30 September 2025

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REGULATING TRADE IN STANDARDISED SUPER-PEAK HEDGE CONTRACTS

EXECUTIVE SUMMARY

Price discovery—the market's stated primary objective—is already working. Empirical analysis of eight months' trading data demonstrates super-peak contracts trade at stable, predictable ratios to ASX futures (120-140% at Otahuhu, 120-135% at Benmore), indicating transparent price formation.[1] Seasonal and locational differentiation reflects genuine risk premiums.[2] This evidence confirms that the market is achieving its core purpose.

The Authority's own evidence contradicts its regulatory rationale. The Authority acknowledges that "fuel or capacity scarcity" drives thin markets, that "retailers have been able to secure substantial shaped hedge cover," and that baseload and peak hedge prices "are likely to be competitive." Yet it proposes volume-based regulatory triggers without investigating root causes or assessing whether current arrangements deliver effective price discovery - which empirical evidence confirms they do.[3] Forcing mandatory market making and minimum traded volumes does not address the underlying cause – fuel and capacity scarcity.

Platform functionality warrants assessment before volume-based triggers are implemented. There are significant operational constraints with the current platform. These include manual broker updates, inability for participants to update own bids/offers, and processing delays impeding efficient trading.[4] Examining whether technical constraints

[1] Stevenson, T, Murray K, Hansen E, Davies P, Young M, Sapere Research Group *Regulating the standardised super-peak hedge contract* – Enhancing price discovery (2025), Section 2.3.2, Figures 2-3, pp. 7, 9.
[2] Sapere Report, Section 2.3.2, Figures 4-5, pp. 10-11.
[3] Sapere Report, Section 2.3.2, pp. 6-11.
[4] Sapere Report, Section 2.3.1, pp. 4-5.

affect trading volumes would help ensure regulatory metrics accurately reflect market conditions rather than platform limitations.

Alignment with established regulatory standards. The Ministry of Regulation and Treasury guidance to regulators on policy and regulation require evidence-informed regulation with empirical investigation, clear problem definition, impact analysis, and assessment of alternatives. However, the Authority's approach does not align with these requirements. For example, the Authority: does not provide a clear and robust problem statement; compares current conditions against an idealised "nirvana" rather than achievable real-world outcomes; proposes regulation after only six months of the standardised product operating and without resolving known platform issues; provides a cursory cost benefit analysis; and does not assess alternatives successfully deployed in other markets.

Proven alternatives deserve proper assessment. There are other approaches that may better service a market with limited sellers. The Global Dairy Trade auction model for example successfully manages concentrated supply (Fonterra) with diverse global buyers through twice-monthly uniform-price auctions, delivering transparent price discovery and $2.7B annual volumes.[5] Similarly, one-sided auction formats in the US corporate bond markets also address concentrated supply structures effectively.[6]Comparing these mechanisms against the proposed regulatory options would provide a fuller assessment of available approaches.

Recommendation: Genesis supports standardised super-peak contracts and is committed to their success. We ask that the Authority pause and: (1) set out a clear problem definition for escalation; (2) address and test platform operational constraints; (3) reconcile its proposed metrics with the Standardised Flexibility Product Co-design Group's criteria; (4) allow sufficient time for genuine market development and cost benefit analysis, and; (5) properly assess alternative mechanisms.

[5] Sapere Report, Section 3.1.2, pp. 15-16.
[6] Sapere Report, Section 3.1.2, pp. 15-17.

INTRODUCTION

Genesis appreciates the opportunity to provide feedback on the Authority's consultation paper "Regulating the standardised super-peak hedge contract: issues and options" dated 19 August 2025 (**Consultation Paper**). As an owner and operator of flexible generation assets and an active participant in electricity risk management markets, Genesis has deep experience with the operational and commercial realities the consultation addresses.

This submission draws on analysis conducted by Sapere Research Group examining eight months of trading data from the standardised super-peak market (**Sapere Report**).[7] The analysis focuses on whether the market is achieving its stated primary objective - price discovery - and what this evidence means for regulatory design. It also examines how the consultation aligns with established regulatory practice standards set by the Ministry of Regulation, and considered alternative mechanisms successfully deployed in comparable markets. A copy of the Sapere Report is **enclosed** with this submission.

Our submission is structured in six parts:

- **Part I** examines empirical evidence of price discovery in the super-peak market;
- **Part II** discusses how the Authority's evidence contradicts the rationale for the proposed regulatory intervention;
- **Part III** discusses platform functionality and its implications for volume-based metrics;
- **Part IV** assesses the Authority's approach against regulatory practice standards;
- **Part V** discusses alternative mechanisms for assessment.

Responses to the specific consultation questions are set out in the **Schedule**.

[7] Stevenson, T, Murray K, Hansen E, Davies P, Young M, Sapere Research Group *Regulating the standardised super-peak hedge contract* – Enhancing price discovery (2025).

PART I: THE EVIDENCE SHOWS PRICE DISCOVERY IS WORKING

The Market's Primary Objective is Being Achieved

The Standardised Flexibility Product Co-design Group identified price discovery of peak products as the urgent, top-priority problem to solve.[8] As the Sapere Report explains, empirical analysis of trading data from January to September 2025 demonstrates this objective is being achieved.

Super-peak contracts trade at stable ratios to ASX futures, indicating effective price discovery:[9]

- Benmore contracts: 120-135% of comparable ASX futures
- Otahuhu contracts: 120-140% of comparable ASX futures
- Ratios stabilized after initial market development (first 2-3 auctions)
- Clear locational differentiation (Otahuhu premiums reflect North Island constraints)
- Seasonal patterns evident (winter quarters show appropriate risk premiums)

This **price discovery operates transparently in practice**. An independent retailer purchasing Q2 2026 Otahuhu contracts at 138% of ASX futures receives market-tested pricing reflecting genuine risk assessment by multiple participants. We would expect that the retailer knows this premium reflects North Island transmission constraints and winter demand patterns - not arbitrary pricing or withheld supply. This is price discovery functioning precisely as the Co-design Group intended.

This relationship reflects sound economic fundamentals. Both super-peak and ASX futures contracts trade in anticipation of the same underlying market fundamentals. ASX futures provide liquid baseload price discovery. Super-peak ratios reflect market participants' assessment of peak price risk relative to baseload—precisely the price discovery the Co-design Group sought to enable.[10]

After initial price formation, the ratios have tracked consistently. For quarters 2026 Q2 through 2028 Q1, the vast majority of Otahuhu trades cluster in the higher band (135-140%), while Benmore trades distribute more evenly across the range.[11] This pattern reflects genuine market views on relative risk, not arbitrary pricing or market power.

Stable Ratios Demonstrate Competitive Pricing. The stable ratio relationship provides strong evidence against strategic withholding. If Genesis or other flexible generators were extracting monopoly rents through capacity withholding, super-peak prices would spike

[8] Sapere Report, Section 2.1, Table 1, p. 2.
[9] Sapere Report, Section 2.3.2, Figure 2, p. 7.
[10] Sapere Report, Section 2.3.2, pp. 6-11.
[11] Sapere Report, Section 2.3.2, Figures 4-5, pp. 10-11.

unpredictably above these stable relationships to ASX futures. Instead, the consistent 120-140% bands demonstrate that competitive forces constrain pricing. Market power could manifest as:

- unpredictable price spikes disconnected from baseload pricing;
- widening ratios over time as sellers exploit position;
- different pricing for identical products based on buyer identity;
- breakdown of locational and seasonal differentiation patterns.

None of these indicators appear in the trading data. The stable, predictable ratios - with appropriate locational and seasonal variation - demonstrate that prices reflect genuine scarcity and risk assessment rather than strategic behaviour.

The Authority cannot have it both ways. The Authority states its analysis indicates "prices for OTC baseload and peak hedge contracts are likely to be competitive." If baseload prices are competitive, and super-peak prices trade at stable, predictable ratios to those baseload prices, then this indicates that super-peak price discovery is functioning effectively.[12]

Areas for Further Assessment

We note that the Authority has not provided evidence that:

- current price discovery is ineffective or inefficient;
- regulatory intervention would improve on observed price outcomes;
- the stable ratio relationship between super-peak and ASX futures indicates market failure;
- independent retailers are unable to access contracts at prices reflecting genuine scarcity.

In addition to addressing these matters, we ask that the Authority examine three critical questions that would distinguish between market failure and market functioning:

- First, demand-side assessment: Do independent retailers seek additional contracts at current market-clearing prices, or do observed volumes reflect genuine demand equilibrium? If retailers are not bidding for additional volumes at current prices, this may suggest the market is clearing efficiently rather than suffering from supply withholding.

- Second, price efficiency: What specific price discovery outcomes would regulatory intervention achieve that current arrangements do not deliver? The empirical evidence shows stable, predictable pricing with appropriate locational and seasonal differentiation. We ask that the Authority must articulate what "better" price discovery would look like and how regulation would achieve it.

[12] Sapere Report, Section 2.3.2, pp. 6-11.

- Third, alternative explanations: The Authority acknowledges that "fuel or capacity scarcity" drives thin markets. Before attributing low volumes to market failure, we ask that the Authority quantify how much of the observed trading pattern reflects physical scarcity versus other factors. This analysis would determine whether regulatory intervention addresses causes or merely penalises participants for physical constraints beyond their control.

Understanding whether price discovery is working is fundamental to assessing whether intervention is needed. The Ministry of Regulation requires empirical investigation before regulatory intervention.[13] However, the Authority proposes to regulate based on volume metrics without assessing whether the market's primary objective - price discovery - is being achieved. The empirical evidence demonstrates that it is.

As discussed in the enclosed Sapere Report, the empirical evidence demonstrates that price discovery - the market's primary objective - is working. The Authority faces a fundamental question: should it regulate a market that is achieving its stated purpose based solely on volume metrics, without first investigating whether those volumes reflect platform constraints, physical scarcity, or demand equilibrium? The Ministry of Regulation/ Treasury guidance require regulators to identify market failure before intervening. However, the Authority has not demonstrated that stable, predictable pricing reflecting genuine risk assessment constitutes market failure requiring correction.

PART II: THE AUTHORITY'S OWN EVIDENCE UNDERMINES RATIONALE FOR INTERVENTION

The Authority Acknowledges Root Cause But Ignores Implications

The consultation paper contains admissions that undermine the regulatory rationale:[14]

Authority's Evidence	Logical Implication	Authority's Proposed Action	Our Assessment
Shaped products are largely backed by flexible generation resources	Physical capacity constrains supply	Mandate minimum trading volumes	Treats symptom, does not address underlying capacity constraint
Fuel or capacity scarcity often being the driver behind the thin and illiquid market	Scarcity is the fundamental constraint	Assess based on traded volumes	Penalises participants for physical reality. Should consider whether volumes reflect scarcity

[13] Sapere Report, Section 4.1, p. 18.
[14] Consultation Paper, section 2.16.

			rather than market failure
Retailers have been able to secure substantial shaped hedge cover through OTC contracts, but the market is neither deep nor liquid	Current arrangements working	Impose market-making requirements if thresholds not met	Solution seeking problem and tilts the playing field against gentailers.
Baseload and peak prices are likely to be competitive	Price discovery functioning	Could not reach same conclusion for super-peak	Contradicted by empirical evidence of stable ratios

The Authority proposes to mandate trading volumes without addressing the physical scarcity it acknowledges drives thin markets. However, generators cannot offer hedge products beyond their physical capacity without becoming speculators – taking on exposure without the underlying generation to manage that risk.[15] Further, this scarcity has implications for volume-based metrics. When physical capacity constrains supply, lower trading volumes reflect genuine scarcity rather than unwillingness to trade. Distinguishing between these scenarios would help ensure regulatory responses address actual market failures.

Clarifying the "Workable Competition" Framework

The Authority states: "In a workably competitive market, available volume to sell should exceed that which is necessary to buy." However, in competition economics, workable competition typically describes a process of rivalry rather than a volume comparison.

The Authority's statement implies generators should maintain flexible capacity in excess of market demand but it is unclear who would pay for this excess capacity.[16] In our view, unmet demand indicates scarcity, not market failure and when supply is tight relative to demand, price discovery becomes more - not less - important. As set out in the Sapere Report, the empirical evidence shows that this price discovery is occurring, which is the appropriate market response to scarcity conditions.

Intervention Exacerbates the Root Problem

The Authority claims applying requirements "evenly across all obligated participants" will "ensure each obligated party is equally incentivised to develop additional flexible resources." However:

- **Economic reality:** Regulatory obligations to make assets available to competitors at mandated terms create equal *disincentives* to invest. No investor commits capital to flexible generation knowing regulatory obligations will force them to make

[15] Sapere Report, Section 2.2, pp. 3-4
[16] Sapere Report, Section 2.4.1, p. 12.

that capacity available to competitors on terms set by a regulator rather than negotiated commercially.[17]

- **The risk is real:** New Zealand needs additional flexible generation investment. Regulatory uncertainty consistently deters capital-intensive investment, as confirmed by Treasury, RBNZ, and international studies.[18] However, the Authority proposes intervention that may deter the very investment needed to address the underlying scarcity it acknowledges.

PART III: PLATFORM FUNCTIONALITY WARRANTS ASSESSMENT

Platform Operational Constraints

The Authority proposes regulatory triggers based primarily on traded volumes. However, it is widely recognised by industry participants there are material operational constraints with the current platform that should be investigated first to assess their impact.

These constraints include:

- participants cannot update their own bids and offers;
- manual broker intervention required for all updates;
- high risk of input errors from manual transcription;
- processing delays impede efficient price discovery;
- platform unsuitable for nimble trading (buying and selling in succession);
- technology described industry-wide as "clunky".

It is important that these constraints are investigated and understood. When technical or operational factors affect trading activity, examining their impact would help ensure volume metrics accurately reflect market conditions rather than platform limitations.

Speed-to-Market Trade-off

The platform limitations are unsurprising. The Co-design Group worked from September to December 2024, with trading commencing January 2025. A platform originally developed for another purpose was adapted rapidly to meet the launch deadline.[19]

This speed-to-market enabled valuable progress in establishing the product and beginning price discovery. The question is whether addressing technical constraints before implementing volume-based regulatory triggers would provide a more accurate assessment of market performance.

Ensuring Metrics Reflect Market Conditions

[17] Sapere Report, Section 4.3, pp. 21-22.
[18] Sapere Report, Section 4.6.1, pp. 27-28.
[19] Sapere Report, Section 2.3.1, pp. 4-5.

The Authority proposes to assess market performance using:

- Volume traded
- Volume offered and bid
- Bid-ask spread
- Depth-dependent bid-ask spread
- Price volatility
- Amihud's illiquidity measure

All these metrics are contaminated if platform constraints suppress trading activity. These metrics would provide valuable information when technical constraints are resolved. If platform limitations affect trading activity, waiting until those issues are addressed would help ensure the metrics reflect genuine market behaviour rather than technical impediments.[20]

Sequencing matters for accurate assessment. Addressing platform functionality first, allowing time for market participants to utilise improved infrastructure, then assessing whether volumes reflect market conditions or ongoing constraints would strengthen the evidentiary basis for any regulatory decision.

PART IV: ALIGNMENT WITH REGULATORY STANDARDS

The Ministry of Regulation and the Treasury's guidance establishes that regulators should:[21]

- use empirical investigation through intelligence, evaluation, data collection and analysis;
- clearly identify the nature and underlying cause of the policy or operational problem;
- assess likely impacts (intended and unintended) of its specific proposals;
- consider a full range of feasible regulatory and non-regulatory options.

The Authority's approach does not align with these principles as discussed in detail in the enclosed Sapere Report.[22]

We ask that the Authority:

(a) **Undertake further empirical investigation:** Several areas require further analysis:

[20] Sapere Report, Section 2.3, p. 5.
[21] Sapere Report, Section 4.1, pp. 18-19.
[22] Sapere Report, Section 4, pp. 18-24.

- **Platform functionality:** Examination of technical constraints identified by participants would help determine whether volume metrics accurately reflect market conditions.
- **Price discovery effectiveness:** Evaluation of the stable ratio relationships evident in trading data would inform whether the market's primary objective is being achieved.
- **Participant needs assessment:** Understanding whether independent retailers seek additional contracts at current prices, or whether observed volumes reflect demand equilibrium, would clarify what problem regulation would solve.

(b) **Improve the Problem Definition:** The Ministry cautions that effective regulation requires moving beyond "generalised concerns about promoting competition and risk management" to articulating "a clear problem that it is intervening to address." An appropriate problem definition would specifically address the following:

- **Specific cause:** What market failure needs correction? (Beyond physical scarcity which the Authority acknowledges)
- **Clear consequence:** What specific harm results from this failure? (Given that retailers are securing substantial cover)
- **Causal relationship:** How does the cause produce the consequence?
- **Compulsion to act:** Why is intervention necessary given current conditions?

(c) **Cost Benefit / Impact Analysis: Quantified analysis including:**

- Estimated costs and benefits of proposals
- Transmission mechanisms that would generate claimed benefits
- Sensitivity analysis of key assumptions
- Net effect on consumer welfare
- Potential investment impacts
- Regulatory uncertainty costs (for which there is extensive empirical literature)

This analysis would enable comparison of whether expected benefits exceed expected costs, and whether the proposal represents the most efficient approach to achieving the stated objectives.

Broadening Assessment of Alternatives

The Ministry requires consideration of "a full range of feasible regulatory and non-regulatory options." The consultation focuses on:

- market making on ASX;
- market making OTC;

- mandatory minimum volumes (urgent option).

As outlined in Part 5 below and discussed in the Sapere Report, additional mechanisms that could be assessed include:

- Global Dairy Trade auction model (twice-monthly uniform-price auctions managing concentrated supply).
- One-sided auction formats (proven in US corporate bond markets with concentrated supply).

Comparing these alternatives against the proposed options would provide a fuller assessment of which approach might most effectively achieve the Authority's objectives while minimising unintended consequences.

Comparing Against Achievable Outcomes

The Authority describes an environment where "all participants have access to options to efficiently manage wholesale price risk, regardless of operating model." The Authority acknowledges constraints to achieving this outcome: "fuel or capacity scarcity" will remain tight "until some period after conditions for investment in flexible capacity and fuel stocks improve."

Good regulatory practice emphasises comparative institutional analysis: Which real-world arrangement best addresses the problem, given actual constraints? Comparing the proposal against achievable alternatives rather than idealised outcomes would strengthen the assessment of whether intervention would improve on current arrangements.

Timeline Considerations

The Authority proposes regulatory assessment after only six and a half months of trading at the time of the Consultation Paper, with potential "enduring" regulation by mid-2026.

The market is nascent and intervention of the nature proposed by the Authority is premature. We ask that the Authority pause and take the time required to properly assess the regulatory case, including to allow:

- resolution of identified platform operational issues;
- market maturity and participant learning;
- assessment of alternatives; and
- quantified cost-benefit analysis.

The sequencing could be refined to ensure regulation, if needed, is based on comprehensive evidence gathered once technical constraints are resolved and the market has had adequate time to develop.

PART V: PROVEN ALTERNATIVES MERIT ASSESSMENT

As outlined in the Sapere Report, there are other approaches that may better service a market with limited sellers and buyers, enhance price discovery and optimise liquidity.[23] The Global Dairy Trade auction model for example successfully manages concentrated supply (Fonterra) with diverse global buyers through twice-monthly uniform-price auctions, delivering transparent price discovery and US$2bn – US$3bn annual volumes.[24] Similarly, one-sided auction formats in the US corporate bond markets also address concentrated supply structures effectively. Comparing these mechanisms against the proposed regulatory options would provide a fuller assessment of available approaches.

Potential Implementation Pathway

Rather than implementing regulation after six months, we suggest an evidence-informed approach along the following timeline:

Immediate (0-3 months):

- Address identified platform operational constraints
- Survey market participants on remaining barriers
- Assess whether independent retailers seek additional contracts at current prices

Short-term (3-6 months):

- Trial improved platform with enhanced functionality
- Monitor price discovery effectiveness alongside volume metrics
- Document market development with technical constraints resolved

Medium-term (6-12 months):

- If intervention appears warranted, assess alternative mechanisms (GDT model, one-sided auctions)
- Conduct cost-benefit analysis comparing regulatory and non-regulatory options

Long-term (12+ months):

- Consider enduring arrangements based on comprehensive evidence from adequate market development period

[23] Sapere Report, Section 3, pp. 15-16.
[24] See https://www.globaldairytrade.info/

CONCLUSION

New Zealand's electricity sector faces genuine challenges in managing increasing intermittency from renewable generation and price volatility. Addressing these challenges effectively requires evidence-based regulation that targets root causes rather than symptoms.

The evidence shows the market is achieving its primary objective. The Standardised Flexibility Product Co-design Group identified price discovery of peak products as the urgent, top-priority problem to solve. Eight months of empirical data demonstrates this objective is being achieved—super-peak contracts trade at stable, predictable ratios to ASX futures with appropriate locational and seasonal differentiation. This is precisely the price discovery the Co-design Group sought to enable.

The Authority's own evidence undermines its regulatory rationale. The Authority acknowledges that fuel and capacity scarcity drives thin markets, that retailers have secured substantial shaped hedge cover, and that baseload and peak prices are likely competitive. Yet it proposes volume-based regulatory intervention without investigating whether these volumes reflect platform constraints, physical scarcity, or demand equilibrium—and without assessing whether current arrangements deliver effective price discovery, which the evidence confirms they do.

The regulatory process falls short of established standards. The Ministry of Regulation and Treasury guidance require clear problem definition, empirical investigation, impact analysis, and assessment of alternatives before regulatory intervention. The Authority's approach does not meet these standards. It compares current outcomes against an idealised "nirvana" rather than achievable alternatives, proposes regulation after only six and a half months without resolving known platform issues, provides cursory cost-benefit analysis, and does not assess alternative mechanisms successfully deployed in comparable markets.

Premature intervention risks exacerbating the underlying problem. The Authority proposes mandatory obligations on generators who have invested in flexible generation to make that capacity available to competitors on regulated terms. Such obligations create disincentives to the additional flexible generation investment New Zealand needs. Regulatory uncertainty consistently deters capital-intensive investment—a risk confirmed by Treasury, RBNZ, and extensive international evidence. The fundamental question: Why would an investor commit capital to flexible generation knowing regulatory intervention may force them to provide that capacity to competitors on terms set by a regulator rather than negotiated commercially?

Genesis supports standardised super-peak contracts and is committed to their success. However, we ask that the Authority pause and take the time necessary to ensure any intervention is evidence-based and addresses root causes. Specifically, we ask that the Authority:

1. **Articulate a clear problem definition** that identifies specific market failure (beyond physical scarcity which the Authority acknowledges), demonstrates clear harm (given retailers are securing substantial cover), establishes causal relationships, and explains why intervention is necessary given that price discovery—the Co-design Group's top priority—is working.

2. **Address and test platform operational constraints** before implementing volume-based triggers. If technical constraints affect trading activity, regulatory metrics must reflect genuine market behaviour rather than platform limitations.

3. **Reconcile proposed metrics with the Co-design Group's success criteria.** The Group prioritised price discovery, not volume. The Authority should assess whether the market meets the criteria the industry established rather than imposing different standards.

4. **Allow sufficient time for genuine market development.** We recommend 18-24 months from when platform issues are resolved to enable market maturity, participant learning, and proper cost-benefit analysis.

5. **Properly assess alternative mechanisms** including approaches proven in comparable markets (Global Dairy Trade auction model, one-sided auction formats) that may better address concentrated supply structures.

This evidence-informed approach would help ensure any intervention addresses root causes and supports—rather than deters—the flexible generation investment New Zealand needs for its energy transition. We trust this submission contributes to regulatory decision-making that balances the genuine need to support competition with the equally important imperative to maintain investment incentives in the flexible generation capacity that underpins the entire electricity system.

Please contact me should you have any queries or wish to discuss our submission further.

Yours sincerely

Warwick Williams
Senior Regulatory Counsel and Group Insurance Manager

SCHEDULE
Consultation Questions

Note: The responses below should be read together with the Sapere Report enclosed with this submission.

Questions	Comments
Q1. Do you agree that access to shaped hedge contracts such as the standardised super-peak hedge contract is an important enabler of competition in the electricity market?	**Yes, with important qualifications.** Access to shaped hedge contracts enables independent retailers to better match customer load profiles and manage peak price risk. However, the fundamental constraint is physical scarcity of flexible generation and fuel, not market structure issues. The empirical evidence demonstrates the standardised super-peak product is already achieving its primary objective—price discovery. Eight months of trading data shows super-peak contracts trade at stable, predictable ratios to ASX futures (120-140% at Otahuhu, 120-135% at Benmore), with appropriate locational and seasonal differentiation. The Authority's own analysis indicates baseload and peak hedge prices are likely competitive. Since super-peak prices maintain stable ratios to these competitive baseload prices, this suggests effective price discovery is occurring. Competition depends on whether prices reflect genuine scarcity and risk assessment rather than market power. The stable ratio relationship provides strong evidence against strategic withholding—if generators were exercising market power, we would observe unpredictable price spikes disconnected from baseload pricing, not the consistent patterns evident in the data. See further the enclosed Sapere Report.

Q2. Do you agree with our objectives for and intended outcomes of trade in the super-peak product?	**We support the Co-design Group's original objectives, particularly the priority focus on price discovery.** The Standardised Flexibility Product Co-design Group identified price discovery of peak products as the urgent, top-priority problem to solve. Our analysis demonstrates this objective is being achieved. The Authority should assess success against these criteria rather than imposing different standards focused primarily on volume. However, we have concerns about the Authority's articulated objectives in the Consultation Paper. The Authority describes an environment where "all participants have access to options to efficiently manage wholesale price risk, regardless of operating model"—but acknowledges this cannot be achieved given fuel and capacity scarcity will remain tight "until some period after conditions for investment in flexible capacity and fuel stocks improve." Good regulatory practice requires comparative institutional analysis: which real-world arrangement best addresses the problem, given actual constraints? Comparing current arrangements against an idealised outcome rather than achievable alternatives weakens the regulatory analysis. The Authority must also consider whether its proposed intervention addresses causes or symptoms. Mandating minimum trading volumes does not resolve underlying fuel and capacity scarcity. Worse, regulatory obligations that force generators to make flexible capacity available to competitors on regulated terms create disincentives to the additional flexible generation investment New Zealand needs.
Q3. Do you agree with our framework and metrics for assessing liquidity in the standardised super-peak market?	**No. The proposed framework prioritizes volume metrics over the Co-design Group's success criteria and may be contaminated by platform operational constraints.** **Critical disconnect with stated objectives:** The Co-design Group prioritized price discovery, not volume. Yet the Authority proposes regulatory triggers based primarily on traded volumes without first assessing whether the market's primary objective—price discovery—is being achieved. The empirical evidence confirms it is.

	Platform contamination of metrics: Multiple market participants report that the platform suffers from significant operational constraints: • Participants cannot update their own bids and offers • Manual broker intervention required for all updates • High risk of input errors from manual transcription • Processing delays impede efficient trading • Platform unsuitable for nimble trading (buying and selling in succession) All six of the Authority's proposed metrics (volume traded, volume offered and bid, bid-ask spread, depth-dependent bid-ask spread, price volatility, and Amihud's illiquidity measure) would be contaminated if platform constraints suppress trading activity. Implementing volume-based regulatory triggers before resolving known technical issues risks attributing to market failure what may reflect platform limitations. **Sequencing matters:** Address platform functionality first, allow time for market participants to utilize improved infrastructure, then assess whether volumes reflect genuine market conditions. This would strengthen the evidentiary basis for any regulatory decision. **Missing demand-side assessment:** The framework does not assess whether independent retailers seek additional contracts at current market-clearing prices, or whether observed volumes reflect genuine demand equilibrium. If retailers are not bidding for additional volumes at current prices, this suggests the market is clearing efficiently rather than suffering from supply withholding.

Q4. Do you agree with our proposed quarterly assessment period for voluntary trading from 2026 onwards?	**No. The proposed timeline is premature and does not allow sufficient time for genuine market development.** **Market maturity requires time:** The Authority proposes regulatory assessment after only six and a half months of trading (as of the Consultation Paper date), with potential "enduring" regulation by mid-2026. This timeline is inadequate for: • Resolution of identified platform operational issues • Market maturity and participant learning • Assessment of alternatives • Quantified cost-benefit analysis **Recommended timeline:** We recommend 18-24 months from when platform issues are resolved to enable proper assessment. This would comprise: • **Immediate (0-3 months)**: Address identified platform operational constraints; survey market participants on remaining barriers; assess whether independent retailers seek additional contracts at current prices

	• **Short-term (3-6 months)**: Trial improved platform with enhanced functionality; monitor price discovery effectiveness alongside volume metrics; document market development with technical constraints resolved • **Medium-term (6-12 months)**: If intervention appears warranted, assess alternative mechanisms (GDT model, one-sided auctions); conduct cost-benefit analysis comparing regulatory and non-regulatory options • **Long-term (12+ months)**: Consider enduring arrangements based on comprehensive evidence from adequate market development period This evidence-informed approach ensures any intervention addresses root causes rather than symptoms.
Q5. Do you think we should allow trading to develop further voluntarily and assess whether to regulate according to the framework set out above, or do you see a need to move more quickly now to regulate? Please provide reasons.	**Trading should develop further voluntarily. There is no case for urgent regulation.** **Price discovery is working:** The market is achieving its stated primary objective. Empirical evidence demonstrates super-peak contracts trade at stable, predictable ratios to ASX futures with appropriate locational and seasonal differentiation. This is precisely the price discovery the Co-design Group sought to enable. **The Authority's own evidence undermines urgent intervention:** The Consultation Paper acknowledges: • "Retailers have been able to secure substantial shaped hedge cover through OTC contracts" • "Fuel or capacity scarcity often being the driver behind the thin and illiquid market" • Baseload and peak hedge prices "are likely to be competitive"

	If retailers are securing substantial cover and prices are competitive, where is the urgent harm requiring immediate intervention? **Platform issues must be resolved first:** Before attributing low volumes to market failure, the Authority must determine whether technical constraints affect trading activity. Regulating based on potentially contaminated metrics risks imposing costly obligations to address a problem that may not exist. **Regulatory process requirements:** The Ministry of Regulation requires clear problem definition, empirical investigation, impact analysis, and assessment of alternatives before regulatory intervention. The Authority's approach does not meet these standards. Moving to regulation now would: • Intervene without a structured, solvable problem definition • Compare current outcomes against an idealised "nirvana" rather than achievable alternatives • Impose obligations after only six months without resolving known platform issues • Proceed without quantified cost-benefit analysis • Skip assessment of alternative mechanisms successfully deployed in comparable markets **Investment implications:** Premature intervention risks exacerbating the underlying problem. Regulatory obligations forcing generators to provide capacity to competitors on regulated terms deter the additional flexible generation investment New Zealand needs. Why

	would an investor commit capital to flexible generation knowing regulatory intervention may force them to provide that capacity to competitors on terms set by a regulator rather than negotiated commercially?
Q6. Do you have views on whether barriers exist to wider or more diverse participation in the super-peak trading events?	**Yes. Platform operational constraints represent a barrier to wider participation.** The current platform limitations include: • Inability for participants to update their own bids and offers directly • Manual broker intervention required for all changes • Processing delays between submission and posting • High risk of transcription errors • Platform unsuited to nimble trading within sessions These constraints are understandable given the speed-to-market priority (Co-design Group worked September to December 2024, with trading commencing January 2025). However, these technical barriers impede efficient participation. Addressing them should be the Authority's first priority before considering whether other barriers exist. **Other potential barriers require assessment:** The Authority should investigate:

	• Whether credit arrangements inhibit participation • Whether the fortnightly auction frequency is optimal • Whether contract specifications meet diverse participant needs • Whether information asymmetries between participants affect willingness to trade **Caution on "barriers" framing:** Not all differences in participation reflect "barriers." Physical scarcity of flexible generation and fuel naturally constrains supply-side participation. The question is whether willing buyers can access available supply at prices reflecting genuine scarcity rather than market power. The evidence suggests they can.
Q7. Do you see a need for additional or better information on price discovery or trading of standardised super-peak contracts? If so, do you have any specific suggestions?	**Yes. The Authority should enhance transparency around price discovery effectiveness, not just volumes.** **Priority information needs:** 1. **Price discovery analysis**: Regular publication of super-peak to ASX futures ratio analysis by node and quarter, showing whether stable pricing relationships continue. This directly measures whether the market's primary objective is being achieved. 2. **Demand-side perspective**: Survey independent retailers on whether they seek additional contracts at current prices, or whether observed volumes reflect demand equilibrium. This distinguishes genuine scarcity from supply withholding. 3. **Platform performance metrics**: Publish data on submission-to-posting times, error rates, and other operational measures. This helps assess whether volume metrics reflect market conditions or technical constraints.

	4. **Participant feedback**: Regular structured feedback from diverse participants on trading experience, remaining barriers, and suggested improvements. **Information to avoid:** The Authority should not publish information that facilitates coordination or undermines commercial confidentiality. Real-time individual participant positions or strategies should remain confidential. **Transparency about assessment:** If the Authority proceeds with its proposed assessment framework, it should publish: • Clear methodology for calculating each metric • Thresholds that would trigger regulatory concern • How metrics weight against each other in decision-making • How platform issues are controlled for in interpretation This transparency would reduce regulatory uncertainty and enable participants to understand how their trading behavior affects regulatory risk.
Q8. Do you agree with our options for enduring regulation? Are there other options you think we should consider?	**No. The Authority has not demonstrated that regulation is warranted, and has not assessed proven alternatives from comparable markets.** **Threshold question not answered:** Before designing regulatory options, we ask that the Authority demonstrate that:

	• Current price discovery is ineffective (evidence shows it is effective) • Regulatory intervention would improve on observed outcomes • Stable ratio relationships indicate market failure (they suggest functioning price discovery) • Independent retailers cannot access contracts at prices reflecting genuine scarcity (Authority acknowledges they can) **Alternative mechanisms warrant assessment:** The Consultation Paper focuses on market-making variations (ASX vs OTC) without considering alternative transaction mechanisms. These include the Global Dairy Trade auction model and one-sided auction formats (US corporate bond markets). See discussion in the main body of this submission and the Sapere Report.
Q9. Do you have feedback on the settings for the options (eg, bid-ask spread, volumes)?	**The proposed settings are premature because:** 1. **No clear problem definition exists:** Settings cannot be calibrated without a structured, robust problem definition that identifies specific cause, consequence, causal relationship, and compulsion to act. 2. **Platform contamination unresolved:** Any volume-based settings are meaningless if platform constraints suppress trading activity. Fix the platform first, then assess what "normal" volumes look like. 3. **No empirical basis provided:** The Authority has not explained how proposed thresholds relate to efficient market outcomes or how they were derived. 4. **Conflicting objective:** The Co-design Group prioritised price discovery, not volume. Settings based primarily on volume metrics are misaligned with stated objectives.

	The Authority should first demonstrate the need for regulation through proper problem definition and cost-benefit analysis. See further the Sapere Report.
Q10. Do you agree with our rationale for who the regulation should apply to, and that it should be evenly spread across the obligated participants?	**No. Applying regulation to named firms is highly unusual in competition policy and inconsistent with competitive neutrality principles.** **Competitive neutrality concerns:** The Authority proposes applying regulation to four specific companies. Regulatory interventions targeting specific firms violate competitive neutrality - the principle that all enterprises are provided a level playing field with respect to a state's ownership, regulation or activity in the market. Three fundamental problems with named-firm regulation: **1. Indicates weak problem definition:** If the core problem is fostering price discovery for super-peak products, narrowing regulatory focus to selected firms is counterproductive. A robust problem statement would identify specific behaviours or outcomes sought from the sector, with well-designed regulation targeting those behaviours, not firms. **2. Regulates business models:** By targeting firms based on their business model (vertical integration), the Authority inadvertently stymies business innovation. In dynamic markets, firms adopt different strategies over time in competing for customers. Some succeed, others fail. Regulators are poorly placed to determine business models. **3. Encourages rent-seeking:** If regulators can be persuaded to apply regulations to some firms while exempting others undertaking similar activities, this encourages "rent-seeking"—entities using the regulatory process to seek advantage at the cost of other stakeholders.

	"Evenly spread" does not create equal incentives: The Authority claims applying requirements "evenly across all obligated participants" will "ensure each obligated party is equally incentivised to develop additional flexible resources." This reasoning is flawed. A regulatory obligation to make assets available to competitors is a disincentive to invest, regardless of whether it applies "evenly." The question is: why would any investor commit capital to flexible generation knowing regulatory obligations will force them to make that capacity available to competitors on terms set by a regulator rather than negotiated commercially? The correct characterization is "equally disincentivised." **Missing analysis:** The Authority has not analysed: • Negative impacts on investment incentives from its intervention • Whether any competitive benefit would exceed the competitive detriment from constraining owners of flexible generation from competing using benefits of their investment • Why targeting specific firms is necessary rather than behaviour-based regulation • How this approach aligns with competitive neutrality principles See further the discussion in the Sapere Report.
Q11. Do you agree with our criteria for assessing options for regulation? Do you think we should include anything else?	**No. The Authority compares regulatory options against each other without establishing whether any regulation is superior to current voluntary arrangements**. See discussion in the main body of this submission and the Sapere Report.

Q12. Do you agree with our assessment of option 1: Market making ASX ?	**No, and more fundamentally, the Authority has not established that any market-making obligation is warranted.** **Assessment deficiencies:** The evaluation lacks: • Quantified estimates of costs and benefits • Analysis of transmission mechanisms • Sensitivity to key assumptions • Comparison against current voluntary arrangements (not just other regulatory options) • Assessment of investment disincentive effects **Specific concerns with Option 1:** **1. Access barriers:** If ASX access is difficult for some participants, this creates unequal trading opportunities. However, the Authority has not investigated: • How many potential participants lack ASX access • What costs and timeframes are involved in obtaining access • Whether access barriers constitute a material impediment • Whether solutions exist to address access issues without market-making obligations

	2. Inflexibility: The Authority notes this option "makes it harder to evolve the product" but does not quantify the value of flexibility or assess how reduced innovation affects long-term market outcomes. Given the Co-design Group recognized "the right product for 2025, might be different to the right one for future periods," this is a material deficiency. **3. Investment signals:** How would mandatory ASX market-making affect investment decisions by: • Current owners of flexible generation • Potential new entrants with flexible capacity • Demand-side flexibility providers The Authority has not analysed these effects, despite regulatory uncertainty consistently deterring capital-intensive investment (documented by Treasury, RBNZ, and extensive international evidence). **4. Compatibility with physical constraints:** How does mandated market-making interact with acknowledged fuel and capacity scarcity? If generators cannot offer hedge products beyond physical capacity without becoming speculators, what happens when obligated volumes exceed available capacity? **Threshold issue remains:** Before assessing market-making options, we ask that the Authority demonstrate: • Current price discovery is failing (evidence shows it is working)

	• Market-making obligations would improve outcomes • Benefits would exceed costs, including investment disincentive effects • Less interventionist approaches have been exhausted This demonstration is currently absent. See further the discussion in the Sapere Report.
Q13. How important do you think it is to retain flexibility for the product to evolve?	**Extremely important. Product evolution is essential for effective risk management in a changing electricity system.** **Co-design Group recognition:** The success criteria explicitly acknowledged "the right product for 2025, might be different to the right one for future periods" and "more products may need to be added over time, or the first product amended in specification." **Drivers of required evolution:** 1. **Changing generation mix**: As intermittent renewable generation increases, the nature of flexibility products needed will change. Wind and solar patterns differ from historical hydro patterns. 2. **Demand-side participation**: Demand response and battery storage are emerging. Products must evolve to enable these participants to offer flexibility. 3. **Transmission constraints**: As the grid evolves, locational requirements for flexibility products may change. 4. **Learning and innovation**: Six months of experience reveals opportunities for improvement. Rigid product specifications prevent capturing these benefits.

	5. **Technology change**: New technologies (e.g., grid-scale batteries, green hydrogen) will alter the flexibility landscape. **Regulatory risk:** Highly prescriptive regulation, especially on exchange platforms with standardized contracts, reduces flexibility to evolve. This creates two problems: 1. **Lock-in effects**: Market participants invest in systems and processes for specific products. Changing regulated products requires costly adjustments. 2. **Innovation deterrence**: If participants know products cannot easily adapt, they may not propose improvements or experiment with alternative approaches. **Balance required:** Some standardisation benefits price discovery and comparison. But the standardisation should be the minimum necessary to achieve these benefits, with freedom to evolve other aspects. Over-specification in regulation reduces adaptability.
Q14. Is access to the ASX a problem for your organisation? If so, please explain why.	Genesis does not have problems accessing the ASX.
Q15. Do you agree with our assessment of option 2: market making OTC ?	**No, and as discussed in Q13 above, more fundamentally, the Authority has not established that any market-making obligation is warranted.** As with Option 1, the evaluation is superficial and not aligned with regulatory practice standards. The "assessment" in Table 5 contains general assertions without: • Quantified costs and benefits

	• Transmission mechanisms • Comparison against voluntary arrangements • Investment impact analysis • Sensitivity analysis Option 2 appears to contemplate using the current platform or similar manual broker-intermediated arrangements. But as discussed in the Sapere Report and above, the current platform suffers significant operational constraints. Mandating market-making on a platform with known technical issues compounds the problem. We ask that the Authority fix the platform first.
Q16. How much of a problem is the administration burden and/or lack of total anonymity in option 2?	This is a material concern. As discussed in the main body of this submission and the Sapere Report, there are operational constraints with the platform that need to be addressed. These include: • participants cannot update their own bids and offers; • manual broker intervention required for all updates; • high risk of input errors from manual transcription; • processing delays impede efficient price discovery; • platform unsuitable for nimble trading (buying and selling in succession); and • technology described industry-wide as "clunky". We observe that:

	• The matching process is extremely manual which causes delays and increases error risk • Time delays between submission and posting impede efficient trading • Staff resources diverted to manual processes represent opportunity costs • Costs compound if volumes increase
Q17. Do you have any feedback on our preferred option for regulating the standardised super-peak hedge contract?	It has not been demonstrated that regulation is warranted and so determining a preferred option is premature. See further the discussion in the main body of this submission and the Sapere Report.
Q18. Do you agree with our description of option A as a possible urgent and short-term response to a material reduction in liquidity of shaped hedge contracts?	**No. The Authority has not established what constitutes "material reduction" or demonstrated that urgent intervention authority is appropriate.** **Threshold questions unanswered:** 1. **What is "material reduction"?** The Authority has not defined quantitative triggers or explained how "material" is determined relative to: ○ Physical availability of flexible generation ○ Fuel availability ○ Demand for shaped products ○ Platform operational capacity 2. **Material relative to what baseline?** Current volumes may reflect:

	○ Platform constraints (not market failure) ○ Genuine scarcity (appropriate response to tight supply) ○ Demand equilibrium (efficient market clearing) ○ Natural seasonal variation 3. **What is "sudden"?** Volume fluctuations may have legitimate causes: ○ Scheduled plant maintenance ○ Fuel availability changes ○ Seasonal demand patterns ○ Legitimate commercial decisions **Urgent Code Amendment concerns:** Section 40 of the Electricity Industry Act 2010 allows urgent amendments without consultation for up to nine months. This is extraordinary power requiring extraordinary justification. The Authority proposes using this power based on volume metrics that may reflect: • Platform technical issues (not market failure requiring urgent intervention) • Physical scarcity (not addressable by urgent regulation) • Normal market functioning (inappropriate to override with urgent regulation)

	Precedent risk: Using urgent amendment powers without: • Clear problem definition • Evidence that current arrangements are failing • Demonstration of imminent harm requiring urgent action • Assessment of unintended consequences This potentially sets dangerous precedent and increases regulatory uncertainty. **Missing analysis:** Further, the Authority has not explained: • What urgent harm would result from "wait and see" approach • Why urgent action is warranted given retailers are securing substantial cover • How urgent intervention addresses root causes (fuel/capacity scarcity) • What unintended consequences might arise from hasty intervention • Whether urgent intervention might deter investment when investment is most needed

Q19. Do you agree option B might be appropriate as an urgent and short-term response to a material reduction in liquidity of shaped hedge contracts?	**No. Option B compounds the problems with Option A and creates additional concerns about forced transactions.** **Forced buying and selling raises material concerns:** Option B involves a requirement to "offer and sell hedges," which implies: • Buyers must purchase even if prices are viewed as unreasonable • Sellers must transact even if buyers' credit is uncertain • Both parties must trade even if commercial terms are unacceptable This forced-transaction approach: **1. Contradicts market principles:** Markets function when participants voluntarily transact at mutually acceptable terms. Forcing transactions undermines the price discovery function markets serve. **2. Raises pricing questions:** • Who determines the price for forced transactions? • If the Authority sets prices, on what basis? • If parties negotiate but must transact, how is deadlock resolved? • How do forced prices relate to genuine market prices? **3. Creates credit risks:**

	• Must sellers transact with buyers they view as credit risks? • Who bears default risk from forced transactions? • How does this interact with banks' credit risk management? **4. Interacts poorly with physical constraints:** The Authority acknowledges "fuel or capacity scarcity often being the driver behind the current thin and illiquid market." If scarcity limits what generators can physically offer, how do forced-sale obligations work? Do generators become speculators, taking on exposure without underlying generation? **Assessment claims unsupported:** The Authority's Table 7 assessment that Option B enables "price discovery may not cover all time periods" is cryptic and unsupported. How does forced buying and selling improve price discovery compared to voluntary trading? **Urgent intervention inappropriate:** If Option A's urgent intervention concerns are serious, Option B's are worse. Forced transactions implemented hastily via urgent Code amendment, without proper analysis, risks market disruption and unintended consequences. If by "material reduction in liquidity" the Authority means a sudden supply curtailment, the appropriate response is investigating the cause: • Plant failure? (Not addressable by forced trading) • Fuel shortage? (Not addressable by forced trading) • Strategic behaviour? (Requires evidence before intervention)

	Forcing transactions without understanding causes treats symptoms, not causes.
Q20. What are your views on the frequency of monitoring for this option?	**The Authority should not monitor for "triggers" to implement regulation that has not been justified.** **Threshold issue:** Before discussing monitoring frequency, the Authority must establish: 1. Clear problem definition 2. Evidence that intervention improves outcomes 3. Proper cost-benefit analysis 4. Assessment of alternatives These prerequisites are missing. **If monitoring proceeds despite these concerns:** **Platform resolution first:** Any monitoring must account for platform operational constraints. Monitoring volumes when technical issues may suppress trading produces misleading signals. The sequence should be: 1. Fix platform technical issues 2. Allow adequate time for participants to adjust (3-6 months) 3. Establish baseline "normal" trading patterns 4. Only then monitor for deviations

	Appropriate monitoring frequency: Given that: • The market is nascent (six months old) • Seasonal variation in flexible generation and demand is pronounced • Fuel availability varies • Platform improvements are needed we suggest that monitoring frequency should be at least quarterly. **Avoid hair-trigger responses:** The Authority proposes assessment "over two consecutive quarters" (six months) as potentially triggering urgent intervention. This is far too short given: • Market still developing • Platform issues unresolved • Seasonal variation not fully observed • Participants still learning A more appropriate threshold would be sustained concerns over 18-24 months, with clear evidence that: • Price discovery is failing (not just volumes are low) • Underlying cause is market failure (not scarcity or platform issues)

	• Intervention would improve outcomes • Benefits exceed costs **Monitoring content:** Rather than monitoring for "material reduction" to trigger intervention, the Authority should monitor: • Price discovery effectiveness (super-peak to ASX ratios) • Participant satisfaction with arrangements • Platform operational performance • Barriers to participation • Market evolution and learning This information-gathering approach enables evidence-based decision-making rather than automatic regulatory escalation.
Q21. Do you agree the Authority needs to be prepared for urgent action if necessary?	**The Authority should be prepared for urgent action in genuine emergencies. However, low trading volumes in a nascent hedge market do not constitute an emergency requiring Section 40 urgent Code amendment powers.** **Appropriate use of urgent powers:** Urgent Code amendment authority under Section 40 exists for genuine emergencies where: • Immediate harm to consumers or system security is imminent • Waiting for consultation would cause irreparable damage

	• The problem and solution are clear • Temporary urgent action enables time for proper permanent solution **Low volumes are not an emergency:** The Authority's proposal to use urgent powers for "sudden and material reduction in the offers or trades of shaped hedges" does not meet the emergency threshold: **1. No immediate harm demonstrated:** • Retailers are securing substantial shaped hedge cover (Authority's admission) • Baseload and peak prices likely competitive (Authority's conclusion) • Price discovery is working (empirical evidence) **2. Root cause is not sudden or unexpected:** • Fuel and capacity scarcity is acknowledged and ongoing • This scarcity "often being the driver behind the current thin and illiquid market" • Known condition does not suddenly become emergency **3. Volume reduction may have legitimate causes:** • Platform technical issues (not market failure) • Scheduled plant maintenance

	• Seasonal fuel availability • Efficient demand equilibrium **4. Urgent intervention may worsen situation:** • Forced transactions create credit risks • Rushed regulation without analysis causes unintended consequences • Investment deterrence when investment most needed **Better preparedness approach:** Rather than preparing to use urgent powers hastily, the Authority should: **Immediate:** • Improve monitoring and early warning systems • Establish clear criteria distinguishing emergencies from normal variation • Develop contingency analysis for various scenarios • Engage with participants on potential concerns **Ongoing:** • Fix platform technical issues • Allow adequate market development time

	• Conduct proper cost-benefit analysis of potential interventions • Assess alternative mechanisms • Build evidence base through systematic information gathering **If genuine emergency:** If evidence emerges of actual market manipulation or strategic behaviour causing immediate harm, the Authority can act urgently. But this requires: • Clear evidence of cause • Demonstration of immediate harm • Targeted intervention addressing specific behaviour • Temporary measure while permanent solution developed Preparing for urgent intervention based on volume metrics in a six-month-old market with known platform issues and acknowledged physical scarcity is inappropriate.
Q22. Do you agree with option B as the preferred option for urgent regulation while more enduring regulation is being considered?	No. As discussed above it has not been demonstrated that urgent regulation is warranted. We suggest it is better to focus on market development. The better approach would be to ensure the market develops properly: • Fix platform issues • Allow adequate maturity time

	• Gather systematic evidence • Maintain ongoing dialogue with participants
Q23. Are there any other ways to correct a sudden and material reduction in the offer and/or trade of shaped hedges, including the standardised super-peak contract?	As discussed in the Sapere Report there are alternative approaches that should be considered. However, the threshold question is whether "sudden and material reduction" requires correction at all. **Diagnose before treatment:** Before identifying ways to "correct" a reduction, the Authority must diagnose the cause: **Cause 1: Platform technical constraints** • **Correction:** Fix the platform (not regulate participants) • **Actions:** Enable direct participant updates, improve processing speed, reduce error risks, enable nimble trading **Cause 2: Physical scarcity (acknowledged by Authority)** • **Correction:** Cannot be "corrected" by forcing transactions • **Long-term response:** Maintain investment incentives for flexible generation • **Short-term:** Accept that scarcity creates thin markets—focus on price discovery effectiveness (which evidence shows is working) **Cause 3: Seasonal or fuel availability variation** • **Correction:** None needed—this is normal market functioning

	• **Response:** Ensure monitoring distinguishes normal variation from problematic patterns **Cause 4: Efficient demand equilibrium** • **Correction:** None needed—if retailers aren't bidding more at current prices, market is clearing • **Action:** Survey whether retailers seek additional volume **Cause 5: Strategic behaviour (not evidenced)** • **Correction:** Investigate and address specific behaviour • **Action:** Gather evidence before intervening

Regulating the standardised super-peak hedge contract

Enhancing price discovery

Toby Stevenson, Kieran Murray, Eric Hansen, Preston Davies, Michael Young

30 September 2025

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Executive summary

In 2024, at the behest of the Electricity Authority and Commerce Commission's joint Energy Competition Task Force, a Standardised Flexibility Product Co-design Group was formed to work with the Authority to develop a traded flexibility product for the wholesale electricity market. The group's brief, from September to December 2024, was to "design and develop one or more standardised flexibility products with a focus on a tradeable product that has utility for buyers and sellers."

The first thing the Co-design Group did was to define the problem the product would address because the Task Force did not provide a problem definition. Critically, the Co-design Group identified price discovery of peak products and price discovery of demand side flexibility as urgent.

The first fortnightly auction for standardised super peak hedge contracts took place on 28 January 2025. Six and a half months later, the Authority proposes to regulate market making and a minimum volume of trades for the four major generator/retailers "should shaped hedge trading suddenly collapse," as judged by the Authority over two consecutive quarters (commencing in January 2026).

The initiative fails several regulatory tests:

1. There is no problem definition for the proposed intervention. The Consultation paper proposing an intervention presents a 'grab-bag' of concerns and assertions, but there is no problem definition that the intervention would address.
2. The Authority proceeds by describing how an abundant supply of shaped hedge contracts would promote competition, when by the Authority's own admission, conditions do not lend themselves to that perfect solution. To a degree, liquidity in flexibility products is a function of limited underlying generation capacity and fuel scarcity. Forcing mandatory market making and minimum traded volumes will not address that problem.
3. The proposal targets intervention at selected participants. Regulatory interventions targeting specific firms are highly unusual, especially in competition policy.
4. The potential intervention is laid out as a regulatory progression implemented with urgency rather than the result of an enduring principled regulatory process. Potential impacts are asserted, not calculated, and that the prospect of the escalation undermines the workings of the market as it is currently.
5. When the Authority asked the Co-design Group to look at new hedge products, it narrowed the field to the sort of products traded over the counter, or on formalised futures exchanges. The Authority perpetuates that narrow focus with its discussion on a possible intervention. There may be other approaches that might better serve a market with few buyers and few sellers, but they have not been explored.

Poor regulatory processes result in very real harm to consumers:

- Uncertainty deters investment, lowers employment and reduces consumer welfare.
- The electricity sector is especially vulnerable to regulatory uncertainty.
- The size of New Zealand's economy exacerbates risks of regulatory error.

- Because of the high cost to society from regulatory uncertainty, reforms to New Zealand's institutions in recent decades sought to reduce erratic and unpredictable changes in policy by providing institutional constraints. The approach signalled by the Authority falls well short of a welfare-enhancing decision made at the margin based on good information and sound policy principles.

The Task Force paid limited attention to how super peak transactions are best facilitated and has not considered the impact that differing microstructure solutions may have on advancing the Authority's objectives for the super peak product.

A possible mitigation is that the Task Force decided to adopt a 'lean startup, fail fast' approach to market microstructure, with a view to learning and iterating over time to what works in practice. If this is the Task Force's strategy, then the Authority's first response to a disappointing result should be to assess whether any shortcomings in the current transaction mechanism are inhibiting success and, if appropriate, consider whether an alternative microstructure may be more effective. A cascade of regulatory interventions should not be considered as a first response to an initial lack of success.

Alternative market microstructure solutions could enhance robust price discovery and better optimise liquidity. Alternative approaches, similar to those implemented in other markets, have potential to be:

a) more robust to one side of the market being concentrated in a small number of participants

b) more suitable for aggregating liquidity across multiple products.

Given the Co-design Group's brief, they did a good job of identifying a product and considering a style of trading in a short period of time. Critically, they identified price discovery of peak products and price discovery of demand side flexibility as urgent, absent any existing solutions and the top priorities for the product.[1] These priorities beg two questions:

1. Has the first six and a half months of trading met the Co-design Group's success criteria?
2. What does the performance of the contract to date tell us whether an intervention might be warranted?

The Co-design Group's criteria for success are as follows:

- Price discovery
- Effective investment signalling
- Appropriate risk arrangements
- Beneficial to buyers and sellers
- Product may change in the future
- Trading urgency.

We tested the veracity of price discovery to date. The prices for the super peak product for individual quarters mirror the shape of the ASX futures. Both contracts trade in anticipation of the same

[1] That is consistent with the GPS on New Zealand electricity which notes the Authority has an important role facilitating improved forward price discovery.

underlying market fundamentals capturing very similar future uncertainties. It appears that prices struck for super peak contracts trade as a ratio of the comparable ASX futures prices and, as the Authority states, prices for baseload contracts are "likely to be competitive." It makes sense that the base load contracts reflect the fundamentals of the market while trade in the super peak contracts just reflect the risk of prices spiking at peak times relative to baseload prices. Shifts in the ratio across the range reflect a meeting of minds on that risk rising or falling. If that is the case the standardised contracts would be addressing the highest and most urgent problem the Co-design Group was looking to address.

We tested the reliability of volume data given that it features in two of the Authority's six metrics for assessment (Electricity Authority, 2025, Appendix A, 3):

> "a. Volume traded
> b. Volume offered and bid
> c. Bid-ask spread
> d. Depth dependent bid-ask spread
> e. Price volatility
> f. Amihud's illiquidity."

We have been advised by several participants that the super peak platform is "clunky," to the extent that it renders the auctions as static. The time it takes between when a participant submits a change to its bid or offer and when it is posted on the platform, and the risk of error arising from manual processes to transcribe (and presumably check) each submission, seriously inhibits the effectiveness of the platform as a trading venue. This would be unsurprising given the time between designing a product and launching the platform was so short.

We were told that compared to other broker based matching platforms the operation of the platform doesn't lend itself to nimble trading, i.e. buying and selling in quick succession, during the trading period. If it's the case that volumes, or any of the Authority's proposed metrics, are impeded by the working of the platform to any degree, that should be of some concern to the Authority as it proposes to regulate the market based primarily on traded volumes.

We urge the Authority to pause before pressing on with its proposal and:

1. Follow good regulatory practice and set out a clear problem definition for the escalation.
2. Test whether the operation of the platform is adequate.
3. Reconcile its metrics with the Co-design Group's criteria.
4. Take the time to carry out an analysis of the costs and benefits of proceeding with an intervention.
5. Include an assessment of alternative microstructure solutions when considering an intervention.

1. Introduction

The Electricity Authority (Authority) is seeking feedback on its proposed approach to regulating the standardised super-peak flexibility product (the Consultation Paper). We have been asked to do the following:

1. Consider the approach taken in the Consultation paper against measures of good regulatory practice.
2. Test what the evidence of trading in the standardised contract shows to date.
3. Look into whether alternative solutions might be worth exploring.

We have structured our comments into three sections as follows:

- Section two reviews the evidence available from trading in super-peak products; on our analysis, the evidence suggests that the problem facing the Authority is how to improve confidence in price discovery of super-peak products and demand side flexibility given the scarcity of the underlying resource (flexible generation and flexible demand).
- Section three outlines the evidence and experience from other markets in enhancing robust price discovery and optimising liquidity in circumstances of a limited number of suppliers and scarcity of the underlying product.
- Section four explains how the Authority's approach and practice to date in regulating super-peak products does not meet the government's guidance and principles for good regulatory practice; the primary hurdle facing the Authority is to refine its concerns into a structured, evidence based, problem definition capable of being solved by regulatory intervention.

2. The performance of the standardised super peak hedge contract

2.1 Price discovery identified as the primary problem

The Electricity Authority and Commerce Commission's joint Energy Competition Task Force was established to investigate ways to improve the performance of the electricity market. At the behest of the Task Force, a Standardised Flexibility Product Co-design Group (the Group) was formed to work with the Authority to develop a traded flexibility product for the wholesale electricity market.

The Group's brief was to "design and develop one or more standardised flexibility products with a focus on a tradeable product that has utility for buyers and sellers." Meetings were set to run from September to December 2024 with the expectation that the group would:

- identify a recommended product
- design the product
- establish the style of trading platform for the product
- complete the work and allow trading to commence early in 2025.

As the Group had been given an imperative—design one or more flexibility products—and not a problem definition, it prepared their own problem definition. The Group also prepared the criteria on which a solution should be judged a success or otherwise.

The flexibility problems the product would address are shown in Table 1 below. The criteria for a measuring the product's success are shown in Table 2.

Table 1: Prioritisation of flexibility problems

Problem	Assessment	Priority
Price discovery of peak products	Urgent No existing solutions	1=
Price discovery of demand side flexibility	Urgent No existing solutions	1=
Managing uncertainty of load and generation	Less urgent No existing solutions	3
Inter-seasonal firming	Not urgent Some solutions	4=
Dry year firming	Not urgent Some solutions	4=

Table 2: Success criteria for the product

Criteria	Details
Price discovery	Must be actively traded/liquid. A general product may be better than many niche products (more liquidity).
Effective investment signalling	Enables new entry of flexibility providers.
Appropriate risk arrangements	Product places risk on the participant who can best manage that risk, noting that the goal is to let parties manage risk rather than remove risk entirely.
Beneficial to buyers and sellers	Sellers can use it to mitigate risk as they sell it.
Product may change in the future	The right product for 2025, might be different to the right one for future periods. More products may need to be added over time, or the first product amended in specification.
Trading urgency	A product that is immediately available to be sold and needs to be bought.

Hence, the Group identified price discovery as the urgent problem to be solved, and specified criteria to gauge whether trading in the product achieved effective price discovery.

The group recommended a super peak product which would provide buyers with protection against high prices in morning and evening peaks. Parties enter into bilateral contracts once price and volume are struck, and once credit worthiness is established. Voluntary trading in the super peak product began in January 2025. Aotearoa Energy[2] is facilitating voluntary trading in the products by running fortnightly trading events.

2.2 Volume determined by fuel and capacity; efficient price is unknown

The Group's finding that the veracity of price discovery for peak products and demand side flexibility flows from the nature of risk management in electricity markets and the Authority's own analysis.

Electricity generators do not naturally offer hedges, or make markets in hedge products, without underlying generation or some risk in their portfolio that they wish to mitigate. If offers were made without underlying generation, the activity would constitute speculation or a form of proprietary trading.

The volume of product available is therefore a function of flexible generation capacity and fuel. Where a generator sells a shaped volume product to independent retailers or large loads, this volume restricts the baseload volume the generator can offer, unless there is a market for non-super peak shaped products.

[2] UK-based broker Icap acquired brokerage firm Aotearoa Energy in March 2024. Aotearoa Energy continues to trade with the same name. See press release here).

The Consultation Paper recognises the link between risk management products and flexible generation, saying (Electricity Authority, 2025, para. 2.8): "shaped products are largely backed by flexible generation resources." Further, the Authority recognises that "The evidence points to fuel or capacity scarcity often being the driver behind the current thin and illiquid market for shaped hedge cover (Electricity Authority, 2025, para. 2.16). Looking to the future, the Consultation Paper acknowledges that (Electricity Authority, 2025, para. 2.12):

> It may become more difficult for generators to supply OTC contracts and other risk management products that meet buyers' needs, as the generation mix changes.

The Authority concluded from its analysis that prices for OTC baseload and peak hedge contracts are likely to be competitive, but it could not reach the same conclusion for OTC super-peak hedge contract prices. The Authority recognises that OTC super-peak hedge contract prices will trade at a *substantial unquantified premium over ASX baseload prices adjusted for shape*. However, the Authority has not been able to determine the efficient level of such a premium, explaining that its estimates suffer from (Electricity Authority, 2024, Appendix 4):

- likely underestimating the shape premia
- likely underestimating the illiquidity premium
- not estimating a spot price volatility premium
- adopting a scarcity premium that underestimates contract prices
- not adding a premium for ASX volatility.

Hence, the efficient price to be discovered for super peak products must signal an increasingly scarce resource both to ensure efficient use of that limited resource and to create powerful incentives to maintain and invest in flexible generation and demand side flexibility. The discovered price must achieve these incentives while not subjecting customers to market power.

2.3 Price discovery – the evidence so far

2.3.1 Qualitative – observations by participants

We interviewed several interested stakeholders representing more than one gentailer, independent retailers and industrials. We understand that market making effort amongst gentailers is mixed. We understand the idea of the current platform is very much welcomed by independent retailers. It is less enthusiastically embraced by large users.

We heard discussions about the available volume, including the relativity between the amount of volume gentailers might have to trade compared with the size of their books, and the ability to secure enough cover in the winter quarters or summer quarters. In section 3 below, we review methods implemented in other industries to provide participants confidence to trade volume and enhance price discovery.

We heard from multiple sources that the operation of the platform is challenging. That is unsurprising given the speed with which the contract was finalised and trading arrangements set up.

There were some early hiccups because a regulatory exemption hadn't been sought at the commencement of trading, but this was resolved. However, there are still issues because traders do not enter orders directly onto the platform. As we understand it orders must go via Aotearoa Energy who rely on remote access to the platform via a virtual machine in Sydney. It makes for a trading environment where placing bids and offers, changes to bids and offers, and a willingness to trade at prices on the screen, take time. We may not have the issues technically correct, but all stakeholders told us that the platform does not lend itself to nimble trading; that is, buying and selling in quick succession, within a trading session.

If our understanding is correct and volumes are impeded by the working of the platform to any degree, that should be of some concern to the Authority as it proposes to regulate the market based on an assessment of (Electricity Authority, 2025, Appendix A, 3):

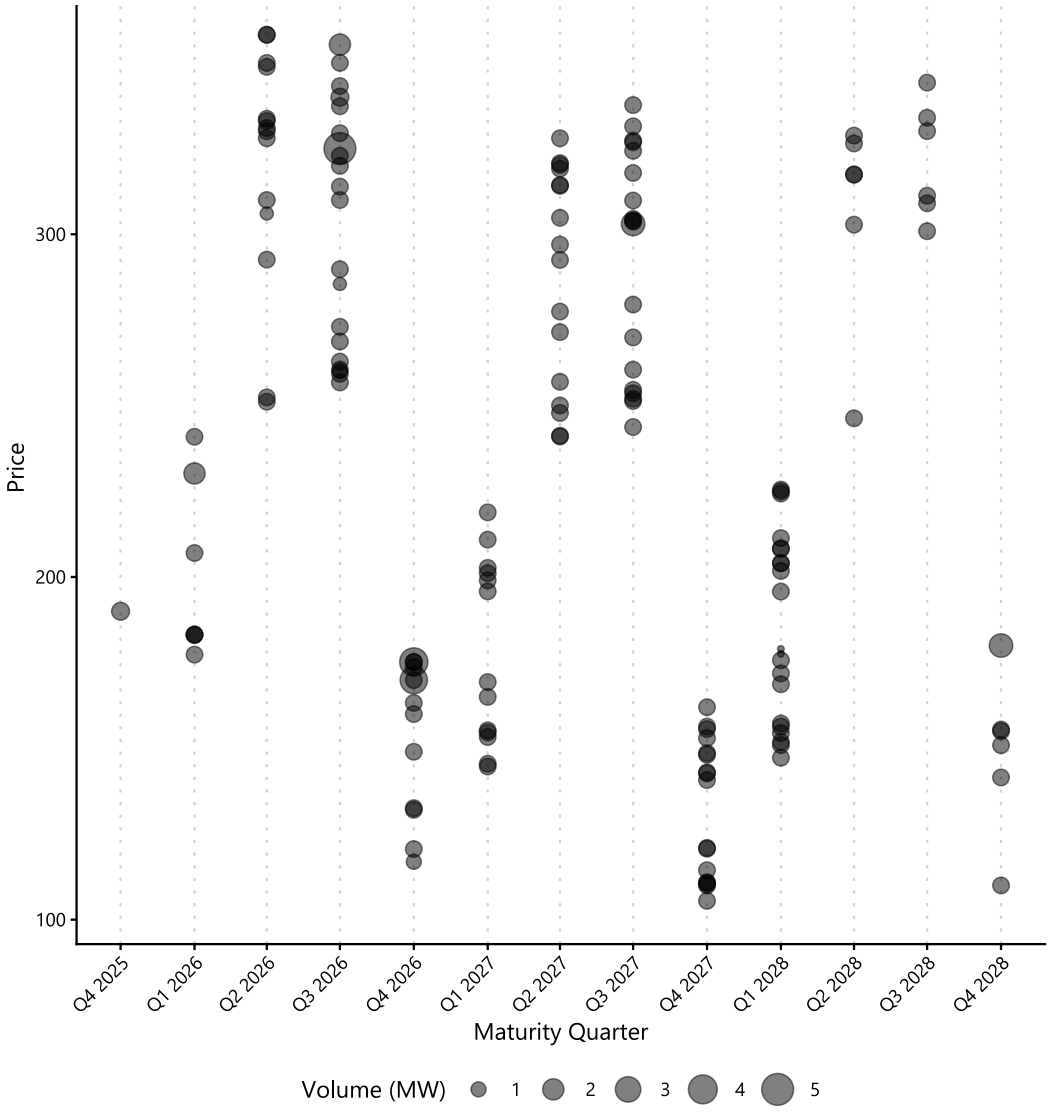
> "a. Volume traded
> b. Volume offered and bid
> c. Bid-ask spread
> d. Depth dependent bid-ask spread
> e. Price volatility
> f. Amihud's illiquidity."

Clearly, using traded volume, or any of the other metrics, will be problematic if there are any issues with the performance of the trading platform.

2.3.2 Quantitative evidence

Figure 1 below shows the prices and volumes for all the trades for super peak auctions that occurred for each quarterly maturity, at Benmore and Otahuhu nodes, across all the auctions to date. The pattern of standardised super-peak prices appears to mirror activity in the ASX baseload contract so we had a look at the correlation between outcomes in the two contracts.

Figure 1: Prices and an indication of volumes for all maturities on the super peak auction platform



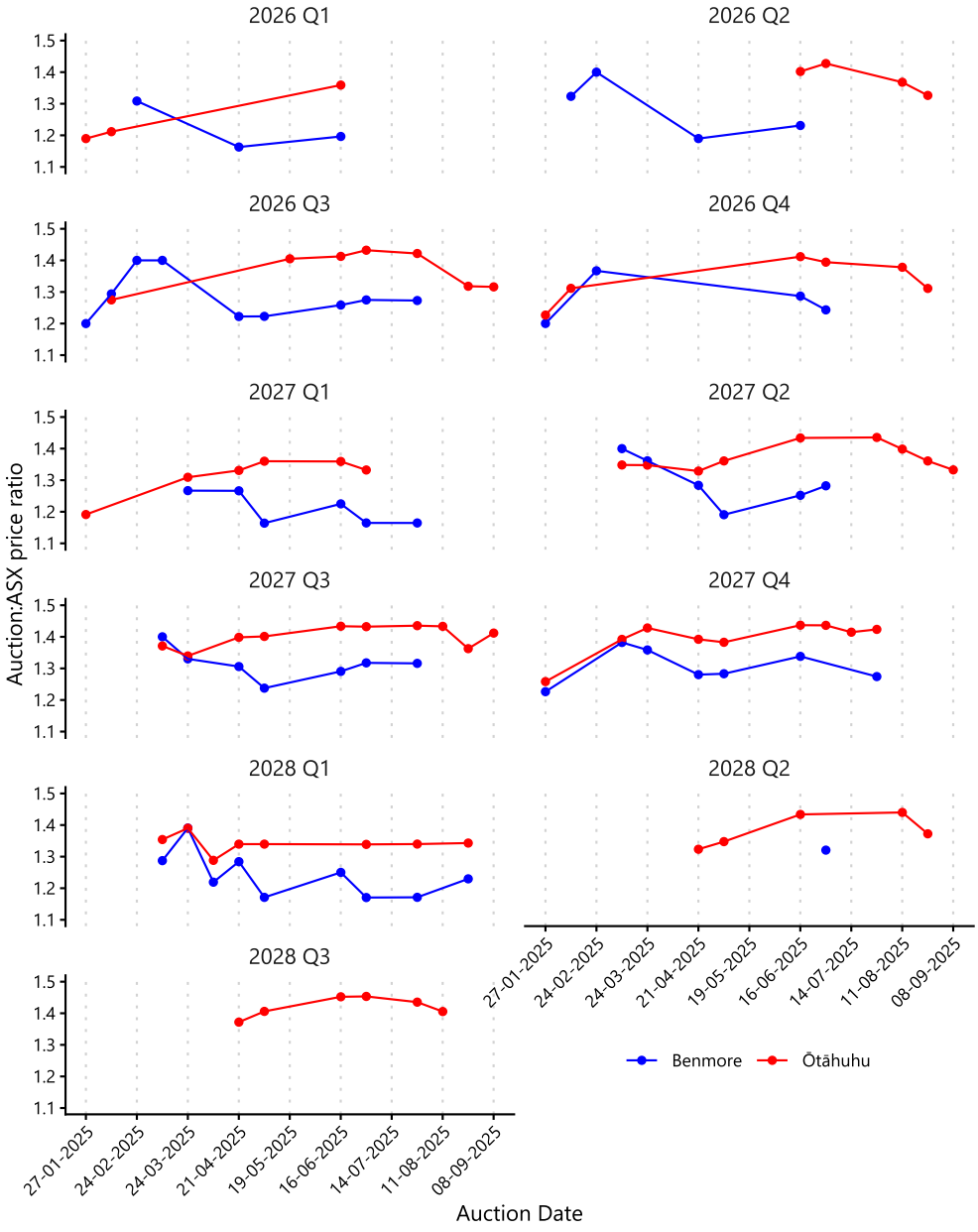
and are now showing a bit of differentiation between the maturities in recent auctions.

Figure 2 plots the ratios of standardised super peak (volume weighted average) prices over the previous day's futures settlement prices for the same maturity, at Benmore and Otahuhu, in each auction to date (Electricity Authority, 2025).[3]

What we learn from and are now showing a bit of differentiation between the maturities in recent auctions.

Figure 2 is that, after a settling down period, Benmore ratios tend to be lower than the ratio for Otahuhu prices at the same time. We see through the period that ratios for Otahuhu firmed up and are now showing a bit of differentiation between the maturities in recent auctions.

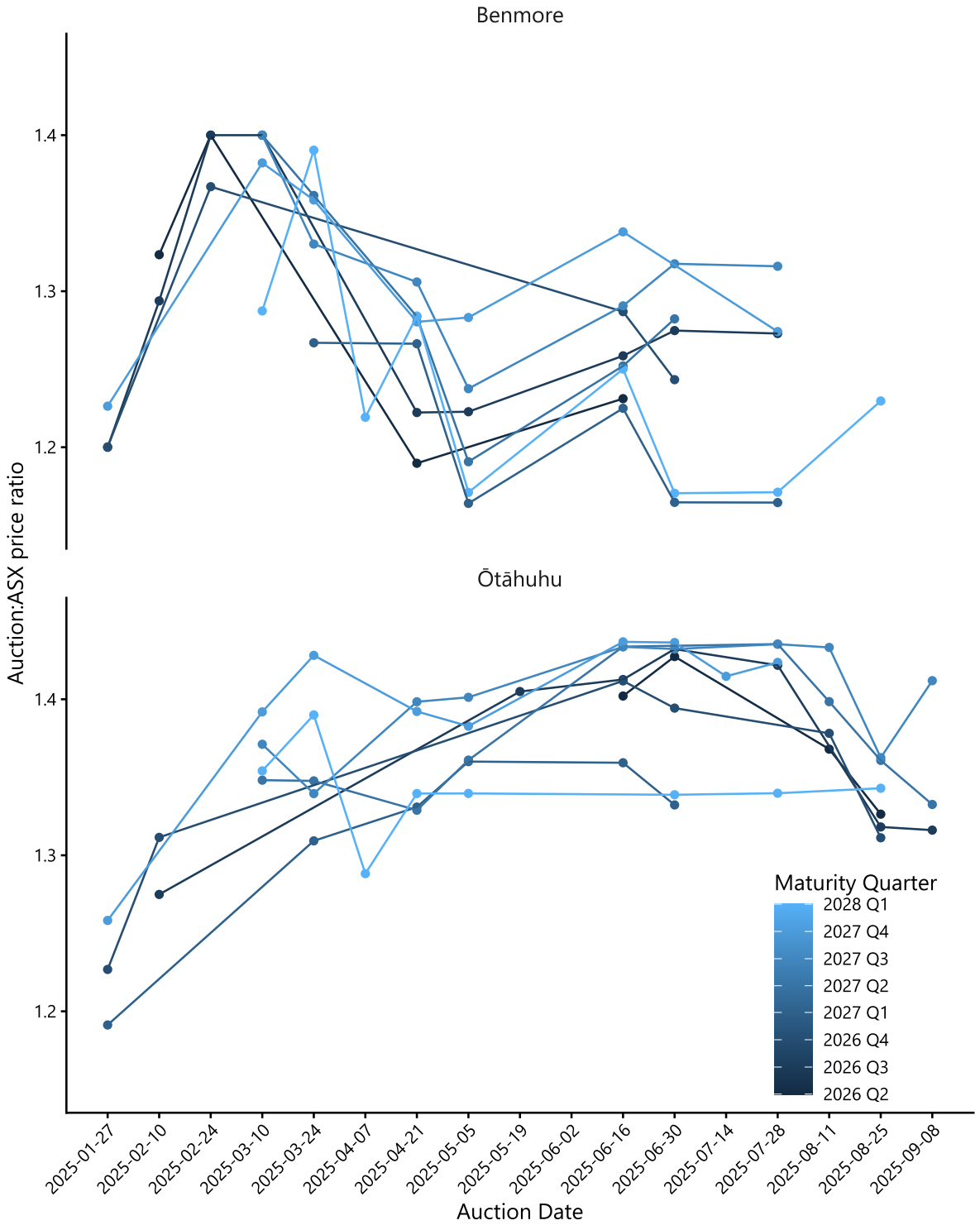
Figure 2: Ratio of prices for trades completed for each maturity auction by auction



In Figure 3 we overlay the ratios for the quarterly contracts 2026 Q2 to 2028 Q1. For Benmore we see that the ratios started firmly in the 130% to 140% range but settled down after a few auctions. Conversely, the ratio between super peak and ASX for Otahuhu firmed through the early auctions and settled into a pattern in the higher range through the more recent auctions.

[3] The Authority refers to this ratio at para 5.3 of the consultation paper. They note that what appears to be an average ratio has tightened since volume has moved onto this platform. We have assessed the ratios maturity by maturity, auction by auction.

Figure 3: Prices for each maturity traded on the super peak platform by node

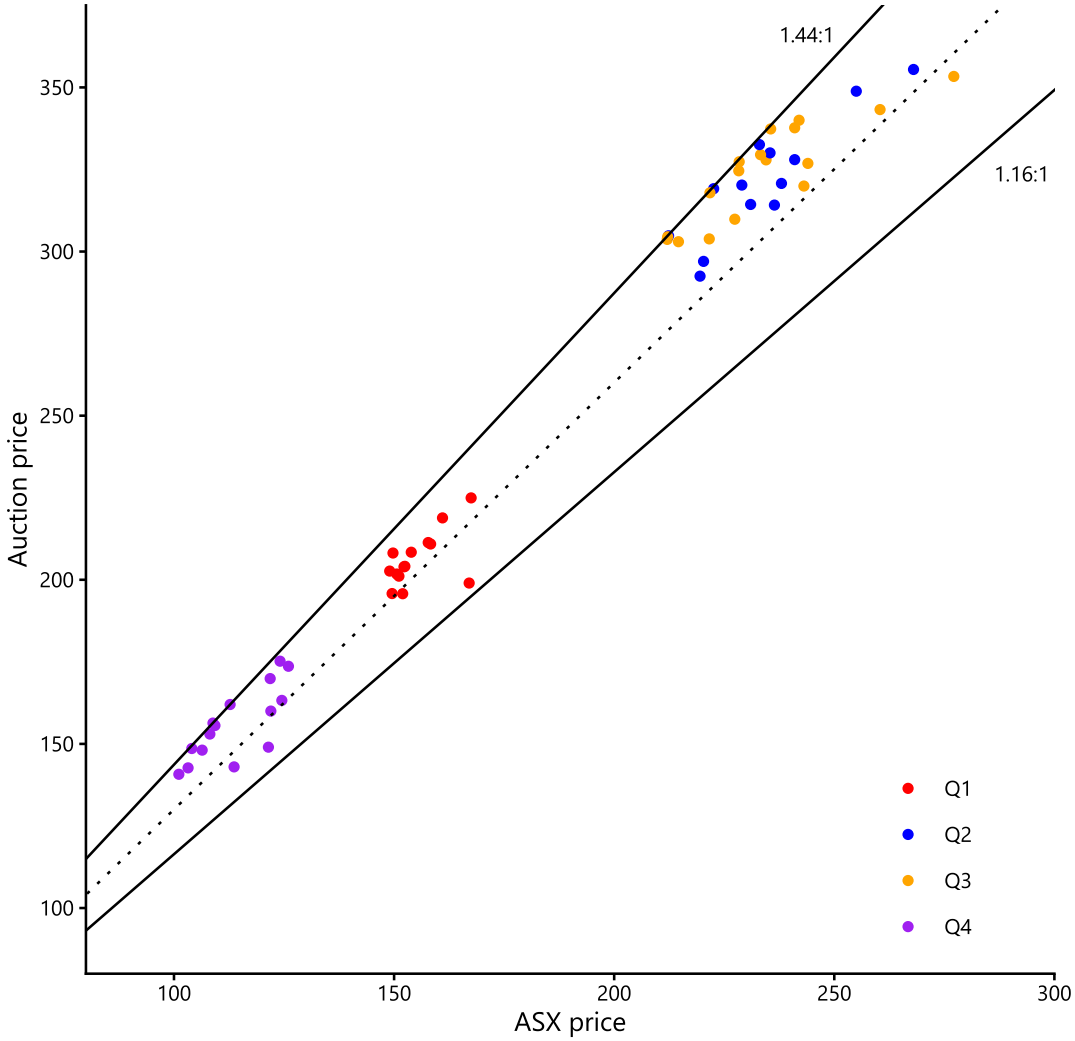


Having established that the ratios might tell us something about price discovery in the super peak products, we plotted the (weighted average) auction prices against the ASX prices for the same eight quarters (2026 Q2 to 2028 Q1) to see if we could observe any patterns. We mapped the line showing the highest ratio and lowest ratio amongst all trades so we could see, for any quarter, whether there

was a bias towards a high ratio (reflecting higher concern about super peak prices over baseload price) or a lower ratio (reflecting less concern between the two).

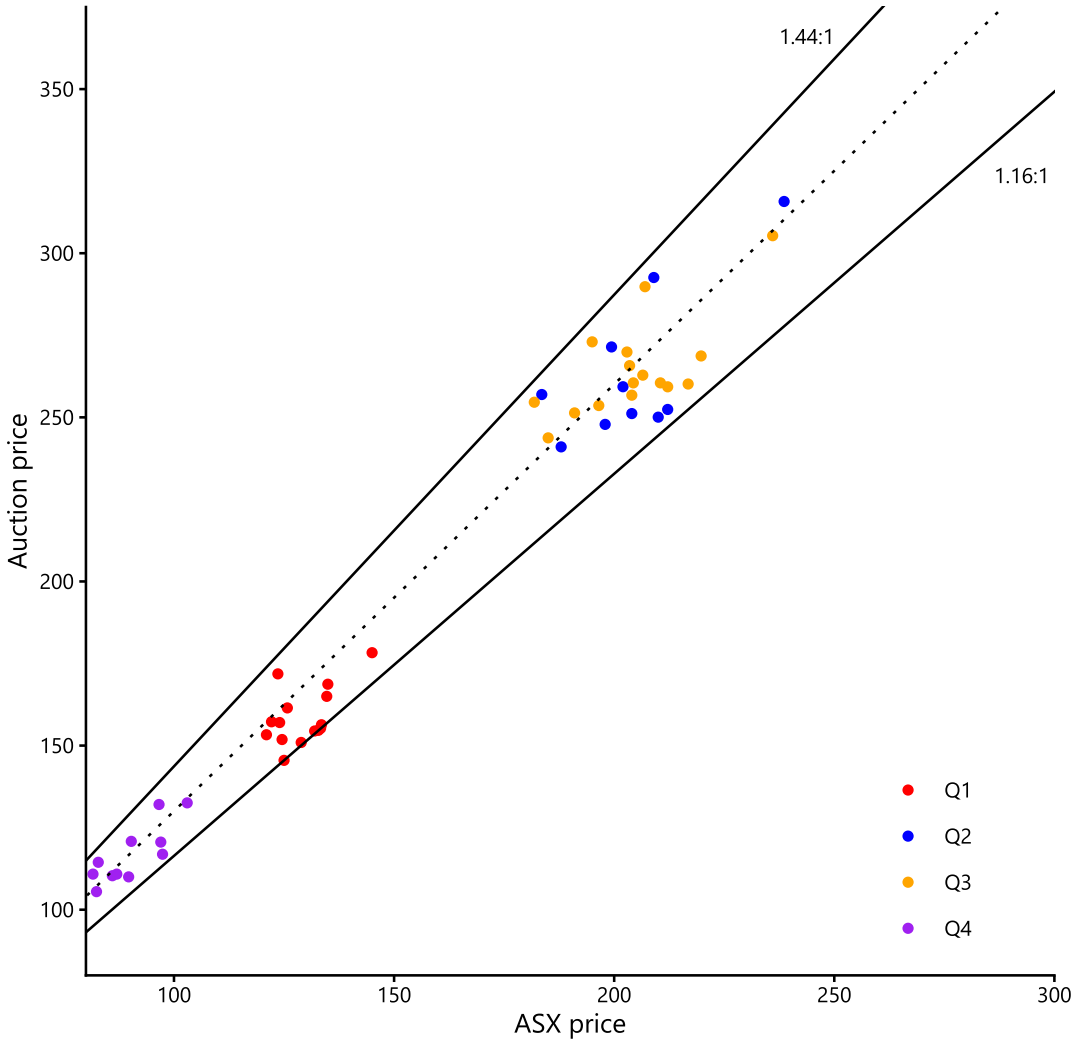
In Figure 4 we see the majority of Auction/ASX price ratios for auctions where Ōtāhuhu trades have occurred located in the higher band, and the same bias visible for the summer and winter quarters. This would come about as a result of sellers reflecting greater risk and buyers being prepared to buy more aggressively. If that had not been the case, we would see trades distributed across the range more.

Figure 4: The ratio of super peak trade prices over simultaneous ASX trade prices for the same maturity at Otahuhu node (quarters 2Q 2026 to 1Q 2028)



Relatively speaking, the same exercise for Benmore shows more incidence of ratios in the lower part of the range in all quarters.

Figure 5: The ratio of super peak trade prices over simultaneous ASX trade prices for the same maturity at Benmore node (quarters 2Q 2026 to 1Q 2028)



Based on these results it looks as though prices struck for super peak contracts trade as a ratio of the comparable ASX futures prices. That would make sense. The base load contracts reflect the fundamentals of the market. Trade in the super peak contracts just reflect the risk of prices spiking at peak times relative to baseload prices. Shifts in the ratio across the range appear to reflect a meeting of minds on that risk rising or falling.

If that is the case the standardised contracts would be addressing the highest and most urgent problem the Co-design Group was looking to address—price discovery. The focus for the Authority, therefore, should be on what can be done to foster the emerging price discovery. In section 3 below, we review lessons from other industries.

2.4 The Authority's proposed trigger for escalating regulation of the standardised super peak contract

2.4.1 Price discovery or traded volume

The Authority seems to have looked past the priority problem identified by its Standardised Flexibility Product Co-design Group; that is, price discovery. Rather than consider the measures of success for the product as developed by the Group, the Authority proposes a trigger for urgent regulation based primarily on a measure of traded volume.

There is no direct relationship between any specific volume measure and price discovery. If traded volumes were higher or lower than the Authority's proposed threshold, we would be none the wiser as whether prices (ratios) were efficient or contained an element of market power because the Authority has already stated it is unable to estimate the premia between super peak prices and baseload prices and have given the reasons why.

We are surprised by the Authority's assertion (Electricity Authority, 2025, Appendix A, paragraph A.12):

> In a workably competitive market, available volume to sell should exceed that which is necessary to buy.

The statement is not a recognisable principle from competition literature. Workably competitive markets describe a process of rivalry, not a comparison of volumes. If the Authority has constructed its volume trigger from a belief that 'available volume to sell should exceed that which is necessary to buy', it would have misdirected its regulatory efforts in two important regards.

Firstly, the statement would imply the Authority conceives a counterfactual in which generators maintain flexible capacity in excess of that which the market demands. It is not clear who would pay for this excess capacity in the Authority's thought experiment. In economics, and in reality, demand is not an indicator that volumes are withheld. It is just an indicator of demand. If supply is tight relative to demand, that means the resource is scarce, and price discovery increases in economic importance.

Secondly, the Authority's statement is the exact opposite of what is required to establish price discovery when supply is constrained relative to demand. As discussed in section 3, auction experts generally agree that the key to achieving efficient price discovery in markets in which suppliers are concentrated is to convert enough potential bidders into actual bidders to generate strong excess demand and establish the conditions for bidders to proceed to bid confidently and aggressively.

2.4.2 Urgent Code Amendment

Under section 40 of the Electricity Industry Act 2010 the Authority can amend the Code on an urgent, temporary basis (for a period of up to nine months) without consultation. What this means in the context of the standardised super-peak contract is that the Authority could intervene in that market without confirming the problem definition the urgent code amendment would address or considering any other ways of addressing the underlying problem (as discussed further in Section 3). The Authority is clear that they would take this course based on the level of offers or trades in the currently traded product (Electricity Authority, 2025, para. 8.7):

8.7. We consider that an urgent Code amendment may be necessary or desirable in the public interest where there is a sudden and material reduction in the offers or trades of *shaped hedges*, including the super-peak product. If it is the case that price discovery is linked to the competitive prices in ASX and there may be operational steps that can be taken to improve liquidity in the standardised contract there may not be such a need for urgency. It may also be that if the standardised contract doesn't satisfactorily address the underlying problem other microstructure solutions may be better options.

2.4.3 Summary

We acknowledge that the Authority proposes to monitor volume traded, volume offered and bid, bid-ask spread, depth dependent bid-ask spread, price volatility and Amihud's illiquidity. What is missing from the Authority's proposed trigger for escalating regulation in the super peak product is:

- No analysis of the veracity of price discovery to date even though it is the number 1 problem the Co-design Group focused on
- Recognition that the super peak trading appears to be tied to trading on the ASX. If that is the case the Authority should be comforted because their analysis "indicated that the prices for OTC baseload and peak hedge contracts are likely to be competitive".
- No analysis of whether the outcome meets the requirements of the intended parties, and no process to make that assessment is proposed prior to escalating regulation.
- No recognition of the possibility that the operation of the platform may be impeding volume despite the fact that the trigger for escalation is "a sudden and material reduction in the offers or trades of shaped hedges, including the super-peak product."
- No reference back to the success criteria identified by the Standardised Flexibility Product Co-design Group.

3. The Authority should consider alternative microstructure solutions

The previous section identified several serious shortcomings in how the OTC trading events are being conducted that potentially account for the low liquidity and shallow trading observed in the super peak product. We propose that the Authority give priority to fixing these shortcomings and to then trial the remediated system for an adequate period before considering further any regulatory action.

This section identifies possible alternative means of advancing efficient price discovery for super peak products. We focus on the specific machinery and methods through which the transactions are undertaken, generally referred to by economists and financial policy makers as the market microstructure.[4] Market microstructures range from completely unorganised markets with no specific trading infrastructure or intermediary services, through to organised markets that are familiar in the financial markets such highly structured centralised exchanges.

We make three key points:

1. The shortcomings in the existing OTC trading events highlight the relevance of market microstructure to achieving price discovery for the super peak product.
2. Alternative microstructure approaches may be:
    a) More robust to one side of the market being concentrated in a small number of participants
    b) More amenable to aggregating liquidity across multiple products.
3. Given that these alternative approaches have been implemented in other markets, it would be remiss of the Authority to proceed with its proposed intervention without assessing and comparing its proposal against these alternatives.

The purpose of the following discussion is not to recommend a specific approach, but to highlight that the Authority should consider these alternative approaches in any future assessment of next steps.

[4] Economists such as Spulber (1996) refer to market microstructure as the study of intermediation and institutions that structure transactions, whether these institutions are firms, brokers, or simply community conventions. Financial economists such as O'Hara and O'Hara (1995) and Madhavan (2000) define market microstructure more narrowly as the process and outcomes of exchanging assets under explicit trading rules, focussing on how bid-ask spreads, order flow, and information asymmetry shape price formation.

3.1 Markets deploy a range of trading mechanisms, each suited to a particular task

3.1.1 Financial markets use a range of auction formats

Financial market trading mechanisms are commonly classified into two broad types: highly structured, centralised exchanges and less structured, decentralised OTC markets.

In centralised exchanges all participants trade with each other through a continuous double auction format that automatically matches orders in real time throughout the trading session. Many exchanges also deploy a uniform price sealed bid format as an opening call auction to determine the trading session opening price for each traded product.

OTC markets historically operated as decentralised processes where buyers, sellers and/or brokers manually searched for counterparties and bargained with them to agree a trade. These manual processes may be viewed as approximations of the exchange auctions. In recent years many OTC brokers have developed automated trading platforms, for example Marex's Neon platform, StoneX's 'StoneX One' platform, and TP ICAP's Fusion platform through which trading in the super peak product is currently managed.

A range of auction mechanisms are also used for initial public offers (IPOs) and primary issues of government bonds and treasury bills. For example, both the US Treasury and NZ Debt Management Office use a mix of the uniform price sealed bid format, where all winning bidders pay the same price, and the discriminatory price format where each winning bidder pays their bid price.

These examples illustrate how the financial markets deploy different trading formats for different tasks. This raises the question of whether the current super peak arrangements are the most suitable to provide the best opportunity for trading to develop successfully.

3.1.2 Other industries deploy auction features to mitigate market concentration and enhance liquidity

A wide range of other industries use various auction formats to discover price and allocate quantity. Of particular interest for this paper are repeated multi-unit auctions, examples of which include advertising slots (e.g. Amazon, Google), radio frequency and spectrum rights, carbon emissions, diamonds, energy markets (including the NZ wholesale electricity spot market), and agricultural commodity products such as corn, wheat and dairy products where both double-sided and one-sided formats are used.

Compared to the double auction format, a one-sided uniform-price format may be better suited to a market structure with concentrated supply side and numerous potential bidders on the demand side. Auctions exist where participants in the concentrated side of the market play no role in the real time price discovery process. Their involvement is limited to independently pre-specifying their reserve price and offer quantity (or multiple (price, quantity) pairs if offer curves are permitted), enabling the auction system to create an aggregate offer curve. Any price outcome above the lowest reserve price

is then determined during the auction process by the competitive interaction of bidders (the more competitive side of the market) relative to the pre-determined supply curve.

Any party with one or more contracts won from previous auctions can be permitted to exit those contracts by offering them at future auctions, where they bear any positive or negative price difference. This can improve liquidity by diluting the concentrated side of the market.

Auctions also exist where the seller's ability to substitute between products is used to enhance liquidity and price discovery. This is achieved by pooling the available quantities across the products to enable each product to access to a single larger pool of available supply.

For example, a seller of hedge contracts may have 1000 units available for a certain calendar period to be allocated to standard and non-standard super peak contracts. Instead of pre-determining the individual quantities available on each of contract type (say, 500 units to each type), the seller would list both contracts as having access to a maximum of 1000 units, leaving it to the auction mechanism to ensure the total sold quantity does not exceed 1000 units while also respecting the seller's required premium or discount on the non-standard relative to standard contract.

The quantity potentially available to each bidder is larger as each bidder can win up to 1000 units (rather than only 500 units) by outbidding all other bidders across all contract types. The net effect is to increase individual buyer liquidity.

The approach also enhances the efficiency and robustness of the price discovery process, in two ways: First, bringing in buyers of the non-standard contract (assuming they are not interested to bid on the standard contract) results in a larger number of bidders with more diverse commercial interests participating in a single price discovery process; Second, some buyers who otherwise would have bid on the standard contract may prefer the non-standard contract and therefore will be prepared to bid more aggressively, thereby increasing net bidding intensity across all products. Net economic welfare is improved as the resulting contract allocation is aligned better with buyer and seller needs.

The twice-monthly Global Dairy Trade auction is an example where these types of features operate successfully.[5]

3.1.3 Performance of alternative trading mechanisms

The auctions and market microstructure literatures have examined the theoretical and empirical performance of alternative trading mechanisms.

The microstructure literature has examined financial markets where several mechanisms coexist to identify the factors that determine the preferences of participants and implications for liquidity and price efficiency. For example, Hendershott & Madhavan (2015) find that periodic one-sided auctions are a viable and important source of liquidity in the US corporate bond market where OTC trading has been predominant. They conclude that these multilateral trading mechanisms constitute a natural compromise between bilateral search in OTC markets and continuous double auctions on exchange platforms and hence offer a possible transition path from OTC to centralized trading.

[5] Disclosure: one of the authors of this report, Eric Hansen, is a former CEO of Global Dairy Trade.

The economics literature on auction design also examines the performance of various auction formats, from those that clearly fell short of commercially reasonable outcomes despite numerous potential bidders, through to those that clearly achieved their objectives even where the market has a small number of participants.

Auction experts generally agree that the key to achieving the best possible auction outcome is to convert enough potential bidders into actual bidders to generate strong excess demand at the opening of the auction and to establish the conditions for bidders to proceed to bid confidently and aggressively throughout the auction process (Klemperer, Paul, 2004).

To achieve this the auction design needs to consider carefully any rules or design features that may cause potential bidders to think they have little chance of winning a contract, since a bidder who does not believe they can win is unlikely to put scarce time and resources into preparing for and participating in the auction.

The auction design also needs to pay attention to avoid bidder collusion and strategic game-playing behaviour that aims to deter other bidders from participating and/or bidding confidently. The details are important and require an understanding of the market structure and product characteristics. Again, this raises the question of whether the current super peak arrangements are the most suitable to provide the best opportunity for trading to develop successfully.

3.1.4 Summary

This section has highlighted that possible alternative methods to enhance robust price discovery and optimise liquidity are available and have been implemented in other industries. Nevertheless, their suitability for the super peak market would require further analysis.

We propose that the Authority hold these options in reserve and instead give priority to fixing the serious shortcomings in the existing OTC market and trialling that for an adequate period before considering whether an alternative trading mechanism may be more effective.

Certainly, given that alternative approaches have been implemented in other markets, it would be remiss of the Authority to proceed with its proposed intervention without assessing and comparing its proposal against these alternatives.

4. The Authority's approach falls short of best regulatory practice

4.1 Guidance by Ministry of Regulation to lift quality of regulation

The Government established the Ministry of Regulation in 2024 to underscore its objective of lifting quality across all regulatory systems and to support agencies with regulatory responsibilities to align with good practice (Ministry for Regulation, 2024a). We summarise below the guidance provided by the Ministry before commenting on whether there are aspects of the Authority's proposed approach and practice to date which fall short of this guidance.

After reviewing international best practice, the Ministry of Regulation concluded that high performing regulatory systems are (Ministry for Regulation, 2024c, p. 16):

- fit for purpose – regulation is chosen when it is the right tool to achieve the policy objective
- effective – regulations are designed so they deliver the right outcomes
- efficient – the direct and indirect costs of regulation are reasonable, affordable, and in proportion with the benefits
- resilient – the regulatory system adapts to challenges, shocks, and changes.

The Ministry of Regulation provides detailed material on its website to guide regulatory decision-making, in terms of process and substance. This advice applies when changes are being proposed and when changes are made (New Zealand Government, 2017):

> "Before a substantive regulatory change is formally proposed, the government expects regulatory agencies to provide advice or assurance on the robustness of the proposed change, including by:
>
> - assessing the importance of the issue in relation to the overall performance and condition of the relevant regulatory system(s), and how it might fit with plans, priorities or opportunities for system improvement already identified
> - clearly identifying the nature and underlying cause of the policy or operational problem it needs to address, drawing on operational intelligence and available monitoring or review information
> - undertaking systematic impact and risk analysis, including assessing alternative legislative and non-legislative policy options, and how the proposed change might interact or align with existing domestic and international requirements within this or related regulatory systems
> - making genuine effort to identify, understand, and estimate the various categories of cost and benefit associated with the options for change
> - identifying and addressing practical design, resourcing and timing issues required for effective implementation and operation, in conjunction with the regulator(s) who will be expected to deliver and administer the changes."

Furthermore, there are additional requirements for regulatory agencies to undertake once a decision around a substantial regulatory change is made: [38]

> Before a substantive regulatory change is formally made, the government expects regulatory agencies to:
>
> - allow regulated parties reasonable time to get familiar with new requirements before the change comes into force (unless this would compromise the outcome sought)
> - test key operational processes required to implement the change
> - anticipate and plan for the possibility of unintended consequences or the potential need for contingency measures
> - provide for any appropriate changes to system monitoring arrangements

The Treasury advise that best practice policy options should be:

- **growth compatible**, including recognising the need for firms to make long-term investment decisions
- **proportional** to the expected benefits
- **flexible and durable**, allowing firms to comply at least cost and with feedback loops to assess how the regulation is working
- **certain and predictable,** with clear processes and decision-making and consistent with other regulatory regimes
- **transparent and accountable**, with clear rules and justifiable decision-making.

We assess below the Authority's proposed approach to regulating super-peak products against the guidance and principles provided by the Ministry of Regulation and the Treasury. We identify three material shortcomings in that the Authority:

- has not described a structured, solvable, problem definition, but rather has expressed a set of concerns
- assesses its concerns against an idealised world, rather than what its interventions can achieve in the real-world
- would tilt the regulatory field against specific firms
- signalled a regulatory progression rather than a principled regulatory process.

4.2 Missing problem statement

The key to world-class policymaking is a sound problem definition. Without such definition, valuable regulatory resources are wasted, with attendant harmful consequences for stakeholders and the wider economy.

The consultation paper describes the Authority's concerns in general terms such as:

- "…improve liquidity and price-discovery" (Electricity Authority, 2025)[6]
- "…manage their exposure to wholesale electricity price volatility…" and "…manage their exposure to wholesale market volatility…"(Electricity Authority, 2025, para. 2.7)
- "effective risk management" (Electricity Authority, 2025, p. 3, para 3.2)
- "greater competition" (Electricity Authority, 2025, pp. 3, 12)
- "…the market is neither deep nor liquid" and "…thin and illiquid market for shaped hedge cover" (Electricity Authority, 2025, para. 2.16 a, b).

These statements do not represent a clear and robust problem statement capable of being addressed by regulation. The phrases are better characterised as a 'grab-bag' of concerns and assertions. A set of concerns is not a problem definition for policy purposes; it is only a starting point for analysis that leads to a solvable policy problem:

> Increasingly, problem definition is emphasised as a key to successful policy analysis.
>
> Many problems start off as vague worries that need to be structured before they can be solved (State Services Commission, 1999, p. 16).
>
> A problem must be solvable to qualify as a policy problem. Before techniques of analysis proper may be applied, analysts must "structure" the problem and ensure it is the right one (State Services Commission, 1999, p. 17).

The Authority's analysis to date has not moved beyond the phase of describing "vague worries" to describe a structured, solvable, problem definition. Links are missing in the Authority's logic chain. These missing links make it difficult to identify the precise problem the Authority aims to address and, therefore, whether the Authority (and others) can be confident its solution will resolve the problem. The absence of a proper problem definition may explain why the Authority is not confident of its proposed actions and contemplates escalating regulatory interventions.

The logic chain of a strong problem definition is not specific to regulation and is well understood in other settings. For instance, a problem statement forms the foundation of a business case for an investment decision. The NZTA states a useful problem statement should include clear (New Zealand Transport Agency, 2018):

- **Cause -** what needs to be fixed; if a problem is to be solved effectively the root causes need to be addressed, so it is worth putting in time and effort to identify the causes (as opposed to symptoms) of the problem.
- **Consequence -** what happens because of the problem; if the consequence is not convincing then the proposed investment should be deferred or abandoned in favour of one that will advance the overarching objectives more successfully.
- **Causal relationship -** the cause and the consequence need to be explicitly linked, to develop solutions that are effective and efficient.

[6] Page 2; Paragraphs 2.17, 2.25, 3.1, 3.6, 3.8, 4.1, 4.3, 4.4, 4.8; Table 1.

- **Compulsion to act -** the problem statement must be compelling; that is, have a strong and demonstrated need for change and 'call to arms'.

The failure by the Authority to move beyond expressing concerns to specify a structured, solvable, problem definition is highlighted by the Standardised Flexibility Product Co-design Group needing to prepare its own problem definition to support the design of the super peak product. There are missing links in the logic chain, between the Group identifying the priority problem as price discovery, and the Authority's proposed trigger for urgent regulation based on a measure of volume.

4.3 Lulled by an idealised world

When considering its intervention, the Authority falls prey to the nirvana (or 'perfect solution') fallacy. This concept was popularised by economist Harold Demsetz some 56 years ago (1969) and is discussed more recently in public policy material in New Zealand (Burton & Hartwich, 2024). The fallacy involves comparing existing 'imperfect' institutional or regulatory arrangements with an ideal alternative; if discrepancies are found, the real world is deduced as inefficient.

Good practice regulation recognises that "the real choice is not between institutions that work and others that do not work, but between highly limited institutions that frequently operate outside their limits and, therefore, frequently 'fail' (Burton & Hartwich, 2024, p. 48). A comparative institution approach assesses which alternative real institutional arrangement seems best able to cope with the economic problem. An ideal norm might be used to provide standards from which divergences are assessed for all practical alternatives of interest; the alternative which seems most likely to minimise the divergence could then be selected (Demsetz, 1969).

However, the Authority proceeds by describing how an abundant supply of shaped hedge contracts would promote competition. In this nirvana, retailers could match customer demand profile, end users could manage price exposure of their residual demand, intermittent generators could sell firm power purchase agreements, and other business models (not underpinned by investment in flexible generation) could enter the market, etc. (Electricity Authority, 2025, para. 2.7).

Unfortunately, the Authority's nirvana cannot be achieved by its proposed regulatory interventions. The Authority has identified that: "The evidence points to fuel or capacity scarcity often being the driver behind the current thin and illiquid market for shaped hedge cover" (Electricity Authority, 2025, para. 2.16). Hence, flexible generation to support risk management products by generators will remain tight relative to demand for the immediate future (and until some period after conditions for investment in flexible capacity and fuel stocks improve).

By proceeding from a comparison of what is happening currently with trading of super-peak hedges, with a situation where all participants have access to options to efficiently manage wholesale price risk as and when they need them, the Authority misdirects its analysis in two important regards.

Firstly, it's comparison overstates the potential benefits of its intervention; the competitive outcomes described by the Authority (e.g., in para 2.7) cannot result from its proposal.

Secondly, and potentially more importantly, the Authority does not analyse the specific effects of its proposed intervention. The Authority is intervening to influence, and potentially set, key terms on which the entities who have invested in flexible generation make the benefits of that investment

available to firms that have not invested in flexible generation. It is intervening in this manner because it believes its actions will promote competition.

A robust regulatory analysis would consider:

- the negative impacts on incentives to invest in flexible generation of the Authority's intervention, and hence the potential to exacerbate the root cause of the problem (tightening supply of flexible generation relative to demand). Oddly, the Authority characterises its proposal to apply regulatory requirements 'evenly across all obligated participants' as ensuring each obligated party is equally incentivised to develop additional flexible resources (Electricity Authority, 2025, para. 6.35). A regulatory obligation to make an asset available to a competitor is unlikely to 'incentivise' the regulated entity to invest further (for the benefit of its competitors); equally *dis*incentivised would be more accurate.
- whether any real-world competitive benefit, say from any observable take-up of the super-peak products by independent retailers, would likely exceed the competitive detriment from constraining the ability of the owners of flexible generation to compete and innovate using the benefits of their investment.

4.4 Tilting the field against identified firms

The Authority would apply its regulation to four specific companies (Electricity Authority, 2025, para. 6.32). Regulatory interventions targeting specific firms are highly unusual, especially in competition policy. Competitive neutrality is achieved when "all Enterprises are provided a level playing field with respect to a state's ownership, regulation or activity in the market" (OECD, 2024). Regulatory intervention should not distort the market in favour of particular market participants or business models. Instead, firms should compete on their merits.

The only precedent identified by the Authority, for moving from competitively neutral regulation, is its own actions (Electricity Authority, 2025, para. 6.32). There are three primary reasons why regulation aimed at promoting competition for the benefit on consumers does not name specific firms.

Firstly, a robust problem statement would have identified the specific behaviours or outcomes sought from the sector. Well-designed regulation would then target those behaviours. Naming firms in regulation is an indicator of a poorly specified problem definition. To illustrate, if the core problem is how to foster price discovery for super-peak risk management products, narrowing the regulatory focus to selected firms may at best be counterproductive.

Secondly, if regulation applies to named firms it, in effect, targets the business model of those firms. Regulators are poorly placed to determine business models. In a dynamic market, individual firms will adopt different strategies over time in vying for customers and continuously search for the most cost-effective means of delivery. Some will succeed and others will fail. By in effect regulating a business model, the regulator inadvertently stymies business innovation.

Thirdly, if a regulator can be persuaded to apply regulations to some firms, while exempting other firms undertaking the same or similar activities, it will encourage 'rent-seeking'—that is, entities will use the regulatory process to seek advantage at the cost of other stakeholders. This type of behaviour is a known risk in small economies as the interdependencies in the interests of various stakeholders

are likely to be more significantly affected by a regulatory intervention. Hence, the "risk of costly interest-group-affected industrial policy in the guise of competition law becomes high" (Gal, 2006).

The Authority appears not to have considered these issues.

4.5 The Authority has signalled a regulatory progression rather than a principled regulatory process

The Authority has signalled the possibility of regulating super-peak product trading "[I]f liquidity does not improve to a sufficient level..." (Electricity Authority, 2025, p. 2).The timeframe for such (enduring) regulatory action is the first half of 2026 (Electricity Authority, 2025, p. 2). The Authority says its options for the (enduring) regulation are (Electricity Authority, 2025, Chapter 8):

- Option 1 – market making on the Australian Securities Exchange
- Option 2 – market making over the counter.

In addition, the Authority "…stands ready to implement urgent regulation should shaped hedge trading suddenly collapse" (Electricity Authority, 2025, p. 3). The options for the urgent regulation are (Electricity Authority, 2025, Chapter 8):

- Option A – a requirement to offer hedges over the counter
- Option B – a requirement to offer and sell hedges over the counter.

The Authority provides an 'assessment' of both the enduring and urgent, temporary regulatory options in tables 5 and 7 of the consultation paper, respectively. Its preferred options are market making over the counter for proposed enduring regulation and a requirement to offer and sell hedges over the counter for proposed urgent, temporary regulation.

We have three key concerns with the way the Authority has conducted itself and come to their position, which we set out below.

4.5.1 Impacts are asserted, not calculated

Good regulatory practice guidance from the Ministry for Regulation requires regulators to make "…genuine effort to identify, understand, and estimate the various categories of cost and benefit associated with the options for change" (New Zealand Government, 2017). Such analysis is required before a substantive regulatory change is formally proposed (original emphasis). In addition, there is a further expectation from the government that systematic impact and risk analysis is undertaken, including alternative legislative and non-legislative options (New Zealand Government, 2017).

The Authority does not identify or estimate relevant costs and benefits of either the enduring or urgent, temporary regulation proposals. Rather, the 'assessment' that the Authority relies on in

reaching its decision on preferred options is qualitative, speculative and cursory. In relation to the proposed enduring regulation, there are general references to (Electricity Authority, 2025, Table 5):[7]

- relative ease of implementation
- medium or low levels of cost
- bolstering of price discovery to support investment
- the likelihood of hedge volume increases over reasonable time frames
- likely participation rates.

Only the timing criteria (i.e. how long will it take for the option take effect?) had quantified measures, and even those estimates were vague.

In relation to the urgent, temporary regulation proposed, the assessment contains general reference to:

- discovery of prices (option A) or price discovery may not cover all time periods (option B)
- compromised investment in flexible supply for both options
- low costs for both options
- likelihood of establishment in a week for both options
- simplicity of operation of both options
- risks of either high (option A) or low prices (option B) due to compliance risks.

Again, such an analysis lacks critical material on the incremental costs and benefits of the proposals, the transmission mechanisms that give rise to such costs and benefits and the sensitivity of any results to changes in key assumptions or parameters. Those elements are all missing.

Furthermore, the assessments are 'within-group' in nature. That is, the assessment compares regulation options against each other and not against possible non-regulation alternatives. The Authority acknowledges that participants could use risk management options other than hedge markets but does not provide any analysis of those options (Electricity Authority, 2025, para. 2.7).

What is most important from society's (and consumers') point of view is the net effect of regulation (that is, to what extent would society or consumers be better off because of the regulatory proposals relative to alternatives). In the absence of such analysis and resulting information, the Authority cannot know what the net effect would be (it could be negative). In the case of the urgent, temporary regulation proposal, the onus on the Authority to produce robust cost-benefit analysis is heightened even further, given the possibility of sudden, significant change.

4.5.2 The timing appears unduly hasty

The Authority is considering regulating based on observations of super-peak hedge market operations between January 2025 and June 2025. As indicated above, the rationale for regulation was not clearly described or evidenced, but regardless, the signalled direction towards regulation when the

[7] Note that the consultation paper contains two tables numbered 5. The one we refer to is on page 27.

market was only introduced in December 2024 seems unduly hasty. No reason has been put forward by the Authority for such urgency.

Furthermore, the almost inexorable march of the Authority towards regulation is even more puzzling considering the Authority acknowledged in its consultation paper that:

> "Retailers to date have been able to secure substantial shaped hedge cover through OTC contracts…" (Electricity Authority, 2025, para. 2.16 a).
>
> "The evidence points to fuel or capacity scarcity often being the driver behind the current thin and illiquid market for shaped hedge cover" (Electricity Authority, 2025, para. 2.16 b).

Returning to Ministry for Regulation guidance on best practice regulation, good regulatory practice requires that "…durable outcomes of real value to New Zealanders are more likely when a regulatory system (New Zealand Government, 2017, p. 2):

- has clear objectives
- seeks to achieve those objectives in a least cost way, and with the least adverse impact on market competition, property rights, and individual autonomy and responsibility."[8]

More recent guidance published by the Ministry for Regulation also acknowledges the choices available to regulators around timing and option choice. It states that (Ministry for Regulation, 2024b, p. 2):

- Regulatory organisations and people who carry out regulatory work need to know how to use the right regulatory activity or tool at the right time to achieve their desired outcomes.
- Each activity or tool has a specific purpose. Regulators apply the activity or tool that will most likely achieve the desired effect.

The spectrum of options available to regulators and the 'order of progression' is contained in the Braithwaite Model for responsive regulation, promulgated by the Ministry for Regulation (see Figure 6). While not specific to regulation for competition, it is a general exposition of a so-called 'regulatory ladder' that should be used in tandem with the guidance around least-cost interventions. In simple terms the harshest/most intensive regulatory option should be reserved for the relatively rare instances of blatant non-compliance or lack of action.

[8] There are other features of good-practice regulation that are mentioned, but the bullets above are first in order.

Figure 6: Braithwaite Model for responsive regulation

The Authority appears to have skipped some rungs on the ladder to reach the top, without clear evidence of blatant non-compliance or opportunistic behaviour on the part of gentailers. By floating the prospect of regulation before fully assessing the extent to which it would be welfare-enhancing and basing such prospects on hastily proclaimed and incompletely articulated competition problems, the Authority creates two regulatory problems.

Firstly, the Authority may find it difficult to conclude that it overstated the harm and the need for regulatory intervention without damaging its public credibility. By making regulatory proposals without clearly identifying the problem to be fixed and from an initial high-level analysis of a system that is still bedding in, the Authority risks creating strong incentives for it to entrench its views rather than assess submissions with an open mind.

To some degree there is evidence of such positioning in respect of the prior Risk Management Review the Authority undertook. In an update paper following submissions, the Authority considered that substantial material put forward in submissions did not lead the Authority to change its preliminary findings, though again the reasons for such an entrenched view were not clearly articulated (Electricity Authority, 2024).

The second problem is that the greater the negative expected outcome associated with a proposed option (the product of the likelihood it will occur and the size of the effect), the greater the likely impact on business decisions. As discussed below, rational businesses would have incentives to adopt a 'wait and see' approach to big, irreversible investments until there is greater policy clarity. Such an outcome is not likely to be one that the Authority intended.

4.5.3 A 'bundled' regulation approach is non-standard

By suggesting both enduring and urgent, temporary regulation options, the Authority is effectively having two bites of the regulatory cherry. That is, if the first attempt at regulation fails to achieve what appear to be the Authority's objectives, it also wants the ability to intervene further. The enduring and urgent proposals appear to be thought of as complements rather than substitutes. Such a 'belt and braces' approach to regulation is irresponsible and unhelpful for two reasons.

Firstly, it suggests that the nature of the problem and the form of response to the perceived problem is not well understood. If the Authority were confident it had identified a problem that could be resolved by an intervention, and was confident it had designed the right intervention, it would not need its threat of further regulation. If the Authority is neither confident it has identified the problem

nor that it has designed the best intervention, the proper course is to pause and complete further work, not regulate in hope.

Secondly, the consequences of such an approach, in terms of regulatory predictability, investment and consumer welfare (discussed further below) appear to be ignored. Expending scarce regulatory resources on such endeavour is inconsistent with good regulatory practice: if a proposal or proposals cannot be shown to deliver net benefits to society or designed in a clear, easily understood and least-cost manner, other alternatives should be explored.

4.6 Poor regulatory processes result in real harm to consumers

The lapses in the Authority's regulatory process have real consequences that extend well beyond trading of super-peak hedge contracts. This section summarises some of harms to consumers from weak regulatory processes. These consequences arise as the absence of a strong problem statement raises significantly the prospect of a 'false positive' – a conclusion or intervention targeting a harm that does not exist or is overstated.[9]

The risk of false positives is likely to have a much higher expected value in a regulatory intervention in the electricity market in New Zealand than the risk of a false negative, for three reasons. We outline these three reasons—investment uncertainty, characteristics of the electricity sector, and limitations of a small economy—in turn below.

4.6.1 Uncertainty deters investment, lowers employment and reduces consumer welfare

There is an extensive and growing literature describing the impact on decisions and behaviour of firms from regulatory uncertainty.[10] Economic and regulatory policy uncertainty arises when the future path of government policy is unknown, unclear or unpredictable. Even moderate amounts of economic policy uncertainty can affect investment and employment (Rodrik, 1991). A misguided or weak problem definition contributes to uncertainty.

When firms invest in both tangible and intangible assets, they forgo present income to increase future income. Firms are willing to make this investment when they expect the benefit from the investment will exceed its costs. Expected benefits and costs are informed by the impact of regulatory actions, as well as the firm's analysis of future market conditions. Increased uncertainty tends to both lower the level of investment and delay the timing of investment. Most major investments by firms are irreversible: the firm cannot disinvest, so the expenditure is a sunk cost; it cannot be used by another firm or industry (Pindyck, 1986).

[9] A 'false negative' on the other hand, is the cost of a regulator failing to prevent an activity that harms consumers.

[10] See: Al-Thaqeb, & Algharabali, (2019); Baker et al. (2016).

When regulatory processes increase uncertainty, holding off investment allows firms to gain more information about the possible future state (Dixit & Pindyck, 1994). The higher the uncertainty, the greater the value of delay, and the more cautious firms become.[11]

In addition to decision paralysis ("wait and see"), regulatory uncertainty can lead to resource misallocation (Giertz & Feldman, 2012). With increased uncertainty, firms may favour holding liquid assets. As firms switch from productive investment to holding liquid assets, resources are misallocated (Duong et al., 2020). This misallocation, while a rational response by the firm, creates a "deadweight loss" to the economy—the unrealised gains to firms and consumers from reduced productivity (Bloom, 2009).

Increased caution is reflected in employment decisions and access to capital. In periods of high uncertainty, firms hire less (Jurado et al., 2015). Firms might "wait and see" instead of engaging in activities, such as new job creation, that create sunk costs (job creation costs are not refundable). Banks are reluctant to lend when uncertainty is high; this might mean finance is harder to obtain or is more costly.[12]

Reduced investment is felt by consumers through its impact on the availability, quality and price of goods and services. Where uncertainty induced by regulation delays the introduction of new services and service innovation, the loss to consumer welfare can be significant; in economic terms, equating to the whole area under the demand curve for that new service (Hausman et al., 1997).

Available New Zealand evidence is consistent with the international literature. Rice et al. explore the effect of general uncertainty on the New Zealand economy over the period 1997 to 2016. They find that both domestic and global uncertainty reduces output, consumption, and investment. The impact on investment is significantly larger than the impact on consumption, and global uncertainty has in the past been relatively more important than domestic uncertainty in driving the New Zealand business cycle (Rice et al., 2018).

Ratcliffe and Tong identify the key drivers of business investment in New Zealand over the past two decades and find that uncertainty has a strong negative effect on investment, but it is not clear whether this involves a cancellation or a delay in investment (Ratcliffe & Tong, 2021).

Sense Partners developed an economic uncertainty index for New Zealand based on media articles related to uncertainty and examined its impact on investment. Their results mirror those in the literature: firms delay investment and hiring decisions until the outlook is clearer, and households reduce their spending. These impacts persist: the economy is much weaker several quarters after the uncertainty shock hits (Sense Partners, 2020).

Finally, Ryan examines the effects of policy uncertainty using measures derived from New Zealand's parliamentary record from 1975 to 2017. The results show that uncertainty has a large negative impact on output and share prices, consistent with declines in investment and consumption (Ryan, 2020).

[11] See: Bloom (2009); Vural-Yavaş, (2020).
[12] See: Alessandri & Bottero (2020); Bloom (2014).

4.6.2 The electricity sector is especially vulnerable to regulatory uncertainty

Prior research has identified the characteristics of industries especially vulnerable to behavioural uncertainty by regulators and to third party opportunism in regulatory processes (Spiller, 2010). These industry characteristics include:

- customer services utilising substantial fixed investment
- increasing returns to scale over elements of service
- services that are consumed by almost everyone.

Taken together, these characteristics make a service inherently political for three reasons:

1. Almost the entire population consumes the services and hence politicians and interest groups are sensitive to price and service levels.
2. Large economies of scale mean a limited number of industry participants for some services.
3. Significant sunk costs provide regulators, political stakeholders, and third parties considerable leeway to act opportunistically.

These industry characteristics—present in the electricity sector—mean regulatory decision-makers face strong pressure to adopt short-run policies that may harm their long-run policy objectives. Hence, achieving regulatory commitment (sometimes referred to as policy credibility) is fundamental if regulation is to benefit consumers in the long term (Levy & Spiller, 1994).

Absent credible and predictable policies (including confidence in the regulators' ability to identify and define problems and design solutions to such problems based on evidence), firms will invest less. To illustrate, a study across 147 countries over the period 1960 – 1994 finds that the higher the degree of regulatory commitment, the greater the investment by private firms (Henisz & Zelner, 2004).

4.6.3 The size of New Zealand's economy exacerbates risks of regulatory error

Leading economists, including Nobel Laureate Michael Spence, have long recognised the effects of the small size of a domestic market on the economic characteristics and performance of markets. The fundamental structural traits of small economies are so pronounced they belong to a "different class of market economies" (Caves et al., 1981).

There are three structural traits of small market economies like New Zealand that mean the relative costs of a false-positive error (overstating harm) are likely to be higher than the costs of false negatives (failing to prevent an activity that harms consumers).

Firstly, small economies are characterised by high industrial concentration levels, high entry barriers, and suboptimal levels of production.[13] These features were explicitly recognised in the Regulatory

[13] For an explanation of these characteristics and their implications for competition policy, see Gal (2006).

Charter for New Zealand's competition system (Ministry of Business, Innovation, and Employment, 2018). These economic characteristics create a basic tension between productive efficiency and competitive conditions—if a given number of firms can operate efficiently in a market of a certain size, then productive efficiency requires the market contain only this number of firms.

Secondly, the relative price paid by a small economy for a false-positive error is higher than that paid by a large economy. This effect arises because in large economies the "invisible hand of the market" has more corrective power, given the size of the market and the number of entities in the market (Gal, 2012).

4.6.4 Hard lessons from experience

Because of the high cost to society from regulatory uncertainty, reforms to New Zealand's institutions in recent decades sought to reduce erratic and unpredictable changes in policy by providing institutional constraints (Evans et al., 1996).

Important examples include the Reserve Bank Act 1989, the Public Finance Act 1989, and the Fiscal Responsibility Act 1994 (Barker et al., 2008). Together, these reforms create constraints to "structure political, economic and social interaction" (North, 1991) and thereby determine New Zealand's incentive structure for savings, investment, trade and production.

Viewed against the hard lessons from experience, which informed the design of regulatory institutions in New Zealand, the approach signalled by the Authority falls well short of a welfare-enhancing decision made at the margin based on good information and sound policy principles.

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