

Clearance application – Meridian/NZAS materially large contract

Decision paper

24 June 2024

Executive summary

The materially large contracts (MLC) provisions of the Electricity Industry Participation Code 2010 (Code) seek to prevent inefficient price discrimination. The policy rationale for the MLC part of the Code was that a heavily discounted contract price provided to a larger user may in effect increase the scarcity of electricity and thereby push up prices for other consumers.

The MLC provisions of the Code define MLCs and prohibit them unless the generator can demonstrate that a 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).

A clearance can be sought to provide parties with comfort that they fall within one of these tests.

The Code also provides: (i) the Authority with greater visibility of MLCs for the purposes of monitoring and compliance through disclosure obligations; and (ii) a voluntary clearance process which gives generators the option to gain assurance that the MLC is not in breach of the Code and that the Authority will not investigate a contract at a later date.

Meridian Energy Ltd (Meridian) has entered into a long-term contract for difference (CFD) with New Zealand Aluminium Smelter (NZAS) (Meridian CFD) and a demand response agreement with NZAS (Meridian Demand Response Agreement) (together the Meridian Agreement). The deal was announced to the New Zealand Stock Exchange (NZX) on 31 May 2024 and is conditional on clearance by the Electricity Authority Te Mana Hiko (Authority) (among other conditions precedent). The Meridian Agreement is caught by the MLC provisions of the Code.

Meridian submitted its clearance application to the Authority on 31 May 2024. Meridian's application is based on the on-selling test, i.e. on the basis that the Meridian Agreement allows NZAS to on-sell any un-used MWs on no worse terms than if it had consumed the electricity itself.

The Authority has decided to clear the Meridian Agreement because it is satisfied, based on the information provided in support of the application, that its terms are consistent with the on-selling test.

1. Purpose

- 1.1. This paper explains the Authority's decision to provide clearance of the Meridian Agreement.

2. Background

- 2.1. 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.
- 2.2. 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.
- 2.3. Meridian has a CFD with NZAS (the Tiwai agreement) which expires at the end of 2024. In advance of that expiry, NZAS has negotiated three separate electricity agreements with three generators, Contact Energy Ltd (Contact), Meridian and Mercury New Zealand Ltd (Mercury). Each of those generator's contracts are caught by the MLC provisions of the Code.
- 2.4. Meridian has entered into a long term CFD with NZAS (Meridian CFD) and a demand response agreement with NZAS (Meridian Demand Response Agreement) (together the Meridian Agreement). The deal was announced to the New Zealand Stock Exchange (NZX) on 31 May 2024 and is conditional on clearance by the Authority under the MLC provisions of the Code.
- 2.5. Meridian submitted its clearance application to the Authority on 31 May 2024. Meridian's application is based on the on-selling test, i.e. that the Meridian Agreement allows NZAS to on-sell any un-used MWs on no worse terms than if it had consumed the electricity itself.

3. The Meridian Agreement

- 3.1. The Meridian Agreement comprises:
 - (a) The Meridian CFD, under which Meridian is the seller and NZAS is the buyer:
 - (i) from 1 July 2024 (or on the fourth business day after all the conditions precedent are satisfied, whichever is later) until 31 December 2024, of 472MW; and
 - (i) from 1 January 2025 until 31 December 2044, of 377MW.
 - (b) the Meridian Demand Response Agreement, where Meridian purchases 75 percent of four tranches of demand response (25MW, 50MW, 100MW, and 185MW) offered by NZAS. NZAS was free to sell the other 25 percent to a third party. Based on information received by the Authority separately this is

to be purchased by Contact pursuant to a separate demand response agreement between Contact and NZAS.

- 3.2. The existing Meridian / NZAS electricity agreement, 2023/2024 demand response Agreement and 2024 peak demand response agreement between Meridian and NZAS (Existing Agreements) all terminate at midnight on the day before the date the Meridian CFD takes effect (if they have not otherwise expired or been terminated earlier). If the Meridian CFD does not come into effect, the Existing Agreements will expire at the end of 2024 at the latest (if they have not otherwise expired or been terminated earlier).
- 3.3. The Meridian CFD and the Meridian Demand Response Agreement are together a MLC. That is, the Meridian Agreement falls within the definition in clause 13.268(1) of the Code as it is not entered into through a derivatives exchange, includes terms under which the buyer itself must consume electricity; and relates to a net quantity of electricity that equals or exceeds 150 MW consumed at a point of time.

4. The Meridian application

- 4.1. Meridian's application was made in reliance on clause 13.272(1)(a) of the Code, which provides that a generator may submit an application to the Authority for a clearance of a MLC that is expressed as conditional on the Authority providing clearance.
- 4.2. Meridian's application is on the basis of the on-selling test. In its application Meridian says that none of the contracts contain any restriction on on-selling any un-used MW quantities. In particular, Meridian noted clauses in the Meridian CFD and the Meridian Demand Response Agreement which provide:

For the purposes of Subpart 7 of Part 13 of the Code, nothing in this Agreement shall be construed as a restriction on [NZAS's] ability to on-sell any un-used megawatt quantities without [NZAS] being subject to any worse terms than if it had consumed the relevant quantity itself.

- 4.3. Meridian also says in its application:
 - (a) The notional quantity under the Meridian CFD is fixed at (i) 286MW per half hour until the end of 2024 and (ii) 188.5MW per half hour from 2025 onwards, unless adjusted due to a force majeure event or a demand response option being exercised.
 - (b) NZAS is not prohibited from on-selling any un-used notional quantity and NZAS is free to negotiate back-to-back provisions addressing force majeure and demand response in any contract for difference with third parties that it wishes to on-sell to.

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

- 5.1. Having considered Meridian's application and the terms of the Meridian Agreement, the Authority is satisfied that the Meridian Agreement allows NZAS to engage in on-

selling without being exposed to worse terms than if it had consumed the electricity in question itself.

- 5.2. In particular, nothing in the Meridian CFD would prevent NZAS entering into a further CFD or similar with a third party (should they chose to on terms that are acceptable to it and a third-party purchaser) for any un-used MW quantities. The Authority notes that the reference to 'on-selling' can include back-to-back CFDs (as contemplated by Meridian in its application) and need not be a physical on-sale.
- 5.3. The Authority is also satisfied that the Meridian Demand Response Agreement does not contain any terms that prevent NZAS from engaging in on-selling. Nor does the Authority consider the Meridian Demand Response Agreement likely to have the practical effect of restricting NZAS from on-selling.
- 5.4. Therefore, clause 13.269(1)(b) is satisfied.
- 5.5. The Authority has therefore decided to clear the Meridian Agreement under clause 13.273 of the Code. The Authority notes that if any changes are made to the on-selling arrangements in the Meridian Agreement then the clearance will no longer apply.