

# Electricity Authority Advisory Group

## EAAG Subgroup Meetings: Virtual disaggregation

The subgroup was made up of the following EAAG members:

- Jamie Silk (Chair)
- Darren Gilchrist
- Fiona Wiseman
- John Hancock
- Paul Baker
- Sam Flemming
- Karen Boyes
- Margaret Cooney
- Tui Gilling

The group met twice between: 22 November and 27 November 2024.

The following is a summary of the meeting of the minutes of each meeting.

### Context for the EAAG Subgroup

The EAAG was established to provide independent advice on the Authority's work programme.

Its members were selected in an independent capacity based on their expertise and experience.

The Electricity Authority and Commerce Commission jointly established [the Energy Competition Task Force \(Task Force\)](#) to investigate ways to improve the performance of the electricity market in September 2024.

Package one of the work programme is focused on enable new generators and independent retailers to enter, and better compete in the market. Included in package one, is the initiative **1C: Prepare for virtual disaggregation of the flexible generation base.**

This initiative involved the development of a high-level design of a backstop competition measure. Such a design would outline the requirements for generators to offer a minimum volume of their flexible generation base to buyers in the form of risk management contracts.

This option will be considered as a backstop if previous measures aimed at increasing the supply of firming contracts in the market don't produce the intended uplift in competition. This is consistent with the [Market Development Advisory Group's recommendation 13](#). Although this is a backstop measure, designing the rules now will advance the work so it can be implemented quickly if needed.

To gain independent advice and feedback on the virtual disaggregation design aspects, the EAAG subgroup was engaged.

The EEAG subgroup's role was to review the Authority staff/Task Force Staff's work to develop a blueprint for virtual disaggregation, as per the MDAG recommendation.

The group operated under the following provisos:

- The Advisory Group is to provide independent advice ahead of public consultation. Discussion are considered category 3 and needs to be kept confidential for now but will become fully public (category 1) once the consultation opens.

## Summary minutes from 22 November Discussion

**Purpose:** To discuss the development of a virtual disaggregation blueprint following MDAG recommendations, aimed at addressing market power and improving competition in flexible electricity products.

Sub group members received a context paper in advance, which included a range of proposed design factors. The discussion focused on questions relating to these factors.

### Key discussion themes

#### Context & implementation

Authority staff outlined virtual disaggregation as defined by the MDAG report, noting:

- Virtual disaggregation differs from market making: it involves offering volumes at set levels to reduce market power concentration.
- Flexible generation mainly refers to large hydro and some thermal—not batteries.
- A six-monthly market stocktake will assess competition; if issues are found, a trigger test initiates virtual disaggregation via urgent Code amendment.

#### Market maturity & timing

The subgroup had feedback as follows:

- Concern that premature assessment could lead to unnecessary intervention.
- Suggested defining progress milestones and allowing time for market making to mature.
- Emphasis on not limiting trading to standardised products.

#### Trigger Tests

Authority staff outlined the test and criteria being considered:

- Primary Test: Objective metrics (e.g., open interest, contract volumes, liquidity).
- Secondary Test: Subjective insights (e.g., participant behaviour, market dynamics).

The subgroup's feedback outlined:

- Strong consensus that the primary trigger test should focus on a very objective set of KPIs and data points, whereas the secondary test should bring in more subjective, rich data elements.

- There was also agreement these tests should function concurrently (in parallel), not consecutively.

#### Fair Pricing

The sub group then discussed the challenge of assessing a fair price for flexibility products, highlighting:

- Difficulty in defining “fair” price; more feasible to assess competitive pricing.
- Suggested using reference prices and structural indicators (e.g., HHI index).
- Need to understand buyer interest and barriers to uptake.

#### Code Amendment

When discussing Code amendment process and timing there was consensus among the group for:

- Pre-emptive Code amendment to enable swift action.
- Avoid delays and strategic avoidance by market participants.
- Code should enable intervention but not prescribe detailed mechanisms.

#### Dispatch Rights

The subgroup discussed the auctioning dispatch rights and revenue allocation:

- Recommended checking the precedence from other industries to consider how long the instruments should be designed to endure for.
- Noted that compared to other industries; noted potential to reduce market power.
- Emphasised the aspects of financial insurance and flexibility in design.
- Suggested that Commerce Commission may have insight here too.

#### Next Steps

- Further refinement of trigger tests.
- Advance planning for Code amendment.
- Exploration of the relationship between flex products and dispatch rights.

## Summary minutes from 27 November Discussion

**Purpose:** To refine the design and implementation of Virtual Disaggregation, focusing on trigger tests, auction mechanisms, and contract structures, following feedback from the previous session.

### Key Updates from the Authority

Authority provided an update on their work to design virtual disaggregation blueprint, noting how they were responding to the feedback from the previous discussion with the subgroup:

- Trigger tests: Will run in parallel, not sequentially. Labels “primary” and “secondary” will be reconsidered to avoid confusion.
- Code amendment: Proposal to implement in April 2025, with consultation paper due February 2025.
- Dispatch rights: Preference for a risk management contract approach; feedback will be invited.
- Transparency: Commitment to publish a dashboard of indicators (objective and subjective) to clarify trigger conditions and incentivise market behaviour.

### Key discussion themes

#### Market power & access

The sub-group’s discussion covered:

- Traded volume being key to identifying market power—not just product availability.
- Open interest is a useful metric but must be supplemented with price, liquidity, and participant diversity.
- Contract term length can indicate market share and flexibility, especially for independent generators.

#### Offer mechanism and pricing

Authority staff outlined their support of a centralised auction with a reserve price to enable robust and timely price discovery while managing transaction costs. The discussion then covered:

*Market power concerns:* While auctions improve access, they don’t fully address the influence of asset control on derivative pricing. To mitigate this, the Authority proposes:

- Requiring generators with market power to offer a fixed volume to the market.
- Removing their ability to set prices for that volume.

*Spot market influence:* Debate arose over whether generators could manipulate spot market volatility to affect derivative prices. Views were split:

- Some argued a liquid forward market reduces spot market power.
- Others pointed to Trading Conduct rules as a safeguard.

*Price setting mechanisms:* Options discussed included:

- Pre-determined multipliers
- Reference products or technologies

*Contract dynamics:*

- Entering a contract itself influences market behaviour.
- Once signed, contracts incentivise volume delivery, limiting further market influence.

*Design principle:* The core aim is to exclude generators with market power from influencing both volume and price.

- ~ Reference: Prof Grant Read's paper on dispatch rights was cited as a relevant model for auctioning generation capacity without conferring market power.

*Virtual disaggregation vs broader reform:*

- Virtual disaggregation targets market concentration.
- Broader reforms (e.g., Taskforce item 1D) address systemic market power.

*Participation:*

- Auctions should be open to all genuine market participants ("Code participants").
- Concern about large offshore banks dominating the market; monitoring suggested.

**Contract duration**

The subgroup discussed the time horizon for contracts and how far in advance they were expected to be offered. This covered:

- MDAG recommends 3–4 year horizons; Authority proposes up to 3 years.
- Contracts may be structured as CFDs, bundled quarterly.
- Discussion on progressive options to manage supply-demand alignment over time.
- Termination process under design; goal is for generators to continue trading beyond initial offerings.

**Chair's summary**

The discussion was concluded with the Chair's summary covering the following key themes:

- Importance of clear terminology and objective thresholds.
- Need for shared understanding of forward vs spot price dynamics.
- Preference for inclusive auction participation with appropriate safeguards.