Via email: TaskForce@ea.govt.nz

28 February 2025

PPA Working Paper

Mercury welcomes the opportunity to submit on the Energy and Competition Task Force's (Task Force) working paper, *Entrant generators – context, headwinds and options for power purchase agreements.* No part of our submission is confidential.

Market-led initiatives can deliver investment in flexible generation

We support the Task Force and the Authority prioritising initiative 1B introduction of standardised flexibility products. A vibrant flexibility market (both standard flexibility contracts and over the counter trading) will provide better price discovery giving independent generators and retailers the confidence the outcomes are efficient and enable them to manage their risks. This evolution of the market-led approach will enable more renewables by providing a signal for investment in flexible generation consistent with the GPS.

Mercury welcomes the initial super-peak product announced in December and co-designed by the sector[i]. We consider it will help address concerns around the trading of these products expressed in the Authority's Risk Management Review. We note that the first auction of the new super-peak product attracted 18 registered participants, including independent retailers, gentailers and a few financial participants. The second auction had more participants and more trading activity.

It will be important to allow time for trade in the new product to be established and to implement the recommendations from the Flexibility Product Co-design Group (Co-design Group) delivered in December 2024.[1] The Co-design Group identified problems to be addressed at the next stage of work that relate to managing uncertainty of load and generation which may overlap with the PPA workstream along with a suite of further products that could be developed and introduced.

The Authority has announced it will have a super-peak price discovery dashboard in place in March 2025. We welcome the Authority publishing a subset of anonymised data from the first trading event in the 11 February Market Brief. Data collection will enable the Authority to monitor the effectiveness of voluntary product trading. It will be important to allow time for trade in the new product to be established. Mercury is committed to making sure these arrangements are effective, including exchange based market making if required. In the absence of market making, it is unlikely that the standard contracts will be successful quickly and we should learn from the experience of implementing the original baseload products on the ASX, where it took many years for the target level of open interest to be achieved.

Mercury recognises that standard flexibility products are not intended to meet all market participant's contracting needs and that parties will still need to enter into more bespoke arrangements over the counter. The Co-design Group has developed a list of potential products that could be progressively introduced. Mercury will
continue to always price these products. We would welcome the opportunity to be directly involved in co-design of further products and consider ourselves well placed to contribute given our role as a large buyer and seller of flexibility.

[1]phttps://www.ea.govt.nz/documents/6444/Standardised_Flexibility_Product_Co-design_Group_recommendation_to_EA_-_December_2024.pdf

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

Role of PPAs
Mercury supports the iterative and collaborative approach taken by the Task Force[2]. Mercury shared our experience with PPAs with officials in November 2024, and we are participating in the Business Energy Council (BEC) work to help raise awareness of corporate PPAs and support the maturing the PPA market, including through creating standard contracts which can help support new entrants.

Where Mercury has been involved in PPAs, we have found it challenging to ensure timely deliverability and achieve a cost-effective outcome for the end customer. For these reasons we support further exploration of the merits of measures designed to educate market participants in all aspects of PPAs, for example through creation of templates. Currently, market participants invest in legal expertise to develop their own templates which are not shared beyond negotiating parties due to the significant intellectual property that goes into developing the template. Any template would benefit from input from the banking sector to ensure understanding of the credit risks posed by developer business models. We attended the first BEC workshop where representatives of the banking sector stressed the importance of market participants engaging with them early in the process of developing a PPA to enable potential creditors to understand the specific context.

Other measures canvassed in the discussion paper that may be worth exploring include matching and pooling services, procurement service guidance and demand information. Another option worth considering is facilitation of PPA aggregator services if there is a need to help small scale market participants pool resources to get a more efficient outcome. Mercury agrees with the working paper assessment that for the 'information' options identified there is a risk of the Authority duplicating or crowding out activities that other parties have incentives to pursue, (for example EVA Marketplace provides a subscription-based newsletter offering market information) and the process and pricing scrutiny options could overlap with or complement initiative 1D.

More interventionist measures such as requiring gentailers to allocate firming resources may not be needed. We agree with the working paper assessment:

> *"It is possible that standardised products available several years into the future could largely address PPA firming needs, particularly if trading provides transparent price discovery and confidence to PPA buyers regarding liquidity (and hence access)."*

In addition, more interventionist measures come with greater risk of undermining efficient investment and risk management leading to higher costs and worse security of supply, for example, as the working paper states:

> *"Firming PPAs is a subset of uses to which firming resources (whether financial capacity or physical resources) can be directed. We would need to consider whether there is a risk that directing allocation to supporting PPAs specifically could inefficiently remove capacity to apply resources to other uses.*
>
> *If so, this could in turn have a chilling impact on non-PPA investment in generation, could skew the technology mix used in system expansion, or could flow through to less optimal use of (and investment in) the physical resources that support firming."*

Some of the key design challenges with PPA's relate to how to better integrate the mechanism into our market design while ensuring security of supply and maintaining competitive neutrality to support investor confidence. New Zealand differs from international jurisdictions in that our renewables investment is market led rather than driven by policy and government support including subsidies. It is possible to include a sleeving arrangement with a PPA, if the generator stands in the middle of the contract and takes credit risk for both the contract with the independent generator and the consumer, however, this might not be sustainable at scale in terms of maintaining security of supply given sleeving PPA's (to firm a new intermittent asset) requires firming assets to back them. Consideration needs to be given to how to efficiently share risk between parties over the long term. The longer the duration of the PPA contract the more difficult it is to price it in a manner that shares the risk efficiently.

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Yours sincerely

[redacted]

Sharron Came
Regulatory Strategist

Appendix 1 Consultation Questions

Consultation Question	Mercury Response
Q1. Is there any other related work that you think is relevant to our consideration of PPA issues?	No.
Q2. Do you have any suggested additions or modifications for PPA terms and concepts?	No.
Q3. Do you agree with our definition of PPAs?	Yes.
Q4. Have we correctly identified buyer and seller motivations for PPAs?	Yes.
Q5. Have we correctly identified how PPAs may fit with other contracts?	Yes.
Q6. Do you agree with our characterisation of how PPAs may impact system evolution?	Yes, in very high-level terms if thinking in averages. Agree subsidies will change incentives and are inconsistent with the GPS.
Q7. Have we correctly identified and understood PPA headwinds?	Yes, at a high level. Mercury sees buy side headwinds including buyers lacking in sophistication and overall volume. The opportunity for foreclosure is overstated and is conflated with the perception that gentailers favour in house options over external while our view is capital discipline incentivises gentailers to choose the most efficient option. Availability of firming generation continues to improve and is recognised by market participants as a key priority (including by the Task Force with its initiative 1B) but is not directly related to buy side headwinds.
Q8. Do you agree with the potential benefits we have identified?	Yes.
Q9. Do you agree with the potential risks we have identified?	Yes.
Q10. Do you agree with the potential options we have identified?	Yes. We agree with the working paper assessment that any allocation option needs a detailed risk assessment to ensure it doesn't undermine efficient investment and risk management leading to higher costs and worse security of supply and any option allocating firming resources overlaps with Task Force Initiative 1B and should be analysed to see if it would provide significant additional value beyond a tradable standardised flexibility product.

Q11. Do you agree with our comments on potential options?	Yes. PPA templates, matching service (bulletin board), procurement resources, demand information and pooling service, process scrutiny, pricing scrutiny (firming), pricing scrutiny (PPAs) and flexibility trading – Mercury considers these options to be potentially useful 'no regrets' options and may help some market participants overcome issues such as affordability (needing to pay for technical experts time) and lack of detailed understanding of market conditions/commercial implications of the instrument integrating with business models). The paper addresses at a high level the pros and cons of these options. We agree with the assessment that allocating firming resources would likely inefficiently remove capacity to apply resources to other uses and could in turn have a chilling impact on non-PPA investment in generation. Mercury agrees that the other options set out in the paper – socialise prudential, revenue and firming risk should not be progressed for the reasons outlined.
Q12. Do you have a view on the most promising options?	Yes see our response to Q10.

[i] We note the co-design group is also considering other potential products including a daily peak contract, an option over baseload futures contract, caps, swaptions, renewable firming products, a night-and-day contract-for difference, energy storage products, fixed-price variable volume contracts and a standard demand response product or contract.