Submission on the proposed Winter Energy Reliability Obligation

Thank you for the opportunity to make this submission on the Ministry of Business, Innovation and Employment's (MBIE) proposed Winter Energy Reliability Obligation (WERO) for the electricity wholesale market. There is no confidential information in this submission.

The consultation paper is detailed and canvasses feedback on a wide variety of high-level principles and technical details. Our submission is intentionally brief and focused on the aspects of consultation most relevant to our businesses.

Overall, we support the intent of the proposal and consider that MBIE's comparison of WERO implementation options should include assessment against:

- **Durability**: Whether the arrangements enjoy broad political support and can therefore be expected to endure and incentivise long-lived investment decisions.
- **Predictability**: Whether electricity market participants are able to reliably predict what is required of them.
- **Minimise gaming**: Reducing the incentives and opportunities for market participants to manipulate the WERO triggers as leverage for selling dry year insurance contracts.

An absence of broad political confidence is a sufficient reason to act

MBIE has described the problem in several ways:

> *"Our electricity system lacks sufficient incentives for long-duration firm energy"*
>
> *"…a serious vulnerability in New Zealand's electricity market: it has not delivered enough long-duration firm energy"*
>
> *"The net result is that there is uncertainty that the market will bring forward enough reliable generation to provide sufficient long-duration firm energy"*
>
> *"The proposals in this paper are targeted mechanisms to ensure that the market has the right incentives to address these system-level risks."*

The Electricity Authority's interpretation of its statutory objective recognises the importance of arrangements for reliable supply being robust over the long-term (our emphasis added in bold font):

> *"In principle, voluntary insurance-type arrangements should be relied on for coping with the impact of those [high impact, low probability] events. But* ***if participation in voluntary arrangements is inadequate****, such that costly interventions occur in the lead up to, during or after adverse events,* ***the long-term benefit of consumers may be served by adopting second-best arrangements*** *after transparently taking into account the benefits from regulatory certainty and potentially the high cost of ad-hoc interventions."*
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> *"In the short-term, second-best arrangements are not as efficient as first-best arrangements, but they are* ***more efficient over the long-term if first-best arrangements for electricity are unattainable*** *due to the realities within which the electricity industry operates."*
>
> *"The Authority therefore interprets the phrase reliable supply for the long-term benefit of consumers to mean efficient levels of reliable supply, where efficiency includes dynamic efficiency gains from adopting time-consistent arrangements – that is,* ***arrangements that are robust to adverse events over the long term****. In regard to minimising total costs, the Authority believes the potential costs of regulatory uncertainty and ad-hoc interventions should be taken into account in determining minimum total costs."*[1]

This provides a useful framework for assessing the adequacy of dry-year firming. The relevant test is not a technical assessment of reliability; it is whether the arrangements have broad confidence among Members of Parliament. An absence of confidence in Parliament is a valid problem that is sufficient to justify intervention.

[1] Paragraphs A.44-A.46 of *Interpretation of the Authority's statutory objective* available from https://www.ea.govt.nz/about-us/corporate-documents/

We consider there is clear evidence of a persistent perceived need for ad-hoc intervention:

- **2003 – Electricity Commission established.** The Government replaced the industry-governed market framework with the Electricity Commission following supply crises in 2001 and 2003.
- **2003 – Whirinaki reserve generation plant.** The Government commissioned and funded the 155 MW diesel-fired reserve power station at Whirinaki as insurance against dry-year shortages, plant failures and transmission outages. Its costs were socialised through levies until 2010 under the reserve-energy scheme.
- **2004 – Huntly Unit 5 gas-risk underwriting.** The Government entered a risk-sharing agreement with Genesis Energy to enable construction of the 385 MW Huntly Unit 5 combined-cycle gas plant (that was otherwise not commercially viable).
- **2010 – Electricity Authority established.** The Government replaced the Electricity Commission following supply crises in 2006 and 2008.
- **2020 – New Zealand Battery Project launched.** The Government established the NZ Battery Project to investigate large-scale solutions (such as Lake Onslow) to the dry-year problem and support a highly renewable electricity system.
- **2024 – Gas Security Response Group established.** The Government directed MBIE to establish the Gas Security Response Group in response to emerging gas security-of-supply concerns and the implications for electricity security of supply.
- **2025 – Huntly Firming Options.** While ostensibly a market-led solution, the Government's strong encouragement was important to the development of the arrangements to keep the Huntly Rankine units operating beyond planned retirement dates.
- **2025 – LNG import terminal procurement.** The Government initiated procurement of an LNG import facility to provide backup fuel for electricity generation and mitigate dry-year and gas-supply risks.

While there was a period of more than ten years without ad-hoc Government intervention, this also coincided with a period where the 2008 global financial crisis had flattened demand growth. In that period, the market showed it could deliver *retirement* of thermal generation (Otahuhu B and Southdown). It is evident that the arrangements have been insufficient to avoid ad-hoc Government interventions.

Assessment criteria should value certainty

While MBIE has not set out explicit assessment criteria for its WERO proposals, we suggest some (non-exhaustive) criteria in the following table:

Criterion	Description	Rationale
Durability	Whether the arrangements enjoy broad parliamentary support.	For the proposal to incentivise long-lived investment decisions it must be credibly regarded as politically durable. To solve the problem of repeated need for ad-hoc Government interventions, it needs to broadly reflect Parliament's desire for a level of security of supply greater than that otherwise delivered by the market.
Predictability	Whether electricity market participants are able to reliably predict what is required of them by the WERO triggers.	While perfect certainty or predictability is not possible, commercial decision-makers will make better, more efficient decisions if the WERO triggers are clear and predictable.
Minimise gaming	Reducing the incentives and opportunities for market participants to manipulate the WERO triggers as leverage for selling dry year insurance contracts.	MBIE's proposals are aiming to incentivise behavioural changes from market participants. As such, it is necessary that the proposed metrics are responsive to relevant behavioural changes (such as the existence and detail of contracts). However, the potential downside of this necessary feature will mean the WERO triggers may serve as an incentive to hold off reaching contracts on firming capability until such time as the purchasers of dry-year cover contracts see maximum risk and have their highest willingness-to-pay. MBIE should prefer WERO triggers with continual, enduring obligations rather than periodic obligations.