2nd November 2023

While we welcome the opportunity to make this brief submission, and to contribute positively to the debate over the operation of the energy markets, there were six papers released by MBIE, and some cover work already underway in the Electricity Authority. Given limited resources, we have chosen to engage primarily with the Electricity Authority workstreams.

Therefore, our response is limited to questions 18 to 26, concerning competition in the electricity market.

Questions on this submission can be directed to Greg Sise, Managing Director, Energy Link Ltd.

PART 2: COMPETITIVE MARKETS	
18.	Do you agree that the key competition issue in the electricity market is the prospect of increased market concentration in flexible generation, as the role of fossil fuel generation reduces over time? *No.* *It is true that competition with thermal generation can act as a constraint on market power in hydro generation, but that does not mean market power will be used to a greater extent in future. Existing large hydro generators will still compete with each other to build the next new generator, and they will compete with smaller existing and new independent generators to do the same. If market power is used to elevate spot prices, the price signal for new generation will be stronger, which risks encouraging entry by others. This being the case, one could even argue the incentive around market power is to keep prices lower in the long run, thus deterring entry by others.* *The bigger issue is competition in the retail sector, covered below.*
19.	Aside from increased market concentration of flexible generation, what other competition issues should be considered and why? *In the retail sector, innovation and competition are driven by new entrants, so keeping barriers to entry low is key. When we say ‘low’, we do not wish to imply that just anyone should be able to set up as a new retailer, and instead we would expect them to be well resourced, well funded and fully capable of setting up, growing, and operating an electricity retail business. But even for the capable, barriers are significant.* *Market share, which is currently around 12% (of ICPs) for independent retailers, is worryingly low given the amount of time independent retailers have been a feature in the market. We suggest that, ideally, at least 20% market share should have been achieved by now.* *The big problem for these retailers is access to hedging instruments which support growth.* *The common factor between independent generators and independent retailers is access to contracts (as opposed to transacting purely at spot prices). For existing smaller, and new independent generators to enter the market with new generation projects, their investors and financers typically require a high degree of contracting at fixed or slowly varying prices, i.e. not spot prices. Access to these contracts is also an issue in respect of competition, although not as pressing as in the retail sector.*

20.	What extra measures should or could be used to know whether the wholesale electricity market reflects workable competition, and if necessary, to identify solutions? *The problems in the retail sector are well known by now, so we believe they should be the focus for ensuring there is sufficient competition.*
21.	Should structural changes be looked at now to address competition issues, in case they are needed with urgency if conduct measures prove inadequate? *In an ideal market, the participants would be smaller and greater in number. Structural changes could move the market closer to this ideal, but we believe other measures should be implemented first, as below.*
22.	Is there a case for either vertical separation measures (generation from retail) or horizontal market separation measures (amending the geographic footprint of any gentailer) and, if so, what is this? *See answer to 21 above.*
23.	Are measures needed to improve liquidity in contract markets and/or to limit generator market power being used in retail markets? If yes, what measures do you have in mind, and what would be the costs and benefits? *Yes.* *As noted above, independent retailers struggle to achieve market share, and the biggest issue they face is access to the right hedge products.* *The Electricity Authority has focused on liquidity in the futures market, and has introduced market-making in all baseload quarterly and six monthly contracts at Benmore and Otahuhu.* *The peak quarterly product does not have market-making and rarely trades.* *Independent retailers tend to grow their businesses by targeting residential and SME customers, which means they have significant peak exposure. Ideally, independent retailers would hedge using a combination of baseload and peak hedges; however this is not possible in the futures market due to the lack of market-making in the peak contract.* *We believe the OTC hedge market is more important to independent retailers because the cash flows on OTC hedge settlement (a) match spot market cash flows in terms of timing and (b) can be used to hedge prudential requirements by lodging OTC hedges with the Clearing Manager (albeit with a 15% difference between spot and hedge settlements due to GST applying to spot purchases but not hedge settlements).* *In 2019/20 we proposed and developed a new type of CFD contract which we called "Flex-CFD". Without going into details (available to MBIE on request), the contract was designed to provide (a) hedge volume shaped to match a retailer's residential exposure and (b) a degree of optionality in the total volume covered.* *We circulated the contract specification to major players in the OTC market for feedback, and believe that, at the time, we arrived at a specification that was ready to be tested in the market. This unfortunately never happened because of the large increase in volatility that occurred around that time, and exit of some independent retailers.* *The contract may or may not have traded, but the point we want to make is that this type of innovation is possible in the OTC market, whereas it is not in the futures market. Whether it is a Flex-CFD or some other shaped product, the OTC market is the right venue to introduce*

	product which can help independent retailers compete, to the ultimate benefit of consumers. *Independent generators may also face issues accessing the contracts they need, either with large consumers, independent retailers, or gentailers. A common issue encountered is that the generation profile of a new renewable generator does not match the demand profile of a large user, or the aggregate demand profile of a retailer's residential customers. In principle, this can be solved by adding a 'firming' contract which fills the gaps between the two physical profiles. Measures that lead to firming contracts becoming available in the OTC market could be explored, along with the shaped products for independent retailers.* *To summarise:* • *Independent retailers would be assisted by access to shaped product in the OTC market.* • *Independent generators would be assisted by access to firming product in the OTC market.* *The benefits of the above would arise from greater competition in both retail and generation. The costs would be relatively low, we believe, because our experience with the Flex-CFD suggests the market would be open to these developments. We also note the Electricity Authority is beginning to look at these issues in more detail as it works through how the market will ultimately function as it approaches 100% renewables.*
24.	Should an access pricing regime be looked at more closely to improve retail competition (beyond the flexibility access code proposed by the Market Development Advisory Group or MDAG)?
25.	What extra measures around electricity market competition, if any, do you think the government should explore or develop? *None other than those described above.*
26.	Do you think a single buyer model for the wholesale electricity market should be looked at further? If so, why? If not, why not? *No.* *Harking back to the 1990s, the rationale for breaking up ECNZ and establishing a wholesale market in the first place, was the concern that centralised control of generation had led to over-building of generation, the bill for which was subsequently paid by taxpayers.* *A major problem for the single buyer is forecasting demand. History shows that no one gets this right, and putting all of one's eggs into the basket of a single buyer increases the risk relative to the current market, in which there is a diversity of views on future demand.* *We should also assume that a single buyer will be conservative, leading to over-contracting, simply because there is a natural desire to avoid negative fall-out if demand growth is higher than forecast. Over-contracting could increase the cost of electricity, not reduce it.* *One of the other major concerns in the 1990s was the dominance of ECNZ, as owner of 97% of all generation in New Zealand; breaking ECNZ encouraged more efficient operations, enhanced competition, and encouraged private investment in new generation, leading to better matching of generation to demand. There is no evidence we're aware of to suggest that a single buyer would perform any better than ECNZ (or the NZED before it) in this respect.*