

Providing an Active Market for Trading Electricity Hedge Contracts – Response to Submissions

The Authority would like to thank submitters for their time in responding to the consultation paper – “Providing an Active Market for Trading Electricity Hedge Contracts”. The Authority’s response to each submission is included below. A general response to submissions on each question is provided in the first instance and where this is sufficient, no further response is provided for individual submissions. Where the general response does not adequately address particular issues, a specific response has been provided beside each submission.

Summary by Question

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?	
Authority General Response	<p>The Authority recognises the need to encourage a wider range of participants into the market. The proposed options were in response to a number of issues that had been raised by potential participants as influencing their decision to participate. Such options, if progressed, could be expected to encourage wider participation over time.</p> <p>To this end, the Authority is and will continue to engage with potential participants. However, it also considers that development, of new products, should be derived from a user-driven process, and that the ASX User Group is the best avenue for this.</p> <p>The Authority has noted that its preference is not to regulate where it is feasible for the market to develop its own beneficial outcomes, but that it could consider a range of potential Code amendments if progress is not satisfactory. The Authority is not progressing Code amendments at this time, but is proposing to closely monitor future progress.</p>

Submitter	Submitter Response	Authority Specific Response
Contact	Yes.	
Genesis	<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>The Authority accepts that wider participation in ASX futures trading is necessary to develop liquidity but considers it unrealistic to require participation by other large purchasers in market-making.</p>

Submitter	Submitter Response	Authority Specific Response
Meridian	<p>Meridian is comfortable with the range of options considered. However, we believe that a key contributor to improving hedge market liquidity will be to encourage a broader range of participants in the market, beyond just the major generators. As such, we believe the Electricity Authority should continue to engage directly with other potential participants (e.g. financial institutions, large consumers) to identify their perceived barriers to participation in the market and alternative options to address these barriers.</p> <p>Meridian believes that the development of an intra-island Financial Transmission Rights (FTR) scheme would also support development of the ASX hedge market. Where an existing or potential participant is physically located away from the available hedge market nodes of Otahuhu and Benmore, the effectiveness of hedging can be diminished by the price differentials which arise between the hedge market nodes and the nodes at which the participant purchases electricity. For example, even if the Tiwai Point aluminium smelter were to purchase hedges at Benmore, it would still be exposed to future price differentials between Benmore and its local pricing node (TWI2201).</p> <p>The existence of an intra-island FTR scheme would allow participants to better manage this locational price risk and, in combination with the ASX hedge market, assist in reducing the participant's exposure to future price volatility. An intra-island FTR and the hedge market are therefore likely to be mutually reinforcing.</p>	<p>The Authority is progressing a solution to intra-island locational price risk, and is currently identifying a list of high level options to be considered. These high level options will be discussed with the LPRTG before the end of 2011, with a view to forming an options paper for consultation in 2012.</p>
MEUG	<p>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.</p> <p>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.</p>	<p>The Authority notes that the development of a liquid futures market cannot be achieved solely by the large generator-retailers, and that it will be particularly important to attract the engagement of a wider range of participants to achieve the desired liquidity. The options canvassed in the consultation paper aimed to help achieve this.</p>

Submitter	Submitter Response	Authority Specific Response
Might River Power	No. The Authority should also focus on how to best achieve the active participation of financial institutions, merchant generators, independent retailers and industrial consumers in the hedge market.	The Authority accepts that wider participation in ASX futures trading is necessary to develop liquidity and is looking to tighter market-maker agreements, and the development of alternative products via the ASX User Group, to encourage participation.
Norske Skog	The Electricity Authority needs to consider vertical disintegration as a solution to the problems identified in section 2.3 of the consultation paper. Any new entrant retailer is up against it trying to compete with the incumbents who can simply sell electricity from their generating arm to their retail arm at prices well below those listed on ASX. Dealing with vertical integration must be done before the Government embarks on a partial or full sale of the SOE electricity companies.	Considering vertical disintegration is not within the scope of the Authority's functions under the Electricity Act.
NZ Steel	Yes. We see that the Authority has identified the issues, the actions available to it and the steps that are likely to have an impact.	
Pan Pac	<p>A good analysis.</p> <p>An issue is whether the parties will become more active. For the Gentailers it must be hard to give your electricity to a possible competitor when you can sell it at a higher price yourself.</p> <p>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.</p> <p>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.</p> <p>As a further option should all else fail, the issue of unbundling vertically integrated entities would have to be considered.</p>	

Submitter	Submitter Response	Authority Specific Response
Powershop	Powershop agrees that the options being considered by the Authority will help in developing liquidity and depth. We also believe a key to increasing the market's liquidity will also be getting more parties involved such as financial intermediaries and aggregators. Powershop agrees that the Authority has considered the range of possibilities for increasing the market's depth and liquidity.	
Pulse Utilities	The biggest option not discussed is the need for stronger involvement from the Electricity Authority in leading this initiative. We do not believe the Gentailers will achieve the required results in the required timeframe. Sadly and as stated above we not believe the Electricity Authority is taking the 3,000 GWh threshold seriously and is simply going to pass the buck. The messaging from the Electricity Authority within this consultation paper is unfortunately significantly confused and not in line with what has been mandated under	The Authority recognises that the 3,000 GWh was an ambitious target, but that pressure must be maintained for the market to develop further. It intends to continue to monitor and take more direct action if progress is unsatisfactory. The Authority has also re-established Unmatched open interest (UOI) targets up to 3,000 GWh by 1 June 2012.
Simply Energy	The Authority may want to consider a Financial Market Participant Code that would allow financial market participants to get access to market data and provide a participant code mechanism to register ASX hedges (subject to this mechanism being implemented) that would allow them to package up hedging products with prudential off-sets. This may allow a financial participant when doing back-to-back OTC swaps to be able to register these hedges with the Clearing Manager for prudential off-sets so that the financial intermediary clients can fully utilise the hedge off-set.	The Authority will consider wider prudential issues, and possible mechanisms to include ASX futures, as part of the Review of Settlement and Prudential Arrangements.
Smart Power	No Yes. In our view, one of the reasons for the lack of the liquidity in the hedge market is because hedges are not available at the node of spot settlement. If the spot settlement nodes were to be significantly reduced to say 5 North Island and 4 South Island nodes then OTC and ASX products could be offered more widely and the proposed FTR's would become unnecessary.	The Authority considers that the current nodal pricing regime provides important efficiency incentives, and that, in combination with an inter-island hedging mechanism, will provide the most effective outcome. The Authority is also progressing other mechanisms to address intra-island location price risk, with advice from the LPRTG.

Submitter	Submitter Response	Authority Specific Response
Tauranga City Council	Not individually addressed.	
TrustPower	The options presented (changing the ASX hedge product mix; tightening market maker agreements; modifying prudential arrangements and providing access to higher quality information) are considered adequate. These represent a fair summary of the recommendations of the Energy Link report at Reference C.	

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?

Authority General Response	<p>Submissions have been generally supportive of the development of different products and suggested that new products could help to build liquidity. However there are mixed views on the preferred type of new products.</p> <p>The Authority supports the view that any new products should be developed by ASX with support from the ASX User Group. It considers that transparent and robust pricing of option or cap contracts is likely to deliver significant long-term benefits for consumers, by providing clarity of pricing of last resort resources. The Authority will recommend that the ASX establish a well-defined work programme and timetable for the ASX User Group including consideration of exchange-traded option and cap products, and alternative contract durations.</p> <p>There should be a clear overall objective of achieving transparent and robust pricing for a product mix that meets the needs of, and encourages participation from, a wide group of market participants, including financial intermediaries.</p> <p>The Authority will invite the ASX to report on progress with new product development by 1 February 2012, after taking advice from the ASX User Group.</p>
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Submitter	Submitter Response	Authority Specific Response
Contact	Contact believes that additional products will complement the existing curve, and could help increase participation. Contact believes that initiatives by generators and financial intermediaries significantly reduce any perceived barriers to new entry.	
Genesis	<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, we have been actively promoting the addition of new Options products in the ASX Futures market.</p> <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.</p>	

Submitter	Submitter Response	Authority Specific Response
Meridian	Meridian's view is that the key barriers to entry to the ASX electricity hedge market for smaller players are credit and prudential requirements. While Meridian is not opposed to reducing contract size, we believe (as suggested by the Authority) that reducing contract size on its own is unlikely to greatly encourage participation of smaller players. Rather, our view is that the Authority should focus on reducing the burden of prudential requirements, and promoting the participation of intermediaries to act on behalf of smaller players. In terms of product, Meridian believes the focus should be on development of the base futures contract and associated options which are yet to trade on the exchange.	The Authority recognises the importance of attracting the participation of wider participants, and is proposing that prudential issues be addressed as part of the wider Review of Settlement and Prudential Arrangements currently underway.
MEUG	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.	
Might River Power	Mighty River Power supports the introduction of new products but believes that this should be developed by the market and led by interested parties and the ASX.	
Norske Skog	Yes. However we would be surprised if the extent of the new products suggested by the Authority would achieve much. It seems to us that new entrant retailers need to be able to manage the profile of electricity consumption throughout the day and also seasonal demand profiles. We would have thought that if the Authority is serious about encouraging new entrant retailers then it needs to make sure that peak contracts, shoulder contracts and off-peak contracts are available by quarter (or perhaps even by month).	The possibility of peak contracts, shoulder contracts and off-peak contracts should be considered by ASX and the ASX User Group. The Authority understands that the ASX User group has already given these types of products some consideration.

Submitter	Submitter Response	Authority Specific Response
NZ Steel	<p>It is possible different products may encourage greater liquidity but our view is that the basic contracts based on the existing specifications should be successful (liquid) before new products are added. New products may dilute liquidity.</p> <p>Paying initial deposits and variation margins is a hassle that may make the difference for some hedgers but this is how futures exchanges manage counterparty risk so this is something NZS is comfortable with.</p>	<p>While the Authority agrees that it is preferable for the existing products to attract greater liquidity before new products are added, it also considers that attracting a wider range of participants will be a key to increasing liquidity, and that encouraging the development of new products may help in this regard.</p> <p>Participation by financial intermediaries may assist with issues regarding initial deposit and margin payments.</p>
Pan Pac	Maybe.	
Powershop	<p>Powershop believes that currently, both the range of products and margin calls act as deterrents to smaller participants participating on the ASX platform. Adding further products will help in managing load growth (such as monthly contracts), overall requirements (such as reduced contract size) and managing peak risk (such as business day day products). However as the ASX platform is a futures market participants are subject to cashflow demands from margin calls that are not aligned with when revenue is being earned. CFDs and bilateral contracts have therefore been a more viable option for smaller participants where cash is often at more of a premium than for the bigger participants. Powershop therefore considers that the Authority's comment that "Profits on futures are available to meet the prudential requirements to cover potential losses on spot market transactions" is not realistic for smaller participants.</p> <p>If financial intermediaries and aggregators can be encouraged into the market then this could increase ASX liquidity and help facilitate smaller participants if they pioneered development of products such as monthly contracts that don't have such onerous cashflow implications as the current futures contracts.</p>	<p>The Authority agrees that prudential requirements should be addressed and that financial intermediaries should be encouraged to participate in the market.</p>

Submitter	Submitter Response	Authority Specific Response
Pulse Utilities	<p>The requirement for initial margins and daily margin calls are not a problem to buying futures in themselves. What creates the impediment is the late price discovery.</p> <p>The forward price curve is generally over priced by the generators and this creates an obvious disincentive to purchase based on price. However there is an additional cash flow disincentive brought about by the daily margins because the ASX market prices begin to correct well before a retailer gains the benefits of lower spot prices in its monthly settlements. In addition, this volatility in price increases the SPAN parameters that are used to calculate the initial margins increasing the risk that these may also be increased.</p> <p>This is in effect causing Pulse to take a shorter term view of the market and preventing us from purchasing longer term contracts as the more and longer terms we purchase the increased exposure to the illiquid and high priced forward curve.</p> <p>Pulse strongly welcomes the introduction of quarterly options enabling the company to take longer term positions. What this does is removes the initial and daily margin calls. Whilst this means we pay a margin for the option we believe this would be far less than the level of over pricing in the forward curve. It also forces the generators to become more realistic in their futures pricing. And we certainly believe this will increase activity in the market from people needing to hedge wholesale electricity purchases.</p> <p>Pulse does not see itself as a trader and is in the market only to hedge its electricity purchase risk. We would not entertain other ways of profit taking or calling generators bluffs by selling futures in the market. To ensure market health however then financial institutions are required to perform that function. Feedback we have received is that financial institutions are much more likely to enter the market when options are available.</p> <p>In relation to calendar months we do see some value in this but believe it is likely too early as these would directly compete with the current quarterly base load contracts. However caps and day load are additional areas of hedging that both large consumers and retailers need that are complimentary and do not compete with the existing contracts forms. Pulse, therefore, strongly supports their inclusion in the market now.</p> <p>We have no issue with the current 1 MW minimum contract size but do not concern that a pseudo 5 MW offer minimum seems to have crept in and believe this is being used as a block to prevent smaller players purchasing and reducing the likelihood of trades from occurring.</p>	<p>The Authority will consider wider prudential issues, and possible mechanisms to include ASX futures, as part of the Review of Settlement and Prudential Arrangements</p> <p>The Authority notes that option and cap products have received relatively strong support from submitters and has requested that ASX with support from the ASX Users Group lead development of new products that will meet the needs of participants as described, and encourage wider participation.</p>

Submitter	Submitter Response	Authority Specific Response
Simply Energy	We believe that concentration of liquidity in the key futures contracts at Benmore and Otahuhu to increase market depth and reduce bid/ offer spread is most important at this stage of market development. A liquid forward market underpinned by major generators market making arrangements will encourage market entry from financial intermediaries to provide a strong market foundation that will enable more products and solutions to be developed that will benefit the market and consumers.	The Authority agrees that tighter market-making agreements should encourage a wider range of participants in the market and that new products may help further in this regard.
Smart Power	Yes, and there are providers for those who would find margin calls difficult to manage.	
Tauranga City Council	Not individually addressed.	
TrustPower	TrustPower considers that smaller contract sizes, and the availability of Whakamaru as a node, would stimulate more participation in the ASX hedge market in terms of numbers of trades.	<p>Most submitters appear to be comfortable with 1 MW contract size and focussing trading on the Benmore and Otahuhu nodes.</p> <p>However, ASX and the ASX User Group is the best forum to consider smaller contract size and other nodes.</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?

Authority General Response	<p>Tightening the market-maker arrangements was recommended by Energy Link as the most likely option to change the market dynamics and facilitate more favourable outcomes in the short-term.</p> <p>Submitters appear to generally agree that tightening the market-maker arrangements would be beneficial in terms of helping to further develop liquidity in the futures market.</p> <p>The Authority notes that important progress has recently been made between generator-retailers and ASX in developing revised market-maker agreements with reduced bid-offer spread and improved mechanisms for making and refreshing bids and offers, and that the observed bid-ask spread on the ASX NZ Electricity Futures has narrowed and depth improved considerably in the last 30 days of trading. The Authority encourages all the major generator-retailers to continue to actively work towards market making agreements.</p>
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Submitter	Submitter Response	Authority Specific Response
Contact	<p>It is not certain that tightening the market-maker agreements will encourage participation, but Contact is supportive of the initiative as a way to provide further encouragement for what we believe is already a robust view of forward electricity prices. Contact believes that in some instances market makers will need to be able to reduce volumes or increase spreads during times of a stressed portfolio. Market maker agreements should provide for this. Traders are often provided with VaR limits they cannot operate within; if these are breached a trader should not be trading in the market. Contact also notes that any requirement to reload bids/offers needs to be best endeavours for practical reasons; for example if all contracts are traded at once it will not be possible to reload as required.</p>	

Submitter	Submitter Response	Authority Specific Response
Genesis	<p>Yes. 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"> • tighten the spread to approximately three to five percent; and • provide more volume by requiring three contracts a side for all nodes and quarters. <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>	
Meridian	<p>Meridian views tightening market maker arrangements as a potentially effective means of promoting hedge market liquidity. As a major generator and retailer, we are working with the ASX to ensure that market maker agreements are in place and are making an active contribution to hedge market trading. We believe all of the “big 5” generators should be subject to such agreements.</p> <p>However, we believe the implementation of such agreements should continue to be a matter agreed between individual participants and the ASX. We view the codification of such agreements as entirely inappropriate given the potential to expose market makers to manipulative trading strategies and increased risk, especially in relation to requirements around re-loading bids.</p> <p>While it was not explicitly detailed as an option in the consultation paper, Meridian would not want to see intermediaries take on the role of market maker for major generators (as opposed to being market makers in their own right). Each market making agreement is in effect a commercial arrangement between the ASX and a participant, and contains conditions specific to that counterparty’s portfolio risks. Assessment of these risks and the design of appropriate conditions is best left to the market makers themselves, rather than third parties motivated by different incentives.</p>	<p>The Authority agrees that the best option for implementing tighter market-making agreements is for the individual participants to work with ASX. The codification of some aspects of market-making agreements is only considered by the Authority to be a backstop mechanism if market-led development is unsuccessful, and this would be subject to a robust cost-benefit analysis.</p>
MEUG	Agree.	

Submitter	Submitter Response	Authority Specific Response
Might River Power	Yes.	
Norske Skog	Yes. A spread of 2% or less is critical – although perhaps the spread could vary depending on the price, as a 2% spread is not much when the price is \$30/MWh but significant when the price is \$500/MWh.	The Authority is encouraging a bid-ask spread for each market-maker of no more than 5%. The actual market spread should tend to be lower than this, and should decrease further as liquidity develops.
NZ Steel	Yes of course. Intermediaries and end users are both more likely to use the futures contract if the presence of bids and offers is more reliable. That in turn will encourage greater liquidity.	
Pan Pac	Unsure as still require Gentailers to want to trade, not just be forced to.	
Powershop	Powershop agrees that tightening market-maker agreements would help in the development of the market. However doing so may lead to unintended outcomes as forcing a market-maker to do something against their interests may also increase prices through higher risk margins and/or potentially manipulative bid and offering behaviour.	The Authority is encouraging market-maker agreements to be negotiated between ASX and the individual parties. Several generator-retailers have been forthcoming in accepting tighter market-making arrangements.
Pulse Utilities	Yes, this is required without question.	
Simply Energy	Yes, as long as spread and refresh rate are sufficiently robust to achieve the objectives.	
Smart Power	Yes	
Tauranga City Council	Not individually addressed.	
TrustPower	Yes, because it will allow new participants to enter the market with a lower risk of ASX products being inefficiently priced. However, the risk to market makers will be correspondingly increased and their energy storage capability will become more of an issue in managing this risk.	The Authority is undertaking a cost-benefit analysis in order to establish appropriate criteria and thresholds for participation in market-making.

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?

Authority General Response	<p>The Consultation Paper noted that Energy Link has suggested that all retailers, but particularly small retailers, would benefit if net ASX futures positions could be taken into account by the Clearing Manager each month when determining prudential requirements.</p> <p>While the Authority shares the reservations raised about complexity and workability, it considers that the feasibility of minimising prudential requirements is worth evaluating further and has requested that the issue be addressed as part of the Review of Settlement and Prudential Arrangements that is currently underway. In particular, the review should consider whether and how the prudential arrangements around the spot market, ASX futures, and OTC hedges might be optimised in order to reduce the prudential burden on small retailers and large customers.</p>
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Submitter	Submitter Response	Authority Specific Response
Contact	<p>Not necessarily. Contact understands that those parties seeking to relax prudential requirements are parties who have indicated that they prefer CFD risk management products as opposed to futures. Financial intermediaries provide facilities for such parties to buy CFDs backed by futures, and CFDs can already be lodged with the Clearing Manager to reduce prudential requirements.</p>	
Genesis	<p>Yes. 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>	

Submitter	Submitter Response	Authority Specific Response
Meridian	<p>Meridian believes the current credit and prudential requirements are a major barrier to encouraging a broader range of participants in the ASX hedge market. Optimising credit arrangements across both physical and financial markets will minimise the overall collateral required, reducing this key barrier to entry, particularly for smaller participants.</p> <p>Meridian notes that the Authority is undertaking a review of settlement and prudential arrangements, incorporating advice from the Wholesale Advisory Group. Due to the complexity of these issues, we consider this separate review process is the appropriate forum for reaching conclusions on the details of any potential changes.</p>	
MEUG	Yes. MEUG recognises this is not a trivial task and may even be realisable; though we support work to investigate the possibility.	
Might River Power	Possibly.	
Norske Skog	Yes.	
NZ Steel	Yes of course. Lodging prudential requirements is a significant business cost and any steps to reduce the cost without compromising the level of security will help net purchasers.	
Pan Pac	Unsure.	
Powershop	<p>From a smaller retailer's perspective, trading on the ASX platform has significantly unattractive cashflow impacts through margin calls, as does trading in the spot market with the high cost of maintaining prudentials.</p> <p>Facilitating the offset of ASX futures contracts against market prudential requirements may reduce the net cost and help smaller participants and broaden the participants in the market. However in Powershop's view this is only likely to be the case if the product mix on the ASX platform is also broadened to incorporate products that are more helpful to smaller participants.</p>	

Submitter	Submitter Response	Authority Specific Response
Pulse Utilities	<p>ASX electricity futures can create positive cash when the ASX market price increases against bought positions. However, this is extremely imperfect with timing likely to differ from prudential calls requirements which need to be paid within 3 days.</p> <p>Ultimately we believe people are missing the point. Hedges are taken to offset the cost of wholesale electricity purchases, not prudential calls.</p> <p>As previously communicated to the Electricity Authority Chief Executive, we remain very concerned about the detrimental effect our entry on to the ASX market will have on our prudential requirements. We have also attempted to highlight the seriousness of the current clearing and settlement system which amplifies the cost of any price spike 2 to 3 times for small retailers like ourselves.</p> <p>Should there be a public conservation campaign and the wholesale price goes to \$500/MWh for extended periods, the transfer of 10MW away from Clearing Manager settled CFDs equates to an increase in prudentials of over \$5m. What is not very well understood is that in addition this causes us to find another \$5m to pay the Clearing Manager on the 20th of the month. Furthermore the Clearing Manager's conservatism is then used to project that high wholesale price forward. And in addition to that we have to pay for all our purchases before we can get paid for the generation we have on our books for which no hedging should ever be required. The cumulative effect of this is a \$5m spike can turn into \$15m.</p> <p>One solution we believe has significant merit as a short term fix which should have no significant detractors is the ability for retailers to make payment on their expected 20th of the month settlement in advance and for this payment to be removed from the prudential calculation. Yes, the fact that Pulse is willing to offer to pay early is a sure sign that there is a significant problem with the current system.</p> <p>This solution goes part way to resolving the current issue by reducing the amplification of costs caused by a price spike. However we have also raised several other serious issues in our letter to Carl Hansen dated 24/08/11 that need to be addressed under urgency if current prudential calculations are not to further prevent ASX futures market development.</p> <p>Our greatest concern with not enabling ASX hedges to be registered with the Clearing Manager however remains the differences in timings of cash.</p>	<p>The Authority will consider improvements to the prudential security system, and possible mechanisms to include ASX futures, as part of the Review of Settlement and Prudential Arrangements</p> <p>Consultation by the clearing manager on 'quick wins' also outlines its proposal for the improved calculation of the price and quantity inputs into prudential levels. A second section of this consultation paper reviews the concept of advance payments and presents a proposal related to this.</p>

Submitter	Submitter Response	Authority Specific Response
Simply Energy	It is a key to encouraging participation by new entrants as without a prudential off-set the hedges do not mitigate all components of price risk and treasury management.	
Smart Power	Yes, particularly if this was to include industrial spot purchasers.	
Tauranga City Council	Not individually addressed.	
TrustPower	No, because daily margining means that any ASX futures balance can already be used to meet prudential requirements since it is available in cash from the exchange.	

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?	
Authority General Response	<p>The Authority considers that access to more and higher quality information is likely to improve forward price discovery and hence liquidity in the futures market. This is a point that the majority of submitters have agreed with.</p> <p>The Authority has established the Wholesale Market Information Project in order to facilitate access to a wider range of market information. It considers that the possibility of publishing higher quality information on a range of factors that contribute towards future price discovery - including information on snow pack, market contract position and fuel availability (storage volumes) - will be best considered as part of that work program.</p>

Submitter	Response	Authority Specific Response
Contact	Contact believes that the majority of the relevant information is already available e.g. outage information, OTC hedge information via the disclosure website, information on hydrology etc.	
Genesis	<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 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"> • snow pack has a short term impact for only one quarter; and • total market contract position and fuel prices are more relevant for a day ahead market, rather than the hedge market. We note the ASX exchange already measures contract open positions. 	

Submitter	Response	Authority Specific Response
Meridian	<p>In general, Meridian supports the provision of relevant market information to all participants as a means of encouraging hedge market liquidity. In particular, we would view the dissemination of information on fuel prices and fuel reserves as likely to promote a more even playing field which in turn will encourage greater confidence and participation in the market. We believe all market participants should be subject to equivalent disclosure requirements, and note the current asymmetry of information availability between hydro and thermal fuel data. This was illustrated by the outage at the Maui gas platform in December 2010, which substantially impacted prices but was only known in advance by some parties.</p> <p>While we support the principle of disseminating information on the market's total contracted position, any requirements should clearly not go so far as requiring the disclosure of the commercial terms of individual contracts.</p>	
MEUG	Yes.	
Might River Power	We are not convinced that a lack of information is currently a barrier to participation or liquidity.	
Norske Skog	Yes.	
NZ Steel	Yes. All participants should be able to access as much information as each other. We don't object to people making their ability to analyse data a point of difference but that is a different issue to asymmetric access to information in the first instance.	
Pan Pac	Yes.	
Powershop	<p>Powershop agrees that high quality decision making information that has a real impact on forward pricing and decision making is currently available only to a select few. For example, hydro inflow and storage information is readily available; however other fuel storage is not.</p> <p>Evening the information playing field will help participants make forward pricing decisions and would also encourage those who don't have an actual position such as financial intermediaries to participate.</p> <p>The Authority should consult further with industry participants and other likely intermediaries to get their input on what information they would want to see.</p>	

Submitter	Response	Authority Specific Response
Pulse Utilities	We are very keen to see progress on the issue of reporting snow pack. This was raised out of the review of the December 2010 and is the most fundamental information missing for those outside “the club”.	
Simply Energy	Yes, the ASX prices and trade data should be combined with OTC hedge reporting into an accessible data base for market participants. This would provide greater level of transparency to the market to encourage active participation in the hedge market that would promote retail competition and development of new generation.	The Authority agrees that there may be efficiencies associated with a central repository for ASX price and trade info, as with the disclosure website. This will also be considered as part of the Wholesale Market Information project.
Smart Power	Yes	
Tauranga City Council	Not individually addressed.	
TrustPower	TrustPower supports the work being done under the Wholesale Advisory Group to enhance market information, and believes that this is sufficient to meet the need.	

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?	
Authority General Response	<p>While a number of participants suggest this information is already available, the Authority notes that the information is delayed and only available for a week, or at a cost from a third party. The Authority therefore considers that there may be efficiencies associated with a central repository for ASX price and trade info, as with the disclosure website.</p> <p>This issue will also be considered as part of the Wholesale Market Information Project.</p>

Submitter	Submitter Response	Authority Specific Response
Contact	Contact doesn't believe a market failure exists. 20 minute delayed data is already available free from the ASX website, and that access to historic data can be purchased from DCypha.	
Genesis	This information is already available from the ASX website. ⁵ The information has a 15 minute delay and a forward price curve is available during each trading day.	
Meridian	No. The potential group of futures market participants is broader than the group of levy payers. As such, we believe that the decision to purchase and the cost of accessing such information should be borne by individual participants.	
MEUG	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.	
Might River Power	No. Market information is clearly a club good as it is easy and cost effective to control access.	
Norske Skog	It seems to us that the failure is in the negotiation with ASX in the first place.	
NZ Steel	It seems obvious that where market prices are not readily available fewer parties will trade so that is consistent with the concept of market failure. Hedgers and intraday traders have a different imperative for immediate prices. Traders may wish to have live prices and that should be a cost of doing business. Hedgers should be able to get delayed prices at no cost.	
Pan Pac	Not enough information to know if such an intervention and levy is justified	

Submitter	Submitter Response	Authority Specific Response
Powershop	No. ASX pricing information is readily available online, albeit on a delayed basis. The depth of the ASX platform is not publicly available, but for participants the cost to access this information is not great. Alternatively the information could be accessed via participant brokers. Powershop's view is therefore that the cost should be borne by individual participants rather than by the Electricity Authority duplicating access to this information.	
Pulse Utilities	Our current trading relationships provide us with sufficient information.	
Simply Energy	Yes, this market data in an accessible format will provide transparency and operation of a more efficient electricity market which we believe is good justification to use levy funds to improve the market.	
Smart Power	No futures and options prices are already available to those who wish to access them	
Tauranga City Council	Not individually addressed.	
TrustPower	No, because futures and options prices are already publicly available at: http://www.sfe.com.au/content/prices/rtp15ZFEE.html ; and http://www.sfe.com.au/content/prices/rtp15ZFEA.html	

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?	
Authority General Response	<p>The Authority maintains its view that the price indexing of the VAS agreements means that the intent of the UOI target has largely been achieved (and would have been achieved if the parties had chosen to convert them into electricity futures).</p> <p>However, the Authority also acknowledges that the pricing features of the VAS agreements are not transparent to other parties and that they do not contribute towards robust price discovery to the same degree as genuinely traded ASX futures, as the VAS agreements follow rather than lead price discovery and the margins calls required under ASX futures mean that there is more 'skin in the game' with futures.</p> <p>Counter-balancing those views, however, is that the volumes covered by the VAS agreements greatly exceed the 3,000GWh target. The Authority is of the view the UOI target has in effect been achieved but it is desirable to have greater transparency on the effective level of UOI (i.e., UOI including the indexed VAS agreements).</p> <p>The Authority also notes that forward price transparency would be assisted if the pricing indexing arrangements in VAS agreements were disclosed and will consider exercising the powers under sections 45 and 46 of the Electricity Act to require the SOEs to fully publish the agreements to the Authority if any of the UOI targets are not met. The Authority would then publish the VAS agreements.</p>

Submitter	Submitter Response	Authority Specific Response
Contact	Contact believes that the indexation of VAS contracts is a factor.	
Genesis	<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>	

Submitter	Submitter Response	Authority Specific Response
Meridian	<p>The ASX futures market represents one aspect of a well-functioning hedge market, and Meridian is working with the ASX to ensure the market develops successfully. Meridian agrees that the indexation of the Virtual Asset Swaps (VAS) to the ASX futures market is a positive step in encouraging a liquid hedge market. However, we believe that other risk-management mechanisms, including bilateral forward contracts, should also be recognised when considering overall hedge market liquidity.</p> <p>Furthermore, Meridian believes a key indicator of a well-functioning hedge market is the breadth of market participants, i.e. the number and range of entities trading. The participation of entities without a physical position in New Zealand's electricity market, such as financial institutions, should be seen as an important measure of the strength of the market. The provision of information on the breakdown of participants (e.g. market makers versus others) in the hedge market would assist all parties gauge the market's strength.</p>	As discussed in the Authority's responses to previous questions, it is agreed that wider participation, particularly by financial institutions, is an important requirement to further development of the futures market.
MEUG	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.	The Authority agrees that further progress is required regardless of whether the intent of the 3,000 GWh target can be considered to have been met or not.
Might River Power	Yes, the target has been achieved in substance as already noted by the Authority.	
Norske Skog	No. Clearly the target has not been met, and indexing to the ASX is not the same as skin on the table with margin calls.	
NZ Steel	Yes and we note that OTC deals are being referenced to ASX futures. The 3000 GWh target for contracts traded through the futures exchange with no reference to total hedge activity seems a bit arbitrary.	
Pan Pac	No, this is a sham	
Powershop	Powershop agrees and believes that there has been good progress in hedge trading through the ASX over the past 12months but liquidity and depth need to be improved further. Powershop's view is that the market is likely to continue to develop over time, but progress still needs to be closely monitored.	

Submitter	Submitter Response	Authority Specific Response
Pulse Utilities	<p>Absolutely not.</p> <p>Pulse strongly disagrees with Electricity Authority's statement that the virtual asset swaps effectively mean that the intent of the 3,000 GWh target has been largely achieved. If this has been achieved, then they should be registered on the market.</p> <p>We note comments that the virtual asset swaps have been indexed to the ASX and note two methods of indexing which without the transparency of being market traded create huge doubt as to their benefit in developing the ASX market as claimed:</p> <ol style="list-style-type: none"> 1. The agreed prices could be at any level of discount factor meaning that they have little effect in determining an accurate market price based on a liquid market 2. Given the virtual asset swaps are based on an equal volume of electricity reciprocally traded, independent of the need to consider location factors, the hedging could have been undertaken at any theoretical price given that the buying and selling of contracts create a zero net cost <p>The Electricity Authority's statement has effectively let the Gentailers off the hook in terms of offering any significant volume on the market or the impetus required to reach a true 3,000 GWh target or indeed the goal of a liquid market. The fact remains that the actual level of trading on the market remains very low with market price realisation very poor.</p>	<p>The Authority considers that good progress has been made during the first year of trading on ASX, but that there is significant room for improvement, and that continued development and monitoring is required to achieve this.</p>
Simply Energy	<p>No, whilst we understand that VAS contracts have some indexation to ASX contracts we do not know or understand whether this is a direct indexation for total volumes, part volume or part price. Therefore we believe that as they have not been directly traded or crossed on the ASX market then these transactions should not be included within the target.</p>	
Smart Power	<p>No definitely not. The hedge and forward markets have insufficient liquidity, particularly judged by the success of the Australian forward market compared to the physical market</p>	
Tauranga City Council	<p>Not individually addressed.</p>	
TrustPower	<p>Yes, we agree with the EA's rationale on this matter.</p>	

Q8: Do you agree that further progress is required to meet the requirements of s42(2)(g) of the Act?	
Authority General Response	<p>The Authority accepts that very good progress has been made in establishing and developing the market for futures contracts. However, the Authority considers that further progress is required to meet the objective specified in s42(2)(g) of the Electricity Industry Act 2010 (Act), which is an active market for trading financial hedge contracts for electricity. Whether the VAS agreements should be considered as contributing towards the target or not does not impact on this conclusion.</p> <p>In particular, the wide bid-ask spread typical in the market and the movements in settlement prices without any underlying economic rationale that can occur from day to day are inconsistent with s42(2)(g).</p>

Submitter	Submitter Response	Authority Specific Response
Contact	Contact does not believe that regulatory intervention is required to meet the requirements of the Act, and that the initiatives in place, and under development will achieve the intent of the Act.	The Authority is not proposing regulatory intervention at this time.
Genesis	<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>	<p>While the Authority considers that market-led growth is likely, and that regulation is not currently desirable, it does not agree that there is no further action required by the Authority.</p> <p>The Authority will be continuing to monitor market development, and will consider action where progress is unsatisfactory.</p>
Meridian	Meridian is interested in having access to a functioning hedge market which allows us to effectively manage the inherent risk in being a hydro generator and retailer. We are working with ASX to ensure that such a market is realised. However, we re-iterate our view that the entire range of options to achieve a functioning hedge market need to be available if this goal is to be accomplished in an efficient and effective way.	Please refer to the response under Q1.
MEUG	Yes.	

Submitter	Submitter Response	Authority Specific Response
Might River Power	We agree only in that we support the implementation of revised market-making agreements between ASX and the 'big 5' if they apply equally to all. We do not consider that any further progress is required in terms of a robust forward electricity price curve and the associated UOI target which has effectively been met. The ASX needs to lead market development and expansion of the number of participants.	<p>The Authority considers that the VAS agreements are not sufficiently transparent to other parties, do not contribute towards robust price discovery to the same degree as ASX settled products, and that further progress is required to provide sufficient liquidity and a robust forward price curve.</p> <p>However, the Authority agrees that market-led development is the best option to achieve this at this point in time.</p> <p>The Authority is undertaking a cost-benefit analysis in order to establish appropriate criteria and thresholds for participation in market-making.</p>
Norske Skog	Yes of course. Clearly 3000 GWh open interest has not been met.	
NZ Steel	Yes. We have stated consistently that acceptable liquidity is required for success. By success we mean a level of activity and style of market making that attracts intermediaries and gives us confidence to use the contract directly. Also the market should have sufficient liquidity such that buyer/seller actions in isolation don't materially move the market.	
Pan Pac	Yes.	
Powershop	Powershop agrees that further progress is required, but believes things are heading in the right direction and it is currently in the best interests of all participants that risks can be managed with as little as possible regulatory intervention. Involving financial intermediaries and other potential participants in future debate and discussions will ensure their concerns and issues are also considered to ensure this progress continues.	The Authority is not proposing regulatory intervention at this time. Discussions will be ongoing with potential participants.
Pulse Utilities	<p>Pulse absolutely agrees that further progress is required.</p> <p>S42(2)(g) is clear in that the requirements for facilitating, or providing for, an active market for</p>	The Authority notes that it is not required to amend the Code under S42(2)(g). However, if the Code is not amended to

Submitter	Submitter Response	Authority Specific Response
	<p>trading financial hedge contracts for electricity must be mandated in the code by 1/11/11. This has not occurred to date and must be completed.</p> <p>As a small competitor Pulse has and must be able to rely on the Electricity Authority to provide strong leadership by ensuring minimum requirements for open interest as well as actual volumes of traded electricity are mandated.</p> <p>Pulse does not agree with the concept of including the virtual assets swaps within unmatched open interest. The definition of unmatched open interest is clear and as provided in the consultation paper means the total number of futures contracts that could not be settled or offset against another contract held i.e. it is a measure of active bids and offers. This means ongoing and active bids and offers of 3,000 GWh.</p> <p>As provided in the consultation paper 600 GWh as at 14/05/11 simply does not equal 3,000 GWh and as at 25/08/11 unmatched open interest is 680 GWh. At this rate of growth it will take over 7 years.</p> <p>Pulse does not concur with the Electricity Authority statement that a primary aim of the ASX New Zealand Electricity Market is forward price curve discovery but indeed is based on the need to provide an active market to secure hedging at a competitive price and this requires volume across the market.</p> <p>Given the time it takes to effect change within the Code and industry, the Electricity Authority must act now to record minimum requirements for the ASX. Gentailers have had an opportunity to deliver, they have not progressed as far as is required, now is the time to mandate requirements. Pulse suggests that the first minimum trading levels should be set to commence from 1/04/12 in time for next Winter where currently prices, particularly Benmore, remain excessively high.</p>	<p>provide for a more active market in electricity contracts, the Authority must report back to the Minister to explain why it has not amended the Code, to suggest alternative methods by which the hedge market outcomes have been or may be provided for, and to set out if, when, and how the Authority proposes to provide for the desired hedge market outcomes.</p> <p>The Authority considers that the objectives of S42(2)(g) have been met, in that the Authority has facilitated an outcome where an active market for trading financial hedge contracts can develop. The Authority will continue to monitor the market and take more direct action if progress is unsatisfactory. The Authority has also re-established UOI targets up to 3,000 GWh by 1 June 2012.</p> <p>Tightening the market-maker agreements should help further with liquidity (especially if it attracts some financial intermediaries) and UOI is expected to develop further. However, the Authority acknowledges that it will take time for new parties, such as financial intermediaries, to get confidence about trading prices, put systems in place for trading, get traders on board, and put limits in place.</p> <p>The revised targets included in the</p>

Submitter	Submitter Response	Authority Specific Response
		Information Paper reflect these realities.
Simply Energy	Yes.	
Smart Power	Yes	
Tauranga City Council	Not individually addressed.	
TrustPower	No. We consider the requirements of the Act have been met; the market is active, there are market makers and brokers facilitating trades for participants and the forward price curve is considered robust because of the indexation of the VAS contracts above.	The Authority considers that policy problems still exist, as noted in the general response above.

Q9: Do you agree that more time should be allowed for the generator-retailers to continue working with ASX to develop liquidity?	
Authority General Response	<p>As a matter of principle, the Authority prefers not to regulate when it is feasible for market participants to develop market arrangements and achieve beneficial outcomes. The development of a viable electricity futures market and a transparent and robust forward price curve appears to be a case where this is possible and likely.</p> <p>Tightening the market-maker agreements should help further with liquidity (especially if it attracts some financial intermediaries) and UOI is expected to develop further. However, the Authority acknowledges that it will take time for new parties, such as financial intermediaries, to get confidence about trading prices, put systems in place for trading, get traders on board, and put limits in place.</p> <p>The Authority therefore considers that regulation via the Code now would be premature and potentially counter-productive, and maintains its position that more time for the market to develop is the best way forward at this time.</p> <p>The Authority will continue to monitor the development of the market against revised targets.</p>

Submitter	Submitter Response	Authority Specific Response
Contact	Yes.	
Genesis	<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>	

Submitter	Submitter Response	Authority Specific Response
Meridian	<p>Experience in other jurisdictions has demonstrated that electricity hedge markets develop incrementally. While it is useful to establish milestones to review progress and consider further options for encouraging market development, it is vital that flexibility is retained in relation to how greater liquidity is achieved. We believe as much time as possible should be allowed for the major players and ASX to work together to develop the market. We oppose any premature Code changes which will restrict the ability of the market participants and the market operator to adopt the most suitable and sensible solution to increasing liquidity. This is particularly so given the general consensus of the ASX User Group that the fundamentals of this new futures market are strong, and that time will be required to see its development. It should be noted the User Group also includes a number of major financial intermediaries who share and endorse this view.</p> <p>Furthermore, we note the high degree of uncertainty in the current economic environment, which will naturally lead to a lower risk appetite amongst existing and potential market players. As such, development of the hedge market can be expected to remain cautious.</p>	<p>The Authority acknowledges that markets do develop incrementally. With reference to the ETAG report, The Australian electricity futures market achieved UOI amounting to 75% of the underlying physical market over a period of 7 years – building progressively over that period at a rate of approximately 10% per annum.</p>
MEUG	Yes.	
Might River Power	<p>We consider that the government's requirements have already been substantially met. We do not support the EA's position of keeping the UOI target of 3,000GWh remain in place, as the intent of this target has already been met.</p>	<p>The Authority considers that the VAS agreements are not sufficiently transparent to other parties, do not contribute towards robust price discovery to the same degree as ASX settled products, and that further progress is required to provide sufficient liquidity and a robust forward price curve.</p>
Norske Skog	No.	
NZ Steel	<p>Yes. The time limit was set at an arbitrary time period. Progress is positive and, as the Authority states, it is better to not regulate if possible.</p>	
Pan Pac	<p>Yes.</p> <p>More time is needed to see if they will increase their trading.</p> <p>I am concerned about why they should from their perspective.</p>	

Submitter	Submitter Response	Authority Specific Response
Powershop	<p>Yes. As noted in the consultation paper, monthly volumes traded have increased substantially over the past 12 months and further liquidity will take time to develop.</p> <p>Powershop believes the Authority should continue to oversee that progress is continuing and encourage involvement of financial intermediaries in any initiatives to develop liquidity and the market further.</p>	
Pulse Utilities	<p>Mandating requirements within the Code and giving the Gentailers more time are not mutually exclusive. The requirements must be mandated but clearly will need to involve increasing levels of commitment over time. This is giving them more time.</p>	
Simply Energy	<p>Yes, the development of a liquid futures market does take time to develop and the best long term outcomes will come from a market solution within a clearly defined “framework”.</p> <p>In regard to this “framework” – as the New Zealand energy and financial markets are small and the vertically integrated nature of the market then for the market to achieve the objectives will require the Authority to help steer market development through setting clear objectives and reasonable time lines whilst allowing the generator-retailers to steer the actual market products.</p>	
Smart Power	<p>Yes but a definite date and volume should be re-set</p>	
Tauranga City Council	<p>Not individually addressed.</p>	
TrustPower	<p>Yes. Although the requirements of the Act may have been met, there are still gains to be made in terms of volumes traded and market activity for ASX products.</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?

Authority General Response	<p>The Authority considers it prudent to continue monitoring progress and consider Code changes if progress is unsatisfactory. Specifically, the Authority will assess whether the new market-making agreements that some generators have already signed up to should apply to a wider range of generators, whether new products that deliver long-term public policy benefits to consumers have been introduced, and whether the volume of trading in the market has reached satisfactory levels;</p> <p>The Authority needs to achieve an appropriate balance between realistic expectations and maintaining the pressure for improved performance. A staged set of targets, as set out in the Information Paper, leading to 3,000 GWh UOI by 1 June 2012, has been adopted.</p> <p>The Authority will consider more direct regulatory intervention, including possible amendments to the Code, if progress towards these targets is not adequate.</p>
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Submitter	Submitter Response	Authority Specific Response
Contact	No. Contact submits that the initiatives in place, and under development, are sufficient to more than address any concerns around the robustness of the forward curve.	
Genesis	<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>	The Authority agrees that the 1 January 2012 target is optimistic. As above, the Authority has since revised its UOI target.
Meridian	As above, we consider that as much time as possible should be allowed for market players to work together to improve liquidity on a voluntary basis. Such an approach maximises flexibility and innovation. Code amendments should only be considered if industry efforts result in a demonstrable lack of progress.	
MEUG	Yes.	

Submitter	Submitter Response	Authority Specific Response
Might River Power	No. We do not consider further Code amendments necessary or desirable.	
Norske Skog	Yes, but it should do so now. The Gentailers have had more than enough time to get this sorted out, and have not done so.	The Authority considers that reasonable progress has been made in establishing and developing the market for futures contracts, but will continue to monitor against the 3,000 GWh UOI target.
NZ Steel	Yes definitely. If progress slows and, in particular, if the generator/retailers continue to be reluctant supporters of the market maker agreements they have with ASX then the Authority should assert its influence over its market participants to meet their obligations in the ASX jurisdiction.	
Pan Pac	Yes.	
Powershop	Powershop agrees that if no noticeable progress is made over time, then Code amendments should be undertaken. The timeframe suggested may however need to be increased, as the market will take time to develop. The last 12months has seen volumes substantially increase. Powershop's view is that the 1 Jan 2012 timeframe may be too tight- however a further review of progress should be undertaken at this point.	The Authority agrees that the 1 January 2012 target is optimistic. As above, the Authority has since revised the UOI target.
Pulse Utilities	The Electricity Authority should be amending the Code now as per our response to Q8.	Please refer to the response to Q8.
Simply Energy	Yes.	
Smart Power	Yes, there seems to be a natural reluctance from gentailers for liquidity in the market to grow	
Tauranga City Council	Not individually addressed.	

Submitter	Submitter Response	Authority Specific Response
TrustPower	<p>Yes, but we do not agree with the EA's proposal to assess progress as including <i>"standardised market making agreements ... are in place between the ASX and all generator retailers with more than 500 MW of capacity by 31 October 20112"</i>.</p> <p>Reference C was commissioned by the EA to provide an independent view of progress towards a liquid hedge market, and to recommend actions to address any shortcomings identified. One such recommendation was that the EA:</p> <p style="padding-left: 40px;"><i>"consider increasing the threshold for mandatory participations as a market maker to generators with 1,000 MW capacity (up from 500 MW), with additional requirements around net position, such that large net retailers may be excluded.3"</i></p> <p>The EA have no included this recommendation as a specific issues for consultation at Reference A. Nor have the possible Code amendments at Reference A included a clear statement of the intended threshold for mandatory market making.</p> <p>TrustPower wishes to make clear that we do not support any market making obligations being imposed now or in the future, unless these have been fully described, with proper consultation carried out and agreement reached with affected participants. We believe there are significant risks associated with market making or a smaller generator such as TrustPower, particularly given our net retail position, our limited energy storage capability and the dispersed and intermittent output of our generation assets. The same risks are likely to apply to future generators who may increase in capacity and be subject to potential obligations.</p>	<p>The Authority is undertaking a cost-benefit analysis in order to establish appropriate criteria and thresholds for participation in market-making.</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?)

Authority General Response	<p>The Authority reiterates its position that the draft Code amendments are not to be pursued at this point in time.</p> <p>However, the Authority maintains its view that the draft Code amendments would support the Authority's objectives if it is later determined that they are necessary because progress has not been sufficient. If this proves necessary, Code amendments will be based on a robust cost-benefit analysis.</p>
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Submitter	Submitter Response	Authority Specific Response
Contact	No. Contact is not convinced that the Code can, or should be used to manage obligations to a market based trading platform.	
Genesis	<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>	The Authority agrees that Code amendments are not the preferred option and would have to be carefully implemented in order to avoid unintended consequences. However, if progress with market-making is inadequate the Authority will consider Code amendments.
Meridian	Meridian is opposed to Code amendments at this stage, and considers it too early to make detailed drafting comments. Should the Authority subsequently deem it necessary to amend the Code, further detailed consultation should be undertaken with market participants.	

Submitter	Submitter Response	Authority Specific Response
MEUG	<p>As a back-stop yes.</p> <p>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.</p> <p>The Energy Link report for the Authority, Evaluation of Hedge Market Liquidity in June 2011 noted (p2, 3):</p> <p><i>“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.”</i></p> <p>If new players do not enter the futures market then implementation of the draft Code amendments with minimum market making requirements would be appropriate.</p>	
Might River Power	No. We consider that the requirement in respect of a robust forward electricity price curve has already been met in substance, and that no further Code changes are required.	
Norske Skog	Yes.	
NZ Steel	Yes definitely. See answers to Q3 and Q10	
Pan Pac	Yes but only because these appear to be only options on the table at this time.	
Powershop	Powershop believes these Code changes are likely to enhance liquidity and performance of the futures market if the initial voluntary approach fails. However as mentioned previously, if these Code changes were implemented without the agreement of affected participants, in Powershop’s view this may to lead to an increased cost and potentially manipulative behaviour by participants (especially in relation to re-loading of bids and offers).	

Submitter	Submitter Response	Authority Specific Response
Pulse Utilities	<p>The Code amendments only cover the market maker functions. This will help improve the market but Pulse strongly believes that minimum levels of trading as well as contracts types must also be set including day load and caps. This will prevent the vertically integrated Gentailers from relying on their own generation portfolios and force them to ensure they buy and sell a percentage of their generation portfolio on the ASX.</p> <p>Pulse does not agree with the Electricity Authority's view to not make Code amendments at this point in time and is dumbfounded as to why the Electricity Authority is going against the political will of the Government and S42(2)(g).</p>	<p>The Authority has explained in response to previous questions why it considers Code amendments is inappropriate at this point in time, and that the proposed approach is still consistent with S42(2)(g).</p> <p>The Authority notes that further Code amendments (beyond what were included in the consultation paper) may be considered in the future if development progress is unsatisfactory.</p>
Simply Energy	Yes.	
Smart Power	Yes	
Tauranga City Council	Not individually addressed.	
TrustPower	<p>Yes, but we note that the draft Code amendments do not specify a threshold for defining those participants who would be subject to market making obligations. We would expect that the specified threshold, when drafted, would be based on a proper analysis of the risks and investments required of affected participants, relative to their energy portfolio and resources.</p> <p>We agree with the EA's preliminary view to withhold Code amendments at this time.</p>	<p>The Authority has is undertaking a cost-benefit analysis in order to establish appropriate criteria and threshold for participation in market-making.</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?	
Authority General Response	There has been no new or material information provided in submissions that has led the Authority to change its view that its proposed approach will not deliver positive net benefits, relative to the counterfactual of making Code amendments now.

Submitter	Submitter Response	Authority Specific Response
Contact	Yes.	
Genesis	Yes.	
Meridian	Yes. Meridian considers that as much time as possible should be allowed for the generators to work with ASX to improve market liquidity on a voluntary basis. As above, we oppose any premature Code changes which will restrict the ability of the market participants and the market operator to adopt the most suitable and sensible solution to increasing liquidity.	
MEUG	Yes.	
Might River Power	As per our letter dated 6 May 2011, there has been substantial progress initiated prior to the Electricity industry Act 2010. There is no reason for further regulatory intervention, apart from ensuring TrustPower is part of the revised standardised market making arrangements.	
Norske Skog	No.	
NZ Steel	Possibly. We note that in the consultation paper those generators assert “the lack of participation by other institutions (especially demand-side participants) is something that they consider needs to be addressed”. In that case demand side participants should be included in any consideration of product design of specifying arrangements to encourage liquidity. We think that approach is more likely to deliver a positive net benefit relative to the counterfactual of making Code amendments now.	As stated in the response to question 2, the Authority considers that the most appropriate avenue for new product development is the ASX Users Group, with demand side participants and financial institutions included amongst its membership.
Pan Pac	Yes.	

Submitter	Submitter Response	Authority Specific Response
Powershop	Powershop considers that: <ul style="list-style-type: none"> • a continuation of the voluntary approach would be most beneficial to all involved; but • the Authority should however continue to oversee that progress is occurring and potentially set milestones for particular developments to occur. 	
Pulse Utilities	Not addressed.	
Simply Energy	Yes, as long as this is reviewed at 1 January 2012 with clear direction to the generator-retailers that the Authority will make Code amendments if defined liquidity is not achieved.	The Authority agrees with submitters that state that the 1 January 2012 target is optimistic. As in the response to Q10, the Authority has since revised its UOI target, with a view to achieving an appropriate balance between realistic expectations and maintaining the pressure for improved performance.
Smart Power	Yes	
Tauranga City Council	Not individually addressed.	
TrustPower	Yes.	