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Energy Competition Taskforce
By email: TaskForce@ea.govt.nz

Dear Ms Kominik and Dr Small

Level Playing Field Measures – Options Paper

1. The Energy Competition Taskforce (the Taskforce) has rightly acknowledged the serious challenges facing New Zealand's electricity market and the need for reform. Vector has consistently advocated for stronger competition across the various markets regulated by the Electricity Authority (Authority), noting previously:[1]

> *Sufficient levels of competition are critical to realising the theoretical benefits of the intended market design. A theoretically perfect market design can be undone by a market structure that is too concentrated. Without a level playing field between large and small participants – for generators, retailers and consumers alike – intended benefits will not be realised.*

2. We therefore strongly support the intent of the Taskforce's interventions in this area.

3. In particular, Vector has consistently emphasised the critical role of hedging contracts in supporting competition and risk management and we welcome the Taskforce's forthright recognition that "hedge contracts matter."[2] Sufficient contracting is essential to unlocking the benefits of the wholesale market design. As we noted five years ago, a well-functioning hedge market and robust forward curve – one that participants can rely on as a fair reflection of expected spot prices – are vital for both price discovery and effective risk management:[3]

> *Vector considers a robust hedge market as core to the development of broader market opportunities for the long-term benefit of consumers. The certainty and confidence in forward prices are important for emerging prosumers, just as it is retailers and generators, both existing and future.*

4. In 2020, we noted that after more than two decades of waiting for a liquid forward market to emerge, it was time for the Authority to act. Five years on, with little progress, the case for change is even stronger, and more urgent, for New Zealand's consumers.

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1 Vector Limited, *Submission on the MDAG Options Paper – Price Discovery in a Renewables-Based Electricity System*, 20 March 2023, p.1.

2 Energy Competition Taskforce, Level Playing Field measures Options paper Energy Competition Task Force initiatives: Level playing field measures and Prepare for virtual disaggregation of the flexible generation base, 27 February 2025, p.2 (hereafter: "Options paper").

3 Vector Limited, *Submission on Hedge Market Enhancements Consultation*, 16 June 2020, p.1.

5. For independent operators especially, the importance of a well-functioning hedge market rests on two key factors:

   a. **access to the hedging instruments** needed to manage spot market volatility in **both the short and long term**; and

   b. just as importantly, confidence that **prices are efficient** and, crucially, **not unduly influenced by market power**.

6. Despite the Taskforce's acknowledgment of these issues and its best intentions, we remain unconvinced that past regulatory interventions, or even current proposals – most recently the mooted non-discrimination rules – will achieve these outcomes. While a positive step overall, and one in broadly the right direction, we are concerned they are not targeting the core issue.

7. Notably, the Taskforce's approach has diverged materially from the problem definition set out by the Market Development Advisory Group (MDAG), and its recommended reform package.[4] It is unclear whether this divergence has been intentional or inadvertent. Recent reports on the Authority's progress in implementing MDAG's recommendations[5] offers no further clarity.

8. Specifically:

   a. To date, the Taskforce has concentrated its reforms – both implemented and proposed – primarily on hedging products and competition issues related to **short-term flexibility** (e.g., the recent introduction of super-peak hedging products).

   b. In contrast, the MDAG report clearly prioritised ensuring effective competition in **long-term flexibility** and backup resources, with a particular focus on **preventing market power consolidation**. Its 'backstop' virtual disaggregation proposal was designed specifically to address **this concern**, **not short-term flexibility issues**, which MDAG did not consider a long-term competitive threat.

   c. Despite the recent Government Policy Statement (GPS) on electricity providing a clear directive to implement the MDAG report's recommendations, the Taskforce surprisingly now favours its proposed **non-discrimination rules** over virtual disaggregation. Again, while a positive step overall, we are concerned they are not targeting the core issue.

9. It is unclear why the Taskforce has taken this approach, particularly given the strong alignment between the MDAG recommendations and the GPS. Without the necessary clarity, it appears the Taskforce may have misinterpreted the intent behind MDAG's virtual disaggregation proposal, and mistakenly assumed that non-discrimination rules can resolve the problem the MDAG report identified. **In our view they cannot**. Non-discrimination rules are highly unlikely to be able to address underlying market power concerns related to long-term flexibility services.

10. Addressing these pressing issues requires a broader set of options. This raises concerns for us about whether the Taskforce is tackling the right problem, or inadvertently overlooking the proverbial "elephant in the room." As we discuss later in this submission, we are also unconvinced that the proposed non-discrimination rules are practicable; indeed, there appears to be widespread confusion among industry participants regarding the Taskforce's proposal. A significant course correction may therefore be warranted.

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4 Market Development Advisory Group, *Price discovery in a renewables-based electricity system, Final Recommendations Paper,* 11 December 2023 (hereafter: "MDAG paper"; available here).

5 Electricity Authority, *Market 2.0: Resilient, affordable electricity for the future – Market Development Advisory Group quarterly implementation update January to March 2025*, 4 April 2025.

The criticality of flexibility and hedging to realising the benefits of the market design

11. A well-functioning financial hedging market relies on the physical flexibility of the electricity system itself. Hedging products are fundamentally underpinned by the ability of generators and demand-side response providers to balance supply and demand in real time. In simple terms, financial risk management tools, such as swaps, caps and shaped hedges are only as reliable as the physical assets that support them. Table 1 outlines the two key types of flexibility and underscores their critical role in enabling efficient hedging.

Table 1: Relationship between flexibility and hedging

	Physical attributes	Relevance to hedging
Short-term flexibility	Involves quickly responding to immediate changes in supply and demand. It includes resources that can be activated or adjusted rapidly, such as peaking plants (gas-fired or other dispatchable generation), demand response (where consumers adjust their electricity use in real-time), and battery storage that discharges power quickly. This flexibility is essential for managing short-term market fluctuations, such as sudden demand spikes, unexpected generation outages or rapid reductions in intermittent, non-dispatchable generation. This will become increasingly important as the penetration of wind and solar generation increases across New Zealand.	Short-term flexibility helps mitigate near-term price risks, enabling market participants to manage daily price volatility. A diverse range of providers offering a deep pool of short-term flexibility (e.g., from solar, batteries, electric vehicle charging and vehicle-to-grid discharging) can potentially foster efficient hedging by increasing competition, liquidity and price confidence.
Long-term flexibility	Refers to the ability to plan and adjust capacity over extended timeframes to meet future supply and demand needs. This includes investments in flexible backup capacity like hydro with long-term storage, which provides stable long-term output and technologies such as large-scale storage solutions that smooth supply over prolonged periods. Long-term flexibility is crucial for managing risks across months or seasons, ensuring sufficient generation during winter months or sustained dry periods.	Long-term flexibility mitigates longer-term price risks, such as those arising from persistent supply shortages (e.g., the need for expensive thermal generation during sustained dry periods). A competitive market with multiple providers of flexible backup capacity helps keep long-term futures prices lower and promotes liquidity.

12. If there is insufficient short- or long-term flexibility in the system – or **if that flexibility is concentrated among a few suppliers** – the hedging market cannot function effectively. In particular:

    a. A lack of flexibility means spot-market risks (such as potential near- or long-term shortages) are **priced into financial products**. Independent operators bear the brunt of this, because they lack the natural, physical hedges that insulate gentailers.

b. When flexibility services – such as firming generation – are controlled by a small number of players, those entities gain **undue influence** over both the availability and pricing of hedge contracts. This concentration of power can distort competition and enable rent extraction.

13. In other words, simply facilitating **access** to hedging products does not "level the playing field." If competition in flexibility services is weak, hedge **prices** will be inflated – handing gentailers a considerable advantage, since they are far less exposed to those costs. While new financial products can sometimes enhance competition, their benefits can be largely – if not entirely – eroded if contract prices are shaped by market power. The MDAG report highlighted this risk and concluded that the far greater competition concerns stem from **long-term flexibility services**.[6]

Steadily increasing supply of short-term flexibility to mitigate competition and access concerns

14. The MDAG report thoroughly examined the competition issues related to flexibility services and their influence on a well-functioning hedging market. It concluded that the transition to a renewables-based system could, in fact, enhance competition in certain areas. For instance, batteries were identified as a potential driver of increased competition in the provision of **short-term flexibility** services and some ancillary products (up to a few days).[7] Furthermore:

    a. There appears to be a significant amount of new investment in wind and solar generation (approximately 1,500 MW by some estimates), including from independent providers.

    b. As electric vehicle uptake grows, this will further bolster short-term flexibility, since the energy stored in batteries enables greater demand-side response – either by increasing charging when supply is abundant, or decreasing charging (and, in future, increasing discharging) when supply is scarce.

15. Over the next five years, strong competition among a diverse range of providers in short-term flexibility services seems likely – a reason for optimism. This raises a question: why has the Taskforce focused so intensely on short-term flexibility in its early deliberations? The answer presumably lies in timing. When the Taskforce was formed last August, it faced the immediate challenge of "surviving the upcoming winter", after last year's highly publicised volatility driven by low inflows and gas unavailability.

16. In response, the Taskforce, in collaboration with the Standardised Flexibility Products Co-Design Group (SFPCDG), introduced a new standardised super-peak hedge product, which began trading in January. The goal was to provide wholesale market participants – particularly independent operators – with a tool to mitigate extreme spot price spikes, such as those occurring on freezing nights when demand surges and supply is tight, as early as winter 2025. The SFPCDG's product design was constrained by the need to deliver a solution capable of making a material impact by winter 2025, as well as the requirement for broad participation from both the demand and supply sides. This limited the SFPCDG's ability to address the problems most emphasised by MDAG, reducing the overlap in scope between the problems the SFPCDG could attempt to solve, with urgency, and the longer-term competitive concerns voiced by MDAG.

17. This pivot was a pragmatic and timely measure to ensure supply security in 2025 – entirely reasonable given the circumstances. The non-discrimination rules in the Options Paper subsequently aim to build on this reform by ensuring non-integrated retailers and generators can

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6 MDAG paper, p.60.

7 Market Development Advisory Group, *Price discovery in a renewables-based electricity system, Options Paper,* 2 December 2022, p.77 (available here).

access an even wider variety of hedge contracts on "substantially the same terms as gentailers supply themselves internally."[8]

18. However, several issues arise upon closer inspection:

    a. The short-term flexibility challenges these reforms address seem unlikely to persist – particularly as battery and EV storage becomes more widespread, access to flexibility should increase and competition should improve as a result. At this point, barriers to entry in short-term flexibility (both from physical and market perspectives) appear relatively low. For example, retailers both large and small are building portfolios of smart hot-water load management, enabled by metering providers.

    b. Moreover, the work of the SFPCDG and the proposed reforms do little, if anything, to address **long-term flexibility risks** – particularly those related to inter-seasonal and dry-year firming – which are critical to the ability of new generators and independent retailers to enter and compete.

    c. As we discuss in more detail later, it is also unclear whether the proposed non-discrimination rules are workable in practice, and there may be more effective ways to improve liquidity and facilitate efficient price discovery.

19. In other words, we fear the Options Paper may be **addressing the wrong problem with the wrong solution**. In particular, the Taskforce appears fixated on improving **access** to hedging products without fully considering how those products would be **priced** if the "access providers" wield substantial market power – especially in long-term flexibility services. The sustained high forward prices in out years do little to provide reassurance that consumers can expect respite any time soon.

20. As we explain below, focusing on the wrong problem and solution may have caused it to prematurely dismiss or delay more effective reforms.

Long-term firmness / flexibility – the elephant in the room?

21. The MDAG report offered a sobering assessment of the potential impacts the transition to a renewables-based system could have on competition in long-term flexibility. It warned that as fossil-fuel thermal plants are retired – a critical and widely-assumed step in the ongoing transition to a highly renewable power system – control over the remaining long-term flexibility services is likely to become further concentrated, primarily in the hands of entities with substantial hydro storage systems (rather than those relying on run-of-river configurations):[9]

> *"…**a significant thinning of competition in the provision of longer duration flexibility products is possible because much of the existing physical capacity to back such products is held by parties with the major flexible hydro schemes**. Analysis in the Options Paper showed that larger generators with substantial flexible hydro bases may well have **greater means and incentive to exercise market power** in the supply of flexibility products as thermal generation declines.*
>
> *A thinning of competition for flexibility products could tear at the fabric of the broader market. That is because flexibility products provide a critical bridge to integrate intermittent supply into products suitable for retail consumers. Put*

[8] Options paper, p.2.

[9] MDAG paper, p.60.

simply, weaker competition for flexibility products could also ***undermine competition in the retail and new investment markets****.*

Although our analysis cannot be determinative because of uncertainties about the future, it highlights a risk that we think cannot be ignored. Our view is that ***the risk of declining competition for longer-duration flexibility contracts must be proactively managed – rather than adopting a 'wait and see' approach.****"*
[emphasis added]

22. Sapere summarised the problem even more succinctly in a recent report: [10]

> *"The "elephant in the room" is that peak demand has outpaced growth in firm capacity for nearly a decade."*

23. The chief concern is that, following the assumed (or inevitable) retirement of thermal plants like the Huntly Rankine units, e3p and TCC, the majority of the country's backup generation capacity would reside within Meridian's Waitaki system. This would grant Meridian (and potentially Genesis, if the Huntly Rankine units were to remain online for the foreseeable future) significant control over the pricing and availability of these services.

24. The potential issues arising from this concentration of control are clear. When discussing the merits of the Lake Onslow virtual battery project, Professor Grant Read noted:[11]

> *"One obvious issue is that a single facility capable of creating a large supply/demand swing, over a short time interval, would also have* ***considerable power to shift market prices in the comparatively small New Zealand market****. While no-one would claim that the market currently operates under perfectly competitive conditions,* ***it seems reasonable to rule out the option of having such a facility controlled by a single commercially motivated party****, unless special organisational/contractual arrangements are made to curb its implicit market power."* [emphasis added]

25. Professor Read was, of course, highlighting the risks of a single, profit-driven entity controlling the Lake Onslow virtual battery facility. He then continued to propose several options that could have been introduced to mitigate those risks. While safeguards could have been introduced for that government-funded project, the same cannot be said for the Meridian Waitaki system. If it becomes an even more dominant source of backup power, Meridian – as a commercially motivated entity – would have strong incentives to influence the pricing and availability of that long-term flexibility to maximise returns for its shareholders.

26. It is obvious that increasing *access* to products sold by Meridian would be of little benefit in such circumstances if the *prices* of those products are not constrained by sufficient competition in that sub-market.

27. To address this issue, the MDAG report recommended that the Electricity Authority "develop a high-level outline of 'virtual disaggregation' to 'put in the draw' ready for use if other measures are not effective."[12] The goal was to create a plan that could compel gentailers to offer a minimum

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10 Sapere, *Responding to matters set out in Reviewing risk management options for electricity retailers – issues paper,* 20 December 2024, p.2 (available: here).

11 Read., G, Storage Options for the New Zealand Electricity Sector Operational and Organisational Issues, Prepared for the Ministry of Business, Innovation and Employment, 14 July 2022, pp.54-55 (available here).

12 MDAG paper, p.95.

volume of their longer-term flexible generation capacity to buyers via risk-management contracts. This proposal was specifically designed to address market power concerns by decentralising access to, and control of, long-term flexibility products.

28. Essentially, the recommendation sought to prevent any single player (most notably Meridian) – or small group of players – from dominating the provision of long-term flexibility services. By doing so, it aimed to foster greater competition and improve overall market outcomes. The recent GPS fully endorses this recommendation, along with the others in the MDAG report. It states that the wholesale market must be updated without delay and that:[13]

> *"This means implementing the integrated package of measures set out in chapter 9 of MDAG's report, which the Electricity Authority has endorsed."*

29. To that end, the Taskforce has outlined a virtual disaggregation option in Appendix D. However, it appears reluctant to pursue it, and indeed it is predicated on monitoring and solving a different problem. Instead, in Chapter 7, the Taskforce states that it favours **non-discrimination obligations** as a more effective solution to the issue MDAG sought to address. We disagree with this approach. The Taskforce seems to have misunderstood the nature of the problem the virtual disaggregation option was intended to solve and incorrectly concluded that non-discrimination rules provide a viable alternative. As we explain below, they do not.

Non-discrimination rules do not address market power problems

30. Non-discrimination rules are designed to ensure **equality of access**. The basic idea is to allow independent providers access products (such as hedge contracts) on substantially the same terms as Gentailers supply themselves internally. This would provide non-integrated suppliers with **access** to a wider variety of hedging products – which, as we note above, is a step in the right direction and is no small thing. But there is also the matter of the **price** at which they would be offered.

31. If a supplier – such as Meridian – finds itself in control of a consolidated base of the market's long-term flexibility services, it will have considerable market power. As the dominant supplier of generation capable of providing the flexibility needed during an extended cold snap or dry winter, it would be well-positioned to drive up prices. For example:

    a. It could significantly increase its spot market bids, forcing wholesale prices higher, and justify these increases by citing the scarcity value of its flexible water resource. For instance, it could argue that there is a risk of shortages (even if the probability is low) and that its bids must account for the significant opportunity costs associated with conserving water if storage is depleted. This justification would be challenging to contest, and the resulting increase in spot prices would lead to higher hedging prices.

    b. Strong incentives could also arise to maintain a tight supply, potentially through intentional under-valuation of water (leading to over-release), in order to preserve scarcity rents. This behaviour would be difficult to detect and regulate, due to the substantial uncertainties surrounding the unobservable value of water in New Zealand's hydro-dominated system, and/or determining which releases were truly 'must run'.

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13 Statement of Government Policy to the Electricity Authority under section 17 of the Electricity Industry Act 2010: New Zealand electricity industry, footnote 10, p.3.

32. The core problem would be the sustained elevation of spot and forward contract prices due to insufficient competition in long-term flexibility. In MDAG's words[14]:

> "*Put simply, it is possible that* ***supplier concentration for longer-duration flexibility could be so great*** *that market-making arrangements (and other tools in Tranche 2 [of MDAG's suite of recommendations]) are insufficient to* ***address the underlying structural market power****." [emphasis added]*

33. It is worth reiterating that MDAG's concluding recommendations followed many hundreds (if not thousands) of hours of input by a range of industry experts and expert consultants, over a process lasting more than two years.

34. **Neither the proposed non-discrimination rules, nor the new super-peak hedging products, would address this issue**. Even with these measures in place, independent operators – particularly retailers – would remain at a substantial competitive disadvantage relative to their gentailing counterparts, because:

    a. Spot and contract prices would likely **rise significantly across the board**, not just in super-peak periods, due to structural scarcity in the system.

    b. Gentailers could reasonably claim that their implicit **natural hedges reflect those higher prices** when offering hedges under non-discrimination rules, even though they are not fully exposed to them, since **these prices reflect the prevailing market conditions**. Monitoring and assessing the efficiency of these prices would be significantly challenging, and likely to end in countless hours of irresolvable disputes. This is a key risk with any non-discrimination regime.

    c. However, due to their vertical integration, gentailers would remain **largely insulated from these price increases**. They would be less impacted by elevated prices because they are not truly exposed to the full cost, unlike independent retailers.

35. **All the non-discrimination rules would therefore achieve in these circumstances is allow non-integrated suppliers to purchase hedges at prices inflated by the exercise of market power.** This would do little, if anything, to "level the playing field."

36. As such, the proposed non-discrimination rules do not adequately address the core issue that led MDAG to recommend virtual disaggregation. Put simply, these reform options are not interchangeable.

37. The Taskforce should note further that discrimination can potentially take forms other than pricing, including information asymmetry. As we have noted in previous submissions[15], the Authority will need to be mindful of how the trading conduct rules, and wholesale market information disclosure requirements, need to evolve as more parties become more active in responding to wholesale prices through portfolios of unoffered distributed energy resources. Similarly, how large-scale demand response options are exercised will also have a material impact on prices; the trading conduct rules and disclosure regime will need to keep pace.

Other options should be on the table to increase hedge market effectiveness

38. Non-discrimination rules are not a cure-all for the competition issues facing the wholesale and retail markets, particularly regarding long-term flexibility. Therefore, if the Taskforce wishes to

[14] MDAG paper, p.61.

[15] Vector Limited, *Submission on updates to scarcity pricing settings*, 29 November 2024, p.3.

address the significant disparities between independent operators and gentailers, while fostering new entry and expansion, other options should be on the table. Virtual disaggregation should certainly be one of these, but, as highlighted in our previous submission, horizontal separation options also deserve attention.

39. Specifically, gentailers' generation assets could be redistributed among existing market participants to help reduce the concentration of ownership in long-term flexibility, potentially enhancing competition. Asset reallocations may offer a practical, elegant solution to these issues, and they are not without precedent. As we noted in our previous submission on this topic:

    a. In 1999, Meridian exchanged some of its thermal generation assets with Genesis Energy to diversify its energy portfolio. This swap aimed to balance the generation mix of both companies, reduce concentration, and promote competition.

    b. Following the 2009 Ministerial Review and the passage of the *Electricity Industry Act*, ownership of the Tekapo A and B power stations was transferred from Meridian Energy to Genesis Energy, again with the goal of promoting competition through more balanced portfolios (see here).

    c. Also, after the 2009 Ministerial Review, Meridian, Genesis, and Mighty River Power (now Mercury) engaged in a series of 'virtual asset swaps' involving financial hedges, which effectively 'switched' southern and northern generation output (see details here).

40. We understand that the virtual asset swaps have a limited duration remaining and will potentially be fully unwound by 1 January 2026. However, it seems plausible that the parties could be compelled to extend them if doing so would help level the playing field.[16] This appears to be a logical and timely step for the Taskforce to recommend in order to address the issues discussed thus far. The arrangements might also be reimagined in ways that include independent generators and retailers, e.g., requiring gentailers to purchase from the former and sell to the latter.

41. Regardless of the options pursued, a core objective must be to ensure equitable access to liquid hedging markets, where participants can rely on efficient prices free from market power distortion. **For the market to function effectively, the forward curve must be trusted**. If the larger gentailers are indifferent to its level and shape – due to their lack of exposure – or worse, are able to manipulate it, the entire market faces higher risks and distorted conditions, particularly independent operators.

42. This was a key finding of the 'Brownlee Review' in 2009. In a highly integrated market, the forward curve can only be trusted if larger gentailers have a vested interest in its integrity – that is, sufficient 'skin in the game' – which they currently lack. The Review concluded that an open, effective, deep and liquid hedge market was essential to mitigate the downside risks of vertical integration. To that end, building the hedge market and strengthening the forward curve became a major strategic focus for the Authority in the five years following its establishment. It is disappointing that, 15 years later, this key conclusion and subsequent effort seem not to have been central to the Taskforce's latest analyses and interventions.

43. Despite the Taskforce's recognition of these issues and its best intentions, we are not convinced that its non-discrimination rules will lead to meaningful change.

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16 Of course, this would depend to a large extent upon the long-term fate of the Huntly plant, i.e., if/when it is likely to be decommissioned.

44. Moreover, as explained below, the workability of the proposed rules is doubtful.

Workability challenges of the proposal

45. The basic intent of the non-discrimination rules is to ensure that independent retailers and generators can access risk management products on terms equivalent to those available to gentailers. But this is easier said than done. Because gentailers do not sell electricity to themselves, there are no internal transactions to benchmark against when assessing whether offers to independents meet this standard. The Taskforce proposes to overcome this problem by requiring gentailers to establish an "economically meaningful portfolio of internal transfer prices (ITPs) for hedges." We are sceptical about the feasibility of this approach.

46. **The idea of constructing robust transfer prices without genuine market transactions seems somewhat unrealistic**. Any administratively set price is likely to be subjective and open to manipulation. Key questions arise, such as how to allocate common costs between the generation and retail arms and how to factor in unobservable variables like endogenous water values or the potential costs of shortages.

47. Moreover, there is a risk that each gentailer could adopt different approaches to these issues, leading to inconsistencies in transfer prices across the industry. Perhaps unsurprisingly, at the Taskforce's workshops, some of the gentailers' representatives seemed unclear about what the Taskforce was asking of them. While they will no doubt elaborate on these concerns in their submissions, the widespread and seemingly genuine confusion raises doubts about the proposal's workability.

48. Even if plausible price benchmarks could be established, monitoring compliance may also prove extremely challenging. For instance, gentailers could often attempt to justify high prices by referencing market conditions, risk factors and opportunity costs. In a hydro-dominated system where unobservable water values often influence prices, it will be difficult to assess whether ITPs are reasonable. Therefore, instead of attempting to set an administratively determined price, the Taskforce should perhaps focus on creating more genuine market-based prices by:

    a. **Expanding market-making obligations and building open interest.** This would require large players to offer both buy and sell prices for standardised hedging contracts at reasonable volumes. By ensuring more consistent availability of hedging products, the Taskforce could increase liquidity in the market, providing independent operators with greater access to risk management options. Increasing open interest would help ensure that forward prices are efficient. Additionally, it is understood that the more contracts a generator has sold, the more incentivised it is to offer its capacity up to that contract level at its short-run marginal cost of generation[17].

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[17] This can be shown mathematically, but in simple terms, if a generating company has sold *y* MW of its generation capacity forward via contract, its profit-maximising offering strategy in the spot market is to offer those *y* MW at, or close to, the SRMC of that capacity. Then:

- If the spot price clears *above* its SRMC, the generator's best option is to generate using that capacity to meet its sales, as it is cheaper for them than buying off the market.
- However, if the spot price clears *below* its SRMC, the generator is better off *not* generating and instead buying off the market to meet its contracted sales.

In summary, forcing forward sales of contracts is a way to incentivise generators' to ensure their spot market offers are set as close as possible to SRMC. However, this does not guarantee either that a) SRMC for hydro generators becomes any easier to assess, as it will be linked to forward prices, or b) the price of those contracts sold will not have been influenced by market power.

b. **Exploring virtual disaggregation**, which would compel gentailers to offer a minimum volume of flexible generation as tradable risk management products. This would inject more competition into the long-term flexibility market, providing independent operators with more options to manage their risk and potentially reducing concentration in long-term flexibility.

c. **Considering horizontal separation options**, such as reallocating generation assets or extending virtual asset swaps. This would help reduce the concentrated control over long-term flexibility and could foster more competitive pricing by decentralising control of key assets and encouraging broader participation in risk management product markets.

49. **The core issue with non-discrimination rules is that they are difficult to implement effectively without a clear market price to anchor them.** Moreover, as we have explained, they would do little, if anything, to resolve the market power issues outlined in the MDAG report.

50. **We therefore urge the Taskforce to redirect its efforts toward measures that have a better chance of promoting competitive market conditions, rather than relying on administrative price-setting.**

51. We would welcome the opportunity to discuss these matters with you in more detail.

Yours sincerely,

James Tipping
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