Via email to rmr@ea.govt.nz

19 December 2024

Reviewing risk management options for electricity retailers – issues paper

Mercury welcomes the opportunity to submit on the Electricity Authority's (Authority's) issues paper, *Reviewing risk management options for electricity retailers*, 7 November 2024.

Mercury is committed to ensuring the energy transition is affordable and the energy system is secure, resilient and supports economic development and productivity growth.

The Authority's findings captured in the issues paper describes the current state and operation of the market for over-the-counter (OTC) baseload, peak and super-peak type hedge contracts. The Authority's analysis concludes that the prices for OTC baseload and peak hedge contracts are likely to be competitive. The Authority, however, could not reach the same conclusion for OTC super-peak hedge contract prices stating the data shows they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape.

Mercury supports actions that focus on understanding better potential issues in the provision of super-peak hedge contracts, including measures that provide greater price transparency for super-peak hedge contracts in actively traded, liquid markets. Mercury also supports greater transparency of trade in super-peak hedge contracts, including where it doesn't align with expected behaviors under the recently established voluntary OTC Code of Conduct.

Our submission and response to the Authority's guiding questions expands on these points.

Price transparency of trading in super-peak hedge contracts

The trade in baseload hedge contracts suggests how price transparency in general might be promoted for super-peak contracts, as the issues paper observes:[1]

> *The ASX also has better price discovery as all contract prices are publicly available up to three years in advance and are based on the same product. The current Hedge Disclosure Obligations do not provide for good price discovery of the OTC market, as not much information is provided about the contract. The Authority has decided to improve the Hedge Disclosure Obligations for contracts signed on OTC (which will be implemented from 30 October 2024), which will improve price discovery of the OTC market by broadening the scope of the information collected and published.*

This highlights that the standardized hedge product provides price discovery for base-load hedge contracts, which is a reference point for the OTC trade. This suggests that the standardized super-peak hedge contract, introduced by the Authority on 18 December, may also facilitate price discovery for OTC trade in bespoke profiled products more generally.[2]

As the above quote also suggests, the amended Hedge Disclosure Obligations, which were only recently implemented, should provide additional information for the full range of traded hedge products. Mercury, however, has recently sought clarification from the Authority regarding information captured and publicly displayed under the amended obligations as it seems, counter intuitively, to now be more limited than previously.

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[1] Chapter 4, paragraph 5.46(c)

[2] Authority announcement, [Energy Competition Task Force announces new standardised super-peak hedge contract - trading begins in January]

The Mercury Building, 33 Broadway, Newmarket 1023
PO Box 90399, Auckland 1142 New Zealand
PHONE: + 64 9 308 8200
FAX: + 64 9 308 8209
mercury.co.nz

Greater transparency of the behaviour in trade of super-peak hedge contracts

The Authority could not conclude that the price for OTC super-peak hedge contracts are likely to be competitive because:[3]

- *While the evidence points to scarcity, it did not definitively show why some gentailers sometimes elected not to respond to requests for proposals for shaped hedges, or why some gentailers provided non-conforming responses*

It is important for the Authority to understand why firms sometimes elected not to respond to requests, or sometimes provided non-conforming responses, particularly as signatories to the *Voluntary Code of Conduct for participants in New Zealand's over the counter electricity market* commit to:[4]

> *… adopting trading practices and processes that are transparent, efficient, and objectively justifiable, and to there being ongoing improvement and monitoring of performance, both of the market as a whole and the individual participants, so as to ensure ongoing confidence in and efficiency of the OTC market.*

Mercury is committed to this and the other voluntary code principles. As the issues paper notes, Mercury prices responses to the vast majority of RFPs. We endeavour to ensure that our conduct is transparent, efficient, and objectively justifiable, and we seek improvements and monitor performance on an ongoing basis.

In order to better understand why firms sometimes elected not to respond to requests or provide non-confirming responses, we suggest that the Authority assess behaviour against the voluntary code of conduct, using targeted information requests coupled with the information provided by the recently introduced changes to the Hedge Disclosure Obligations.

Coordination and sequencing of Task Force initiatives

Suggestions are made above to enable improvements in the pricing and trading in super-peak type contracts, utilizing the standardised flexibility product, the amended Hedge Disclosure Obligations, and monitoring of commitment to the OTC Voluntary Code of Conduct. The introduction of the standardized super-peak hedge contract by the Authority highlights how these suggestions and the issues paper overlap with the Energy Competition Task Force package 1 actions more generally.

Mercury proposes that the Authority consider how these initiatives fit together and should be sequenced. MDAG provided a useful starting point for considering this question. The diagram, *Progressive 'rachet' steps for competition in supply of flexibility, Figure 23,* in the MDAG report *Price discovery in a renewables-based electricity system*, sets out the sequencing of initiatives and timing of decisions. Mercury notes that the Authority is progressing the MDAG recommendations, but we would welcome greater transparency, particularly we suggest that the Authority communicate, in a similar way to the MDAG proposal, how its package 1 actions and others would be coordinated and sequenced.

We look forward to continuing to engage with the Authority, the industry and stakeholders on promoting greater price and conduct transparency in the trade of super-peak hedge contracts.

Yours sincerely

Tim Thompson
Executive GM Wholesale

[3] Issues paper, page 3.

[4] Paragraph 21.8 of *Voluntary Code of Conduct for participants in New Zealand's over the counter electricity market*.

ANNEX: Mercury response to guiding questions for submissions

1. Do you agree that retailers have a range of different options for managing wholesale price risk, but that shaped OTC hedge contracts will remain an important option for at least the short to medium term?	Mercury offers customers a range of different hedge options for managing price risk of wholesale spot prices. In addition, Mercury is willing to engage in negotiations with retailers on new and innovative options. We also consider that hedge contract options will be crucial in the short, medium and long term.
2. Do you have any comment on our preliminary findings in relation to the supply and pricing of super-peak OTC hedge contracts? Specifically: (a) Do you have any further evidence that could assist us to better understand the impact of scarcity (fuel and capacity) on the supply and pricing of super-peak OTC hedge contracts? (b) Do you have any further evidence regarding the risk premia that may be applicable to super-peak OTC hedge contracts?	We do not have any further direct evidence regarding the impact of scarcity on the supply of super-peak OTC hedge contracts, other than to note that we face scarcity pressures from time to time. As suggested above, additional transparency would help identify these considerations. We also do not have evidence regarding the risk premia for super-peak contracts. As noted above, a standardised flexibility product may enable more information about the value of such premia.
3. Do you have any views on how we have assessed in chapter 7 the indicators for and against gentailers having market power in relation to super-peak OTC hedge contract prices and availability?	As both the Commission and the Authority have stated, this analysis is complex and neither party has reached conclusions on either the relevant market or whether any party has a substantial degree of market power in any market. As a general comment, the risk management market is dynamic and substitutes for baseload and portfolio products (such as, as noted in para 2.3 of chapter 7, battery renting, demand response – especially with mass market consumers, and retail tariffs) are emerging and disciplining prices. Mercury's view is that it does not have substantial market power. At para 5.12(b) of chapter 7, the Authority notes that the evidence does not prove why some parties are choosing not to price RFPs and in the absence of clear evidence the Authority will consider both scarcity being the driver and the potential for that being a convenient excuse in any policy response. As above, Mercury's view is that Authority should seek to better understand that position before making any policy decision.

4.	Do you agree with the criteria for intervention we have set out in Chapter 8? Have we missed any that you think are important?	Mercury notes that it is not clear how these criteria might align with the Task Force package 1 initiatives, particularly, virtual disaggregation backstop option. As noted above, it is important that the Authority sets out clearly the initiatives, indicators, and timings for any decisions. The criteria for intervention will be crucial for this process.