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Submissions
Electricity Authority
PO Box 10041
Wellington 6143

Mighty River Power Limited
Level 14, 23-29 Albert Street
Auckland 1010
PO Box 90399
Auckland Mail Centre
Auckland 1142

Phone: +64 9 308 8200
Fax: +64 9 308 8209
www.mightyriverpower.co.nz

DDI: +64 9 580 3623
Direct Fax: +64 9 308 8209

Dear Sir or Madam

Market Making Obligations - CBA

Thank you for the opportunity to comment on the Electricity Authority's cost benefit analysis (CBA) of market making obligations. No part of this submission is confidential.

As a central participant in the pre-cursor (Energy Hedge) to the current futures market, Mighty River Power has long supported the development of a competitive and effective hedge market. While our preference is for the current futures market to develop without the need for regulatory intervention, we have actively participated in the development of the ASX market and contributed to the Government's current trading targets.

The key conclusion of the Authority's CBA paper is that there is unlikely to be a net economic benefit from introducing Code-based market-making obligations on TrustPower – who, as noted, is the only generator out of the big five currently not acting in a market-making capacity on the ASX.

The report highlights that an important cost consideration in the CBA is the size of any incremental costs TrustPower could be expected to incur in order to enhance its internal

trading capabilities in undertaking a market-making role. In this regard the report considers that:

> "One view would be that this cost should be nil or very modest because TrustPower has been a participant in the wholesale and hedge markets in New Zealand for many years. Indeed, it could be argued that its smaller and less flexible portfolio of physical assets (in relative terms) has required it to develop more sophisticated financial trading capability than the four other large generators."

As the Authority did not have access to detailed information to quantify these costs, three scenarios were instead modelled: effectively a low case (zero incremental cost), the so-called central (or medium cost) case and a high cost case. Crucially, the analysis finds that if the market-making obligation is put on five parties via a Code-based requirement, then under the central cost case there are higher net benefits than if it were just placed on the current four parties voluntarily.

We consider that the quantum of costs assumed in the central case are not unreasonable and potentially on the high side given our own experience of the cost of participating in the market.

We also agree that, given the dynamic nature of both the wholesale and financial markets, circumstances could change which could reduce the ability of market participants to adequately perform market-making functions. In this instance, the achievement of the Government's 3000 GWh of unmatched open interest could be jeopardised.

It is unclear from the analysis why net benefits arise from having five generators provide market-making services under a code-based requirement, yet not in a voluntary situation where potentially only one participant would face a market-making obligation.

Given that the majority of market participants are already providing market-making services voluntarily, it is difficult to envisage how a code-based requirement would materially alter costs. In any instance, it is impossible to take a view on the magnitude of such compliance costs as they are not made explicit in the analysis. It would rather appear that the cost analysis is more sensitive to the potential incremental costs of

TrustPower assuming market-making obligations which, as the paper highlights, are unlikely to be on the higher side of the estimates used in the modelling.

In conclusion, we consider the results of the CBA are not as clear cut as presented in the information paper. We would support further clarification being provided around the potential compliance costs and their relative weighting in the analysis prior to a final decision being made.

Yours sincerely

Nick Wilson
Senior Market Regulatory Advisor