22 June 2021

Electricity Authority
Level 7, ASB Bank Tower
2 Hunter Street
Wellington

To whom it may concern,

Re: Levy Consultation: Commercial Market Making Scheme

The Electricity Authority ('Authority') is seeking to improve the performance and reliability of market making services in New Zealand electricity futures contracts by introducing a commercial market making scheme.

Contact is supportive of the move towards a fully commercial market making scheme. We believe the fully commercial scheme will deliver the most efficient market making outcome for New Zealand electricity market participants and consumers.

Our response to the levy consultation is outlined below.

Appropriation

The Authority proposes to seek a maximum of $14.4m of funding for commercial market making. Based on the assumption that the current market making scheme settings are taken into the commercial market making scheme, we feel this is appropriate.

If the required market making volumes are increased, or the spread lowered, this amount may need to increase.

Market Making Scheme

Contact believes the volume associated with the current market making arrangement are more than adequate for the size of the New Zealand electricity market. In the 12 months ended 31 May 2021 over 70 terawatt hours (TWh) of NZ electricity futures contracts volume traded. The traded volume represents approximately 1.75 times the annual demand for electricity in New Zealand.

As the Authority notes in the consultation document, the major costs associated with market making are heavily dependent on the volume and bid-ask spread required of the market maker. In a New Zealand electricity context, the cost of meeting the bid-ask spread is largely determined by the underlying volatility of the wholesale electricity market.

The consultation paper identifies the increasing costs of the market making scheme as the bid-ask moves closer to 2%, however, we believe the reduction in market making costs in moving from 3% to 5% are not linear, and the costs should be lower than published for bid-ask spreads at 4% and 5%.

Ideally, market makers should frame the market, with trades occurring within the market making spread. We have observed that contracts at the front end of the curve often trade

Contact Energy Limited Level 2 Harbour City Tower, 29 Brandon Street, Wellington 6011 | PO Box 10742, Wellington 6143
P: +64 4 499 4001 | **F**: +64 4 499 4003 | **W**: contactenergy.co.nz

within seconds of market makers bids and offers being placed into the market. We believe this reflective of the market making spread being too narrow.

Increasing the number of market makers

Increasing the number of market makers will naturally lead to a lowering of the bid-ask spread and share risk among an increased number of participants. A new market making participant can also add a differing view on the market.

We find it difficult to place a value on this being provided by one of the current market makers versus a market maker from outside the current group.

Ranking of preferences

We rank the following spread and volume preferences.

Rank	Spread	Volume
1	5%	2.4 MW (12 MW total)
2	5%	2.0 MW (10 MW total)
3	4%	2.4 MW (12 MW total)
4	4%	2.0 MW (10 MW total)
5	5%	1.6 MW (8 MW total)

If there is anything in our response that you wish to discuss further, please feel free to contact me.

Yours sincerely,

Nigel East
Forward Markets Manager