

Clearance application – Contact/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.

Contact Energy Ltd (Contact) has sought clearance of a long-term and short-term contract for difference with New Zealand Aluminium Smelter (NZAS) (Contact CFDs) and a demand response agreement (Demand Response Agreement) with NZAS (together the Contact Agreement) under clause 13.272(1)(a) of the Code. 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).

Its application relies on NZAS's ability to on-sell un-used electricity on no worse terms than if it had consumed the electricity itself.

The Authority is satisfied, based on the information provided by Contact, that the Contact Agreement allows NZAS to on-sell un-used electricity on no worse terms than if it had consumed the electricity itself and that it is therefore not prohibited by the Code. The Authority has therefore decided to clear the Contact Agreement.

1. Purpose

- 1.1. This paper explains the Authority's decision to provide clearance of the Contact 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.
- 2.2. 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.
- 2.3. Meridian Energy Ltd (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, Meridian and Mercury New Zealand Ltd (Mercury). Each of those generator's contracts are caught by the MLC provisions of the Code
- 2.4. Contact has entered into two CFDs with NZAS and a demand response agreement with NZAS. Contact announced its deal with NZAS on 31 May 2024, and submitted an application to seek clearance of a signed contract, which is conditional on clearance by the Authority.
- 2.5. Contact's application relies on the on-selling test.

3. The Contact Agreement

- 1.2. The Contact Agreement is comprised of:
 - (a) A long-term CFD, comprised of two volume tranches:
 - (i) 100MW starting on 1 July 2024 and concluding on 31 December 2024;
 - (ii) 120MW starting on 1 January 2025 and concluding on 31 December 2044.(Long-Term CFD)
 - (b) A short-term CFD for 25MW, commencing on 1 January 2025 and concluding on 31 December 2026.
(Short-Term CFD)
(Together the Contact CFD)
 - (c) A demand response agreement (the Contact Demand Response Agreement) between Contact and NZAS, where Contact purchases 25% of four tranches of demand response (25MW, 50MW, 100MW, and 185MW) offered by NZAS. The other 75% is to be purchased by Meridian pursuant to its separate proposed Meridian demand response agreement with NZAS.
(together the Contact Agreement)

- 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.¹
- 3.2. Two or more contracts can also be a 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. In addition, where there are 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, then each of those contracts is a MLC. Those contracts are interdependent or reliant on each other and are included in the definition of a MLC under the Code for clearance purposes (see clause 13.268(1)(b) and 13.268(1)(c)(iii)).
- 3.3. The Contact Agreement does not meet the 150MW threshold on its own. However, when taken together with other generators' contracts with NZAS, the volume of the group of contracts exceeds 150MW. This interdependence with the other generators' contract is made clear by one of the conditions precedent in both the Long-Term CFD and the Short-Term CFD, which provides:

NZAS notifies Contact that one or more Comparable Transactions have been executed and are unconditional (excluding any conditions precedent in such transaction(s) that relate to this Agreement becoming unconditional) which, in aggregate together with this Agreement, provide for the supply of, or financial settlement in respect of, electricity capacity no less than 572MW.
- 3.4. The Contact Demand Response Agreement also comprises part of the same MLC for clearance purposes.
- 3.5. Even though the Contact Agreement is part of a group with other generators contracts for the purposes of determining whether it meets the threshold for a MLC, the Contact Agreement must be considered independently from the other generators' contracts for the purposes of the clearance application, in accordance with clause 13.268(2) of the Code.

4. The Contact application

- 4.1. Contact'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. Contact relies on the on-selling test in the Contact application, ie that the Contact Agreement allows NZAS to on-sell any un-used MW quantities on no worse terms than if it had consumed the electricity itself.
- 4.3. Contact explains in its application that the Long-Term CFD volumes are fixed, except in the following cases:
 - (a) Contact Demand Response applies: If Contact Demand Response applies, then the volume of demand response that Contact purchases pursuant to the

¹ Clause 13.268(1) of the Code

Contact Demand Response Agreement shall be deducted from the Contact CFDs.

- (b) Clause 4.3 applies: Clause 4.3 provides that if Clyde Dam and/or Roxburgh Dam are affected by a major force majeure event which reduces aggregate generation from both facilities to below 100MWh / trading period, then the volume supplied to NZAS will be reduced proportionately.
 - (c) Clause 4.4 applies: Clause 4.4 provides that if NZAS' physical consumption is reduced as a result of force majeure affecting NZAS's Tiwai Point Smelter, the volume that they are required to 'purchase' from Contact is reduced proportionately.
- 4.4. The Short-Term CFD contains an almost identical volume structure (clause 4.1). The only exceptions are that:
- (a) the Contact Demand Response provisions described in paragraph 4.3(a) do not apply to that agreement; and
 - (b) the force majeure provisions described in paragraph 4.3(b) above do not apply to that agreement.
- 4.5. Contact explains that the volumes 'supplied' under the Contact CFDs could be on-sold by NZAS in two ways:
- (a) NZAS could reduce consumption and sell a CFD to a third party, or
 - (b) NZAS could reduce consumption and take the difference between the spot price and the contract price.
- 4.6. Finally, the Long-Term CFD and the Short-Term CFD each include a clause, which Contact also notes in its application, which provides that:
- The Parties acknowledge that there will be no physical transfer or sale of electricity to NZAS pursuant to this Agreement and that nothing in this Agreement shall be construed as a restriction on NZAS' ability to on-sell any unused megawatt quantities without NZAS being subject to any worse terms than if it had consumed the relevant quantities itself*

5. The Contact Agreement allows NZAS to on-sell unused megawatts and has been cleared by the Authority

- 5.1. Having considered Contact's application and the terms of the Contact Agreement, the Authority is satisfied that the Contact 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 Contact 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 Contact in its application) and need not be a physical on-sale.

- 5.3. The Authority is also satisfied that the Contact Demand Response Agreement does not contain any terms that prevent NZAS from engaging in on-selling. Nor does the Authority consider the Contact Demand Response Agreement is 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 Contact Agreement under clause 13.273 of the Code. The Authority notes that if any changes are made to the on-selling arrangements in the Contact Agreement then the clearance will no longer apply.

