

26 November 2012

Paul Roberts  
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Dear Paul

## **NZ Hedge market arrangements - market making agreements**

Over the last two years, the Electricity Authority (Authority) has been actively engaging with stakeholders on the development of the ASX NZ electricity futures market. A liquid electricity futures market is important because it provides an additional means, either directly or through an intermediary, for parties to manage their electricity price risk and it contributes to establishing a robust and transparent forward electricity price curve. A robust forward price curve has considerable value beyond the futures market per se, such as informing decisions relevant to other forms of hedging instruments and it signals expectations around the future electricity supply/demand balance. Consequently, the Authority regards a liquid electricity futures market as being vital to achieving greater competition in generation and retailing.

The Authority prefers market facilitation methods over regulation and was encouraged by the four generator-retailers voluntarily agreeing, in October 2011, to market-making for ASX NZ electricity futures, with tighter bid-ask spreads than had previously been the case. Good progress has followed: bid-ask spreads have narrowed, trading volumes have increased greatly, and UOI has increased to around 2,200 GWh on average over the last eight months. It is also encouraging that the market is responding to new information and changes in physical circumstances, both over short timeframes for hydro storage and generation outages, and longer timeframes for the Tiwai, Pukaki, Norkse Skog and Solid Energy announcements. This suggests that futures prices are being determined robustly and are appropriately being influenced by market fundamentals.

Overall, the Authority has been pleased with the progress made in the ASX NZ electricity futures market to date, and I acknowledge the significant part that ASX and the four market-makers have played in achieving this.

However, our job is not complete as some areas of the hedge market need further development. The Authority is pursuing initiatives that fall into four categories: maintain the initial progress made with respect to market-making; increase awareness of the need for parties with spot market exposure to manage that risk; increase confidence in the market and the forward price curve; and reduce barriers to participating in the futures market (such as the better integration of spot and futures margins).

The Authority would be extremely disappointed if the current progress was not maintained. The market-making agreements underpin the success so far, and the Authority is concerned that these, having expired, are yet to be renewed. I understand that all of the existing market-makers have continued market-making in the interim, and have expressed a willingness to renew the

agreements. While this is positive progress, I would be pleased to see ASX and the market-makers come together promptly to finalise these arrangements.

The Authority is keen to notify wider stakeholders of the renewed market-making commitments, in order to demonstrate that the ASX NZ electricity futures market has longevity and stability. Accordingly, I would appreciate receiving confirmation when you have renewed the agreements.

I look forward to your timely response to this important issue.

Yours sincerely



Carl Hansen  
**Chief Executive**

cc: Dennis Barnes, Contact Energy  
Doug Heffernan, Mighty River Power  
Albert Brantley, Genesis Energy  
Mark Binns, Meridian Energy