-retailers and disadvantage to social retailers; and

(e) the scale of the expected wealth transfer to non-integrated retailers and smaller vertically integrated retailers and the need for caution when considering the claims of non-integrated firms due to their overwhelming commercial self-interest in regulatory intervention of this kind.

Longer-term competition benefits are by comparison uncertain, and the Authority would need to be certain the scale of any competition benefits would outweigh the costs to consumers and over what timeframe that benefit might be realised.

Carl Hansen has estimated the best-case outcome could be that it takes around *14 years* for enhanced competitive pressure to outweigh the effect of an initial increase in retail prices. This is under the highly optimistic assumption that competitive pressure is double the strength that it was between 2013 and 2018 with more conservative assumptions suggesting it could take twice as long before any net benefits are realised.[101]

The near-term cost impact of any regulatory developments should also be considered in the context of existing price rises for the distribution and transmission components of consumer bills for the regulatory control period that began 1 April 2025 and wider cost of living pressures.

[98] Options Paper, para 5.12
[99] Options Paper, para 6.51
[100] CSA, Section 2.5
[101] CSA, Appendix 2

5 Alternative approaches

Despite the fact that we consider the Authority has not clearly described and evidenced the problem it is seeking to address, we recognise the Authority may nevertheless continue down the path of progressing a 'level playing field' intervention. For this reason, we set out below two alternative options (one of which the Authority itself has identified) which we consider would better balance the Authority's objective to promote retail and wholesale competition while avoiding unintended consequences.

5.1 Market making the standardised super peak product

As discussed in Section 3.1 above, the key issue identified in the Authority's Risk Management Review was that it was unclear if pricing for OTC super peak hedge contracts was competitive as they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape. In contrast, the Review confirmed that pricing for baseload and peak products was likely to be competitive.

While we consider that concerns over the pricing of super peak products are overstated (see the discussion in Section 3.1.2 above), this represents – in our view – the clearest potential 'problem' the Authority has identified. As such, it would make sense to focus any proposed intervention on this particular issue. Introducing market making obligations on the new standardised super peak product would be a more proportionate and targeted solution than the Authority's current proposal.

The Options Paper notes that competitive pricing of baseload hedges is supported by ASX market making requirements.[102] Adopting similar obligations for the standardised super peak product could reasonably be expected to drive an increase in liquidity and would provide greater assurance around the competitiveness of super peak pricing. This would assist independent retailers in managing their wholesale market risk, support retail competition and improve price discovery.

We assume Meridian would face market making obligations under such a regime, with considerable associated cost (as is our experience in market making baseload ASX contracts). Nevertheless, the costs of such an intervention would be much more identifiable than is the case with the Authority's level playing field proposal and risks of unintended consequences would be substantially reduced.

NERA have also concluded that market making of super peak products would be a preferable alternative to the Authority's proposal (emphasis added):

> *"In order to ensure all parties have access to contracts, without unduly limiting the ability of gentailers to operate efficiently as well-hedged retailers, the EA could consider introducing a market-making obligation on super peak (and possibly peak) contracts.*
>
> *In practice, this would involve requiring gentailers to make a certain volume of contracts available each day, and with a maximum bid-ask spread. If the gentailer offered contracts at an artificially high price, then the limit on the bid-ask spread would create an opportunity for another party to arbitrage, by selling contracts to the gentailer at an artificially high price.*
>
> *Such a direct intervention would be* ***a more targeted approach appropriate to the problem of limited access to and high pricing of super peak contracts,***

[102] Options Paper, para 6.6(b)

without creating so many additional complications or unintended consequences that a functional unbundling would."

5.2 A negotiate-arbitrate regime

Option 3 in the Options Paper is the introduction of negotiate-arbitrate regulation. As the Authority notes, such a regime could involve imposing an obligation on generator-retailers to provide access to hedge contracts on fair, reasonable and non-discriminatory terms, backed by a binding arbitration process if commercial negotiations are unsuccessful. The Authority's assessment of this option identifies that it would be relatively low cost to implement and would preserve existing benefits of vertical integration. Identified limitations are that it would need to be well-designed, would rely on a qualified and independent arbitrator, and could create challenges around information asymmetries (although particular design approaches could overcome the latter issue).

In its criteria-based assessment in Table 5 of the Options Paper, the primary differences between negotiate-arbitrate regulation and the Authority's preferred option relate to costs and timing, with the Authority concluding:[103]

(a) Principles-based non-discrimination obligations would be "relatively quick to design and implement" while generator-retailers would face "some system costs to ensure compliance"; and

(b) Negotiate-arbitrate regulation "would take longer to implement" and "could be costly if used regularly".

Meridian disagrees with this assessment. As set out in Section 4.7 above, we consider that a principles-based non-discrimination obligation is, in fact, likely to take some time to implement effectively. This is both because of the complexities of the requirement for generator-retailers to establish a robust internal hedge portfolio (when one currently does not exist) and because we would expect there to be a 'learning period' as generator-retailers develop, deploy and adjust their respective approaches. Our view is that the costs faced by generator-retailers would be considerable as they work through the various complexities.

In contrast, while we acknowledge that a negotiate-arbitrate regime would require some upfront effort to develop, our view is that it would likely be less costly to implement in the long run. This is because initial arbitration decisions are likely to establish helpful precedents in the methodologies used to determine particular hedge prices which will provide guidance to subsequent commercial negotiations and likely lead to fewer arbitrations being required over time. At the same time, a negotiate-arbitrate regime would focus more clearly on the issue of competitive pricing of hedge contracts and would avoid the wider consequences and risk of unintended consequences that would arise from the virtual vertical separation that is inherent in the Authority's non-discrimination proposal. We recommend the Authority reconsider the relative merits of the negotiate-arbitrate option.

Carl Hansen has also identified the potential advantages of a negotiate-arbitrate approach and has proposed offering such an option as a 'safe harbour' within a non-discrimination obligation regime:[104]

[103] We acknowledge that the Authority has also identified that negotiate-arbitrate regulation "doesn't fully address issues with ITPs". However, under such an approach, independent retailers would be able to demonstrably access competitively priced hedge products – in such a situation, ITPs would be completely irrelevant.
[104] CSA, para 20

"Making the negotiate-arbitrate approach a safe harbour option will avoid compliance risks for gentailers, give [non-integrated retailers] greater certainty, and avoid the risk of short-term price rises for residential and commercial consumers."

Mr Hansen also sets out some potential high-level aspects of the design of such a safe harbour and notes that such an approach could convert some of the cons of a negotiate-arbitrate approach into pros:[105]

"The Options paper states the arbitration approach could be costly if used regularly, depending on the decisions needed…However, having the approach available as an option means gentailers will consider those costs when choosing the negotiate-arbitrate safe harbour. Gentailers will only choose to incur additional costs if the additional benefits exceed those costs. As the interests of non-integrated parties is protected by their right to appoint arbitrators…offering the negotiate-arbitrate approach as a safe harbour option will be welfare improving."

Meridian would similarly support a negotiate-arbitrate safe harbour, although we note the potential downside of this would be that the Authority has to effectively develop the detailed design of two different regimes.

6 Conclusions

Meridian supports competitive wholesale and retail markets. Our view is that New Zealand's electricity market has delivered and is continuing to deliver value for electricity consumers. We nevertheless recognise that the sector is in transition and that sources of energy we have previously relied upon (i.e. gas) are no longer available to the same extent. Both wholesale and hedge prices are reflecting that new reality.

The means to alleviate these current supply constraints is investment – investment in new generation capacity and in new flexibility. It is the sector's responsibility to deliver this investment. And it is the responsibility of policy and regulatory decision makers to ensure that the regulatory framework maintains strong incentives to invest. Anything that inhibits this will inevitably impact the future security and affordability of the electricity system. As noted by Carl Hansen:[106]

"The best thing the Authority can do is encourage more supply to the market, to reduce wholesale electricity prices and end the price supercycle as soon as possible."

We share the concerns of our expert advisors that the Authority's proposal, if not designed and implemented carefully, risks impacting investment incentives and driving higher and more volatile retail prices. If the Authority continues with its proposal, we suggest careful consideration of these impacts. We also consider there would be merit in awaiting the findings of the current Government review to ensure any final proposal is consistent with the Government's broader policy direction.

Regardless of what is ultimately progressed, Meridian will do our utmost to make any changes work for the sector – and most importantly – for electricity consumers. We appreciate the Authority's willingness to engage with us on this proposal to date. We remain available to support the Authority at any point as it progresses its proposal through the next stage of development.

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[105] CSA, Section 5.2
[106] CSA, Section 1

Appendix A: Meridian responses to consultation questions

1. 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.
As noted in Appendix B, we consider the benefits of vertical integration in managing wholesale market volatility have been well-canvassed in New Zealand and around the world. We would refer to the 2021 review of academic literature on this subject by Dr Richard Meade for ERANZ as a useful overview.[107] Carl Hansen, in his expert report, discusses the ability of vertically integrated entities to offer price smoothing to consumers, materially improving their welfare. Refer, for example, to Section 3 of his report. NERA's expert report also includes an extensive discussion on the benefits of vertical integration in Section 3, including the following benefits for electricity consumers specifically: • Decreasing generators' incentives to exercise market power, which can result in a decrease in retail prices; • Increasing the stability of retailers, which can assure stable retail prices; and • Facilitating the construction of new generation which is essential to maintain the reliability of the grid and can lead to lower retail prices.
2. 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 you have any evidence to better specify and quantify the competition risks of vertical integration?
Our views on the Authority's problem definition – including its description of competition concerns – are set out in Section 3 above. In summary, we consider: • Many of the Authority's concerns are speculative; • It is clear in a number of cases that the Authority has not been able to differentiate between genuine competition concerns and other factors (such as scarcity, fuel shortages, policy uncertainty, and investment lag); • The Authority appears to have ignored – or at least has not sought to understand – potential alternative explanations for the high-level trends it has observed or evidence that is not consistent with its competition concerns; and • The Authority has mischaracterised the findings of its own Risk Management Review. Our view is this does not provide a sound basis on which to progress an intervention.
3. 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?

[107] https://www.cognitus.co.nz/_files/ugd/022795_90a6a69bdaca4de9b752db7798bf2a2d.pdf

Our views on this are discussed in Section 4.6. In summary, we consider if the Authority implements its measures as proposed, smaller generator-retailers like Nova, Pulse and Lodestone would have a competitive advantage because they will not incur the same costs and inefficiencies and would be able to continue to offer longer-term price smoothing based on their generation investments and deliver the benefits of their chosen business model to end consumers. There is no justification for applying any proposed principles selectively to vertically integrated firms above a certain scale.
4. Are there other specific areas (other than access to hedges) where Gentailer market power and vertical integration are causing competition concerns?
Meridian disagrees with the assertion that gentailer market power and vertical integration are causing competition concerns. We emphasise the importance of the Authority robustly testing and understanding any suggestions of abuse of market power or competition concerns. As discussed in our submission and in the reports of our expert advisors, there are alternative explanations to the Authority's claims that observed trends in the retail market can be traced back to issues of market power. We also consider that the Authority's single-minded focus on identifying competition concerns have led it to ignore other critical market issues, notably the decline of New Zealand's gas sector.
5. Do you agree with our preliminary view that the evidence indicates 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?
We disagree. As discussed in our submission, Meridian's view is that the Authority's problem definition is vague, lacks robust evidence and is, at times, misleading. It does not establish a convincing basis for subsequent intervention. We consider that a level playing field already exists between generator-retailers and independent retailers and generators. Rather than a level playing field, the Authority's proposal seems to be aimed at achieving level outcomes. The Authority should not prefer one business model over another or seek to advantage one type of participant over another. It will only result in greater costs for consumers if New Zealand subsidises or supports inefficient business models.
6. 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?
As discussed in Section 5, our view is that mandating market making of super peak products or a negotiate-arbitrate regime would represent better targeted interventions and would likely have lower costs and lower risk of unintended consequences than the Authority's proposal.
7. Are there any other important factors we should consider when identifying options (see paragraphs 4.2 to 4.5)?
We consider the identification of options should be clearly focussed on those areas where there is evidence of a problem. In this case, based on the Authority's Risk Management Review, this suggests an intervention focussed on the market for super peak products.
8. Are there other key features, pros or cons we should consider in our description of the four Level Playing Field options?

As discussed throughout our submission, we consider the key risks – or cons – of non-discrimination obligations are the chilling of investment incentives and higher and more volatile retail prices. We also consider that the description of non-discrimination obligations as being "relatively low cost" and "relatively quick to design and implement" is overly optimistic. In our view, this approach will be highly complex to implement which will drive high compliance costs, risk unintended consequences, and may be less likely to achieve the Authority's desired outcomes. With all generator-retailers subject to these high compliance costs, these costs are ultimately likely to be passed through to consumers.

9. Have we identified the right criteria for assessing Level Playing Field options (Figure 6)? Is there anything we should add or remove?

We suggest adding the criteria 'near-term impact on retail prices/affordability'.

10. Do you agree with our application of the assessment criteria (Table 5)? Are changes needed to the colour coding or reasoning?

With respect to Option 2:

- We consider the 'generation entry/build' criteria should be rated 'negative'. As described by NERA, there is a strong risk the proposal will have a negative impact on investment incentives, including incentives to invest in flexible capacity;
- We consider the 'investment in new flexibility' criteria should be rated 'negative' for the same reasons described above;
- We consider the 'other efficiencies' criteria should be rated 'very negative' given this option will effectively virtually disaggregate generator-retailers over time, eroding the well-established efficiency benefits of vertical integration;
- We consider the 'costs and timing' criteria should be rated 'weak negative' given this option is complex and will require significant effort and judgement to be applied by generator-retailers to implement. Transaction costs are ultimately likely to flow through to consumers.

With respect to Option 3:

- We consider the 'costs and timing' criteria should be rated 'neutral'. As discussed in our submission, our view is that a negotiate-arbitrate regime would be less costly to implement in the long run as initial arbitration decisions are likely to establish helpful precedents in the methodologies used to determine particular hedge prices which will provide guidance to subsequent commercial negotiations and lead to fewer arbitrations being required over time.

Our lack of comment on other options or criteria should not be taken as an endorsement of the Authority's ratings – we are simply focussing on the critical factors and options that we have identified and discussed in our submission.

11. Are there any other material benefits or risks that should be considered (but are currently not) in our assessment of options?

As per our response to Question 9, we suggest adding the criteria 'near-term impact on retail prices/affordability'.

12. Do you agree with our selection of non-discrimination obligations as our preferred Level Playing Field measure? Why/why not?	
As discussed in our submission, mandated market making of super peak contracts and a negotiate-arbitrate regime would both be preferred interventions to the Authority's proposal. The reasons for this are discussed extensively in our submission and in the accompanying expert reports from Carl Hansen and NERA. Regardless of which option is ultimately progressed, Meridian will do our utmost to make any changes work for the sector – and most importantly – for electricity consumers.	
13. What are your views on our proposed roadmap for the implementation of non-discrimination obligations?	
We consider that the ambiguity of the proposed principles-based approach to non-discrimination obligations will create a high risk that the Authority will need to progress to Step 2 in its roadmap. This will create a slippery slope of intervention. As noted by Carl Hansen, the proposal risks further harming the reputation of the electricity market if the Authority assesses compliance breaches, introduces prescriptive rules, creating more compliance breaches until gentailers learn what the Authority expects, and on and on. Reputational harm could be very costly for the wider industry.	
14. 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 other interactions between Gentailers and their competitors which would benefit from non-discrimination rules?	
As discussed in our submission, it is clear from the Risk Management Review findings that the only concern the Authority has identified is in relation to the pricing of super peak products. However, the Authority's proposal as currently written will capture all hedge contracts offered by generator-retailers, including those the Authority has confirmed are likely to be trading competitively. In our view, this significant broadening of the scope of the intervention is inconsistent with a robust regulatory development process and heightens the risk of unintended consequences without any underlying justification. If the Authority is confident that the analysis in its Risk Management Review remains robust, then a more proportionate and reasonable response would be to focus its intervention on ensuring a competitive and liquid market for super peak products.	
15. 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 allowance should not be extended to volume (at paragraph 13 of Appendix B)?**	
As discussed in Section 4.8 of our submission, if the Authority intends to develop this proposal further, several changes are necessary to improve its workability. At a minimum, these include:	

• Clearly specify that the standalone commercial viability of a retail segment should be assessed over several years; • Better define the term "observable market rates"; • Limit "buyers" to New Zealand wholesale participants; • Explicitly enable notional hedge portfolios to grandparent in historic prices; • Specify how generator-retailers should quantify "uncontracted risk management contract capacity"; • Specify how the proposal applies to new generation and flexibility investments; and • Ensure volume can be considered in credit and collateral arrangements with buyers (i.e. we disagree that the allowance for a "cost-based, objectively justifiable reason" should not be extended to volume).
16. Do you agree that escalation options are needed if principles-based non-discrimination obligations are implemented initially? Why/why not?
Refer to our response to Question 13.
17. 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)?
We consider these escalations are not suitable given the available evidence on the nature and scope of the problem i.e. it is unclear whether super peak products are being competitively priced. We consider more proportionate and targeted options would be mandated market making of a super peak product or a negotiate-arbitrate regime. These options are discussed further in our submission and in the reports from our expert advisors.
18. 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 requirements for ITPs?
We consider it would be challenging and costly to adopt a more prescriptive approach. However, as discussed in our submission, we consider the proposed principles-based approach is likely to see generator-retailers choosing to implement the proposal in different ways, resulting in a more chaotic implementation. It is hard to see how this will benefit consumers. As stated by Carl Hansen: "Unless the Authority offers a 'safe harbour' option…it may be better for the Authority to introduce prescriptive non-discrimination obligations. At least that way the Authority would have to confront the realities of what they are requiring of gentailers".
19. 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?
Our understanding is that the Authority is seeking to implement this requirement through the principle that "a gentailer must not discriminate against buyers in favour of its own internal business

units…without a cost-based, objectively justifiable reason" and the associated guidance that a generator-retailer should "allocate its uncontracted risk management contract capacity on a non-discriminatory basis, such that the gentailer is unable to prioritise supplying its internal business units over buyers".

Meridian's view is that, if such a requirement is to be effective, the Authority needs to provide greater guidance on how "uncontracted hedge volumes" should be calculated. Hedge portfolios are complex and dynamic, and different generator-retailers may take substantially different views on how this requirement should be interpreted. Further changes to improve the workability of the Authority's proposal are summarised in our response to Question 15 above and in Section 4.8 of our submission

20. Do you have any views on the triggers for implementing the stronger regulation proposed in our roadmap?

As noted in our submission, our view is that the standalone commercial viability of a retail segment should be assessed over several years. This would allow any judgement on this matter to reflect the strength of a business' balance sheet to ride through a commodity cycle and be profitable over the long run.

At this stage, we do not have views on the specific triggers which should be used for progressing to stronger regulation. However, as per the above, we consider the timeframes for assessing those triggers need to be sufficient to allow for long run commercial viability to be assessed.

If the Authority does proceed with its proposal, it needs to be clear at the outset what it considers the triggers to be and how it will make the decision to intervene further. See Section 4.9 of our submission for further discussion of implementation and enforcement challenges.

21. 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?

The Authority appears to be referring here to the issue of a future concentration in the supply of flexibility services. As noted in our submission, MDAG recommended that a 'virtual disaggregation' option be developed to 'put in the drawer' ready for use if other measures are not effective and in the event of thermal retirements and concentration of flexibility. Meridian's view is that it is currently premature to pursue virtual disaggregation. We agree that the electricity system will need additional flexibility going forward. Our own analysis indicates 200 MW of additional flexibility will be needed each year for the next 25 years. In this context, it is critical that there are clear and stable investment incentives to develop additional flexibility.

Meridian's view is the Authority's proposal:

- Is effectively implementing virtual disaggregation now (although this is *vertical* disaggregation rather than the horizonal disaggregation of flexible generation or storage considered by MDAG). As generator-retailers will be unable to prioritise sales to their own retail business units, the inevitable consequence over the long run is that generator-retailer's generation and retail units will become disaggregated, increasing costs and inefficiencies, and significantly impacting the benefits that arise from vertical integration and the price-smoothing services enjoyed by consumers; and
- Will negatively impact incentives to invest in flexibility. As set out by NERA, if a gentailer is not able to fully use its flexible generation to offset risk for its retail arm, and does not capture the full value of the insurance it provides because it is forced to sell at below market value

to other firms, then this takes away a substantial portion of the value of building it, and hence reduces the incentive to build it. Similarly, to the extent the proposal increases retail price volatility, gentailer earnings will be more volatile and financing to support investment may be higher cost as a result.

Rather than addressing the underlying issue identified by MDAG, our view is the Authority's proposal will make this issue worse by chilling investment in flexible generation while imposing additional and unnecessary costs on consumers.

22. Do you have any views on whether virtual disaggregation 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?

As above, MDAG's virtual disaggregation option was developed to address a completely different concern to the risks now identified by the Authority.

Appendix B: Benefits of vertical integration in the New Zealand electricity sector

Wholesale electricity markets are recognized as one of the more volatile types of commodity markets in the world. While MDAG concluded that the New Zealand market is considerably less volatile than other international markets, significant volatility is still expected given the system's need to instantaneously balance supply and demand, limited capacity for storage, and a reliance on unpredictable and uncontrollable weather.[108]

The advantages of adopting a vertically integrated structure to manage this volatility have been well canvassed in New Zealand and around the world. A 2021 review of academic literature on this subject by Dr Richard Meade for the Electricity Retailers Association of New Zealand (ERANZ) found that:[109]

(a) vertical integration – where it naturally arises – is superior to vertical separation in managing wholesale price risks, supporting investment, reducing incentives for the exercise of market power, and providing better outcomes for consumers;

(b) while vertical integration can give rise to anticompetitive opportunities such as foreclosure (refusing to supply rivals), integration is not always associated with such activities, especially in electricity systems which have design and regulatory features which reduce foreclosure risk;

(c) even when foreclosure incentives exist, the benefits of integration are sufficient to result in net consumer benefits; and

(d) where naturally-occurring vertically integrated firms are forcibly separated, there is solid evidence from a variety of sectors around the world that this harms consumers.

NERA's expert report similarly concludes that vertical integration delivers benefits for both market participants and for consumers:[110]

> *"…by reducing transaction costs, providing firms with flexible risk management through an internal hedge, and assuring that their risk management needs are met, vertical integration can be a more efficient way for electricity market participants to manage wholesale electricity market risk."*

and:[111]

> *"In electricity markets specifically, vertical integration can provide value to the consumers of electricity in several ways, including by:*
>
> - *Decreasing generators' incentives to exercise market power, which can result in a decrease in retail prices,*
> - *Increasing the stability of retailers, which can assure stable retail prices, and;*

[108] Price discovery in a renewables-based electricity system – Final recommendations paper, MDAG, December 2023, link, pp37-39
[109] https://www.cognitus.co.nz/_files/ugd/022795_90a6a69bdaca4de9b752db7798bf2a2d.pdf
[110] NERA, Section 3.3
[111] NERA, Section 3.4

- *Facilitating the construction of new generation which is essential to maintain the reliability of the grid and can lead to lower retail prices."*

The Authority itself acknowledges seven benefits of vertical integration in the Options Paper: risk management, reduced financing costs, reduced transaction costs, coordination of investment, economies of scope, elimination of double marginalisation, and financially robust.

The Authority also acknowledges the claim of independent retailers that the benefits of vertical integration are largely financial or risk management-based rather than relating to productive efficiencies.[112] This apparent dismissal of financial and risk management benefits significantly underemphasises their importance. NERA refers to the independent retailers' claim and notes it would be:[113]

> *"…incorrect to downplay any efficiencies from vertical integration in electricity markets on the basis they are financial or risk management based, given these efficiencies relate to one of the core functions of electricity markets".*

NERA also notes that the 'productive efficiencies' referred to by independent retailers are likely a very small part of the cost of retail electricity sales and should therefore be of lesser concern than efficiencies related to risk management.

The merits of vertical integration have also been well considered in a New Zealand regulatory context:

(a) The 2009 Ministerial Review concluded that vertical integration was beneficial to consumers and highlighted the criticality of a liquid contracts market in mitigating the downsides of vertical integration;

(b) The previous Government's Electricity Price Review found that vertical integration can provide significant benefit to consumers while forced separation would be "disruptive, undermine investor confidence and stall or delay the huge amount of generation investment needed to move to a low-carbon economy";[114]

(c) MDAG concluded from its comprehensive assessment of the wholesale market that ownership separation between generation and retail activities should not be adopted as a backstop tool;[115] and

(d) The Electricity Authority rejected vertical separation in its 2023 Decision Paper following its review of competition in the wholesale market.[116]

It is clear that there is a wealth of evidence – in New Zealand and globally – that vertical integration is an efficient business model that delivers significant consumer benefits while, in contrast, vertical separation would work to the detriment of consumers.

[112] Options Paper, para 3.18
[113] NERA, Section 3.1
[114] Electricity Price Review: Final Report, link, p41
[115] Price discovery in a renewables-based electricity system – Final recommendations paper, MDAG, December 2023, link, p166
[116] Promoting competition in the wholesale electricity market in the transition toward a renewables-based electricity system – Decision Paper, Electricity Authority, May 2023, link, para 4.11

Appendix C: Meridian’s approach to portfolio management

With the formal reset of market arrangements that occurred in 2011 and further encouraged by market listing in 2013, Meridian has now spent the last 14 years efficiently managing and investing in our existing hydro and wind assets, creating new generation and new flexibility assets, securing a large pipeline of new generation and flexibility options, and building up a large, diverse retail and customer base including a number of formalised demand-response agreements.

By their nature some of these actions are relatively short-lived, some medium-term, and many, especially when linked to assets, require a multi-decade perspective and commitment. For all of these commercial activities, financial exposure is only ever exposed in the fullness of time, when price and volume become the ultimate arbiter of whether any particular decision in hindsight was a good idea or not. That is the nature of the significant investment risk that Meridian and other market participants face.

These activities cover generation, contracting, and retailing actions. The nature of the New Zealand half-hourly wholesale market means that generation and contract income can help to offset load and contract purchase costs, to some degree, especially when in a similar location and of a similar scale. As imbalances between sales and purchases occur and as underlying spot prices rise and ebb, significant operational portfolio cashflow risks can still remain.

This can occur in response to anything that materially impacts on supply or demand, from hydrology and storage lakes, new demand, retrenchment of demand, transmission constraints and plant failures, through to the impacts of renewable intermittency. This is a measurable risk, for an assumed state of the market, and Meridian takes great care in balancing available energy and capacity against contract and other load commitments.

Broadly speaking, Meridian does this in a way that continuously tries to balance and ensure adequate returns against a reasonable level of financial risk. Viewed through this lens there is no ‘spare’ capacity waiting to be released into the market. At least over a 12-24 month horizon, we maintain a fully committed ‘book’. This position is adjusted as hydrology and other key uncertainties unfold and deviations from this optimised position will create earnings losses, additional portfolio financial risks, or both. A version of what these risks might mean can be seen recently, when Mercury and Meridian both posted significantly negative profit results for the final six months of 2024.

All participants in the market must manage these risks to varying degrees and all will have a different approach on how they do that and on what they think works best for them and their owners. There is no definitively correct approach. Somewhat conventionally, Meridian manages short and medium-term portfolio risks along with some amount of longer-term investment risk by maintaining a vertically integrated business. That is to say, we are a business that balances quantities of generation income, customer sales incomes, and market purchase obligations from half-hour to half-hour. There are no internal contracts that achieve this: under current settings these would be entirely redundant and impose unnecessary transaction costs. Instead, we rely on offsetting and measurable positive and negative cashflows.

As outlined above, in Meridian’s case this position has been built up over a number of years and includes a range of agreements with other parties at different prices, scales, shapes and durations. At the point of agreement, both parties were happy with the terms and conditions by demonstration. Whether parties remain happy is moot – these are the risks that both parties engage with.

Meridian balances financial returns against an appropriate level of investment, portfolio and physical risks, all while delivering secure, renewable energy and flexibility to the market with our customers at the forefront of all of our decisions. Over the last 14 years we have invested at our own risk, managed our own contract and retail positions, bought, sold, created short-term and long-term arrangements – all to create the business that we have today. There is nothing wrong with this approach, and by the very nature of our market, any party including independent retailers or new entrant generators could similarly take this approach should they so choose. Indeed, Lodestone Energy has recently taken such a step.[117] As reflects the realities of the power system and the energy needs of New Zealand, this requires long-term commitment, investment, and balancing risk and reward to be at the centre of their – and our – decisions.

[117] https://lodestoneenergy.co.nz/lodestone-becomes-an-energy-retailer/

Appendix D: Expert report from Carl Hansen (Capital Strategic Advisors)

Appendix E: Expert report from NERA