



11 Chews Lane  
PO Box 10568  
The Terrace  
Wellington 6143  
New Zealand

Genesis Power Limited  
trading as Genesis Energy

Fax: 04 495 6363

29 August 2011

Carl Hansen  
Electricity Authority  
2 Hunter Street  
WELLINGTON

By email: [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)

Dear Carl

## Market-led developments will drive a liquid hedge market

---

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Electricity Authority ("the Authority") on the consultation paper "Improving the Opportunities to Hedge New Zealand Electricity Prices" dated 1 August 2011.

We endorse the Authority's view that the major generator-retailers be allowed more time to develop the market for electricity futures contracts and that amendments to the Electricity Industry Participation Code ("the Code") are unnecessary at this stage. Market-led developments will provide the necessary improvements sought by the Government and we support the Authority's preliminary view that the intent of the 3,000 GWh target has largely been achieved.<sup>1</sup>

As a company, we are fully committed to developing a market for futures contracts and have specifically recruited new resources within our wholesale team to drive this work. We are very close to signing a new market making agreement with ASX that will see narrower bid-ask spreads and a greater volume of contracts across the two nodes. We expect this new agreement to be in place by 1 November 2011.

---

<sup>1</sup>Section 3.4.3 of the consultation paper.

We are actively participating in the ASX NZ Electricity Futures user group and promoting the addition of new Options products.<sup>2</sup> It is also encouraging to note the recent participation of some banks and brokers in the futures market.

Our responses to the Authority's consultation questions are set out in Appendix A.

If you would like to discuss any of these matters further, please contact me on 04 495 6354.

Yours sincerely

A handwritten signature in black ink, appearing to read 'K Collins', with a stylized flourish at the end.

Karen Collins  
Senior Regulatory Advisor

---

<sup>2</sup>Refer to our product development activity noted in our letter to the Authority dated 6 July 2011.

## Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
<p>Q1. Do you agree that the options considered by the Authority cover the range of possibilities that should be considered?</p> <p>Are there other options that should be considered?</p>	<p>The Authority has established a good list of possibilities in the consultation paper. We note that it would have been helpful if the Authority had additionally prioritised the options so parties could understand the relative benefits of each of the options.</p> <p>We also recommend that, in principle, the Authority should consider adding to its list the option of requiring large purchasers to be market makers. This reflects that the success of futures trading in New Zealand is not a matter that is in the hands of generators alone.</p> <p>We suggest that a suitable threshold could be purchase of 17 GWh per annum. This level would only catch the largest purchasers within New Zealand, who from our understanding, generally have robust treasury functions and already deal with financial exposure on a daily basis.</p>
<p>Q2. Do you agree that offering different products through the ASX platform could help to encourage more participation, or would the requirement to provide initial margins and daily margin calls continue to deter new entrants?</p>	<p>Yes, we agree that adding new products could attract more participation.</p> <p>We would prefer to see Options over quarterly futures made available and/or cap products. As noted in our previous letters to the Authority,<sup>3</sup> we have been actively promoting the addition of new Options products in the ASX Futures market.</p>

<sup>3</sup> *Hedge market development*, Genesis Energy letter to the Electricity Authority, May 2011 and *Increasing futures market activity*, Genesis Energy letter to the Electricity Authority, 6 July 2011.

QUESTION	COMMENT
	<p>We do not support reducing the size of contracts. While it is possible for ASX to change the size of contracts, it will be expensive, time consuming and as noted by Energy Link, will introduce practical difficulties in respect of filling larger orders.<sup>4</sup></p>
<p>Q3. Do you agree that tightening the market-maker agreements would encourage participation, deliver more active hedge trading, and provide a more robust view of forward electricity prices?</p>	<p>Yes.</p> <p>We support the move to smaller bid-ask spreads and are working with ASX to confirm a new market making agreement that will:</p> <ul style="list-style-type: none"> <li>• tighten the spread to approximately three to five percent; and</li> <li>• provide more volume by requiring three contracts a side for all nodes and quarters.</li> </ul> <p>These proposed arrangements with ASX would provide 26 GWh per side for each node if all of the big four generator-retailers sign up. Our discussions with banks have indicated that having market makers at this level will improve the situation and make it possible for them to participate in the market with confidence.</p> <p>As noted in our previous letter, we would welcome the additional market depth that TrustPower would provide if it entered into a market making agreement with ASX.</p>

---

<sup>4</sup> *Evaluation of Hedge Market Liquidity*, Energy Link report prepared for the Electricity Authority, June 2011.

QUESTION	COMMENT
<p>Q4. Do you agree that doing more to ensure prudential arrangements for the spot electricity market acknowledge ASX electricity futures would encourage participation in the futures market?</p>	<p>Yes.</p> <p>We agree in principle that this proposal should encourage participation but believe in practice it may be difficult to implement and will require further consideration.</p> <p>It is possible that cash from ASX futures contracts will not always be available to call upon for prudentials. For example, if the Clearing Manager does not hold both the contract and the profit or loss from the daily margins, the Clearing Manager has nothing of value to offset the prudentials in the New Zealand Electricity Market (NZEM). To remedy this, the holder of the contract would need to lodge the contract with the Clearing Manager and also pay the money for margin calls into their prudential account.</p>
<p>Q5. Do you agree that there is a need to provide higher quality information to all participants in order to encourage participation, deliver more active hedge trading, and provide a more robust view of forward electricity prices?</p>	<p>As a general rule, good information can improve market function, but we are unconvinced that the information the Authority is suggesting will significantly change participation in the futures market.</p> <p>We note that the Authority's wholesale advisory group is examining the case for improving market information arrangement and we look forward to participating in the process at the discussion paper stage.</p> <p><u>Relevance of information</u></p> <p>In the meantime, we note that daily changes in factors such as snow pack and energy storage are largely irrelevant to hedge market participants, as futures settle on average quarterly prices. The prices should reflect the</p>

QUESTION	COMMENT
	<p>long-run marginal cost (LRMC) of generation from all fuel types, rather than short-run costs. By way of an example:</p> <ul style="list-style-type: none"> <li>• <i>snow pack</i> has a short term impact for only one quarter; and</li> <li>• <i>total market contract position and fuel prices</i> are more relevant for a day ahead market, rather than the hedge market. We note the ASX exchange already measures contract open positions.</li> </ul>
<p>Q6. Do you believe there is a market failure justification for it using levy payers money to buy access to futures and options prices for all interested parties either on a real-time basis or a 20-minute delayed basis?</p>	<p>This information is already available from the ASX website.<sup>5</sup> The information has a 15 minute delay and a forward price curve is available during each trading day.</p>
<p>Q7. Do you agree that the intent of the 3,000 GWh target has largely been achieved because of the indexation of the VAS contracts?</p>	<p>Yes.</p> <p>As noted in the consultation paper, the unmatched open interest (UOI) and virtual asset swap (VAS) volume in combination is greater than the 3,000 GWh target.</p>
<p>Q8. Do you agree that further progress is required to meet the requirements of s42(2)(g) of the Act?</p>	<p>No.</p> <p>We believe no further action is required by the Authority as the market is continuing to develop organically. The new ASX market making agreements in particular should provide an uplift in market liquidity, depth and participation.</p>

<sup>5</sup>New Zealand electricity delayed prices, ASX website, [http://www.asx.com.au/products/delayed\\_prices.htm](http://www.asx.com.au/products/delayed_prices.htm)

QUESTION	COMMENT
<p>Q9. Do you agree that more time should be allowed for the generator-retailers to continue working with ASX to develop liquidity?</p>	<p>Yes.</p> <p>The signing of new market making agreements with the “big four” generator-retailers should lead to significant improvements in the liquidity of the futures market.</p> <p>To progress beyond this level will require the entry of more buyers and intermediaries such as large industrials, banks and brokers acting as resellers of risk instruments. We note that some financial intermediaries and banks have already engaged in the futures market and this is a promising indication of growing confidence in the market.</p>
<p>Q10. Do you agree that the Authority should reconsider amending the Code if progress towards a standardised market-making agreement is too slow, or if it considers that the objective of a robust forward electricity price curve has not been met by 1 January 2012?</p>	<p>We expect to sign a new market making agreement shortly so do not see the need for Code amendments.</p> <p>We question why the Authority has chosen to review progress against the 3,000 GWh target by 1 January 2012. We believe this will be too early to see any real progress as the new market making agreements will have only been in place since 1 November 2011.</p> <p>We consider that a review after the agreements have been in place for a minimum of six months (May 2012) would be more appropriate.</p>

QUESTION	COMMENT
<p>Q11. Do you agree that the draft Code amendments contained in Appendix 2 would be likely to enhance the performance of the electricity futures market sufficient to provide for a robust forward electricity price curve (while noting that the Authority's preliminary view is to not make Code amendments at this point in time?)</p>	<p>No.</p> <p>Genesis Energy considers that the Code amendments may actually deter market makers. The automatic re-load requirement would be onerous, unnecessary and would be unacceptable to the risk appetite of most players. All businesses are likely to have "stop-loss" limits in place as part of their risk management practices to control the level of loss that they are and can be exposed to.</p> <p>We consider that there is already enough liquidity in the market and this will only improve as the new market making agreements are signed. There is already a fairly robust forward price curve and the fact that the VAS contracts are indexed against the Futures curve clearly indicates that the target of a liquid hedge market has been achieved.</p>
<p>Q12. Do you agree that allowing the generators to work with ASX to develop the market-making arrangements (with the possibility that Code amendments might be required later) is likely to deliver a positive net benefit relative to a counterfactual of making Code amendments now?</p>	<p>Yes.</p>