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nova energy

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28 November 2025

Submissions
Electricity Authority

By email: wholesalemarkets@ea.govt.nz

Nova Energy submission to the Electricity Authority's issues and options paper: Improving prudential security arrangements

Nova Energy (Nova) supports the Authority's objective of improving the efficiency and effectiveness of prudential security settings. However, Nova's experience is that the current methodology is producing outcomes that are increasingly misaligned with actual market risk and imposing unnecessary and disproportionate costs, particularly on smaller retailers who do not have the benefit of investment grade credit ratings. Infrequent updates to exit period pricing mean that prudential requirements are often calculated using ASX values that may be several months old, leading to material swings in credit support obligations that do not reflect genuine exposure. For Nova, this has resulted in significantly higher working capital demands during periods when market prices have eased but the methodology continues to rely on historic, elevated price assumptions.

The framework also does not recognise the value of dispatchable generation capacity that does not operate during periods of low prices. Nova maintains peaking generation assets, so they are available during times that renewables are not able to generate yet this firm capacity currently provides no prudential benefit unless it is dispatched. This creates a distortion where prudential requirements can increase when market risk is low, while ignoring the natural mitigation that occurs if prices rise and the plant begins generating revenue. This approach undervalues investments in flexible and firming resources that enhance both competition and security of supply.

Nova therefore encourages the Authority to prioritise two targeted improvements:
(1) more frequent—ideally weekly—updates of exit period pricing to ensure prudential assessments better reflect current market conditions; and
(2) recognition of dispatchable generation capacity and other firming resources within prudential calculations.

These changes could substantially improve the accuracy and fairness of prudential settings, reduce unnecessary costs, and support more efficient and competitive market participation without increasing credit risk for generators.

Yours sincerely,

Tamiris Robinson

Regulatory Advisor

Nova Energy

Nova submission: Improving prudential security arrangements

Questions	Comments
Q1. Do you agree that the current risk profile of the prudential framework is appropriate? If not, why/how should risk be redistributed?	A PLGD of 25% essentially implies that one-quarter of the time there has been a failure to accurately estimate pricing, volume, or the time required to exit a defaulting participant. On the face of it, a PLGD of 25% appears high, as shown in the comparatives referenced. While different markets have differing characteristics, deep, liquid, and stable markets typically exhibit far lower LGD, even with lower prudential requirements. This raises questions about the volatility and characteristics of the markets used for comparison.
Q2. Do you agree that the issues identified by the Authority are worth addressing?	Yes. Compliance and prudential costs are significantly higher for smaller operators than those faced by larger competitors, limiting competition and ultimately affecting consumer outcomes. The current prudential system imposes inequitable burdens on smaller participants, creating barriers to competition and increasing consumer costs without providing any real corresponding benefit.
Q3. Are there other issues with the current prudential security settings that we have not identified but are worth addressing?	Exit pricing calculations are highly inaccurate because they rely on a fixed point in time, often far in the past, and not reflective of current market conditions. Nova recommends modifying the methodology to update exit period pricing weekly based on ASX pricing levels, rather than relying on quarterly price resets. The current methodology can materially under- or overestimate prudential requirements when actual prices diverge from quarterly ASX values. Understating credit support increases credit risk for generators, while overstating credit support increases working capital costs—particularly for retailers without investment-grade credit ratings. A further issue is the lack of recognition of dispatchable generation capacity, which has required real capital investment. For example, when prices are low and dispatchable generation (such as Nova's peaking plant) is not operating, higher credit support requirements can arise when paired with exit pricing based on historic high prices. If actual prices were high, generation revenue would be received and would be factored into exit period calculations. The current treatment therefore creates distortions and fails to recognise the risk-mitigating value of dispatchable capacity.
Q4. Do you consider that there are other adjustments that the Authority could make that would better reduce	Reflecting the value of peaking generation and other flexible generation (or demand sources) in prudential calculations will further incentivise parties to develop firming resources and create other market benefits. The

cost and enhance efficiency in prudential requirements for small retailers without significantly increasing credit risk for generators.	current methodology tends to penalise, rather than reward, operators of flexible or dispatchable resources.
Q5. Do you support the transition to a more dynamic adder? If not, what are your concerns?	In isolation, yes. However, the adder appears largely immaterial given the variability of underlying pricing structures. Adders would be less relevant if exit period pricing were accurate. ASX pricing provides a reasonable guide to actual pricing, but generally only within an 8–10 week window. Using the current methodology—where forward prices may be up to five months old—leads to large prudential requirements where little risk exists, and small requirements where large risks exist. Updating exit pricing weekly would likely reduce the PLGD (as noted in Q1) without necessarily increasing prudential requirements.
Q6. Do you support the proposal to allow reductions in the post default exit period? Why/why not?	Yes, provided the exit period is sufficient to complete all required activities following a default, as stated in Q3.
Q7. Do you agree that the threshold for qualifying for a reduced post-default exit period should be 1,000 ICPs?	An ICP threshold does not reflect actual prudential exposure. A retailer with a small number of large commercial or industrial customers may have significantly greater consumption volumes—and therefore far higher financial exposure—than a retailer with thousands of small household ICPs. For example, 900 large commercial ICPs could represent many times the total volume of 20,000 residential ICPs. A volume-based threshold would therefore provide a much more accurate and risk-aligned benchmark.
Q8. If broader changes to the trader default process make it feasible to reduce the post-default exit period for all independent retailers, should the Authority pursue this? Why/why not?	Yes, provided the exit period remains sufficient to complete all the activities required past default.
Q9. Do you agree with the proposal to reallocate residual funds to retailers on a scaled basis?	Yes. Residual funds arise largely due to retailers' activities and should be returned to retailers accordingly.
Q10. Is there an alternative model by which residual funds could be	If it is possible to determine where residual value originates, it may be more appropriate to return funds to the parties that generated them. Paragraph 5.30 suggests that the necessary data largely exists to enable this

reallocated to retailers in a fair manner that still achieves the policy objectives?	allocation.
Q11. Do you support a possible physical and futures offsetting arrangement? Why/why not?	Yes, all relevant instruments should be able to be applied to offset prudential requirements, including (but not limited to) NZX futures, PPAs and dispatchable generation capacity.
Q12. Are existing market-based work arounds to physical and futures offsetting arrangements sufficient for managing the issue?	Potentially for this specific issue, although such workarounds are not cost-free and can create additional transactional and management overhead.
Q13. If ASX futures positions could offset spot market prudential requirements, would you be more likely to trade in the futures market?	Yes.