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POWERING A BETTER NEW ZEALAND TOGETHER

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21 July 2026

Ministry for Business, Innovation and Employment (MBIE)

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Submission on the proposed Winter Energy Reliability Obligation

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy sector advocacy organisation. We represent participants from across the energy system, providing a strategic sector perspective on energy issues and their adjacent portfolios. We enable constructive collaboration to bring coherence across the energy sector through and beyond New Zealand's journey to net-zero carbon emissions by 2050.

2. We welcome the opportunity to comment on the allocation and design of the proposed Winter Energy Reliability Obligation ('the WERO').

3. We agree that it is not acceptable to continue stumbling from winter to winter in the way that has become commonplace in New Zealand. We have a market-led system and that needs to be strengthened to encourage more firming and flexibility throughout winter when the weather has not delivered enough energy to get us through. This needs to be seen as a kind of insurance option.

4. Our submission **supports** the WERO as the least-cost intervention. But there are caveats. A principled approach is needed to make design decisions such as allocation, threshold tests, capability to manage the dry-year risk, and penalties. These need to be carefully designed to ensure they match the problem definition, which also needs some scrutiny. We provide some illustrative examples to support our views.

Overarching feedback

5. We agree with the problem definition. For a number of reasons (both market and government failures since 2018) the electricity system is lacking sufficient backup 'firm' capacity as it becomes increasingly renewable. Recent media coverage has labelled New Zealand's productivity crisis 'an energy crisis,' and energy has been touted as a key election year issue.[1] Hence, we are seeing such a strongly

[1] See for example: NZ productivity crisis is now an energy crisis | The Post

directive intervention from the Government to address concerns about firm capacity for electricity.

6. The problem definition reflects a classic free-rider problem: while all consumers benefit from a reliable electricity system, individual market participants may lack sufficient incentives to invest in or contract for reliability that benefits the wider system. Left unaddressed, this creates a growing risk that investment in firming will lag behind new demand and renewable generation, increasing exposure to supply shortages during dry years and other periods of system stress.

7. In these circumstances, some form of regulatory intervention may be justified. However, intervention should be targeted at correcting the market failure rather than prescribing particular technologies, fuels or commercial solutions.

8. The objective of the WERO should be to establish clear reliability outcomes while preserving competitive markets to determine how those outcomes are achieved.

9. The WERO needs to be a triaged response, rather than elective surgery. Regulatory intervention should be limited to where and when market failure has been proven, with graduated implementation calibrated over time to respond to evolving market conditions and evidence.

10. Security of supply is not something to be purchased at great cost to the consumer or taxpayer. A principles-based, technology-neutral framework targeted at the wholesale market will deliver this in the most efficient way and provide greater confidence for consumers and market participants making long-term decisions.

11. The WERO is fundamentally an investment mechanism. The design should prioritise long-term, bankable investment signals that encourage new capacity to be built without undue compliance.

12. Other capacity interventions have been considered and were not progressed (we refer to table 4 in the discussion document). We have long held that a fundamental change to the design of the market is not needed and would be destabilising.

Summary position

13. While we support the WERO's intention, we are not entirely convinced that the proposal put forward in the discussion document is the only, or best, solution.

14. Our submission walks through our thinking on the important design elements.

Short-term and long-term obligation

15. The consultation seeks views on a short-term obligation design and a long-term obligation. In our view, there are existing mechanisms and arrangements that will cover the short-term.

16. We think MBIE should focus on long-term solutions that build in sustainable and predictable investment conditions so that the solutions can arrive from domestic or offshore parties and be matched with demand in a market-led way. Some sort-term dry-year risk solutions are already underway, but some are still uncertain. We would expect a long-term WERO to hasten or further incentivise these solutions to enter the New Zealand market. These include:

    a voluntary arrangement between the four gentailers to maintain Huntly and coal as a backup option for ten years – noting that torrefied biomass is a domestically sourced storable, renewable, transportable and dispatchable solid fuel capable of using existing thermal-generation infrastructure, and has been successfully trailed at Huntly;

    b allowing new generation and fuel options (such as torrefied biomass) and technologies (such as long-duration energy storage of 50MW and above[2]) to enter the market; all responding to short-term dry-year risk and price exposure;

    c forthcoming liquified natural gas (LNG) which is currently in a procurement process; and

    d new investment in natural gas exploration (6 new permit applications, oversubscribed $200m gas security fund, for example).

17. Although the short-term obligation may be unnecessary as a standing regime, a transitional mechanism may still be required where a credible new resource could be available before the long-term obligation is triggered but cannot reach investment decision without timely, bankable contracts. Any such mechanism should be competitive, technology neutral, time limited and additional.

18. New, long-term, legislated obligations will need to provide participants and affected parties with lead time to prepare. Equally, the WERO should provide sufficient confidence that the fuel and technology will be required for a long-term period beyond ten years.[3]

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2 See Highview Power's long-duration energy storage solutions, for example which can provide day-long battery-like storage using a range of technologies. They say the WERO could significantly improve incentives to invest in New Zealand.

3 MBIE now expressly identifies the absence of bankable revenues, the 10-15 year contract-tenor gap and the difficulty of financing new long-duration firm-energy resources.

19. In our view, MBIE should discard the short-term WERO design choices and focus on long-term options only.

20. Having said that, the Government could consider a limited, competitive transitional underwrite for the first tranche of new long-duration firm energy to meet new demand from the WERO. This could enable New Zealand to establish a commercial-scale domestic biocoal supply chain for Huntly and new infrastructure for battery storage, as a couple of examples.

Allocating the obligation

21. Our primary concern with the proposals is how the obligation will be allocated. New Zealand's energy-only system is heavily interconnected and depends on participants having access to information about the risks and market conditions of investment. It will not be an efficient system if supply and demand are not appropriately matched.

The obligation should be placed on the source of the reliability risk

22. Dry-year risk is one manifestation of a wider reliability problem that arises when the electricity system lacks sufficient **long-duration energy cover** to meet demand under periods of sustained system stress (MBIE's wording). Those periods may be driven by low hydro inflows, fuel supply disruptions, prolonged renewable generation shortfalls, unexpected plant outages or future changes in demand.

23. The obligation should be placed on the party that creates the need for additional reliability. As electricity demand grows, the requirement for long-duration energy cover also increases. The obligation should sit with those responsible for serving that demand, allowing the market to determine the most efficient means of providing reliability.

24. This approach is consistent with the principles of competitive electricity markets. It doesn't favour technologies or fuels; it establishes the reliability outcome that must be achieved while allowing participants to determine how best to meet it.

25. Technology neutrality should not mean that all resources are treated as economically identical. Eligibility should be neutral, but capability and value-for-money assessment should recognise differences in additionality, construction lead time, contract tenor, fuel security, emissions exposure and reliance on imported supply chains.

Retailers are well placed to manage this obligation (but not just because they are retailers)

26. Retailers are well placed to manage this obligation through a combination of generation contracts, demand response, storage, fuel diversity, firming arrangements or other commercial solutions. This preserves technology

neutrality, supports innovation and competition, and ensures reliability is delivered at least cost.

27. Importantly, framing the obligation around long-duration energy cover provides a more durable regulatory framework. As technologies evolve and the generation mix changes over time, the obligation remains focused on the reliability outcome required by consumers, rather than the characteristics of today's market or assumptions about which technologies will provide tomorrow's firming capacity.

28. As currently proposed, there is a risk that *participant type* guides the allocation. The four generator-retailers are identified as the most likely obligated participants which risks missing out other, including future participants who could play a significant[4] role in either*:*

    a the dry-year *problem*; or

    b helping the system to find a *solution* in a dry-year.

This moral hazard (or free-rider) risk needs to be addressed.

29. In our view, the obligation should be allocated according to a two-stage test:

    - **size/scale** – does the participant (or group of participants?) have a sufficiently large impact on winter reliability to justify regulation? (you could call this the causation test)

    - **potential** – does the participant have practical means to improve winter reliability through investment, contract, fuel procurement, storage, demand response, or other firming measures? Or conversely, expose the system to dry-year risk with no practical means to cover that risk?

30. This simple framework aligns regulatory responsibility with commercial capability, encourages efficient investment, and minimises unnecessary compliance costs.

Useful comparison between liquid fuels MSO and electricity market WERO

31. This type of insurance framework is already reflected elsewhere in New Zealand's energy regulatory framework. The Fuel Industry Act 2020's Minimum Stock Obligation ('MSO') for liquid fuels is placed on fuel suppliers because they control fuel procurement, storage and inventories – not on fuel users, who have little ability to influence national fuel security.[5] This promotes efficient

[4] We discuss the role of 'significance' below in the context of threshold tests.

[5] We acknowledge the recent Commerce Commission approved merger between fuel importer (Gull) and a retail-only distributor (NPD), and shared acquisition by parent companies outside New Zealand. This may trigger a reallocation of the MSO and illustrates how flexibility in design to allocation is very important in future-proofing.

investment, minimises unnecessary compliance costs, and aligns regulatory responsibility with commercial capability.

32. The same logic should underpin the design of the WERO. However, the MSO addresses a *physical* inventory obligation (holding enough fuel in reserve). The WERO is intended to stimulate *ongoing investment and operational decisions* in a dynamic electricity market.

33. That means the WERO will almost certainly need more flexibility in how participants comply than the MSO does. The key lesson from MSO implementation is "listen to and adapt with the industry".

Allocate by capability rather than participant type

34. We think that the WERO should recognise the different ways major participants can contribute to system reliability, rather than prescribing obligations solely by participant category (as we discuss above, the obligation should sit with the causal parties).

35. Generators (by size, only the four gentailers would apply here) are well placed to carry the primary obligation because they make investment and operational decisions that directly influence winter reliability. They can procure fuel, maintain dispatchable generation, invest in storage, contract demand response, or develop new firming technologies. Importantly, they are also best placed to determine the most efficient means of compliance.

36. Large electricity users occupy a different position. While they may not be able to increase electricity supply, some have the capability to make a significant contribution through varying their demand. Participants that can significantly reduce demand during periods of system stress should have this recognised as an equivalent contribution to reliability rather than being expected to invest in generation assets.

37. New connections present a further distinction. Large new loads can increase pressure on the electricity system, particularly if they are running a baseload demand throughout winter that cannot be turned down or off. But a blanket obligation on all new connections risks discouraging investment and electrification while doing little to improve system reliability. Where exceptionally large new loads are likely to have a significant impact on winter demand, it may be appropriate to require them to demonstrate how they will manage that impact, for example through flexible demand, on-site storage, backup generation, or commercial arrangements that support new firm capacity.

There needs to be careful consideration of the impact the participant could have on the problem and/or the solution. The same principle should apply to the dry-year risk.

38. A fuel neutrality approach allows participants to respond to changing market conditions without Government prescribing which fuels or technologies should provide reliability.

39. That said, natural gas currently provides a substantial proportion of New Zealand's dispatchable electricity capability and is likely to remain an important firming resource.

40. Long-duration electricity reliability cannot be separated from investment confidence in fuel supply. Market participants considering investment in gas exploration, appraisal, development, storage and import infrastructure require confidence that future reliability mechanisms will appropriately value firm energy resources.

41. Maintaining generation assets alone is insufficient if fuel supply is not available when required. Reliability arrangements should recognise the importance of securing both generating capability and the fuel needed to operate those assets

Ability to influence dry-year risk

42. Not every market participant has a meaningful ability to influence winter reliability. We are talking about sustained shortfalls of supply, measured in weeks rather than days or hours – but system-wide. Applying the obligation universally would impose compliance costs that are unlikely to deliver commensurate reliability benefits.

43. Thresholds should be designed to minimise unnecessary compliance costs while ensuring that participants with a significant influence on system outcomes contribute appropriately.

44. We support the use of appropriate *materiality thresholds* so that the obligation applies only to participants capable of making a meaningful contribution to system reliability.

45. These should be applied according to the risk or reward they can offer the system, as such, should be graduated rather than applied under blanket terms.

46. This may call into question the application of the compliance burden, which is rising from $2 million per offence to $10 million, three times commercial gain, or 10% of a company's turnover, whichever is the greater. There may need to be some grading of compliance and enforcement to accommodate the thresholds for application of the WERO.

Illustrative examples

47. The following examples demonstrate how the obligation could be allocated according to capability:

- **a large generator**, such as *Genesis Energy*, owns dispatchable generation assets, procures fuel, and makes investment decisions affecting system reliability. It is therefore appropriate that it carries a primary reliability obligation while retaining flexibility over how it complies (noting some structural barriers that may restrict dispatch at short notice or in large volumes).

- **a large industrial electricity user**, such as the *Tiwai Point* aluminium smelter, cannot readily provide additional generation to the market but can materially reduce demand during periods of system stress. Recognising verified demand response as an alternative means of compliance would reward behaviour that improves reliability without unnecessarily increasing costs for productive industry.

- **a large new data centre** may significantly increase winter demand but have limited ability to improve reliability unless it incorporates flexible demand, storage, backup generation or long-term contracts supporting firm supply. Rather than imposing a blanket obligation on all new connections, any requirements should be targeted at system-significant loads where the participant has a genuine opportunity to manage its impact.

Finding the right threshold to trigger the obligation

48. MBIE has asked for views on the appropriate *de minimis* threshold. Any obligation that is threshold-based creates incentives to change behaviour around the threshold rather than improve reliability.

49. Considering the systemic nature of the WERO's approach and potential application, we think there are some options to consider regarding thresholds that aren't reflected in the proposals.

50. In the discussion document, MBIE favours a GWh/year measure because it can be time-bound to cover the dry-year risk period (i.e., winter). However, there are other ways of looking at threshold measures and this is useful when considering potential new participants, or where multiple participants might be considered together as a consortium.

51. It is also worth considering the potential for 'gaming the system' or arbitrage, if potential participants are incentivised to display their credentials in certain ways to avoid the obligation.

52. Our option analysis (using X as proxy for final figures to be determined by MBIE):

Option 1: installed capacity (MW)	This is intuitive for generators and new connections. For example: • **X MW** = too low. Captures many small renewable projects and imposes disproportionate compliance costs.

	• **XX MW** = more reasonable, probably the minimum level at which a participant becomes 'system-significant', but still catches a large number of smaller participants. • **XXX - XXXX MW** = captures only the larger participants but risks excluding assets that collectively matter. On balance, **XX MW** is a better starting point if MBIE chooses a simple installed-capacity threshold and would capture new players appropriately. For example, a 50 MW generator operating during winter peaks is a meaningful contributor to system reliability, as would 50 MW of demand reduction.
Option 2: annual energy (GWh) *(MBIE's preference)*	This may be a better measure for retailers and large users as a measure of scale but has less relation to causation. For example: • **200 GWh/year** – large commercial participant • **500 GWh/year** – major industrial load or retailer • **1,000 GWh/year** – only the largest market participants. The benefit of this approach is that it reflects **market exposure**, not simply plant size. It can be time-bound to focus on winter dry-year risk. **500 GWh/year may be too high** as it would most likely preclude new entrants or solutions.
Option 3: peak winter demand (MW)	Dry-year risk is about unexpected long-duration energy shortage, not annual energy supply. For example: • participants with more than **XX MW** (potentially shared if they are a developer) winter demand could become obligated. This option directly links the obligation to the dry-year problem. The risk is it complicates the situation. New entrants should not be favoured over current players and there could be workarounds that seek to avoid the obligation by being small.
Option 4: portfolio threshold	Instead of individuals or individual assets, the WERO could apply to, say: • a gentailer with **XX MW** across several stations; or • a developer with several **XX MW** wind farms. This could avoid, or incentivise, gaming the system by joining or splitting assets, ownerships and titles. Both scenarios need to be considered as part of the design.

53. Setting the threshold too low risks creating unnecessary barriers to entry, increasing compliance costs for emerging technologies and smaller participants, and inadvertently reinforcing market concentration.

54. Conversely, setting it too high risks excluding participants capable of making a meaningful contribution to winter reliability (either because of timing or calibration of business, or the unintended consequences of arbitrage). The threshold should be calibrated to target system-significant participants while preserving competition and innovation.

Penalties

55. Penalties should form part of the incentive to bring forward investment in firming. They are not intended to punish participants who are acting within agreed laws and frameworks. Penalties should be sufficiently credible to deter deliberate non-compliance, while remaining predictable, proportionate and focused on behaviours within an obligated party's control. For example:

    a unexpected fuel outages;

    b transmission constraints;

    c consenting delays;

    d force majeure events; or

    e government policy changes.

56. Again, a principled approach will help with the design. Proportionate, reflective of actual reliability harm, a graduated or flexible compliance pathway, and commercial incentives should remain stronger than penalties to be encouraging of new investment.

Conclusion

57. The objective of the WERO should be to ensure that participants with a substantial ability to improve winter reliability contribute in ways that reflect their role in the electricity system.

58. The WERO should procure a reliability outcome, not prescribe a reliability solution. A framework based on capability, thresholds, and technology neutrality will create stronger investment incentives, preserve competition, encourage innovation, and deliver winter reliability at least cost.

59. This approach is consistent with the principles of efficient market design and aligns with existing approaches to managing energy security risks elsewhere in New Zealand's energy sector.