

Hedge Market Enhancements

NZ Wind Energy Association Submission

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Submissions
Electricity Authority

By email: HME.feedback@ea.govt.nz

Introduction

1. The New Zealand Wind Energy Association (NZWEA) welcomes the opportunity to provide a submission on Hedge Market Enhancements (market making).
2. The Association also submitted on wholesale market competition in response to the Electricity Price Review (EPR) First Report (October 2018) and Options Paper (March 2019).
3. The Association, in its submission to the EPR, focused on two key aspects relating to wind farm development namely extending the duration of the electricity futures market and product innovation to assist management of wind's variability particularly for independent generators without alternate sources of generation or a retail position.
4. NZWEA's focus is therefore on how the hedge market can best support new renewables development.

Summary Comments

5. NZWEA notes that the current consultation seeks feedback on the Authority's initial analysis of problems and opportunities primarily in relation to market making, bid-ask spreads and liquidity. However the opportunity for the futures market to better support new renewable generation investment decisions through a robust longer duration forward price curve and risk mitigation products should not be overlooked.
6. In this submission the Association therefore references the feedback provided to the EPR on the Association's view that:
 - The current market term should be extended from 3 to a minimum of 5 years to provide a higher level of contract cover to support new investment.
 - The need for product innovation, such as an electricity price cap product, which may better enable independent retailers to manage risk and contract variable wind farm output.
7. It is noted that the development of cap product was identified as a priority in December 2015 and the Association understand there have been a number of factors including systems development and market depth that have delayed implementation.
8. The Association recognises the need to address short-term hedge market enhancements as a priority but also considers the New Zealand electricity market lags other geographies in the independent development and ownership of generation assets which have been important to the growth in renewables.

9. Given the requirement for a significant increase in the level of renewables development to support decarbonisation, the key role the wholesale market has in supporting the transition needs be recognised and built into future delivery plans.

Response to the EPR Options Paper

10. Summary comments on reinforcing wholesale market competition were as follows:

- Information disclosure and availability is key to wholesale market performance and needs to be consistently available for all fuels.
- In addition to mandatory market making the continued development of the wholesale contract market with new products and term extensions is important as is the emergence of a PPA market to support new investment. Mandatory market making needs to recognise participant risk positions and the costs of providing the service.
- The Association considers that, given the level of new investment in electricity generation required, and an increasing level of intermittent generation, there needs to be a fit for purpose assessment to ensure the widest possible participation levels in the spot market for independent generators, aggregators of storage and controllable demand.

11. Specific comments on Section D reinforcing wholesale competition were:

1. Toughen rules on disclosing wholesale market information

Supported.

Access to market information is essential to a well-functioning and transparent market.

The Association considers that fuel availability is a key issue and that the level of information that is currently available for hydro storage levels needs to be replicated for all thermal fuels and, as wind energy increases, potential wind generation levels based on wind speed forecasts.

2. Introduce mandatory market making obligations

Supported.

A continued investment in the wholesale contracts market is important to support the development of all renewables including wind generation and should lead to a more liquid market. The wholesale market is particularly important for independent generators to be able to firm future revenue to reduce earnings volatility, support investment decisions and secure funding.

The Association notes a number of members have been actively participating in the wholesale contracts market on a voluntary basis. Should compulsory market be introduced NZWEA considers it important that the risk positions of participants and the cost of market making are recognised in rule setting.

NZWEA considers that an issue with the current market that has not been addressed include the term of the market which should be extended from 3 years to a minimum of 5 years to provide a higher level of contract cover given that wind farms are a 20+ year investment.

The Association also notes that wholesale market product innovation is behind that of other markets. For example, the Australian wholesale market offers a quarterly base load cap on future products. An electricity price cap product was identified as a priority in December 2015 however for a number of reasons has not been able to be delivered. While a cap product has limited direct benefit to a wind farm owner it may enable a retailer to be more prepared to contract with a wind farm owner recognising the variable nature of production. Similarly the ability of independent generators, aggregators of storage and controllable demand to participate in the market needs to be ensured with systems and processes reflective of their scale.

As the market matures, we expect to see greater volumes of energy openly traded through the wholesale market which should support more dynamic generation / retail interactions and outcomes.

The Association notes that a number of contracts are transacted on a bi-lateral OTC basis outside of the ASX including a proposed PPA to support the development of a new wind farm. In addition to the wholesale market, OTC and PPA contracts are important market instruments to enable the variable output of renewable generation to be firmed.

The Association considers that the EPR in commenting that “a mandatory market-making obligation could be introduced relatively quickly” has, depending on the intended level of market-making, underestimated the complexity and risks to incumbent generators of doing so.

4 Monitor contract prices and generation costs more closely

Supported.

The Association considers that monitoring contract prices to new generation costs has merit and does not support the position that spot market pricing should always reflect the short run marginal cost (SRMC) of individual generation plant and considers plant and fuel availability a key determinant of price.

New wind farms would be uneconomic if revenue was derived from a spot market based SRMC.

About the NZ Wind Energy Association (NZWEA)

- The NZWEA is an industry association that promotes the development of wind as a reliable, sustainable, clean and commercially viable energy source.
- We aim to fairly represent wind energy to the public, Government and the energy sector.
- Our members are involved in the wind energy sector and include electricity generators, wind farm developers, lines companies, turbine manufacturers, consulting organisations and other providers of services to the wind sector,
- By being a member of NZWEA you are assisting the development of wind energy in New Zealand and helping to reduce our greenhouse gas emissions to meet climate change targets.

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