

Clearance application – Mercury/NZAS materially large contract

Decision paper

11 June 2024

Executive summary

The materially large contract (MLC) part of the Code prohibits generators giving effect to MLCs unless the net value from the contract is positive relative to alternatives or where the buyer can on-sell unused electricity on no worse terms than if it had consumed the electricity itself. The Code also provides the Authority with greater visibility of MLCs for the purposes of monitoring and compliance through disclosure obligations and includes a voluntary clearance process, which gives generators the option to gain assurance that the MLC is not in breach of the Code.

Mercury NZ Limited (Mercury) has applied for clearance from the Electricity Authority Te Mana Hiko (Authority) of a draft contract (Contract) between itself and New Zealand Aluminium Smelters Limited (NZAS) under part 13 subpart 7 of the Electricity Industry Participation Code 2010 (the Code).

The Authority decided to provide clearance of the Contract, on the basis that NZAS has the right under the Contract to on-sell any unused MW quantities on no worse terms than if it had consumed the MW quantities itself.

The Contract was subsequently signed and publicly announced on 31 May 2024 and the clearance remains applicable.

1. Purpose

- 1.1. This paper explains the Authority's decision to provide clearance of Mercury's draft contract with NZAS.

2. Background

- 2.1. The MLC part of the Code seeks to prevent inefficient price discrimination. The policy rationale for the MLC part of the Code was that a heavily discounted contract price benefits all sellers by increasing the scarcity of electricity and thereby pushing up prices for other consumers. This can only happen with MLCs.
- 2.2. The Code defines MLCs and prohibits them unless the generator can demonstrate that an MLC passes one of two tests:
 - (a) an economic test of whether the value of the MLC to the generator is greater than the value to the generator of its best alternative (net value test); or
 - (b) a legal test of whether the MLC allows electricity to be on-sold by the purchaser to a third party, on no worse terms than if the purchaser had consumed the relevant quantity itself (on-selling test).
- 2.3. A clearance can be sought to provide parties with comfort that they fall within one of these tests.

3. The Contract is a MLC

- 3.1. A MLC is defined in the Code as a contract which is: (i) not entered into through a derivatives exchange; and (ii) includes terms under which the buyer itself will consume electricity; and (iii) relates to a net quantity of electricity that equals or exceeds 150MW consumed at a point of time.
- 3.2. Two or more contracts can each be an MLC if, when taken together, they relate to a net quantity of electricity supplied to a buyer that equals or exceeds 150MW consumed at a point of time.
- 3.3. Those contracts can be between two or more different generators contracting with one buyer, where both contracts are needed (are relied on) to supply the buyer with more than 150MW. Each of those contracts is a MLC. Although the generators will not necessarily know about the other generator's contract with the buyer, a generator will often be able to imply this given public knowledge about minimum viable load requirements of major load users. If a generator only supplies a portion of a large load user's minimum viable consumption it can assume there may be other related contracts, unless it has reason to believe that the load user is relying upon spot contracting for the rest of its load.¹
- 3.4. Mercury's contract with NZAS is for less than 150MW but it is still considered to be a MLC because it is only supplying a portion of NZAS's minimum viable consumption. The terms of the Contract also indicate that NZAS needs to contract for additional supply before the Contract can come into effect. These types of smaller contracts still

¹ ea.govt.nz/documents/2545/Decision_paper_-_Inefficient_price_discrimination_in_very_large_electricity_contracts.pdf

fit within the definition of a MLC when they are part of a group of contracts supplying the same user, which when added together, exceed 150MW.

- 3.5. The Authority's view is therefore that the Contract fits within the definition of an MLC in accordance with clause 13.268 and is therefore prohibited under the Code unless it passes either the net value test, or the on-selling test.
- 3.6. Even though the Contract is part of a group of contracts for the purposes of determining whether it meets the threshold for a MLC, the Contract must be considered independently for the purposes of a clearance application, in accordance with clause 13.268(2) of the Code.

4. Mercury's application

- 4.1. Mercury's clearance application was made in reliance on cl 13.272(1)(b) of the Code, which provides that generators can make applications to the Authority for clearance of MLCs that have not yet been signed by the parties. In those circumstances, any clearance provided by the Authority expires if the Contract is not signed within 20 business days of the clearance being provided.²
- 4.2. Mercury's application is on the basis of the on-selling test. Mercury says that, under the Contract, NZAS has unrestricted rights to on-sell any unused MW quantities (noting that the contract is financial in nature) and is also not restricted from agreeing with the counterparty such terms as it considers commercially acceptable. Mercury says that NZAS could seek to do this by entering into a back-to-back contract for difference (CFD), or in any other manner it considers appropriate to sell MW quantities.

5. The Contract allows NZAS to on-sell un-used megawatts and has been cleared by the Authority

- 5.1. The Authority notes that in clause 13.269(1)(b) the reference to "on-selling" can include a back-to-back CFD (as is contemplated here by Mercury as the means of on-sale) and need not be a physical on-sale.
- 5.2. Having considered Mercury's application and the terms of the Contract, the Authority is satisfied that the Contract allows for on-selling, in particular a CFD, to be entered into by NZAS (should NZAS choose to do so on terms that are acceptable to it and a third-party purchaser) and accordingly that clause 13.269(1)(b) is satisfied.
- 5.3. The Authority therefore decided to provide clearance of the Contract under clause 13.273 of the Code. The Contract was subsequently signed and publicly announced on 31 May 2024, and the clearance remains applicable. The Authority notes that if any changes are made to the Contract's on-selling arrangements then the clearance will no longer apply.³

² Clause 13.272(7) Electricity Industry Participation Code 2010

³ Clause 13.272(6)(b) Electricity Industry Participation Code 2010