Reviewing risk management options for electricity retailers

Update paper following submissions

27 February 2025

ELECTRICITY AUTHORITY
TE MANA HIKO

Contents

1. Purpose

1.1. In November 2024, the Electricity Authority Te Mana Hiko (Authority) invited stakeholder feedback on the preliminary findings of our review of risk management options for retailers. These preliminary findings were set out in our issues paper: *Reviewing risk management options for electricity retailers – issues paper* (Issues paper).

1.2. This paper considers and responds to key themes in submissions, confirms the findings of the risk management review, and comments on next steps.

2. Preliminary risk management review findings – confirmed

2.1. Submissions have not caused us to change our preliminary risk management review findings set out in the Issues paper. We still consider that:

- *'All retailers managing wholesale price risk use a portfolio of complementary risk management options – there is no one "right" solution when insuring against wholesale electricity market volatility.*
- *There are several close risk management substitutes[1] for an over-the-counter (OTC) contract-based portfolio (baseload hedges and any super-peak hedges, peak hedges or caps) eg, baseload hedges combined with one of battery renting, demand response, or retail tariffs. However, these alternative options are only starting to be deployed in the New Zealand market, so may not yet – and perhaps for a few years – be able to discipline the prices of shaped OTC hedge contracts.*
- *Retailers to date have been able to secure substantial shaped hedge cover through OTC contracts,[2] but the market for shaped cover is neither deep nor liquid. Over a third of the time retailers receive only one offer in response to requests for shaped hedges.*
- *The evidence points to fuel or capacity scarcity often being the driver behind the current thin and illiquid market for shaped hedge cover.*
- *Our analysis indicates that the prices for OTC baseload and peak hedge contracts are likely to be competitive.[3] However, we could not reach the same conclusion for OTC super-peak hedge contract prices as they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape.*
- *While the evidence points to scarcity being a driver,[4] there is also a plausible driver that has competition implications (ie, refusing to supply products on appropriate terms to counterparties who are downstream competitors), indicating that some level of market power could have been in play.'*

1 That is, they provide a similar aggregate level of risk reduction over a range of scenarios.

2 Around half of the OTC contract requests issued during our 14-month assessment period resulted in a trade.

3 Based on a comparison with ASX traded baseload prices, which we consider to be an accurate forecast of future prices.

4 Behind thin and illiquid shaped hedge cover.

2.2. The Authority is charged with promoting competition, reliability and efficiency in the electricity industry for the long-term benefit of consumers. The findings above highlight competition risks regarding the availability and pricing of shaped hedge contracts. In the short to medium term this in turn risks impacting the expansion of non-integrated retailers, the entry of new generators, and/or the financial risk management of industrial customers. The onus is on the Authority to respond accordingly, to address potential competition issues, and promote generation and retail competition to deliver better performing markets for consumers.

2.3. While submitters put forward a range of views for and against these findings, parties that disagreed with the Authority's competition concerns did not present further data or specific evidence to support those views, despite having the best access to relevant information. Given the lack of evidence provided to disprove or reduce the Authority's competition concerns, we consider it is appropriate to take steps to address these concerns to promote competition in, and the efficient operation of, the electricity industry for the long-term benefit of consumers. The Authority is taking these steps now, through the Energy Competition Task Force (Task Force) that was jointly established by the Authority and the Commerce Commission in August 2024.

2.4. The findings of the risk management review provide an important evidence base for the ongoing work of the Task Force. This includes work that specifically relates to the availability and pricing of shaped hedges and firming (Task Force initiatives 1A and 1B), and regulatory interventions targeted at mitigating broader gentailer market power concerns, particularly discrimination between internal and external customers (initiative 1D).[5]

2.5. The findings will also inform the Authority's continued monitoring of the OTC, retail, and wholesale markets, and other Authority initiatives to increase price transparency for shaped products, improve incentives for generation investment, and otherwise strengthen the electricity market.

3. Submissions expressed a range of views

3.1. The Authority received 11 submissions on the Issues paper. We have carefully considered all submissions received and we thank submitters for their feedback.

3.2. This paper provides a thematic response to key points made in submissions to explain why we have reached the conclusions set out above. It is not intended as a fulsome summary of submissions, nor to respond to all points raised in submissions.

3.3. Where we have sought to summarise a particular submission, this is necessarily at a high level and may not reflect all the nuances of the submitter's view. The full submissions are available on the Authority's website.[6]

[5] More information about the Task Force initiatives is available on our website: Energy Competition Task Force | Our projects | Electricity Authority.

[6] Risk management options for electricity retailers | Our consultations | Our projects | Electricity Authority.

Table 1: List of submissions received

Submitter
Contact Energy
Flick Electric
Genesis
Independent Electricity Retailers[7]
Mercury
Meridian
Major Electricity Users' Group (MEUG)
Neil Walbran Consulting
Nova
Octopus
Paua to the People

3.4. Submissions were broadly consistent within the category of submitter:

(a) Gentailers were generally of the view that scarcity of firming capacity is the principal driver of the thin and illiquid market for super-peak contracts rather than any exercise of market power.

(b) Non-integrated retailers, in contrast, reiterated their competition concerns and called for policy intervention to address market power concerns and promote competition in the OTC market, and wider electricity markets.

3.5. A common theme of submissions was the need to increase incentives for investment in more firming capacity.

4. Scope of the risk management review

4.1. The Authority's review was focused on risk management options available to retailers. The Issues paper analysed data requested and received from gentailers and non-integrated retailers with more than 1,000 ICPs, focusing on responses non-integrated retailers received to requests to buy contracts of 1MW or more.

Some submitters argued that the scope of the review was too narrow

4.2. The Independent Electricity Retailers, Octopus and MEUG argued that the Authority should have considered competition in the wider electricity market, rather than limiting its review to the market for OTC risk management contracts. Concerns included that this narrower focus ignored critical context, resulted in reliance on incorrect assumptions about workable competition in the broader wholesale market, and failed to address key concerns around vertical integration and retail margin squeeze. Octopus commented that, by narrowing the scope, the Authority had missed a valuable opportunity to collect comprehensive information on competition issues in the electricity market.

4.3. Paua to the People submitted that the Issues paper should have covered the needs of small, micro, and community retailers. It argued that these retailers cannot access appropriate risk management options.

[7] The Independent Electricity Retailers are 2degrees, Electric Kiwi, Flick Electric and Octopus Energy.

4.4. MEUG submitted that the Issues paper should have explored the issues facing industrial customers seeking risk management contracts. MEUG was concerned that the scope of the review meant not all necessary information was gathered, consequently limiting the ability for the Authority to develop solutions to address underlying problems.

Authority response

4.5. The Authority's risk management review was a focused review, targeted at an issue with wide implications for the electricity market – including retailers, new generators, and large industrial customers. Targeting the review in this way meant the Authority could progress its identification of, and response to, any concerns identified on a much shorter timeframe than if we had committed to undertaking a broader review of competition in the wider electricity market.

4.6. The competition risks identified in the risk management review are clear and we consider they need to be responded to by the Authority. Having considered submissions and weighed up the likely benefits of further data collection and analysis at this point,[8] we consider that it is preferable to focus on exploring effective policy interventions to the issues identified in the risk management review through the Task Force work programme.

4.7. We acknowledge that there will always be more insights that can be obtained from a wider dataset. We expect the ongoing work of the Task Force will be relevant to all parties that rely on risk management contracts to manage their wholesale spot price risk or seek firming contracts from generators. We welcome further input and data from these parties, particularly in response to the Task Force initiatives that are already progressing at pace, where they can play an active role in contributing to the policy development process.[9]

4.8. We note that the Task Force is also considering a separate initiative to enable industrial customers to be appropriately rewarded for the benefit their flexible electricity use brings to the system, potentially providing industrials with an additional revenue stream (Task Force Initiative 2D).

4.9. In response to some of the broader points raised:

(a) While the risk management review focused on the OTC market, we have not lost sight of concerns about retail market competition. These concerns are being actively considered as part of the ongoing Task Force work programme. The Authority will soon be publishing its final decision on requirements for regular provision of information about retail pricing through its retail data project.[10]

(b) Wholesale market competition also remains a key priority for the Authority. We are particularly focused on ensuring the market settings efficiently encourage new generators into the market, including through exploring

8 For example, more data from smaller retailers, independent generators or large industrials; analysing requests for smaller hedge contracts (ie, less than 1MW).

9 We note for example that a representative of a large New Zealand industrial customer has already played an important role in testing the industry co-designed standardised flexibility product that started trading in January 2025 (Task Force Initiative 1B).

10 Amended information notice and updated analysis | Our consultations | Our projects | Electricity Authority.

whether gentailers should be required to provide firming for Power Purchase Agreements entered into by those generators (Task Force Initiative 1A).

(c) We see regular, close monitoring of the trading conduct rules in the Electricity Industry Participation Code 2010 as a key tool for detecting market power concerns in the wholesale market. We publish our weekly and six-monthly analysis of trading conduct, which provides a robust evidence base for assessing competition in the wholesale market.

4.10. The Authority will continue to monitor competition in the OTC market using the new hedge disclosure obligations data[11] and information obtained through the trading of the new standardised flexibility product.[12]

5. Views on availability and pricing of OTC contracts

5.1. Our preliminary finding in the Issues paper was that the market for shaped hedge cover is neither deep nor liquid. While the evidence pointed to fuel or capacity scarcity as often being the driver behind this thin and illiquid market, we could not conclude that prices for OTC super-peak hedge contracts were competitive as they trade at a substantial unquantified premium over ASX baseload prices adjusted for shape.

Some submitters pointed to scarcity as being the primary driver of the thin and illiquid hedge market

5.2. Contact and Genesis see increasing scarcity of firm capacity, rather than exercise of market power, as driving the tight conditions in the supply of risk management products. Contact submitted that capacity of firming generation has not kept up with increases in peak demand in recent years, and that this has occurred for a number of reasons not linked to any exercise of market power. It commissioned a report from Sapere that puts forward a view that there is a conceptual difficulty in estimating economic costs of premia, as economic costs and prices are jointly and simultaneously discovered via the competitive process.[13]

5.3. The Independent Electricity Retailers, however, argued that scarcity is a function of competition issues in markets throughout the supply chain, and that scarcity is used as an excuse by some gentailers not to supply hedges. They argued that the Authority should consider the broader context of why scarcity exists.

Further evidence in relation to supply and pricing of super-peak OTC hedge contracts was not forthcoming

5.4. We invited further evidence to assist us to better understand the impact of scarcity on the supply and pricing of super-peak OTC contracts. Sapere's report for Contact provided a generic description of the process and considerations when pricing a peak

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11 On 30 October 2024 new hedge disclosure obligations took effect, requiring participants to disclose a wider data set about OTC hedges they enter into: New hedge disclosure obligations | Electricity Authority.

12 Trading of a new standardised flexibility product to improve competition in the wholesale market began on 28 January and is expected to continue with fortnightly trading events: New standardised flexibility product trading begins on 28 January | Electricity Authority.

13 Sapere's report is available on our website as an attachment to Contact's submission: https://www.ea.govt.nz/documents/6363/Contact_Energy_zW7Gvmh.pdf.

or super-peak product, commenting that pricing hedge contracts is fundamentally a forward-looking analysis and involves the pricing of risk (risk premia). Neither Sapere's report nor Contact's submission set out any data to support the appropriacy of the risk premia applied.

5.5. Mercury submitted it did 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 it faced scarcity pressures from time to time. It also did not have evidence regarding the risk premia for super-peak contracts.

5.6. Meridian and Genesis' submissions were both silent on this point.

Authority response

5.7. Careful consideration of submissions has not led the Authority to change its preliminary findings on the possible drivers for the tight conditions in the supply of super-peak contracts.

5.8. The analysis provided by Contact is consistent with the preliminary finding in the Issues paper that scarcity is often the driver behind the current thin and illiquid market. But that is not the full picture.

5.9. Further, submissions did not provide any evidence to help show that super-peak prices were competitive. For example, further insights into calculating risk premia for super-peak hedges, which would have provided better evidence of whether or not these hedges are over-priced, were not forthcoming. In circumstances where the gentailers have a substantial information advantage, if this evidence existed we would have expected them to put it forward.

5.10. Our view remains that, based on the evidence, we are unable to conclude that prices for super-peak hedges are competitive. While the evidence points to scarcity often being a driver, there is also a risk that there are market power issues at play (discussed in the next section), resulting in refusals to supply products on appropriate terms to counterparties who are downstream competitors.

6. Views on market power analysis

6.1. The Issues paper included an examination of whether any of the gentailers individually or collectively exercised substantial market power. Our preliminary findings were that:

(a) the evidence is mixed in relation to whether gentailers have the ability and incentive to individually influence the price or supply of hedge contracts for reasons other than fuel scarcity,

(b) we have not seen any evidence to suggest that coordinated market power is being exercised.

Submitters expressed different views on market definition

6.2. Some gentailers considered that the market definition adopted in the Issues paper was too narrow, and that competition from other substitutes such as batteries is disciplining hedge prices.

6.3. Contact submitted that the market definition adopted in the Issues paper departed from existing Commerce Commission precedent. It argued that the market for risk management products is much broader than OTC contracts, and that nascent risk management products (eg, demand response and batteries) are even closer substitutes than the Authority suggested. Contact appended a submission from Bell Gully, which considered based on Commerce Commission precedent that the appropriate market definition is the national wholesale electricity market. Contact also argued that some of the limitations to batteries and demand response as substitutes for shaped hedges relate to market design, which is within the Authority's control to address. Adopting a wider market definition, Contact argued, would help with assessing the best set of interventions. Ultimately Contact's position was that its concerns with the Authority's market definition flowed through to the Authority's determination of market power.

6.4. Of the other large gentailers:

6.5. Mercury submitted that risk management substitutes (such as battery renting, demand response – especially with mass market consumers, and retail tariffs) are emerging and disciplining prices.

6.6. Genesis submitted that the Huntly Firming Options (HFOs) and other new supply/products demonstrated the development and evolution of market-based solutions, and it expects further products will be developed as more grid scale batteries enter the market.

6.7. In contrast, other submitters considered that the market definition was too broad. The Independent Energy Retailers argued that other risk management options explored in the Issues paper – in particular demand response – are not good economic substitutes (as demand-side management cannot be, as a matter of economic principle, considered a substitute for a supply-side input), and that including such options understates gentailers' market power and wrongly equates demand-side management with a supply-side input.

6.8. Octopus separately raised concerns about demand response as a substitutable risk management product. It considered that, as demand response requires customers to accept an interruption, it is not a hedge substitute per se. Octopus also considered the HFOs to be a complex product more suited to generators with fuel management capability and not an accessible or suitable product for small independent retailers. Octopus noted that the scale of a retailer's customer base will impact its ability to use particular risk management products.

6.9. Neil Walbran Consulting agreed that demand response is a viable alternative to risk management products but was concerned that current technology limitations may limit the timing and development of a deep demand response market in New Zealand.

Authority response

6.10. The Authority does not share Contact's view regarding the significance of market definition. Market definition is a tool to inform competition analysis, not an end in itself. In the Issues paper, we took an approach that we considered best isolated the issues and assisted with robust competition analysis, rather than seeking to precisely identify the boundaries of the market.

6.11. Ultimately, the key question in any competition analysis is the extent of any constraint on the exercise of market power, regardless of whether that constraint comes from within the market or from outside. This approach is consistent with the Commerce Commission's position when defining markets.[14]

6.12. Some parties also pointed us towards earlier Commerce Commission analysis of electricity markets, which we had also considered in chapter 7 of the Issues paper. In our view, previous approaches to market definition by the Commerce Commission, while helpful, must be viewed in the context of that time (before some aspects of existing wholesale market arrangements were in place) and in the context of the specific investigations being undertaken by the Commerce Commission at that time. In addition, the Authority has a significantly different remit to the Commerce Commission in relation to promoting competition, and was investigating a specific hedge market concern, so the Commerce Commission's previous analysis in a different context, and not focused on the hedge market, is of limited assistance.

6.13. Submissions on the Issues paper did not provide any further material evidence that would lead us to revise our market definition or our preliminary view that emerging substitutes (battery renting, demand response and retail tariffs) may be some way from being able to discipline prices for other risk management options. However, we do not share the Independent Electricity Retailers' view that demand response should not be considered a substitute for some hedges – demand response is a potentially viable mechanism for retailers to reduce risk (and is already being used in this way, including by smaller retailers), regardless of the fact it requires demand reduction in a way that hedges do not.

6.14. In relation to Contact's submission around market design limiting uptake of batteries and demand response, the Authority agrees that it would be valuable to do more to facilitate uptake of these emerging substitutes and is considering this further as part of its broader work programme. This does not however change our current state analysis that these substitutes are just starting to be deployed, and so may be some way from being able to effectively discipline prices for other risk management instruments.

No consensus on what the evidence revealed about market power

Gentailers did not consider the evidence identified any exercise of market power

6.15. The gentailers did not consider that the evidence analysed in the Issues paper demonstrated any exercise of market power.

6.16. Contact submitted that the evidence 'definitively rules out market power as a driver of the tight conditions in the supply of risk management conditions'. It considers that none of the four conditions the Authority identified as needing to be present for a gentailer to hold market power were met.[15] It argued that the market is much broader than OTC hedge contracts (discussed above at paragraph 6.3), there is a very real

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[14] See Commerce Commission Guidelines: Mergers and acquisitions (May 2022).

[15] The four conditions are discussed in Chapter 7 of the Issues paper and are: (1) Shaped hedge contracts are a necessary aspect of efficient peak time risk management; (2) Having flexible generation and fuel is a pre-requisite to sustainably offering those shaped hedge contract; (3) There are high barriers to building new flexible generation capacity for all participants, including gentailers; and (4) Gentailers have the ability and incentive to individually influence the price or supply of hedge contracts, for reasons other than fuel scarcity, despite there being other suppliers and/or substitutes.

likelihood of other risk management options constraining hedge pricing (and there are examples of this occurring, particularly grid scale battery investment), and there is strong evidence showing gentailers do not have the ability or incentive to influence the price or supply of OTC super-peak contracts. On the latter point, Contact pointed to factors including the investment underway to increase super-peak capacity. It suggested that the Authority could have assessed whether super-peak contract prices are aligned with the cost of new entry into capacity like grid scale batteries and demand response. Contact argued that not responding to or offering non-conforming offers is always explained by fuel conditions.

6.17. Sapere's report for Contact considered that, absent accurate estimates of premia over ASX baseload prices adjusted for shape, commentary as to whether observed prices or terms for super-peak hedge contracts are impacted by market power becomes speculative. It said that the 'elephant in the room' is that growth in peak demand has exceeded growth in any type of firm capacity for nearly a decade, and this lack of investment must be a central feature in any analysis of flexibility contracts.

6.18. Genesis agreed that there are generally only three gentailers with portfolios that can offer super-peak hedges, but disagreed with the notion that a gentailer declining to price or participate in a RFP or providing a 'non-conforming' response to a RFP indicates the existence of unilateral substantial market power. It observed that gentailers are not homogenous and have different portfolios, commercial objectives and risk management considerations. At any time, one or more of these factors may be particularly relevant for a gentailer, impacting their assessment of a RFP opportunity.

6.19. Mercury's view is that it does not have substantial market power. It noted that the risk management market is dynamic and substitutes are emerging and disciplining prices.

6.20. Meridian suggested there are a broad range of parties who could provide risk management capacity. It suggested that the Authority should not start with a narrow subset of current participants (ie, gentailers) who can respond to super-peak requests. Meridian suggested, for example, that other generation should be able to participate in the super-peak product designed by the Standardised Flexibility Product Co-Design Group, and noted the availability of hydro other than long-term hydro storage, such as Manawa hydro, the availability of Nova's capacity (200MW), and other forms of flexibility that could back super-peak products, such as batteries. Meridian did not agree that investment decisions are more complicated in relation to batteries than for ordinary generation, noting several participants have already invested or are contemplating investing in batteries.

Non-integrated retailers reiterated their competition concerns

6.21. The Independent Electricity Retailers reiterated their view that current market conditions are not workably competitive, referring to previous reports by the Commerce Commission, Electricity Price Review and Market Development Advisory Group (MDAG). They argued that the inability or difficulty in finding conclusive evidence of the exercise of market power is a common issue with vertical integration and why it is considered regulatory best practice to separate vertically integrated parties to address the real risk of such exercise of market power. The Independent Electricity Retailers' position is that gentailers do not have incentives to expand generation to keep pace with demand, and there is insufficient liquidity in hedge markets which disincentivises independent generators from building new generation or entering the market. Collectively this forces independent retailers to limit the growth of their customer base.

6.22. In terms of the Issues paper analysis, Independent Electricity Retailers submitted that measuring response rates to RFPs is not an adequate measure of hedge market competition as over time retailers request fewer RFPs as they would expect to receive unfavourable terms or non-conforming responses. Further, even if pricing is nominally reflective of competitive markets, the Independent Electricity Retailers submitted that there are different ways that supply can be constructively withheld: through non-conforming offers, onerous credit terms, or requests for financial information disclosure which are misaligned with the risk of the trade.

6.23. Octopus similarly considered that the Issues paper appears to downplay the presence of market power and assumes the market is workably competitive without presenting a robust evidential basis for these conclusions.

6.24. Flick submitted that the evidence included in the review 'reveals that gentailers use a range of ways to refuse to supply OTC contracts to independent retailers.' Its view is that gentailer activity in the wholesale market, including the OTC market, constitutes a margin squeeze.

Authority response

6.25. The Authority acknowledges the different views of submitters but does not consider that any further evidence has been provided to cause the Authority to change its findings. No evidence has been provided that would definitively rule out market power being a driver of super-peak pricing.[16]

6.26. In relation to Contact's reference to grid-scale battery investment as demonstrating low barriers to entry, the Authority notes that such investment, in a relatively small number of batteries to date, and mainly from gentailers, does not in itself mean that there are no/few barriers to entry into the market for shaped hedge cover. Scale battery investment remains in its infancy in New Zealand, with virtual battery services only beginning to be developed and direct investment being a lumpy and significant capital commitment that may or may not match (say) the firming needs of a new generator (ie, they may still need some firming from a gentailer before being able to enter into a PPA to secure a revenue stream that enables construction finance).

6.27. Equally, no evidence has been provided that causes us to definitively conclude that the exercise of market power to reduce competition is occurring. However, the risk that market power is being exercised remains clear. While some submitters argued that scarcity is the primary driver, the presence of scarcity does, in itself, not exclude the possibility of market power being exercised – both may exist.

6.28. Nor do we consider there is evidence that current and potential substitutes are having a stronger discipline on super-peak pricing than we assessed in the Issues paper, ie, they are technical substitutes, but have yet to reach the point of being a practical or economic substitute in most cases. The need to encourage uptake of these emerging substitutes discussed above does not materially change our assessment of these constraints in current market conditions. Nor does it detract from the need to promote

16 As such, we do not agree with the position asserted by Contact in response to the conditions for market power noted in chapter 7 of the Issues paper.

the availability of shaped hedges, at competitive prices, to enable retail and wholesale market competition in the short to medium term (while making sure that those interventions do not have the unintended consequence of disincentivising investment in substitutes).

7. Criteria for policy intervention in chapter 8 of the Issues paper

7.1. The Issues paper proposed key criteria that might guide any policy intervention in risk management.[17]

7.2. Several submissions commented on the criteria. Flick did not consider the criteria would be effective in ensuring a deeper and more liquid OTC market (but did not give reasons). Octopus submitted that the criteria are insufficient to address access problems identified or the broader competition issues that were not considered in the review. Octopus recommended that the primary criteria/objective should be to establish a framework that ensures a level playing field and does not permit preferential treatment or discrimination against external parties compared with internal businesses. The Independent Electricity Retailers similarly noted that the criteria do not address reliable access and supply of hedge products, and submitted the criteria should simply be whether/how well the policy interventions would promote competition. Mercury submitted it was not clear how the criteria align with Task Force Package One initiatives.

Authority response

7.3. The criteria are intended to help with the development of any policy intervention in the risk management space. That is, any potential policy interventions – such as interventions aimed at ensuring a deeper and more liquid OTC market (which could include level playing field measures) – are more likely to lead to successful outcomes if they meet these criteria.

7.4. To the extent that Task Force Package One initiatives focus on risk management, we expect the criteria to be a helpful guide for any decisions on policy intervention. The criteria should not be confused with the justification for the intervention, or with the policy intervention itself.

8. Focus of future policy interventions

Interventions must be evidence-based and avoid unintended outcomes

8.1. Contact, Meridian and Mercury emphasised the need for any policy interventions to be evidence-based. As discussed above, Contact considered that the evidence definitively ruled out market power as a driver of tight supply of shaped hedges and cautioned that any interventions to address market power or encourage further liquidity of the super-peak market need to be carefully considered given the potential to create perverse outcomes, harming efficient market incentives, reducing investment, and ultimately reducing security of supply. Contact submitted that the

[17] Chapter 5 of the Issues Paper.

Authority should make it clear to the market how long it would allow for liquidity to grow, and on what basis it would judge that trading and price discovery was insufficient.

8.2. Meridian suggested that more evidence is needed to justify regulatory intervention, noting that the Authority had not been able to reach firm conclusions in the Issues paper, including in relation to drivers for high offer prices for super-peak contracts. Meridian submitted that the Authority's statement that it cannot definitively conclude that super-peak prices are competitive is of limited value in assessing the case for intervention. Meridian noted that any interventions encouraging further liquidity of super-peak products need to consider the possibility of disincentivising investment (including in demand response) and/or resulting in additional costs for consumers.

8.3. Mercury submitted that the Authority should better understand the role of scarcity versus market power as drivers before making any decisions on policy responses. Mercury also encouraged the Authority to consider and communicate how different Task Force initiatives fit together and should be sequenced.

8.4. MEUG also submitted that any actions or interventions need to avoid distorting the development and investment in other risk management options.

Authority response

8.5. The Authority agrees that interventions should be supported by evidence and appropriately sequenced, and that care is needed to ensure that responses do not have unintended consequences for investment in other risk management options. As explained in the Issues paper, an important criterion for intervention is that investment incentives are maintained.

8.6. The Authority disagrees with the suggestion that the evidence does not support intervention. The preliminary findings in the Issues paper, which have not been displaced by submissions,[18] highlight a risk that market power in relation to shaped hedge contracts in the short to medium term is impacting competition, eg, limiting the expansion of non-integrated retailers. The onus is on the Authority to respond accordingly, to address potential market power issues and promote better access to competitively priced shaped hedges to deliver better performing generation and retail markets for consumers. We discuss next steps below.

Differing views on what should be the focus of any future policy interventions

8.7. Several submitters suggested that the focus of any future policy interventions should be on bringing firming capacity to market.

8.8. Contact submitted that forward price transparency and liquidity for flexibility products should be pursued over intervention into pricing of super-peak contracts. It commented on interventions that may help bring more firm capacity to market, including ensuring sufficient price signals, addressing technical matters that limit the effectiveness of batteries, adding measures to improve uptake of demand response, and strengthening the Security and Reliability Council. Sapere's report suggested that new risk management capacity is already in the process of being developed and will continue to be developed provided appropriate incentives remain in place.

18 For example, submissions did not provide any further data or evidence to help show that super-peak prices were competitive.

8.9. Meridian submitted that investment in assets underpinning the supply of risk management products should be the fundamental solution to the issues identified in the Issues paper. Its modelling indicates 200MW of new flexible capacity is needed each year for the next 25 years.

8.10. Nova submitted that issues of scarcity in dispatchable generation are unlikely to be resolved through regulating access to terms for peak demand risk products. Instead, new investment in dispatchable generation capacity will be required. Nova noted that typical shaped products are generally for short periods of time and do not contribute to underwriting investment in new dispatchable generation capacity – contracts would need to be for much longer terms than currently, of 10 or more years if that was to occur.

8.11. Non-integrated retailers, in contrast, expressed support for level playing field measures to address liquidity concerns. The Independent Electricity Retailers reiterated their concerns in relation to vertical integration and submitted regulatory best practice is to separate gentailers to address the real risk of exercise of market power. At a minimum, they considered an access regime is required to ensure access to a liquid hedge market.

8.12. Octopus submitted that the gentailers lack the scale and incentives to deliver the scale of generation needed, and that a level playing field is therefore essential to attracting new investment and fostering innovation.

8.13. Flick submitted that the only solution to ensure a workably competitive wholesale market is for the Authority to regulate an equal access regime that ensures there is no price discrimination or cross-subsidisation by generators.

Authority response

8.14. The Authority agrees that there is a need to promote investment in firming (both supply-side and demand-side) and is progressing work in this area. Making prices more transparent and discoverable is a key focus of the standardised flexibility product development, the new hedge disclosure obligations, and the Authority's work programme to implement MDAG's 2023 recommendations to strengthen the market.[19] We will also shortly be consulting on proposals to increase disclosure and publication of bids and offers in the OTC market.

8.15. We see this transparency objective as an important complementary objective alongside the core direct response to the risk management review findings, which is addressing concerns around the availability of super-peak hedge contracts. This will contribute to the scarcity risk being more evenly shared among gentailers and non-integrated retailers.

8.16. The Task Force is considering level playing field options as part of its work programme. It has published an options paper on level playing field measures for consultation, alongside this update paper, drawing on the evidence from the risk management review, which includes as an option non-discrimination obligations for both pricing and other non-price commercial terms.

19 Delivering changes to strengthen the future of the wholesale market | Electricity Authority.

Support for the new standardised flexibility product

8.17. Submitters generally supported the new standardised flexibility product to improve price discovery, although it was noted that a one size fits all product may not suit retailers that pursue a differentiated product strategy. Genesis and Mercury considered the new product may help improve price discovery. Contact considered it would be important that natural buyers and sellers of the product are allowed to emerge, and that forcing larger participants to be net sellers may result in the product being undervalued.

Authority response

8.18. The Authority is closely monitoring uptake of the new standardised flexibility product. While trading is initially voluntary, as part of Task Force Initiative 1B the Authority is also designing regulated terms should voluntary trading not achieve the intended outcomes (increased liquidity at a competitive price). The Authority will take account of the above feedback in that work.

Differing views on the future role of ITP disclosures

8.19. Some submitters commented on internal transfer prices (ITPs):

(a) Contact supports the continued use of ITP and retail gross margins as key indicators of long-term retail competition, but considers work is needed to assess whether these tools can be made more effective.

(b) Genesis, in contrast, submitted that the ITP regime should cease as it provides little or no benefit.

8.20. Paua to the People similarly submitted that ITPs are 'meaningless' due to a plethora of retail tariffs, and considered that gentailers should be required to disclose to the Authority a cost breakdown of their tariffs.

8.21. Independent Electricity Retailers urged the Authority not to ignore ITPs but to focus on the original intended purpose of the ITP regime and consider how to address the existing flaws with the regime. They noted the Authority needs to look at retail pricing behaviour to determine this.

Authority response

8.22. The Authority is reviewing options for addressing the issues identified with the ITP disclosure regime in our 2024 post implementation review.[20] The Task Force level playing field measures options paper includes discussion about these issues.

9. Next steps

9.1. The Authority is charged with promoting competition, reliability and efficiency in the electricity industry, for the long-term benefit of consumers.

9.2. The Authority commenced its risk management review in December 2023 and the review was originally intended to commence in two sequential phases (investigation phase and policy response phase).

[20] Internal Transfer Price and Retail Gross Margin post implementation review.

9.3. In August 2024, while the investigation phase was still underway, the Authority and the Commerce Commission jointly established the Task Force. This was in the context of a period of sustained high wholesale electricity prices, driven primarily by fuel shortages. The Task Force, with the Ministry of Business, Innovation and Employment (MBIE) as an observer, is focusing on short- to medium-term actions to improve the performance of the electricity market. A key outcome is enabling new generators and independent retailers to enter, and better compete in the market.

9.4. The Task Force programme will now effectively take over what we had expected to be the second (policy) phase of the risk management review. The two programmes are well aligned. The findings of the risk management review provide an important evidence base for the ongoing Task Force work programme. This includes work that specifically relates to the availability and pricing of shaped hedges and firming (Task Force initiatives 1A and 1B), and regulatory interventions targeted at mitigating gentailer competition concerns (initiatives 1C and 1D).[21] The Task Force level playing field measures options paper proposes a clear, staged pathway of policy intervention. We welcome industry feedback and any further relevant evidence in response to the level playing field measures options paper, which was released alongside this update paper.

9.5. At this point we remain of the view that the Task Force Package One initiatives represent an appropriate and proportionate response to the findings from the risk management review.

9.6. The risk management review findings will also inform the Authority's continued monitoring of the OTC, retail and wholesale markets throughout winter 2025 and beyond. It is also informing other key Authority initiatives to increase price transparency for shaped products, improve incentives for generation investment, and otherwise strengthen the electricity market, discussed in this paper.

[21] More information about these initiatives is available on the Authority website: Energy Competition Task Force | Our projects | Electricity Authority.