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nova energy

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Submissions
Electricity Authority

By email: rmr@ea.govt.nz

Re: Reviewing risk management options for electricity retailers – issues paper

Nova Energy (Nova) appreciates the opportunity to comment on the above-mentioned issues paper from the Electricity Authority (the authority). In answer to the Authority's guiding questions:

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?

- Potentially. However, possibly not in many circumstances given the stated objectives of several of the independent retailers that they are seeking to provide a differentiated service through innovation and providing consumers with the ability to engage with the market in a new way. As an example, Electric Kiwi provides for customers to utilise a free hour of power each day as long as that hour is an off-peak hour. Nova understands that as a result Electric Kiwi's aggregated customer load profile follows a non-standard shape as customers shift their power consumption activity away from peak demand periods to off-peak periods. Octopus Energy seeks to provide EV users with sophisticated pricing arrangements that also take advantage of lower off -power prices as well as network tariff costs. If independent retailers seek to attract customers that are prepared to shift their consumption patterns, then a standardised shaped OTC product, assuming it is based on an average consumers load profile, will create mismatches between their customers wholesale demand profile versus that of the shaped product.
- Nova notes that in general, the nature of retail innovation appears to be consistent or similar to those taking place in other international markets, so New Zealand's market is not deprived of innovation occurring. International markets are far larger than New Zealand's market and as such there are many more early adopters where even niche innovators can gain some scale.
- Those that seek to compete of some other basis, such as bundling other products for example, may also have non-standard consumer profiles – i.e.: customers that use natural gas for heating or hot water will have a different profile to that of the standard electricity consumer, like those that may have solar PV. Again, a one size fits all consumer profile for an OTC shaped product may not suit retailers that pursue a differentiated product strategy.
- The major generator/retailers make a significant proportion [~85-90%] of the market in terms of consumer load. This leaves 10-15% being supplied by independent retailers, two of which have their own generation (Nova and Pulse). Given that baseload product will account for at least half of the independent retailers' load, then the relevant volume for peak and super peak product is likely to reflect less than 5% of total demand. Consequently, it is not surprising that there is not a great deal of

depth and liquidity for the trading of such a product. Super peak products generally involve small volumes relative to baseload hedges, and in Nova's view, an issue that is not considered in this paper are the transaction costs (time and effort) for parties to price shaped products, especially those that have specific criteria, consider credit risk of the counterparty and to document the transaction, which is for a relatively small volume (MWhs).

- The typical shaped hedge product is generally developed for a short period of time – a few months to 1 or 2 years. Such products are underwritten by existing sunk investment capacity and do not contribute to underwriting investment in new dispatchable generation capacity, whether that be batteries, new peaking facilities or new hydro generation. Typically, contract periods would need to be for 10 or more years if that was to occur. This paper does not appear to recognise the disconnect between the short-term nature of the spot and wholesale risk product markets and the type of contracts that assist to underpin new capacity investment. New investment in dispatchable generation capacity will be required to support the transition to a future market environment with close to 100% renewable supply. Shorter term contracts do not support new investment since the spot market post-investment decision will be impacted creating free-rider issues for the new capacity investor.

Do you have any comment on our preliminary findings in relation to the supply and pricing of super-peak OTC hedge contracts?

Nova notes that the analysis supports that as an effective risk mitigation strategy, there are a number of substitutes for super peak OTC contracts and as such, the *market* definition for the purposes of this paper should be broader than short term morning and evening demand peaks.

(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?

- Scarcity is not the only factor driving up the pricing of electricity firming contract pricing. Factors affecting the cost of those services include the increased cost of carbon costs for thermal fuels. This has accounted for a significant increase in costs ($40 -$80/MWh) over the last two years and could increase substantially again in the future should carbon prices increase significantly. Other factors include the cost of capital applied to investments in thermal generation. Australasian banks have commenced withdrawing financial support for thermal generators which has led to an increase of debt / investors having to reduce debt and fund ongoing investment in gas exploration, development and production as well as thermal generation with higher priced equity.
- Alternatives to coal and gas that are renewable in nature such as biomass are significantly more expensive fuels than what New Zealand relies upon. Wood pellets for the Huntly power station are likely to cost ~$30/GJ on a delivered basis, 2-3 times that of coal at current carbon prices.

Do you agree with the criteria for intervention we have set out in Chapter 8? Have we missed any that you think are important?

It is Nova's view that the issues of scarcity of dispatchable generation are unlikely to be resolved through regulating access to terms, or terms for peak demand risk products. It would be better for scarcity to be relieved through investment in new supply of dispatchable generation. For this to occur and for capacity to find its way to independent retailers then investors and purchasers of risk products will be better served entering longer term contracts (10-15 years).

Lastly, Nova agrees with the assessment that price volatility is increasing as intermittent generators make up larger proportion of supply. Nova also notes that there are other factors at work that have led to an increase in the underlying price overall, and which shows up in volatility: Higher carbon prices for thermal generation leading to higher marginal prices, dampened incentives to build renewables to displace thermals due to the uncertain future for the Tiwai smelter (now resolved) and Government policy setting with respect to thermal fuels, and plant and slow passage of projects through the consenting process, sometimes for no good reason. In Nova's view, the Tiwai decision took too long to be made and meant that project developments that could have displaced thermal generation have been deferred. Only now are projects reaching the commitment phase with yet 1-2 years build time being required.

Nova thanks the authority for creating the space to share Nova's view and looks forward to the next steps and decisions.

Yours sincerely

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