

5 October 2023

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Out of scope

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4.6. Out of scope

[REDACTED]

(i) Out of scope Electric Kiwi and three other independent retailers have recently made formal a complaint to the Commission alleging misuse of market power by the major gentailers.

(b) Out of scope

[REDACTED]

Out of scope

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**[REDACTED]**

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- 7.5. Smarter technologies, tariffs and services can empower consumers to engage with price signals and benefit from adjusting their energy usage to better align with the availability of low-carbon electricity.

***Stakeholders have raised concerns with the Authority about market competition***

- 7.6. Some electricity retailers are testing the Authority's views on market competition, access to 'fairly priced' wholesale electricity, and challenging the degree of regulation to which the market is subject.
- 7.7. The relevant component of the wholesale electricity market is the hedge market – financial hedge contracts participants use to manage the risk of future spot price movements. There are three key markets in the New Zealand hedge market:
- (a) Standardised electricity futures and options contracts are traded and settled on the ASX.
  - (b) Over-the-counter (OTC) hedges with direct negotiation on price have a key role. Contracts can be customised and provide flexibility for both parties.
  - (c) Financial transmission rights help parties manage differences in spot prices between two locations.
- 7.8. Some independent retailers have raised concerns with the Authority about the competitive challenges they face. The basis of their concerns is that the gentailers have an advantage in managing their spot price risk because they have natural hedges for the electricity they sell to their own retail operations. Some argue this comparative advantage is at odds with promoting retail competition.

***The Authority has a range of initiatives underway to improve competition, including better access to information and contracts***

- 7.9. The wholesale market arrangements are seen by some stakeholders as a barrier to innovation and as impeding new types of business models and services from emerging.
- 7.10. The conclusions of the Wholesale Market Review are reflected in specific actions noted in the review, and the Authority's subsequent work programme.
- 7.11. In the wholesale market, the Authority is focussed on:
- (a) improving market making on the ASX, specifically facilitating liquidity and providing a forward price curve in the traded products
  - (b) ensuring the market in over-the-counter (OTC) contracts remains fit-for-purpose, including a new voluntary code of conduct for the OTC market
  - (c) ensuring the market settings for financial transmission rights are fit-for-purpose
  - (d) assisting the Market Development Advisory Group's (MDAG) investigation into how the electricity market might operate with an electricity supply that is near 100 percent renewables-based with economically efficient price signals and efficient operation of the electricity industry for the long-term benefit of consumers.

***The Authority is considering whether more work is required on the retail market***

- 7.12. The underlying problems for independent retailers are:
- (a) Retail prices are lagging wholesale prices as vertically integrated suppliers (gentailers) look through short term price volatility and smooth prices for their retail customers.

- (b) This means that business models that rely on hedging products to manage spot price risk (ie, independent retailers) could face falling margins, when wholesale prices are spiking or trending higher.
- (c) This is more apparent for those independent retailers that mostly sell into the residential market which has the peakiest load.

7.13. The independent retailers argue that:

- (a) gentailers are precluding access to hedges despite the existence of voluntary and mandatory market making
- (b) wholesale trades are not being priced competitively or on similar terms to gentailers' internal transfer prices (and possibly 'non-competitors', such as industrials)
- (c) If you accept that wholesale prices are competitive, then the gentailers are predatory pricing through their retail pricing (implementing a margin squeeze) to force independent retailers out of the market.

7.14. In addition, MBIE highlights in the EMM issues paper that:

- (a) retail gross margins are similar across gentailers and independent retailers
- (b) high spot and hedge prices are presenting challenges for new entrants
- (c) comparisons of gentailers' internal transfer prices (ITPs) with benchmark ITPs represents a range of plausible retailer hedging strategies
- (d) benchmark ITPs appear high relative to the retail gross margins needed for a retailer to be competitive.

7.15. It is important that the retail market delivers good outcomes for all consumers. The Authority has been considering whether more work is required in response to recent changes in the retail market such as:

- (a) the disclosure of by generator retailers of all ITP information as result of improved transparency measures
- (b) higher hedge market prices
- (c) concerns of the independent retailers.

7.16. Based on current concerns expressed about retail competition we are undertaking work to look at competition in the retail market, including:

- (a) recent trends in the retail market generally
- (b) the specific issues raised by independent retailers about competition in the retail market
- (c) what interventions (if any) may be required to address these.

7.17. A starting point for the first two steps of this work is listed below. We may discover other areas we want to look into as we progress, and we may find that the data we can get does not support all this analysis and we will have to adapt. Our process is outlined below:

- (a) Understand what is happening in the market now. We have some data from this market and are scoping work to collect a more comprehensive dataset. The market is most often comprised of bilaterally negotiated contracts or is based on RFPs and tenders for contracts. We will ask for these variations, and check with our over-the-counter working group to ensure that we capture everything that is relevant for this review.



- (b) Create a set of arbitrage free prices based on various methods. At this point these could range from one extreme the cost of building infrastructure to substitute for contacting (for example building a battery and buying a baseload ASX contract would allow the investor to self-provide spot price risk). To the other end simply using an average cost of energy. In between we will use a set of ways to estimate a reasonable contract price, such as using an ASX hedge and the spot market, using an ASX hedge and a peak hedge.
  - (c) Use the data we collect on OTC contracts and ASX prices to find prices for shape, location and institutional differences like credit risk, transaction costs and liquidity (this is conditional on whether our dataset will support this analysis).
  - (d) Use gentailer credit policies and limits management frameworks, the most recent credit assessment of a list of independent retailers and their current approvals for this list, to investigate whether they differentially price in the OTC market on the basis of credit standing.
  - (e) Use the 2023 retail gross margin data from retailers to identify whether the cost of electricity is different between integrated and independent retailers.
  - (f) Use our existing data and MBIE's Quarterly Survey of Domestic Electricity Prices (QSDEP) to understand the relative rates that wholesale and retail prices have changed over recent years.
- 7.18. This work is still in its early stages and has not been communicated to industry participants. We intend to communicate the work we are undertaking with the sector once it has been fully scoped.
- 7.19. In addition, we also have a project underway to improve the quality and quantity of retail data that the Authority receives and analyses. This information will enhance the Authority's evidence base to assess the effect of policy changes in the retail sector. The next key milestone is a public consultation, which is expected to start in mid-November and finish prior to the Christmas holiday break.

**Potential points for reflection:**

- (a) The Authority would like to invite the Commission to participate in scoping out the indicative work programme.
- (b) Are there issues of interest to the Commission where the Authority can provide more information?

8. **Out of scope**

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