MAJOR ELECTRICITY USERS' GROUP

29 August 2011

Tim Street
Electricity Authority

By email to submissions@ea.govt.nz

Dear Tim

Consultation Paper – Improving the Opportunities to Hedge New Zealand Electricity Prices

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority "Consultation Paper – Improving the Opportunities to Hedge New Zealand Electricity Prices" dated 1st August 2011[1]. MEUG members have been consulted in the preparation of this submission. Some MEUG members are also making submissions.

2. Responses to the questions in the consultation paper follow:

Question	MEUG response
Q1. Do you agree that the options considered by the Authority cover the range of possibilities that should be considered? Are there other options that should be considered?	The different products, options to tighten market-maker agreements, modifying prudential arrangements and access to higher quality information considered in section 5 of the consultation paper are comprehensive. Should the large vertically integrated suppliers market fail to voluntarily develop a liquid futures market or the back-up Code amendments proposed in the consultation paper fail to improve hedging opportunities, then the options of mandatory hedging and mandatory futures trading analysed by Energy Link and referred to in paragraph 3.3.2 should be re-considered. As a further option should all else fail, the issue of unbundling vertically integrated entities would have to be considered.

[1] http://www.ea.govt.nz/our-work/consultations/priority-projects/-improving-opportunities-hedge-electricity-prices/

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Question		MEUG response
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?	Agree different product offerings are more likely as suppliers can assess how futures options and cap products might fit given recent decisions on FTR and that scarcity pricing will apply only to unexpected capacity shortages.
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?	Agree.
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?	Yes. MEUG recognises this is not a trivial task and may even be realisable; though we support work to investigate the possibility.
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?	Yes.
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?	A survey of possible users could help answer this question. If the cost is modest and the number of potential direct and indirect users' large, then purchasing of this information by the EA would be justified even if the market failure was small.
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?	Yes but perceptions are important; hence having actual unmatched open interest in excess of 3,000 GWh is preferable to a notional sum comprising actual unmatched open interest plus virtual asset swaps where those are settled to futures prices.
Q8.	Do you agree that further progress is required to meet the requirements of s42(2)(g) of the Act?	Yes.
Q9.	Do you agree that more time should be allowed for the generator-retailers to continue working with ASX to develop liquidity?	Yes.

Question	MEUG response
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?	Yes.
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?	As a back-stop yes. The preference of MEUG is that the large vertically integrated suppliers voluntarily develop liquidity to the point that intermediaries and others decide to participate. This in turn will further deepen liquidity that will benefit all futures market participants including the large suppliers. The Energy Link report for the Authority, Evaluation of Hedge Market Liquidity in June 2011 noted (p2, 3): *"Entry of new players into the new futures market, particularly small retailers and intermediaries, would be a sign that there is confidence in the wider New Zealand electricity market and in the futures market."* If new players do not enter the futures market then implementation of the draft Code amendments with minimum market making requirements would be appropriate.
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?	Yes.

3. This submission is not confidential.

Yours sincerely

Ralph Matthes
Executive Director