Major Electricity Users' Group

Promoting a robust electricity market

7 March 2025

Sarah Gillies
Chief Executive
Electricity Authority
PO Box 10041
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Sent via email: policyconsult@ea.govt.nz

Dear Sarah

Code amendment omnibus #5

1. This is a brief submission from the Major Electricity Users' Group (MEUG) on the Electricity Authority's (Authority) consultation paper *Code amendment omnibus #5: stress test update, backup pricing, trader default amendment*[1] published on 4 February 2025.

2. MEUG members involved with the stress test regime have been consulted on the approach to this submission. This submission does not contain any confidential information and can be published on the Authority's website unaltered. Members may lodge separate submissions. Due to resourcing constraints, we have focused our comments solely on the proposed changes to the stress test regime. We appreciate the opportunity to meet with Authority staff in early March 2025 to expand on the high-level points raised in our submission.

Broader focus needed on affordable and internationally competitive hedge prices

3. MEUG acknowledges the recent reports such as MDAG's final report[2] and the events of winter 2024 that have driven the need for a review of the stress test regime and informed the proposed improvements. It is always important to ensure that any regulatory regime meets the needs of both participants and the regulator and provides useful information to inform future market decisions.

4. However, we are disappointed that the Authority has not taken this opportunity to explore the broader issues facing large industrial and business consumers when seeking hedge contracts, and what the underlying issues are that are driving the increase in prices across the market and the resulting hedging behaviour. In addition, we consider that the needs of demand-side participants are quite different to generators and retailers, yet a relatively consistent, "one size fits all" approach is taken across all groups with the stress test regime.

5. From MEUG's perspective, the Authority needs to consider the following points:

   - **The entrenched industry view that being fully hedged is the best option**: There seems to be an evolving view that being under-hedged is like being "under-insured" and therefore being under-hedged is a negative activity and a sign of participants not managing their own supply risk. MDAG describe this as a "moral hazard."

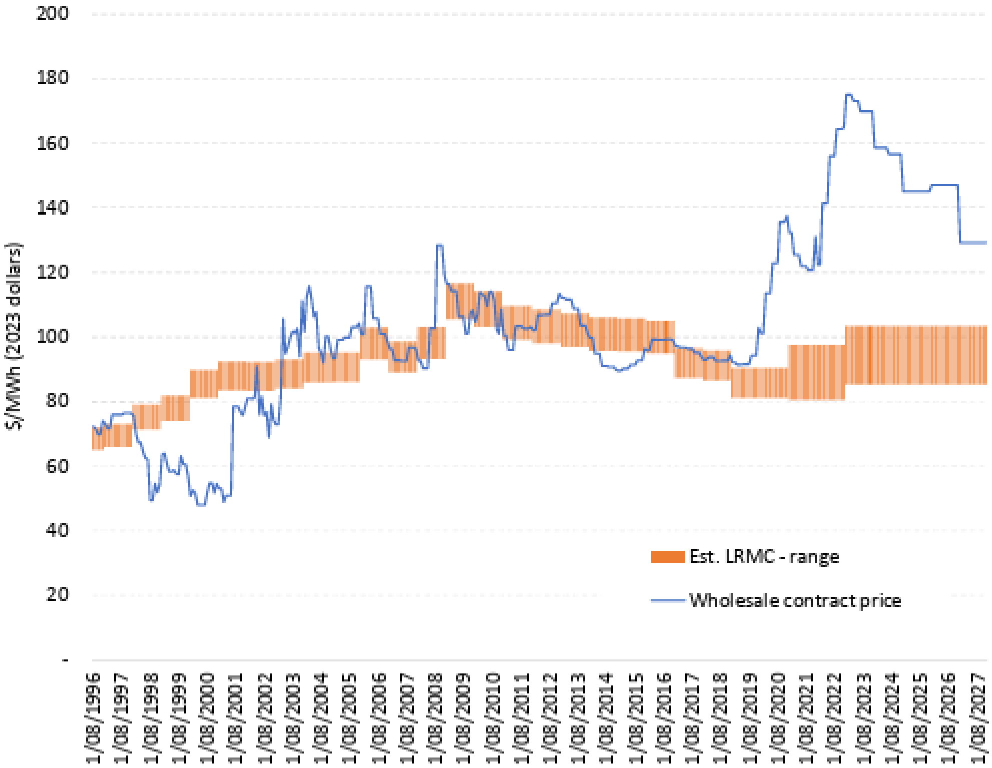
1 https://www.ea.govt.nz/documents/6450/Omnibus_5_Consultation_paper.pdf
2 Price discovery in a renewables-based electricity system: Final Recommendations PAPER 2023, MDAG report, Appendix C.

This simplistic view ignores the variety of factors that businesses must consider when looking to source electricity for their operations. While a hedge may protect participants during periods of high prices (i.e. August 2024), it also costs the participant during periods of low prices (i.e. September – November 2024, when prices dropped to under $10/MWh due to increased rainfall / wind). There are both upsides and downsides to being largely or fully hedged as a business. This was also evident during events such as the COVID lockdowns and post cyclone Gabrielle, where businesses were not able to operate but still had hedges in place.

There is a risk that the focus and scrutiny of businesses securing hedges to manage electricity market risk is perceived as financial advice from the Authority. For this reason, we support the Authority's proposal to ensure the non-supervisory nature of the stress test regime is clearly stated and understood by all participants.

- **Electricity is an important factor, but not the only factor, in business decisions**: By taking a consistent approach across all participants, the stress test regime does not consider the unique considerations of large demand-side participants and the nuances that influence their decision-making. There are many factors alongside electricity (and broader energy) that businesses consider when looking at business risk and profitability of their operations. For example, the cost of other inputs such as labour, the markets the company sell / export their products into, and whether they are a price seeker or price taker. In some cases, it may be the most efficient option for a business to temporarily shut production if input costs get too high – as was seen in August 2024 when prices spiked, and several pulp and paper mills ceased operations for around a month. In addition, some types of hedges, such as power purchase agreements, don't guarantee delivery of actual energy and there is complexity associated with financial instruments, and their treatment within business accounts.
- **The actual prices that large demand-side participants face when looking for hedges and contracts**. From a large user perspective, the Authority is not looking at the actual prices and contract terms that consumers are faced with, when looking for hedges to cover their operations. There is no assessment of whether:
    - The hedges being offered are based on affordable and internationally competitive prices. Nor are the terms of the contracts fair and in line with consumer expectations, noting that many large industrial operate and compete across many jurisdictions.
    - Hedges prices are aligned with future ASX prices, noting that in recent years, these prices have increased significantly. There seems to be a considerable risk premium built into the futures prices which is impacting decisions around hedging, beyond simply the next one to two years.
    - We would encourage the Authority to continue investigating the disparity between the current contract prices, and the long-run marginal cost (LRMC) of generation and see why the gap between the two is increasing, not closing over time. We note that this has been looked at as part of the Authority's consultation on level playing field measures – we have replicated the graph prepared by Concept Consulting which illustrates MEUG's concern with pricing in the market since 2018.
    - We note that the Authority has proposed to introduce new requirements so that participants can assess their risk management positive relative to the market (i.e. benchmarking). We do not believe that this additional information will be of value, given the inherent differences between each of the participants in the stress test regime.

Figure 1: **Contract prices and estimated costs for new baseload supply (2023)**[3]



Source: Concept Consulting[28]

Welcome opportunity to discuss our comments further

6. MEUG appreciates the opportunity to meet with Authority staff to discuss the points raised through this submission and provide insights from members on their experience to date with the stress test regime and hedging. If you have any questions, please contact MEUG on 027 472 7798 or via email at karen@meug.co.nz.

Yours sincerely

Karen Boyes
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[3] Figure 4, page 30, Level Playing Field measures Options paper, Electricity Authority, 27 February 2025.