HEDGE MARKET DEVELOPMENT STEERING GROUP

13/14 March 2007

Summary of submissions received on Hedge Market Development Issues and Options

This paper provides a summary of submissions on the Hedge Market Development Issues and Options paper, and presents the Group's analysis of the submissions.

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Wholesale work plan task W1

Introduction and background

1 The Government Policy Statement of Electricity Governance of October 2006 (GPS) invites the Electricity Commission (Commission) to give priority (among other things) to improving hedge market transparency and liquidity.

2 To this end, the Commission created a specific work stream and formed the Hedge Market Development Steering Group (Group). Its task has been to investigate and consider issues relating to electricity and transmission hedges.

3 The Group completed its preliminary consideration of the issues, and assisted the Commission in developing two consultation papers. A technical paper, covering the issues and options in detail, and an overview paper, summarising the recommendations and analysis in the technical paper for the benefit of those without the time or need to study the full version. The papers also covered the Group's recommendations to the Commission on the initiatives that should be implemented, and the procedures and timelines with which this could be done.

4 The Commission believed the papers provided a useful platform on which to seek wider industry views and consequently the two papers were released for consultation on 25 August 2006, accompanied by six questions that the Commission wanted parties to address in their submissions. The Commission's intention was then to consider submissions on the Group's analysis and recommendations before reaching its own conclusions.

5 Submissions on the consultation paper closed on 25 October 2006.

Purpose of this paper

6 The purpose of this paper is to:

a. provide a summary of submissions;

b. highlight topics where submitter's views support or diverge from those formed by the Group;

c. provide the Group's analysis of submissions; and

d. provide the Group's advice on the next steps for each initiative.

Summary of submissions

7 The consultation papers invited interested parties to make submissions on the Group's analysis and recommendations. The Commission requested that submitters answer the six questions contained in the technical and overview papers.

8 Submissions were received from 22 organisations:

1. ANZ National Bank;
2. Carter Holt Harvey (consumer);
3. Comalco New Zealand (consumer);
4. Contact Energy (generator/retailer);
5. Electricity Networks Association (advocacy group);
6. Energy Market Services;
7. Energy Link;
8. Genesis Power (generator/retailer);
9. King Country Energy (generator/retailer);
10. MainPower New Zealand (distribution);
11. Meridian Energy (generator/retailer);
12. Major Electricity Users' Group (advocacy group);
13. Mighty River Power (generator/retailer);
14. New Zealand Steel (consumer);
15. New Zealand Sugar Company (consumer);
16. Norske Skog Tasman (consumer);
17. Orion New Zealand (distribution);
18. Transpower New Zealand;
19. TrustPower (generator/retailer);
20. Unison Networks (distribution);
21. Vector (distribution); and
22. Winstone Pulp International (consumer).

9 These submitters represent a diverse range of parties with an interest in New Zealand's electricity industry. Of the 22 submitters, 6 are large electricity consumers, 6 are generator/retailers, 4 are electricity distribution companies,

and 2 are advocacy groups. Other submitters include ANZ National Bank, Transpower, Energy Market Services (EMS) and Energy Link.

10 This paper draws out the themes emerging from the submissions, highlights topics where submitter's views diverge from those of the Group, provides the Group's analysis of the submissions and suggests next steps for the development of initiatives.

11 The submission responses reported in this paper are paraphrased versions of the original submissions. Several submissions, such as those from ANZ National Bank, Norske Skog, and Unison, provided general comments and suggestions. These submissions have been addressed under the relevant questions. The Group's analysis that is included in this paper provides advice on how to address the issues raised in the submissions.

12 This paper addresses each question in turn and concludes with a summary of the key points from the submissions. The wording of the questions in this paper is taken directly from the consultation paper. A tabular summary of the submissions is contained in Appendix B.

***Question 1* – The Group defined its policy objective as promoting a well-functioning hedge market. By contrast, the GPS policy objective for the hedge market is to improve transparency and liquidity. The Group questions whether liquidity is a goal in itself, and the extent to which it can be achieved in the New Zealand context. Do submitters agree with the Group's policy objective? If not, please outline what you consider the policy objective should be.**

Agreement and qualified support

13 Of the 16 submitters who agreed in general with the Group's policy objective, several of them also commented on the relationship between a well functioning market and the two ideas of transparency and liquidity. Among these submitters there was a general theme emerging that the primary objective should be for a well-functioning market, and that liquidity and transparency are means to an end, rather than ends themselves.

14 Contact Energy noted that the goal should be to enable the optimal level of liquidity to be found for the market. This is consistent with the Group's view, expressed in paragraph 61 of the overview paper, that it may be unrealistic and artificial to try to sustain a very highly liquid market for hedging electricity price risks, particularly when the level of demand for hedging arrangements is not well developed. Contact's submission discussed the nature of the New Zealand electricity market and the key requirements for a liquid hedge market.

15 King Country Energy's submission stated that it believes that the policy objective of "promoting a well-functioning hedge market" is a necessary, though not sufficient, prerequisite for achieving the GPS objective.

16 The New Zealand Sugar Company noted that developing increased transparency and liquidity through increased simplicity and standardisation is key to organisations of its size being able to interact effectively in this market.

The New Zealand Sugar Company describes itself as a medium to large sized industrial electricity consumer.

17 Winstone Pulp International (WPI), a milling and pulp manufacturing company employing around 300 staff, considered that the Group's proposal is appropriate in that a well functioning hedge market would, by definition, incorporate optimal transparency and liquidity. WPI also noted that transparency and liquidity may well be key features required to enable long term hedge contracts to be entered into.

18 WPI also expressed concerns on what it called a fragmented approach taken by the Commission on issues related to transmission pricing. WPI considers that a full conference and consultation that integrates all matters around transmission pricing would be advisable and valuable. In the conclusion of its submission, this theme is reinforced by WPI submitting that the LRA proposal and the potential wealth transfer that may arise, needs to be considered against a full review of transmission pricing and a reconsideration of the Commission's previous decisions on the transmission pricing methodology.

19 Meridian, while in agreement with the Group's policy objective, suggested that a transparent and liquid hedge market can and must be developed in New Zealand and that it should continue to be the objective of the Commission. Meridian also noted its view that the theory that New Zealand derivatives may be unable to reach a high level of liquidity must be tested rather than simply accepted.

20 Mighty River Power (MRP) noted that an initiative directed at increasing liquidity may not result in net benefits for consumers or address barriers to entry in the retail market. MRP provide a detailed commentary on its view of the principle objectives and specific outcomes for the Commission[1]. MRP's conclusion is that the Commission should critically assess whether action is consistent with the Commission's principal objectives and specific outcomes set out in the Electricity Act 1992. MRP further notes that this is particularly important in respect of the actioning by the Commission of general GPS policy objectives.

21 The Electricity Networks Association (ENA) noted that there seems to be an absence of a full examination of possible developments in relation to liquidity. Although ENA endorses the Commission's scope for the Group, being to "provide advice to the Commission on the development and implementation of a transparent and liquid hedge market", it assumes that this extends to the introduction of an appropriate Financial Transmission Rights (FTR) as provided for in the GPS.

<u>Disagreement</u>

22 Five submitters (Comalco, EMS, Mainpower, Transpower, and Vector) clearly disagreed with the Group's policy objective.

[1] MRP Submission to the Electricity Commission on Hedge Market Development – Issues and Options, Appendix 2.

23 Comalco stressed that the goal of developing a transparent or liquid market should not be dispensed with yet. Comalco asserted that the policy objectives expressed in the GPS should be adopted by the Group.

24 The view stressed in EMS's submission is that a "well functioning market" is an insufficient policy objective and that this objective will not deliver the intended outcomes necessary for an efficient wholesale electricity market. EMS noted that the term "well functioning market" has different meanings depending on an individual's commercial position.

25 The EMS submission states the policy objective described in the GPS should be retained as written and used as the guiding principles for the development of the packaged hedge market solutions. EMS also disagrees with the Group's conclusion that it may be unrealistic in the current circumstances for the relatively small New Zealand electricity market to sustain a highly liquid market for hedging electricity price risks.

26 Transpower notes the Group's objective for developing a hedge market and the differences with the GPS objective. Transpower notes that the locational rental allocation methodology proposed by the Group reduces the transparency of the marginal locational price signal. It notes that this is because the allocation methodology contains components such as reference nodes and participation factors that are only obtainable from complex calculations.

27 Transpower states that it has no comment to make on whether liquidity should be an objective within the GPS; it believes transparency should remain an objective.

28 The main theme in Mainpower's submission is the need to encourage greater transparency and liquidity in the hedge market. Mainpower asserts that the Group's recommendations will not improve liquidity and transparency because they are too minimalist in their effect.

29 Vector noted that liquidity is one of the fundamental issues identified in the GPS and it is concerned about the Group's apparent move away from this issue.

Analysis – Question 1

30 After reviewing submissions, it appears that some submitters believed the Group was dispensing with liquidity as a goal. Liquidity remains a focus for the Group but the Group considers that the optimal level of liquidity should be found by market participants, using the additional tools provided in the Group's recommended package, rather than be predetermined. The Group's aim is to provide the industry with the necessary information and risk management mechanisms to facilitate this discovery process. The Group notes that participants exposed to price risk, with the exception of Comalco, generally endorse the Group's approach.

31 In addition, the use of "by contrast" in the Commission's question may have suggested to submitters that the Group's policy objective is not aligned with

that of the GPS. In hindsight, it appears that the wording of the question may have been misleading for some submitters.

32 As described above, liquidity remains a goal for the Group but it believes the appropriate level must be demand driven. Even if a high level of liquidity had remained the primary goal for the Group, the demand driven philosophy would probably have resulted in a broadly similar set of preferred initiatives.

Question 2 – Has the Group correctly identified the key problems relating to risk management in Section 3.3? If not, please outline what you consider to be the problems.

33 With the exception of EnergyLink, submitters generally agreed the key problems relating to risk management had been correctly identified within section 3.3 of the consultation paper.

34 In Energy Link's opinion, the list of key problems relating to risk management is incomplete and misses some of the key structural issues that act to reduce liquidity in the hedge market. Energy Link offered its own list of structural issues:

a. Uncertainty around hydro inflows combined with the lack of a capacity market;

b. Vertical integration of retail and generation;

c. Relative size of hedge market participants;

d. Imperfect grid;

e. Conditions on contracts for physical supply; and

f. The dynamic interaction between the spot and hedge markets.

35 Energy Link's list above, describes problems arising from the physical, institutional, and commercial characteristics of the wholesale electricity market and transmission grid. Energy Link submits that a number of these characteristics need to be addressed if the hedge market is ever to be considered a liquid forward market.

36 King Country Energy listed the five key problems identified by the Group. King Country Energy also noted that the lack of competitiveness (whether real or perceived) should be a key focus for the Commission in all areas of work, and that lack of understanding is also present throughout almost all issues facing the Commission.

37 EMS agrees with the five key issues identified, but stated that the primary issues facing the market is access to appropriate information to manage price risks.

38 Although Meridian had no specific comments on the problems that were identified in the survey of hedge market participants, it recommended that the

survey be repeated annually to help determine whether the objectives of the GPS were being achieved (assuming that the preferred package of initiatives proposed by the Group are implemented).

39 It should be noted that the technical paper discusses a periodic survey[2] in detail, but does not specify if the survey would be carried out on a regular basis or how frequently market participants would be surveyed.

40 While agreeing in broad terms with the problems identified by the Group, Genesis Energy, in paragraphs 13 to 19 of its submission, has characterised problems in the context of a market failure framework. Genesis Energy infer that the Group addressed two market failures in the New Zealand market:

a. An incomplete market - that is, the need to rectify deficiencies in the electricity risk management (with possible consequences for retail competition) as the market has failed to provide the necessary mechanisms; and

b. An information failure – that regulatory action is motivated by imperfect information and the belief that the hedge market, by itself, will supply too little information to ensure that efficient decisions are made.

Analysis – Question 2

41 With the exception of Energylink, all submitters generally endorsed the Group's identification of the key problems.

42 Many of Energylink's comments related to items that the Group had identified as outside its scope. The Group did consider the affect of vertical integration and the related initiative of "synthetic separation" was fully assessed in the technical paper. The Group had previously identified some of the other issues that Energylink raised and these factors were considered during the selection and design of the Group's preferred initiatives.

43 In paragraph 80 of the overview paper the Group noted the items that were outside the scope:

> *Hedge market policy intersects with a wide range of other issues. The HMDSG carefully considered its role relative to the mix of other Commission work-streams, and the general categorisation of policy issues under the GPS. The HMDSG also noted the Commerce Commission's role in relation to competition issues. Based on this mapping, the HMDSG concluded that the following issues, while related to price risk management, raise wider policy considerations that come within the ambit of other processes, and are therefore not within the HMDSG's scope:*
>
> *a. The adequacy or otherwise of the level of competition in the various electricity markets – retail, wholesale, system operation, reserves, frequency keeping, etc. The Group noted that this was*

[2] Technical Paper, 6.2 Regular survey initiative, pages 61 to 65

being actively considered by the Commerce Commission and that duplicating this work was undesirable;

b. *The structures of the wholesale and retail markets;*

c. *The legal separation of the ownership of retailers and generators;*

d. *Issues underlying the spot wholesale electricity market;*

e. *The sufficiency of the level of generation for security of supply;*

f. *The ownership of market participants; and*

g. *The overall regulatory arrangements of the electricity industry.*

Question 3 – Do you agree that the evaluation criteria outlined in Section 4.2 are appropriate criteria for assessing the initiatives? If not, please outline the evaluation criteria that you consider more appropriate.

44 All submissions that explicitly addressed question 3, agreed the evaluation criteria are appropriate. However, several submitters commented that a quantitative cost-benefit analysis is also needed. These submitters generally endorsed the rigor of the qualitative cost benefit analysis already completed, but emphasised the need for a robust and potentially more extensive quantitative approach.

45 Meridian Energy encouraged the use of a quantitative cost-benefit analysis, and suggested the Commission should review and update any quantitative analysis carried out in a year following the implementation of any proposals in order to assess their effectiveness. This suggestion appears to be aimed at assessing if estimated costs and benefits are actually realised. In addition to Meridian's suggestion, the Group should note that this "one-year on" review of any quantitative analysis could tie in with the first regular survey of market participants.

46 MEUG noted that the evaluation framework should be standardised into an economic cost-benefit analysis framework, comparing the detailed proposal(s) with a counterfactual. MEUG sees the advantage of standardising and quantifying all possible benefits and costs as exposing the true economic efficiency gains that can be achieved.

Analysis – Question 3

47 There was good support for the evaluation criteria although some submitters requested a more extensive quantitative cost benefit analysis at the next stage of consultation.

48 In accordance with the Act, the Commission will complete a full cost benefit analysis for initiatives that require a rule change (publication of contract details, LRA and the publication of outage and fuel information). The market impact and cost involved with the annual survey and training initiatives probably doesn't warrant a full cost benefit analysis. For the development of

EnergyHedge and the model master agreement initiatives the Commission is only performing a monitoring role.

49 Meridian's suggestion of a "one-year on" quantitative cost-benefit analysis should be included in a post implementation review of any initiative and linked to the information gathered from the annual survey.

Question 4 – Do you consider the Group has correctly identified and described an appropriate range of potential initiatives in Sections 6 and 7 of the Technical Paper? If not, please outline any additional initiatives you believe the Group should have considered.

50 The majority of submissions agreed the Group had correctly identified and described an appropriate range of potential initiatives.

51 Transpower provided commentary on each initiative, some of which it accepts as being appropriate, and some did not. Specifically, Transpower's submission is critical of the development of EnergyHedge, and requests more clarity on the publication of outage and fuel data due to the direct effect this has on Transpower as an asset owner[3].

52 Genesis Energy makes comment on the initiatives that were not included in the preferred package. Specifically, Genesis Energy questions the need to separate the "non-preferred" initiatives into a "wait and see if needed" category and a "do not use" category. This view is based on issues around regulatory uncertainty and the wide ranging implications of legal or synthetic separation of generation from retail being dealt with in the narrower context of hedge market development.

53 Meridian submitted that the Group had identified and described a range of potential initiatives that are both substantial and wide ranging. Meridian also considered that the Group's preferred initiatives represent a reasonable package that should promote efficient and effective price risk management among participants in the electricity market.

54 ENA noted that the development of a more visible market place of exchange for bilateral or forward contracts should be considered further and not dismissed because it doesn't enjoy the support of generator/retailers. ENA believes that the Group has not fully considered an appropriate range of potential initiatives, and it is of the view that the auctioned FTRs and the hybrid (allocated) FTRs are appropriate initiatives to be considered in addressing the Government's policy objective.

55 ENA further notes that neither it nor any lines companies were involved in the development of the initiatives, so it has relied on the consultation papers to gain an understanding of the development process, and consideration of the implementation issues with each of the proposed initiatives.

[3] For a full discussion, see Transpower NZ Ltd, Response to Electricity Commission consultation on Hedge Market Development – Issues and Options, section 3.

Analysis – Question 4

56 There was strong support for the range of potential initiatives proposed by the Group.

57 Some submitters queried the detail of particular initiatives. To clarify ENA's *EnergyHedge* query, the Group recommended that the Commission adopt a monitoring role for the development of *EnergyHedge.* This initiative does not endorse *EnergyHedge* or preclude the establishment of alternative platforms. For example, Meridian Energy considered an alternative platform for the development of their energy futures product. However, Meridian Energy has acknowledged the benefits of having a single platform for the industry and is discussing development options with the owners of *EnergyHedge.*

58 Although the development of the LRA initiative is a key initiative in the Group's preferred package it still requires further development and will be assessed against FTRs and hybrid FTRs during the formal cost benefit analysis. The Group advises the Commission that lines companies and other experts should be involved in the LRA development process.

Question 5 – Do you agree with the preferred package described in Section 8 of this Technical Paper? If not, please outline the initiatives you consider are more appropriate and describe the benefits they deliver, with particular reference to the policy objectives.

59 The Group's preferred package of initiatives was defined in the consultation papers as[4]:

a. Regular survey;

b. Publication of contract details;

c. Centralised publication of information;

d. Model master agreement;

e. *EnergyHedge* development;

f. Understanding risk management; and

g. Locational rental allocation.

60 The majority of submitters agreed with this preferred package and a summary table of their views is included in Appendix A. However, several of those indicating general agreement with the package qualified this view by noting exceptions or suggesting design refinements. These suggestions have been bracketed in the table contained in Appendix A.

61 Submitters' main concerns related to the LRA and publication of contract details initiatives, which are discussed under question 6.

[4] Technical paper, section 8.4

62 Some submitters also suggested the Commission explore alternative solutions to the development of *EnergyHedge*. They believed the volume of trades on *EnergyHedge* would provide a limited view of forward price curves.

63 Energy Link offered two views on the preferred package. The first was based on acceptance of the Group's policy objective; the second was based on acceptance of the GPS policy objectives. The latter included the following changes:

a. reducing the impact of vertical integration through measures such as corporate separation of retailers (e.g. from generation, lines or other) or detailed disclosure rules;
b. development of an exchange traded set of forward and/or futures contracts at key nodes;
c. using loss and constraint rentals to fund initiatives that would reduce the level of surplus; and
d. development of a model master physical supply agreement to work in tandem with the model master ISDA hedge agreement.

64 If Energylink accepted the Group's objectives then they would still recommend that bullets c and d from the above list be implemented.

65 EMS made three suggestions on the preferred package:

a. That FTRs be compared with the final LRA design on a like-for-like basis by parties that have no commercial interest in the outcome;

b. That the LRA design proposal includes a closed tender process as part of the allocation and that once allocated via that tender, the LRA be a tradable instrument either on the primary or secondary market; and

c. That the Commission consider mandating an exchange based trading platform.

Analysis

66 With the exception of LRAs, where several submitters raised significant concerns, there was general agreement with the preferred package. Some submitters raised design issues with the publication of contract details initiative but the Group believes these can be addressed. Publication of contract details and LRAs are discussed in detail under question 6.

67 In addition, no submitters recommended alternative initiatives that could be implemented within the Group's original scope. Some submitters suggested structural changes to the wholesale market but, as described in paragraph 42, these were outside the Group's scope.

68 Some submitters raised concerns about the development of *EnergyHedge* and encouraged the Commission to consider alternative options. The Group's *EnergyHedge* initiative recognises there is an existing industry platform that could usefully be developed further but it is not intended to provide an endorsement from the Commission, and does not preclude the development of alternative platforms.

69 As suggested by EnergyLink and EMS, the Group considered a mandatory exchange for trading of standardised contracts in the technical consultation paper but came to the conclusion it carried a high risk that the designated exchange would discourage participation in the risk management market. The Group decided further consideration of mandatory exchanges should be deferred to allow evolution of the contracts market in response to other initiatives in the preferred package.

Question 6 – The Group identified two initiatives in the preferred package that, in its view, would make the biggest difference in improving existing market arrangements: disclosure of contract information and changing the allocation of loss and constraint rentals. Please describe your views on the practicality and acceptability of these initiatives.

Disclosure of contract information

70 The majority of submitters favoured disclosure. Observations from those favouring disclosure, are that it is a feasible way of supplying a greater level of information on risk management, and increased transparency.

71 A minority of submitters opposed disclosure on the grounds of commercial sensitivity.

72 Comalco's submission in particular notes the business impact from a competitor being able to obtain information on its cost structure, and the difficulties associated with not retaining anonymity for large contracts.

73 An additional argument put forward by Comalco against disclosure is based on the questionable value of disclosing long-term contracts to improve information in a short-term hedge market. For these two reasons, Comalco clearly states that it does not support the proposed disclosure of contract information.

74 Norske Skog and WPI, however, both offer some middle ground in the argument for and against disclosure. Both submitters appear to be in favour of contract disclosure *in principle*, but have concerns on the extent of disclosure due to commercial sensitivity and the adverse commercial impact to large electricity purchasers if competitors can obtain contract information. This suggests some degree of compromise between disclosure and preservation of confidentiality.

75 MEUG also highlighted these concerns in their submission. They described a mechanism where purchasers with very long-term "partnership" style contracts, that often contain many bespoke components, would only be required to disclose a subset of contract information. MEUG explained that the Commission needs to balance the public benefit of disclosure against the cost of disclosure for the company.

76 MEUG also noted that while the disclosure of contract information and LRA initiatives are important, it sees the development of the forward price curve (EnergyHedge) and voluntary standard ISDA (International Swaps and

Derivatives Association) agreements as necessary components of a minimum package.

77 Genesis Energy also references the extent of resistance to high levels of disclosure. While generally supportive of the Group's information-based initiatives, Genesis notes that it shares the Group's view (discussed in paragraph 372 of the technical paper) that disclosure of the full contract details would meet considerable market resistance and is in any event unnecessary in order to gain most of the benefits of disclosure. Genesis raised three additional points:

- Genesis has reservations about the significance of the forward prices produced given the variables published. For example, the price of an off-peak profile compared to a peak profile would be significantly different.
- A short time frame for sellers to publish contract details, such as 15 minutes, seems highly impractical and unnecessarily short.
- Genesis suggested the Commission ensures that the Commerce Commission is aware of the initiatives.

78 Genesis states that it disagrees with the Group's prioritisation and notes that it believes that all of the initiatives should be afforded the same implementation priority.

79 In its submission, ENA has welcomed the enhanced disclosure of contract information. It further noted this initiative seems to be consistent with the Government's policy objectives and would also be in the interest of consumers.

80 Some submitters, notably TrustPower, King Country Energy, and Carter Holt Harvey, expressed strong support for the two initiatives. TrustPower noted endorsement of the contract disclosure initiative but stated that it would not be comfortable if the proposal was modified to require the node at which contracts are struck to be published instead of a geographic region. This contrasts with Cater Holt Harvey's view, which called for the actual node and the name of the generator that wrote the contract to be disclosed.

81 TrustPower also noted that it would be comfortable with the transaction day being displayed as opposed to month or quarter.

Analysis – Question 6

Disclosure of contract information

82 Commercial sensitivity was the main concern submitters raised with the disclosure of contract information initiative. Submitters expressing these concerns were typically large industrials that are price takers in international commodity markets. Although they claimed the initiative would negatively affect their competitive position, it is not evident why (or the degree to which) this would occur, particularly given the price-taking nature of the markets in which they operate.

83 The Group believes the Commission should request further information from these submitters before deciding whether the Group's disclosure proposals need to be changed to address their concerns.

84 The Group has considered the issue of commercial sensitivity and identified two preliminary options that may alleviate the issue.

A one-off dispensation for Comalco

85 The scale of Comalco's electricity purchases in the New Zealand market may make a one-off dispensation appropriate. It could be argued that disclosure of Comalco's contract information will not benefit the market because no other participant has a similar electricity requirement. Under this option, Comalco would be required to provide evidence that disclosure of their contract information would negatively affect their competitive position.

General dispensation with specific criteria

86 If a purchaser of electricity could provide substantial evidence that the disclosure of their contract information would negatively impact their competitive position then some form of general dispensation to disclose contract information could be provided in the disclosure rules.

87 Options for this dispensation include:

a. No disclosure of information – the participant would be fully exempt from any form of disclosure.

b. Limit the volume information that would be disclosed – if a contract is longer than two years and greater than 50MW then the contract volume would be disclosed as >50MW. To enable participants to understand the level of contracted volume in the market the full volume could be included in aggregate statistics for a region.

c. Normalisation to a central hub – historic location factors would be used to normalize the contract location to a central hub. This option may require elements of option b if a party could still be identified from the contract volume, such as Comalco.

88 The Group believes the fundamental presumption should be in favour of disclosure, and therefore stringent criteria would need to be specified to minimise inappropriate dispensations.

89 At this time, the Group believes further proof is required before serious consideration is given to providing dispensations for the disclosure of contract information. If the Commission would like a full investigation into dispensation options this could be referred back to the Group for further consideration.

90 The Group agrees with the concept raised by MRP that a notional volume will be associated with any FPVV (Fixed Price Variable Volume) contracts. In addition, it should be noted that under the Group's proposal, no historical contract information would be retrospectively disclosed.

Allocation of loss and constraint rentals

91 TrustPower noted strong support for the LRA initiative as a practical solution for a broad range of market participants looking to manage locational risk.

92 Some of the submissions supporting the LRA initiative discussed the complexities of implementation. Contact noted that although it considered LRAs have a higher chance of a successful implementation than FTR's, changing the allocation of loss and constraint rentals would be a more complicated proposal to implement.

93 To assist MEUG form a view on the development of LRAs as a mechanism to hedge locational risks, MEUG commissioned the New Zealand Institute of Economic Research (NZIER) to analyse the LRA initiative proposed by the Group. MEUG's submission is consistent with the view expressed in this paper and a copy of the NZIER report titled 'Locational Rental Allocation and Financial Transmission Rights', was included in its submission.

94 Several submissions noted concern over the LRA proposal. The four key concerns related to:

a. Wealth transfers resulting from the LRA methodology;

b. Linkages to transmission pricing;

c. The effects on lines company and retailer pricing decisions; and

d. Consistency with GPS objectives.

95 Comalco and WPI both questioned whether LRAs improve the ability for participants to manage price risk and view this initiative as a wealth transfer. They both highlight the linkage to the transmission pricing methodology and suggest an integrated approach should be adopted. Comalco supported the locational allocation of rentals provided it was also adopted for the allocation of interconnection asset costs.

96 Vector noted that it believes the Group has not clarified the extent to which the recommendations on LRAs meet the Government's policy objectives. Vector noted its continuing support for FTRs until substantial analysis is provided that shows an alternative proposal (such as LRA's) better meet the GPS objectives. Vector also requested that the Commission view all work carried out by the Group as being without due consideration to the impact on transmission and distribution investment.

97 ENA noted that it is not convinced by the consultation paper that the proposed LRA product could achieve consistency with the Government's policy objective. It is of the view that the FTR should be fully considered by the Commission to see if modifications could result in a product that achieved the Government's policy objectives and was practicable for the New Zealand context.

98 ENA also highlighted the impact that LRAs would have on energy prices. Lines companies and retailers would have to adjust their pricing to reflect the loss and constraint rentals being passed back to consumers via a different route and on the basis of a different methodology. ENA did not believe that it was clear the Group had considered the possibility that the price readjustments required by the introduction of the LRA might be considered arrangements that have the effect of fixing, controlling or maintaining the price for goods and services or being seen as a discount allowance rebate or credit in relation to goods and services which could be captured by section 30 of the Commerce Act.

99 Transpower's key concern in its submission was the LRA initiative. Transpower noted that in order for the LRA to provide the missing element of the wholesale electricity market structure, it believes there are a number of fundamental issues still to be addressed:

a. Efficient market design;

b. Impact on nodal pricing;

c. Gross load allocation as a barrier to entry of competition;

d. Impact of the choice of reference node;

e. Impact of the choice of participation factor;

f. Impact of the information used in allocation calculations;

g. HVDC;

h. Incorporating losses into the methodology; and

i. Allocation of interconnection rentals only.

Analysis – Question 6

Allocation of loss and constraint rentals

100 The main conclusion that can be drawn from submissions is the need to develop a prototype LRA system that could then be evaluated against the FTR and hybrid FTR. Several submitters supported the LRA concept but requested more detail to understand how LRAs would affect their risk position.

101 It should be noted that submitters opposing the introduction of LRAs were generally not exposed to price risk. The Group believes the successful implementation of a transmission risk instrument needs to be driven by the needs of parties exposed to price risk rather than by parties wanting to supply risk instruments to the industry.

102 The four main areas that were raised by submitters are analysed below:

<u>Wealth transfers resulting from the LRA methodology</u>

103 The wealth transfers created under the LRA methodology occur because rentals would be paid to parties exposed to location price risk rather than being spread nationally regardless of location risk. The Group believes it is not defensible to preserve current wealth transfers where they arise from inefficient or unfair arrangements.

104 The current rental allocation methodology was designed to preserve the efficiency of nodal pricing signals but this approach didn't take into account the large second order effects that arise for large consumers when they can influence nodal prices by altering their electricity consumption levels. The locational allocation of rentals will start to alleviate these second order effects and improve the efficiency of nodal price signals provided by the wholesale market.

Linkage to transmission pricing

105 The development of the LRA methodology is specifically designed to introduce a stronger location component to the rebate of loss and constraint rentals. The Group acknowledges these changes will not align with the existing TPM but believe there is a pressing need to resolve the basis (locational) risk issue and this should not be deferred until a review is undertaken of location-based transmission charges. Rather, it should add impetus to undertaking that review.

The effects on lines company and retailer pricing decisions

106 In developing the LRA initiative the Group believed it was important that rentals be passed back to those exposed to the price risk. It was the Group's understanding that a number of lines companies already pass through the rentals received from Transpower in order to manage the revenue restrictions imposed by the Commerce Commission.

107 The concerns raised by the ENA appear to relate to lines companies who do not currently pass rentals to their customers. Although the LRA requirements may necessitate a change in pricing by these lines companies, the Group believes the provision of a transmission hedge will improve the final outcome for parties exposed to price risk.

108 It should be noted the issues raised by the ENA will apply to both LRAs and FTRs. The FTR policy framework in the GPS[5] states:

> A distribution company should pass through rental-related or FTR-related cash flows to the distribution company's customers, retailers, and/or end users. The pass through should be transparent, should not discriminate between parties in a like position, and should as far as possible be non-distortionary. It should be consistent with the guiding principles for an FTR market, and in particular have due regard to promoting competition between retailers.

Consistency with GPS objectives

[5] Paragraph 15 of Appendix One

109 The GPS specifically references the development of financial transmission rights (FTR) to enable market participants to manage risk in respect of transmission losses and constraints. A statement of policy concerning financial transmission rights is then outlined in Appendix One[6] and includes the guiding principles for an FTR market:

1. "Realistic long term risk management mechanisms must be made available to end users and to competing retailers.

2. Economic efficiency is a critical goal that should be pursued in a robust but realistic fashion. The concept of economic efficiency includes the integrity of nodal price signals for price-sensitive generation, consumption and investment decisions.

3. FTR design and allocation should give priority to ensuring consumers have access to competitive markets, particularly in regions subject to transmission constraints, but otherwise have due regard to preserving continuity with established price relativities and commercial arrangements.

4. Pragmatic solutions must be developed which are implementable and endurable.

5. Transpower should not be required to take on commercial risk as a result of FTR arrangements without the agreement of Transpower's Board.

6. The design of FTR arrangements should mitigate and manage risk to distribution companies."

110 The Group believes that the LRA methodology is consistent with these six guiding principles. To ensure there are no issues with this approach the concept should be tested with the Ministry of Economic Development before a consultation process is started.

111 Although the conceptual design of the LRA methodology appears to deliver a good transmission hedge, which has support from most submitters exposed to the basis (locational) risk, the Group acknowledge the need for a quantitative comparison with a hydrid FTR.

112 Before this comparison can be meaningfully undertaken the LRA methodology requires a significant amount of further development. The Group has recommended to the Senior Adviser Wholesale that a technical group be formed to develop a prototype LRA system.

113 In parallel with this work, an investigation will need to be completed to develop the allocation component of the hybrid FTR model. This will need to identify the areas of the grid with limited competition and develop an allocation methodology.

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[6] GPS Appendix One - http://www.med.govt.nz/templates/MultipageDocumentPage____6679.aspx

114 To provide the comprehensive analysis that will be required in the next consultation paper, the Group also recommends that both these options are compared with the status quo and a standard FTR product.

Summary Analysis

115 Submitters were generally supportive of the recommendations made by the Group and believed that many of the initiatives now need to be implemented. For some of the initiatives this will involve a period of consultation while others can be implemented immediately.

116 After reviewing submissions, it appears that some submitters believed the Group was dispensing with liquidity as a goal. Liquidity remains a focus for the Group but there is a belief that the optimal level of liquidity should be found by the market rather than be predetermined. The Group's aim was to provide the industry with the necessary information and tools to facilitate this discovery process. If the preferred package does not deliver the desired outcome the Commission can implement other initiatives.

Next Steps

117 The following section briefly outlines the Group's advice on the next steps for each of the seven initiatives contained in the preferred package.

<u>Publication of contract details</u>

118 Submitters were in general agreement with the concept of contract information disclosure. Submitters making claims of commercial sensitivity need to provide more information to support their argument. However, there appear to be options that address submitters' concerns (see paragraph 84) if they have substantial validity. A consultation paper should be developed by the Commission to set out the detailed specification.

<u>Locational rental allocation</u>

119 Although the LRA initiative raised the most concerns during the consultation process, only Energylink raised an alternative option to the development of some form of transmission hedge product. The LRA concept now needs to be prototyped so a full comparison with FTRs and Hybrid FTRs can be developed for the consultation paper.

120 To progress this prototype the Group recommends that the Commission forms a technical working group. To expedite this development work the technical working group should only focus on developing the LRA prototype. Any broader policy issues that arise should be addressed by the Group.

<u>Centralised publication of information</u>

121 No submitters objected to this initiative but some did request greater detail about the information that will be published. The Group advises that the Commission should develop a consultation paper that does a complete stock take of the current information sources and assesses the gaps in this data. Detailed options can then be developed and consulted on.

EnergyHedge development

122 Since the development of the consultation paper *EnergyHedge* has implemented, or is in the process of implementing, the following initiatives:

Implemented from 1 December 2006

a. **Trading term -** The trading term of *EnergyHedge* has been extended by 12 months out to three years, with the inclusion of 4 additional quarterly contracts.

b. **Near Month Trading** – Participants can now trade the first month in the next quarter rather than having to wait for the quarter to start. For example, from 1 December *EnergyHedge* members can trade monthly contracts for January, February or March 2007 instead of these months combined as Q1 2007.

c. **Implied Strip Prices** – This initiative displays implied calendar year average prices based on the average of the quarterly contracts.

Targeted for implementation for trading from January 2007

a. **Implied Prices (nodal) -** Display implied calendar year average prices at any node selected based on historical location factors between the given nodes and Haywards. Location factors will be based on 3 year average prices up to the last full month.

b. **Graphic display -** Display a basic graph of volume and last trade done for the life of each contract.

c. **12-Month Analysis** - Display a basic summary of activity over the past 12 months for each contract, including number of trades, high and low.

d. **Model Master Agreement** – The Standard ISDA agreement that has been developed by the industry will be available for download in pdf format.

123 In addition to this work, the owners of *EnergyHedge* are in discussions with Meridian Energy about including their product requirements on the *EnergyHedge* platform.

124 For this initiative the Group advises that the role of the Commission is to monitor developments and that no further consultation is required.

Model master agreement

125 Since the publication of the consultation paper, the model master agreement has been completed and is now being used within the industry. This document will be added to the *EnergyHedge* website early in the New Year. To publicise its availability a link should be added to the Commission's website to direct participants to the document.

126 Once these tasks are concluded the Commission's involvement in this initiative is finished and no further consultation is necessary.

Regular survey

127 With the exception of Norske Skog, all submitters agreed that a survey was beneficial and should be procured by the Commission. Some submitters commented on the frequency of the survey and the Commission needs to take this into consideration before repeating the survey.

Understanding risk management

128 The consultation paper described two components to the initiative:

a. Encouraging certification of training providers and risk advisors; and

b. Developing information programmes to inform the market as a whole (particularly time-of-use customers) of the importance of understanding risk management techniques in the electricity market.

129 The Group recommends that the Commission should focus at this stage on bullet (a).

Appendix A: Summary of preferred package responses

✓ - Support ✗ - Oppose ( ) - Comment

	Submitter	Publication of contract details	Locational Rental Allocation (LRA)	Development of EnergyHedge	Support for model master agreement	Publication of outage and fuel data	Promotion of training & advisors	Annual survey of market participants	Notes
1.	ANZ National Bank	✓	✗ (Still complex – consider hub and spoke)	✓	✓	✓	✓	✓	
2.	Carter Holt Harvey	✓ (Node and generator disclosed)	✓	✓ (Consider Meridian objectives)	✓	✓	✓	✓	
3.	Comalco New Zealand	✗ (Commercially sensitive)	✗ (Linkage to transmission pricing)	✓	✓	✓	✓	✓	
4.	Contact Energy	✓	✓	✓	✓	✓	✓	✓	
5.	Electricity Networks Association	✓	✗ (Implications for energy prices)	✗ (Explore alternatives)	✓	✓	✓	✓	
6.	Energy Market Services	✓ (Mandatory via an exchange traded product)	✓ (Design changes)	✗ (Explore alternatives)	✓	✓	✓	✓	

Appendix A: Summary of preferred package responses

✓ - Support   ✗ - Oppose   ( ) - Comment

	Submitter	Publication of contract details	Locational Rental Allocation (LRA)	Development of EnergyHedge	Support for model master agreement	Publication of outage and fuel data	Promotion of training & advisors	Annual survey of market participants	Notes
7.	Energy Link	✓	✗ (Design changes – reduce surplus at source)	✓ (Question credibility of EnergyHedge but support development)	✓ (Also requires model master physical)	✓	✓	✓	Energylink raised a number of concerns with the HMDSG objectives. This assessment assumes acceptance of HMDSG objective.
8.	Genesis Power	✓	✓	✓	✓	✓ (Not public disclosure)	✓	✓	
9.	King Country Energy	✓	✓	✓	✓	✓	✓	✓	Assigned different priorities
10.	MainPower New Zealand	-	-	-	-	-	-	-	Focussed on structural issues
11.	Meridian Energy	✓ (Compliance and competition issues)	✓ (Require more info)	✓ (Suggested developments)	✓	✓	✓	✓	
12.	Major Electricity Users' Group	✓ (Suggested design options)	✓ (More work required)	✓	✓	✓ (Convert to graphical form)	✓	✓ (Notes on timing)	Development of forward curve and standard ISDA are necessary component of a package.
13.	Mighty River Power	✓ (Add FPVV notional quantity)	✓	✓	✓	✓ (Not contract prices)	✓	✓	

Appendix A: Summary of preferred package responses

✓ - Support ✗ - Oppose ( ) - Comment

	Submitter	Publication of contract details	Locational Rental Allocation (LRA)	Development of EnergyHedge	Support for model master agreement	Publication of outage and fuel data	Promotion of training & advisors	Annual survey of market participants	Notes
14.	New Zealand Steel	✓	✗ (More work required)	✓	✓	✓	✓	✓	
15.	New Zealand Sugar Company	✓	✓	✓	✓	✓	✓	✓	
16.	Norske Skog Tasman	✓ (Commercially sensitive)	✗ (More work required)	✓	✓	✓	✗ (Should be individual's responsibility)	✗ (Prove value of survey)	Believe synthetic separation has merit.
17.	Orion New Zealand	✓	✓	✓	✓	✓	✓	✓	
18.	Transpower	✓	✗ (Integrated investigation into an efficient market)	✗ (Explore alternatives)	✓	✗ (Needs clarity)	✓	✓	
19.	TrustPower	✓ (Retain regional)	✓	✓	✓	✓	✓	✓	
20.	Unison Networks	✓	✗ (Price signals)	✓	✓	✓	✓	✓	Package is a move in the right direction.
21.	Vector	✓	✗ (More work required)	-	✓	-	✓	✓	

Appendix A: Summary of preferred package responses

✓ - Support   ✘ - Oppose   ( ) - Comment

	Submitter	Publication of contract details	Locational Rental Allocation (LRA)	Development of EnergyHedge	Support for model master agreement	Publication of outage and fuel data	Promotion of training & advisors	Annual survey of market participants	Notes
22.	Winstone Pulp International	✘ (Commercially sensitive)	✘ (Linkage to transmission pricing)	-	-	-	-	-	

Appendix B: Consultation Submission Summary

Appendix B: Consultation submission summary

Question 1: The Group defined its policy objective as promoting a well-functioning hedge market. By contrast, the GPS policy objective for the hedge market is to improve transparency and liquidity. The Group questions whether liquidity is a goal in itself, and the extent to which it can be achieved in the New Zealand context. Do submitters agree with the Group's policy objective? If not, please outline what you consider the policy objective should be.

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
1.	Agree	Carter Holt Harvey	Improving transparency is fundamental. Agree that improving liquidity is a less important objective.
2.	Disagree	Comalco	Working towards improving transparency and liquidity will improve the functioning of the hedge market. It may ultimately prove not to be possible to develop a transparent or liquid market, but these goals should not be dispensed with yet. The goal of the Group should continue to be the goal expressed in the GPS.
3.	Agree	Contact	Contact agrees that liquidity is not an end in itself. Rather, the goal should be to enable the optimal level of liquidity to be found for the market. We note that while the Government Policy Statement states that *"a transparent and liquid hedge market is a critical component"*[1] of a wholesale market, it does so in the context of risk management and facilitation of retail competition. Contact considers that there are characteristics of the New Zealand market that make expectations of high levels of hedge market liquidity unrealistic. Some of those characteristics are similar to those experienced by other commodity and derivative markets in New Zealand. A liquid hedge market, by definition, requires a large volume of trades. That is, there needs to be a large number of market participants engaged in trading, as well as sufficient reason for these traders to engage in recontracting. The New Zealand market is limited in both respects.

[1] Government Policy Statement, para 76

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			The size of the overall market, and thus the number of participants trading, is a major limiting factor. The IEA, in its report on energy in New Zealand, states that *"it is difficult to develop deep, liquid futures and forwards markets because fewer market participants want to contract for energy in any particular time period in the future."*[2]. Another key requirement for liquidity is a large volume of trading in secondary markets. Secondary market trading is a result of end users and traders striving to rebalance their portfolios consistent with a certain strategy, in light of newly available information. A key determinant of trading volume is therefore the manner and frequency with which new information becomes available. However, the fundamental characteristics of the New Zealand electricity market contain only a small number of key spurs to frequent recontracting, and hence to a high volume of trade.[3] Planned outages may lead to some recontracting, but unplanned outages happen too quickly, and variations in demand happen too slowly, to provide a major source of liquidity. New information about hydrology arrives frequently and is inherently unpredictable, but it does not generally lead to a large amount of recontracting in New Zealand, as thermal generation can act as a natural hedge against variation in hydro output. Thus Contact considers that there are characteristics inherent in the New Zealand electricity system that mean that the development of high levels of market liquidity is unrealistic. We concur with the approach of the HDMSG; that is, to focus instead enabling *"efficient and effective price risk management among participants in the electricity market,"* as suggested in the discussion document.
4.	Disagree	Electricity Networks Association	ENA agrees with the Government's policy objective with respect to hedge markets generally and FTRs specifically and notes that the Electricity Commission is required to

[2] New Zealand 2006 Review, Energy Policies of IEA Countries, OECD/IEA, 2006.
[3] "Hedge Markets and Vertical Integration in the New Zealand Electricity Sector," National Economic Research Associates, October 2004, section 5.2. A copy of the paper has been provided previously to the Electricity Commission in response to the State of Competition and Barriers report, on which the Commission invited submissions. It is available on the internet from http://www.electricitycommission.govt.nz/pdfs/submissions/pdfsretail/pdsfcompetition/Contact-ref.pdf

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			give effect to GPS objectives and outcomes[4]. With respect to hedge market transparency and liquidity the GPS states, "a transparent and liquid hedge market is a critical component of an efficient wholesale market. It enables market participants to manage their risks and facilitates retail competition." [5] The policy objective of a transparent and liquid hedge market is reflected in the scope provided to the Steering Group so it is not clear to us what the status of the Steering Group's proposed policy objective is. We commend the Steering Group for developing the initiatives in relation to transparency and support these. However, we are a little surprised that the Steering Group is seeking to deliver on the mandate given it by the Commission by developing an alternative policy objective[6] and then seeking to serve that with respect to liquidity. The Steering Group is recommending that the achievement of a transparent and liquid hedge market be replaced with "provide the foundations for a well functioning market for instruments used by buyers and sellers to manage their price risks efficiently". [7] As a result there seems to be an absence of a full examination of possible developments in relation to liquidity. The discussion of any sort of trading platform, central market place for trading hedges/forward contracts/futures contracts, an exchange, broker support or any other forum for developing liquidity and open exchange directly is rejected with what seems

[4] Electricity Amendment Act 2004section 16 172O 1 (j)
[5] Government Policy Statement on Electricity Governance 16 November 2005 paragraph 76
[6] Paragraph 19 Electricity Commission Hedge Market Development – Issues and Options: Overview Paper 18 July 2006 "since its formation the Group has established appropriate policy objectives for price risk management in the New Zealand context".
[7] Paragraph 211 Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006
[8] Section 6.9 Overview Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006
[9] . EnergyHedge is referred to in the Overview Paper as a "web-based platform for parties to trade standardized derivatives". In the Technical Paper EnergyHedge is variously described as a "trading platform" and a "very simple and low cost mechanism for obtaining generator/retailer views on forward prices for standardized derivatives".
[10] Paragraph 520 Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006
[11] Government Policy Statement on Electricity Governance 16 November 2005 Appendix I Financial Transmission Rights
[12] See Appendix F Technical Version of the LRA Methodology Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			to be limited analysis. "Given these uncertainties, and the prospects that other initiatives may voluntarily increase standardisation of contracts, the prudent approach is to defer further consideration of the initiative to provide time for the derivatives market to evolve in response to the other initiatives recommended in this paper"[8]. The "other initiatives recommended in this paper" seem to rely a great deal on the inter-generator arrangement known as EnergyHedge. (The web based screen page EnergyHedge[9] is governed by the generator/retailers' own rules and their own governance.) This "market" is effectively illiquid and its governance is beyond the Commission's control. The GPS policy objective is for the Commission to seek greater transparency <u>and</u> liquidity. It looks as thought the Steering Group has acquiesced to the views of the generator/retailers on the steering group by proposing an alternative policy objective and, with little in depth analysis, deferring exploration of a forum for open exchange of contracts in some form or another under the Commission's guidance. The Technical Paper essentially confirms this with the comment that: "other platforms are unlikely to be successful anyway as they do not have generator backing, which is necessary for market making and trading to occur."[10] With respect to FTRs the GPS states that the Electricity Commission should oversee the development of financial transmission rights (FTR) to enable market participants to manage risk in respect of transmission losses and constraints and sets out the guiding principles for this. Specifically this includes the point that "economic efficiency is a critical goal that should be pursued in a robust but realistic fashion. The concept of economic efficiency includes the integrity of nodal price signals for price sensitive generation, consumption and investment decisions" [11]. The FTR product previously proposed and now dismissed by the Steering Group is in operation in the PJM, New England and New York electricity markets having been developed over a number of years. The LRA concept proposed by the Steering Group is not in operation anywhere, there is not enough developed detail to evaluate it alongside the FTR[12] and it is not clear that it meets the objectives set out in the GPS.
5.	Agrees	Energy	EMS agrees with the policy objectives outlined in the Government Policy Statement (GPS)

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
		Market Services	that states that hedge markets should "improve transparency and liquidity". EMS does not agree that a "well-functioning market" is a sufficient policy objective as outlined by the HMDSG. A "well functioning market" means different things to different parties depending on their commercial position and the revised statement does not reflect the intended outcome outlined by the Minister in the GPS. The intentions of the GPS were to develop and implement a hedge market for buyers of electricity to manage its underlying risks due to price volatility in the physical market. In order to achieve a suitable hedge product that values the hedge commensurate with these underlying risks, the hedge must not only be transparent so that all participants have access to all relevant information, but the liquidity levels must be sufficient to ensure that appropriate hedge values are struck. "Transparency" and "liquidity" are therefore two primary necessities in any derivative market to ensure that the instruments act as suitable hedges. EMS fully subscribes to these concepts and therefore disagrees with the HMDSG's revised policy objective.
6.	Disagree	Energy Link	As far as we are aware, there is no standard definition of a 'liquid market', but commonly available definitions have one or more of the following characteristics. In our training courses we define market to be liquid when: 1. trades can be made easily and readily; 2. individual trades do not significantly affect the price of immediately subsequent trades; 3. forward prices (of traded contracts) are readily available to any person wanting to trade on that market. By this definition a liquid market also has a high degree of transparency, at least as far as the prices and volumes of contracts traded on the market are concerned A liquid market does not necessarily require a very large number of trades per unit time, but if trading volumes fall below some threshold then at least criteria 1 above will not be met and 2 will be in danger of being violated. A forward curve is simply the graph of the prices of forward dated contracts, such as

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			electricity hedges, plotted against time to maturity. Any forward market has a forward curve but in our hedge market training courses we refer to the forward curve arising from a liquid forward market as a 'robust forward curve'. A robust forward curve is significantly more useful to would-be hedgers than just any old forward curve – for example, it allows hedge contracts to be marked-to-market (which simply means valued) at any point in time . The fundamental question to ask is – can a hedge market be functioning well but not liquid? If trades can not be made easily and readily then it is doubtful whether the market is working well since it might fail to trade at times, even though there are would-be hedgers willing to trade. So condition 1 is necessary for a hedge market to function well. When a robust forward curve is available to a market then market participants will still refer to other sources of information about future prices of the underlying asset or commodity, e.g. forecasts (their own, industry or independent forecasts), some form of technical analysis (e.g. trending) or to market 'fundamentals.' If forward prices are not readily available to hedgers then they must rely on these other sources of information – but even then the market could conceivably still be working well. It is possible to imagine a market in which individual trades do 'move the market' yet the market is still functioning well. For example, it may be that forward prices are known to tend to move in a particular way after larger trades. However, if forward prices move significantly due to a lack of competition in the forward market then these movements could be highly unpredictable and could also impact on the willingness of would-be hedgers to make trades, thus impacting on the overall ease with which trades can be made. To conclude, a market could be working well even if not liquid. A market that is liquid, by our definition, will be working well and will be transparent. An illiquid market that is considered to be working well should at least allow for trades to be made easily and readily and there should be enough information available about forward prices and future expectations to support hedgers. Tech Paper paragraph 213 states that "the HMDSG identified four fundamental elements for a well functioning risk management market:

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			a) competitive underlying physical market; b) sound rules and standards; c) appropriate infrastructure, covering both technical and human factors; and d) high quality information and efficient information flows." Since the group abandoned the more stringent criteria of a liquid market, we are not convinced that the four elements listed above are sufficient for the 'well functioning' hedge market. In particular, we are not convinced that developing elements a through c listed above will lead to trades being made easily and readily. For example, the underlying physical market may be competitive but does this guarantee that the derivative hedge market is competitive? If the hedge market is not competitive in its own right then trading could be limited and prices could be manipulated. Neither the Overview Paper nor the Technical Paper address this particular issue satisfactorily, in our view. We would like to have seen more consideration given to potential solutions to underlying structural problems, the solving of which might lead eventually to a liquid market. **New-entrants** A less obvious issue around the policy objective, is that of barriers that new-entrant retailers and generators face in the hedge market. We are aware of a number of apparently beneficial generation prospects developed by small would-be generators, for whom hedging the output remains a significant and largely insurmountable barrier, especially as the option of also becoming a retailer requires the development of two new businesses, not just one. Becoming a retailer also entails high fixed costs, due to the current set of EGRs developing around the potentially flawed assumption that "retailers must have scale." While there is already a high level of competition to be the builder of the next generator, despite vertical integration, the structure and illiquidity of the hedge market nevertheless reduces the potential pool of beneficial generation proposals able to be brought to market. Due to illiquidity in the hedge market, new-entrants are more often than not forced into

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			negotiating with one or more direct competitors, i.e. one of the vertically integrated generator-retailers. While there is the potential for hedging directly with purchasers, the feasibility of this approach is significantly curtailed by the lack of purchasers in the hedge market who are in the market for hedges at the right time, and who are large enough to absorb a significant portion of a new generator's output. A fully liquid hedge market would remove this potential barrier and promote further competition in the generation sector. In this case the policy objective for HMDSG should definitely be GPS objective of a liquid hedge market (which would also lead to transparency by our definition of a liquid market.) Would-be new retailers face an even tougher task because, unlike would-be generators, their business does not require the acquisition of high-value and long lived assets which can assist in securing capital. Given current margins2 in the retail business any merchant retailer would require a high level of hedge cover at a competitive price to reduce working capital requirements to a level which would deliver a return on investment commensurate with the risks faced by such a retailer. A liquid hedge market would provide would-be retailers with an effective way to manage spot market risks. A "well functioning" hedge market as envisaged by the HMDSG almost certainlywould not. **Policy Summary** While implementing the HMDSG's recommendations could help the hedge market function well in a limited sense, improving on the market as it is today, ultimately liquidity is required to achieve the wider benefits implicit in the GPS, especially when it comes to lowering barriers to the entry of new generators and retailers. The HMDSG's objective for the hedge market falls significantly short of the objective expressed in the GPS. If the objectives of the GPS are to be met then the hedge market will need to meet our three criteria for a liquid market listed in section 2. We note at this point, however, that the changes required to get the hedge market to be fully liquid would almost certainly require significant changes to the structure or operations of the current set of generator-retailers. In our opinion it would have been unrealistic to expect the HMDSG, under its original terms of reference, to have tackled changes of that scope and magnitude.

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
7.	Agree	Genesis	Genesis Energy agrees with the HMDSG that the primary objective should be to achieve conditions that allow for efficient and effective electricity price risk management rather than forcing a highly liquid electricity hedge market. Given the characteristics of the New Zealand electricity market, any attempt to force a liquid market (whatever that means) is likely to be counter-productive.
8.	Agree	King Country	The GPS objective of "*implementation of a transparent and liquid electricity hedge market"* reflects a desirable end state. KCE agrees with the Steering Group position that liquidity in the market is not a direct outcome achievable in their work. We believe, however, that their defined policy objective of *"promoting a well-functioning hedge market"* is a necessary, though not sufficient, prerequisite for achieving the GPS objective.
9.	Disagree	Mainpower	The Electricity Commission must be seeking outcomes that are likely to substantially improve the liquidity and transparency of the electricity hedge market. The Advisory Group's recommendations do not achieve this – they are too minimalist in their effect. With liquidity and transparency, there is the best prospect of competition entering the market. EnergyHedge, for example, exists, but the volumes are so small and much of the non-price information months out of date, to suggest that the market is ineffective; it does not provide real liquidity or transparency.
10.	Agree	Major Electricity Users Group	The GPS focus on liquidity is too narrow although the suggestion that transparency needs to be improved is agreed. MEUG agree with the HMDSG focus on improving the risk management market for TOU consumers, suppliers, intermediaries and potential new entrants.
11.	Agree	Meridian	The HMDSG was initially set up to "provide advice to the Commission on the development and implementation of a transparent and liquid electricity hedge market"[13]. The basis for the HMDSG terms of reference was paragraph 76 of the GPS which is set out below:

[13] HMDSG terms of reference.

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			76. *A transparent and liquid hedge market is a critical component of an efficient wholesale market. It enables market participants to manage their risks and facilitates retail competition. Concerns are regularly expressed that the current hedge market does not operate particularly well.* The HMDSG came to the view that it may be unrealistic in the current circumstances for the relatively small New Zealand electricity market to sustain a highly liquid market for hedging electricity price risks. Therefore the HMDSG decided that its objective should be amended and restated as to "recommend to the Commission a package of initiatives that would collectively provide the foundation for efficient and effective price risk management among participants in the electricity market". Meridian agrees that the objective of the HMDSG should be to provide the Commission with a voluntary package of initiatives that support development of efficient and effective price risk management. Meridian considers that the job of the Commission should then be to determine whether this package is likely to deliver 'a transparent and liquid' hedge market as set out in paragraph 76 of the GPS or whether the Commission needs to recommend regulations as suggested in paragraphs 71 and 77 of the GPS, (set out below), to realise this goal. 71. *The Commission is also expected to be active in monitoring developments, using the powers available to it, and, if necessary, making recommendations to the Minister on any further powers it believes to be necessary to ensure the market operates efficiently. This may involve:* • *Undertaking co-ordination tenders to incentivise (via payments) a combination of hydro storage and thermal fuel that is sufficient to achieve the security of supply*

[14] Meridian has read the 2004 "Hedge Markets and Vertical Integration in the New Zealand Electricity Sector" paper prepared by NERA and while that paper is well founded, the conclusion that New Zealand derivatives market may be unable to reach a high level of liquidity must be tested rather than simply accepted. Meridian for one, suggests that a liquid and transparent forward market can develop in New Zealand.

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			standard over a short term timeframe (e.g. one year) • *Using the proposed additional powers in the Electricity Act 1992 to recommend regulation or rules, which should be applied in non-discriminatory manner, to:* • *set minimum requirements on generators to hold or provide for reserve fuels (including water)* • *set requirements on generators to offer by tender a minimum volume of contracts that enable the price associated with the spot market to be managed, including requirements relating to the terms and conditions of those contracts (excluding prices and reserve prices). This would incentivise generators, if those contracts were taken up, to hold sufficient capacity and fuel to meet those contracts or to cross insure with other generators for that purpose* • *set requirements on retailers and other direct buyers of electricity from the wholesale market to maintain minimum levels of hedge and contract cover with generators and/or minimum levels of hedge and contract cover with generators and/or minimum levels of demand-side management programmes and contracted demand response.* *77. The Government has amended the Electricity Act 1992 to provide regulation making power to establish and promote hedge markets. As with other regulation making powers, the Commission may only recommend regulations if it has first established that there are significant problems that are not resolvable through voluntary arrangements and co-operation. The regulation making power cover:* • *Disclosure of information on hedge and contract volumes and prices;* • *Requiring generators to offer by tender a minimum volume of contracts that enable the price risks associate with the spot market to be managed, including the terms and conditions of those contracts (excluding prices and reserve*

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Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			prices); • *Requiring generators to post buy and sell prices for hedge (including futures) contracts; and* • *Requiring buyers of electricity from the wholesale market to maintain minimum levels of hedge and contract cover with electricity generators.* If the Commission is satisfied that these voluntary initiatives, with modifications based on submissions received, are likely to resolve any problems then it should develop specific rules (where necessary), consult with industry on those proposed rules and implement the initiative as and when practical. Meridian suggests that a transparent and liquid hedge market can and must be developed in New Zealand and that it should continue to be the objective of the Commission14. The Commission should not seek to make amendments to the GPS in this regard. The degree of liquidity and transparency is by definition subjective and should and will continue to be debated.
12.	Agree	Mighty River Power	We agree that the focus on liquidity in the Steering Group's terms of reference, although well intentioned, is not a valid approach in a small market such as New Zealand. In our view, the more practical outcomes approach as adopted by the Steering Group is far more likely to deliver economic benefits to the industry and to end-users than a focus on liquidity.
13.	Agree	NZ Sugar	We are supportive of the broad range of initiatives being proposed by the Hedge Market Development Steering Group, and in particular the focus on providing tools and mechanisms that facilitate and encourage use of more standardised derivative contracts. Developing increased transparency and liquidity through increased simplicity and standardisation is key to organizations of our size being able to interact effectively in this market.
14.	Agree (with caveats)	Transpower	The New Zealand wholesale market is a small market relative to other deregulated electricity markets around the world. As a result the Government Policy Statement's (GPS) objective of a liquid hedge market is not an easy one to realise. This is recognised by the

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Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			HMDSG and as such they have chosen to replace the GPS objective of promoting a transparent and liquid hedge market, with one of "promoting a well functioning market". The HMDSG replacement drafting of this objective has dropped two key elements – the concept of transparency and of facilitating retail competition. In addition the HMDSG statement has moved away from the stated hedging mechanism required as part of the GPS. **Transparency** Transparency and liquidity, although they can reinforce each other in markets with greater depth than that in New Zealand, do not necessarily have to go together. That is, while the focus on liquidity may or may not be relevant in New Zealand's particular circumstances, this does not mean that the promotion of transparency at the GPS level should likewise be replaced. If anything, if liquidity is not to be an objective of the GPS, this change makes the promotion of transparency yet more important. Transpower notes that the locational rental allocation methodology proposed by the HMDSG reduces the transparency of the marginal locational price signal. This is because the allocation methodology contains components such as reference price nodes and participation factors that are only obtainable from complex calculations. The result of the allocation is therefore known only to each participant who receives their own individual allocation. The calculation of FTRs is also complicated, however an FTR auction clearly indicates the market price of the FTR, and apart from over the counter trading this should be the same for all relevant participants. Therefore, while Transpower has no comment to make on whether liquidity should be an objective within the GPS, Transpower is of the view that transparency should remain an objective. **Retail competition** The other crucial distinction between the two objectives is that the GPS objective seeks to manage risk and facilitate retail competition. A number of the proposed initiatives in the package seek to achieve a level playing field upon which participants can fairly compete in the same market. However, there is a risk that smoothing out the differences and assisting in information disclosure may create circumstances in which it benefits participants to collude. The HMDSG policy statement needs to emphasise the requirement for competition within the wholesale market and should ensure that the preferred package initiatives reflect this aim.

Question 1: Do submitters agree with the Group's policy objective?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
15.	Agree	Trustpower	Yes, TrustPower agrees with the groups policy objective the group developed, and agrees in particular that to apply liquidity as a primary measure of success is too narrow in the context of the New Zealand market.
16.	Disagree	Vector	Vector has some concern over the working group's apparent move away from the issue of liquidity, which Vector believes is one of the fundamental issues- as identified in the Government GPS. Vector does not support any move toward mandatory forward prices at this stage, but does support monitoring of forward hedge arrangements, so that the situation can be clearly monitored.
17.	Agree	Winstone Pulp International	WPI considers that the Group's proposal is appropriate in that a well functioning hedge market would, by definition, incorporate optimal transparency and liquidity. Transparency and liquidity may well be key features required to enable long term hedge contracts to be entered into. It would be difficult for electricity users to sign long term hedges if a liquid exchange market that allowed for adjustments over time did not exist.

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3? If not, please outline what you consider to be the problems.

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
18.	Agree	Carter Holt Harvey	The problems identified by the HMDSG cover the key areas. From Carter Holt Harvey's perspective the hierarchy of importance of each problem area (in descending order) is as listed in the paper. i.e. 1. Lack of robust information 2. Lack of confidence in competitiveness 3. Lack of instruments to manage locational-based prcie risk 4. High participation and transaction costs 5. Lack of understanding of electricity price risk The issues left out of the scope of the HMDSG also seem appropriate.
19.	Agree	Comalco	Yes
20.	Agree	Contact	The problems identified by the HDMSG are: • Lack of robust information about forward prices, fuel levels, planned outages, etc • Lack of confidence in the competitiveness of the market for term contracts • Lack of a suitable instrument to manage locational-based or transmission price risks • High participation and transaction costs • Lack of understanding in the marketplace of the advantages, techniques, and uses of price risk management Contact Energy agrees with this assessment.
21.	Agree	ENA	ENA substantially agrees with the problem definition. However, section 3.3 spends more time asserting the merits of the proposed initiatives than it does analysing the problems. "EnergyHedge provides a highly transparent forward price curve, but it covers only a very small volume of contracts. Some observers argue that is therefore

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholde r	Comment
			of limited relevance. On the other hand some generator/retailers say that their customers are often using it as a reference in bilateral negotiations."[15]. This is neither in-depth analysis nor effective problem identification but the proposition contained here seems to be the basis for the conclusions reached elsewhere in the paper. ENA's view is that liquidity remains the problem and the Steering Group has not represented the Commission's objectives by taking guidance from and alternative policy objective. Section 3.3 recognises the lack of a suitable mechanism for market participants to manage their location price risks and we concur that that is a problem. The objective for introducing FTRs is interpreted as being "the challenge is to find an effective pragmatic and cost effective solution to the lack of transmission hedges. " We agree that this is an aspect of the problem. The risk with the LRA discussed in the section on transmission risk management initiatives is that, while it might result in rentals being allocated in a pragmatic and cost effective way, it compromises nodal price signals and efficiency. The point that any development of a tool for locational hedging is an advance on the status quo and that it has been a long time coming is a point well made. However, the LRA is not a financial transmission right. The problem remains that there is a lack of an FTR and the objective remains to install an FTR that achieves economic efficiency including the integrity of nodal price signals for price sensitive generation, consumption and investment decisions The key problem has been interpreted as the allocation of loss and constraint rentals rather than the integrity of nodal price signals and so it is no surprise that the paper concludes that the best solution is the LRA concept. ENA's view is that the problem that should have been addressed is an FTR that achieves economic efficiency

[15] Paragraph 253 Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholde r	Comment
			including the integrity of nodal price signals for price sensitive generation, consumption and investment decisions.
22.	Agree	EMS	The UMR Research activities identified the 5 key issues facing the market that are either inhibiting competition and/or barriers to implementing a hedge market to manage price volatility. EMS agrees with these key issues and agrees with the findings of the HMDSG. However the primary issue facing the market is access to appropriate information to manage price risks.
23.	Disagree	Energy Link	In our opinion this list is far from complete, and misses some of the key structural issues which act to reduce liquidity in the hedge market. Our list of structural issues is: • uncertainty around hydro inflows combined with the lack of a capacity market; • Vertical integration of retail generation; • Relaive size of hedge market participants; • Imperfect grid; • Conditions on contracts for physical supply; • The dynamic interaction between the spot and hedge markets. <u>Key problems summary</u> The hedge market is illiquid due to the underlying characteristics of the physical, institutional and commercial structure of our wholesale electricity market, including imperfections in the grid. Ultimately, a number of these characteristics need to be addresses directly if the hedge market is ever to be considered a liquid forward market.
24.	Agree	Genesis	In broad terms, Genesis Energy agrees with the key problems identified by the HMDSG but questions the logic and nature of some, as outlined in other paragraphs 13 – 19 of the cover report.
25.	Agree	King Country	• Lack of robust information is one of the key factors that create suspicion in those who are not intimately involved with the market. In our opinion this is the most important of al issues raised.

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			• Lack of competitiveness (whether real or perceived) should be a key focus for the EC in all areas of its work. • Management of locational-based price risk will certainly assist all market participants but particularly the small and/or new entrant players. • High participation and transaction costs are, in our belief, one of the key factors that inhibit participation by new and small participants in the market. • The issue of lack of understanding is pervasive throughout almost all issues facing the EC and it is critical that this is treated on a broad basis and not solely in individual work groups such as this.
26.	Agree	Mainpower	At the Christchurch briefing of the Advisory Group, those of us present were advised that the problems with the current market are; 1. Lack of robust and timely information 2. No hedge for location price risk 3. Lack of confidence in competitiveness 4. Weak understanding of price risks and how to manage 5. High participation and transaction costs We would agree with the assessment as regards points 1 and 3-5. This is a result of the industry environment that has evolved in New Zealand. It is our view that these points are hugely interrelated – the lack of **liquidity and transparency** are the fundamental issues.
27.	Agree	MEUG	The problems identified by the HMDSG reasonably reflect the experience of MEUG members and the issues identified by the UMR survey.
28.	Agree	Meridian	Meridian has no specific comment on the problems that were identified in the survey of hedge market participants. However, it does recommend that the survey should be repeated

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			annually to assist determine whether the objectives of the GPS are being delivered upon (assuming the preferred package of initiatives proposed by the HMDSG are implemented). Meridian does agree that forward price risk management and hedging is important to the economy and that the process of entering into forward contracts must continually be refined and improved. So rather than focus on problems, Meridian has focussed on the proposed package of initiatives to determine whether they are likely to materially improve price risk management activities among participants in the electricity market. Meridian submits that the package generally achieves this objective (with modification as suggested in this submission).
29.	Agree	Mighty River Power	Mighty River Power agrees that the over-the-counter (OTC) and wholesale electricity markets may not be as competitive as they could be (compared against a perfect competition standard). However, Mighty River Power cautions the Electricity Commission on drawing conclusions based on the above premise without evidence. In this respect we note that the Steering Group states: Independent retailers and generators may be deterred or foreclosed from entering the New Zealand market. This foreclosure concern arises from new entrant concerns that they may not be treated fairly by incumbent generator/retailers when it comes to negotiating contracts through the OTC market, either when they seek to enter the market or when they seek to renegotiate contracts. This statement suggests the existence of anti-competitive conduct on the part of incumbent generator/retailers. However, neither the Technical Paper nor the Overview Paper provides any evidence to support this suggestion. We argue the lack of evidence is because none exists. The Technical Paper states:[14] Both the MED and Commerce Commission have considered this issue in response to pressure from purchasers. John Small prepared a report on hedge market issues for the MED in March 2002 which did not reach any conclusion on whether or not market power exists. The Commerce Commission has considered market power issues on several occasions; however, in no case did it determine that market power had been exercised.

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholde r	Comment
			The Steering Group states that "many electricity participants have a limited understanding of the benefits of hedging and limited knowledge and experience of thinking in terms of managing the risks of electricity prices moving." We acknowledge that there may be a lack of understanding on the part of some participants. However, this lack of understanding may very well reflect that price risk is not a material matter for many end-users (e.g. because the cost of electricity is a relatively small component of their costs, allowing them to effectively 'self-ensure'). This could well explain lack of demand, and therefore a lack of importance of hedges for many participants as noted by the Steering Group, there is a perception among firms that the purchase of electricity is a procurement function rather than a risk management function. We agree that commercial solutions as opposed to political interference are the way forward in dealing with electricity price risk; and that the view of some participants that political interference in the market is required is driven by a lack of understanding about the potential of price risk management techniques to deal with price risk management. Mighty River Power agrees with the Steering Group's analysis of hedge market policy as it intersects with other Electricity Commission work streams and with competition issues properly the domain of the Commerce Commission. Namely that the following matters are not within the Steering Group's scope: • The adequacy or otherwise of the level of competition in the various electricity markets – retail, wholesale, system operation, reserves, frequency keeping, etc. The Group noted that this was being actively considered by the Commerce Commission and it duplicating its work was undesirable; • The structures of the wholesale and retail markets; • The legal separation of the ownership of retailers and generators; • Issues underlying the spot wholesale electricity market; • The sufficiency of the level of generation for security of supply;

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			• The ownership of market participants; and • The overall regulatory arrangements of the electricity industry. **Concluding remarks on key problems** Mighty River Power recommends that the Electricity Commission accept the Steering Group's assessment of the key problems associated with the price risk management market, but cautions that the perception among some participants that there is a lack of competitiveness in the risk management market is ill conceived. Although the market may not be operating optimally, there is no evidence to suggest that this is caused by the exercise of substantial market power. The conclusion that Mighty River Power draws from the Steering Group's analysis of the regulatory problem is that there are imperfections in the market but these are not a consequence of inadequate competition or substantial market power. This has important implications for the appropriate options for consideration; namely that the regulatory options that will be most appropriate are ones aimed at facilitating the market rather than regulating market participants. This is a point that is discussed further in relation to some aspects of the options that the Steering Group identified and considered; notably this point suggests that options such as synthetic separation would be misdirected and inappropriate. Mighty River Power notes that we consider that the Electricity Commission should only consider options for facilitating the hedge market that do not entail regulating market participants.
30.	Agree	Transpower	The key problems relating to the hedge market identified by HMDSG are: • Lack of robust information about forward prices, fuel levels and plant outages • Lack of confidence in competitiveness of market for term contracts • Lack of suitable instruments to manage locational based or transmission price risks • High participation and transaction costs • Lack of understanding of advantages, techniques and uses of price risk management Transpower agrees with the HMDSG that the identified problems– notably the lack of

Question 2: Has the Group correctly identified the key problems relating to risk management in Section 3.3?

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			instruments to hedge transmission risk - are key problems.
31.	Agree	Trustpower	Yes, Trustpower considers the group has identified the key problems relating to risk management
32.	Agree	Vector	Vector also agrees with the points of the working group's definition of 'the problem with hedge arrangements', particulary on the lack of understanding of the benefits of hedge arrangements and forward price curves and their importance in maintaining confidence in electricity markets generally.

Question 3: Do you agree that the evaluation criteria outlined in Section 4.2 are appropriate criteria for assessing the initiatives? If not, please outline the evaluation criteria that you consider more appropriate.

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
33.	Agree	Carter Holt Harvey	Yes
34.	Agree	Comalco	The basic criteria have merit, however a quantitative cost benefit analysis is also needed. As the initiatives identified by the HMDSG allinvolve at least a set-up cost it is important to know that these costs arejustified. It is acknowledged that a quantitative cost benefit analysis maybe difficult to undertake, however it is an important step to take beforeany of the proposed initiatives are implemented. Several of the issues discussed in the papers (and especially the contract disclosure and LRA) have significant implications for many participants. It would be poor regulatory practice for new rules and regulations to be drawn up without a robust economic evaluation that clearly establishes the need for such interventions.
35.	Agree	Contact	Contact agrees that a qualitative cost-benefit analysis is appropriate in this case, along with an evaluation of the implementation time.
36.	Agree	ENA	"An evaluation framework that includes economic costs and benefits (including administrative and compliance costs), the timeframe for implementation, certainty of net benefits and inter-dependencies and linkages"[16] sounds like an appropriate evaluation criteria. The consultation paper provides a high level qualitative view of economic costs and benefits. It is not clear whether the conclusions reached are based on this analysis or a more quantitative analysis not shown in the paper. The evaluation criteria seem fine but the execution of it seems a little light especially with respect to the LRA.
37.	Agree	EMS	EMS agrees with the evaluation criteria outlined in Section 7 with the exception of the criteria applied to the LRA proposal. The LRA proposal will **not** act as a suitable hedge to manage

[16] Paragraph 278 Electricity Commission Hedge Market Development – Issues and Options: Technical Paper 18 July 2006

Question 3: Do you agree that the evaluation criteria outlined in Section 4.2 are appropriate criteria for assessing the initiatives?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			transmission risk unless the LRA design incorporates a tender process as part of its allocation and allows the LRA to be a tradable instrument.
38.	Unclear	Energy Link	No comments to make.
39.	Agree	Genesis	Genesis Energy agrees with the evaluation framework utilised by the HMDSG to come up with a preferred package of initiatives for the reasons outlined in section 4 of the Technical Paper. While a quantitive cost-benefit analysis may not have been warranted at this stage of the analysis, its completion will be imperative for the next stage.
40.	Agree	King Country	Evaluation criteria chosen are a logical outcome of the problem identification
41.	Agree	MEUG	The evaluation criteria and largely qualitative approach used by the HMDSG were relevant for this study as a means of identifying and prioritising the mix of options that the Commission should develop further. As options are firmed up and specific interventions by way of rules or regulations are proposed, the evaluation criteria should be standardised into an economic cost-benefit analysis framework comparing the detailed proposal(s) with a counterfactual. The latter is the most likely case that will occur should the option not proceed. The counterfactual need not be the status quo[17]. The advantage of standardising and having to quantify all possible benefits and costs is that some factors that on the surface appear to have merit, can be exposed as having a shallow political motive such as wealth re-distribution without any economic efficiency gains.
42.	Agree	Meridian	The HMDSG used three general criteria to evaluate the competing initiatives: • Did the initiative contribute towards addressing the electricity price risk management problems it had identified? • Do the likely economic benefits from each initiative, or linked initiatives, exceed the costs of implementation (it did not conduct a formal quantitative assessment of these

[17] Refer The Treasury Cost benefit Analysis Primer, Dec-05, http://www.treasury.govt.nz/costbenefitanalysis/default.asp

Question 3: Do you agree that the evaluation criteria outlined in Section 4.2 are appropriate criteria for assessing the initiatives?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			but did asses them qualitatively and tried to gauge the likely net benefits of each)? • How long will each initiative, or linked initiatives, take to implement (the HMDSG considered that, other things being equal, it would prefer the initiative which would take the shorter time to implement)? Meridian broadly supports the criteria adopted by the group as providing an appropriate assessment of the proposed initiatives. In particular, Meridian suggests that significant weight should be placed on the economic cost and benefit criteria as it is an objective measure. Given this, Meridian submits that either the HMDSG, the Commission or a subsequent advisory group further develop the cost and benefit criteria from a quantitative perspective. Meridian understands that the Commission intends to undertake additional consultation before adopting any specific proposal. Meridian suggests that the Commission could include more robust and quantitative analysis at that point. Meridian also suggests that the Commission review and update any quantitative analysis a year following the implementation of any proposals in order to accurately assess their effectiveness.
43.	Agree	Transpower	The evaluation criteria used by the HMDSG were: • Qualitative economic costs • Qualitative economic benefits • Time to implement the initiative Transpower agrees that these pragmatic criteria are the three components of economic efficiency and are therefore relevant as evaluation criteria against which the different options should be assessed. However, the simplified versions of these criteria that were applied can only provide an initial evaluation and indicative idea of the merits and disadvantages of each of the proposed initiatives. Detailed costing and time assessment should be sought by the Electricity Commission in order to provide an objective basis for decision. **Economic Efficiency** Section 7.1.4 of the technical paper presents an analysis which suggests marginal locational pricing in the electricity market creates an excessive signal, especially for large consumers.

Question 3: Do you agree that the evaluation criteria outlined in Section 4.2 are appropriate criteria for assessing the initiatives?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			Transpower believes the problem is not with marginal pricing per se, but with the monopsony or oligopsony power that is created within a constrained region. Whichever way the analysis is viewed, Transpower agrees that an inefficiency is created. However this inefficiency, the magnitude of which is unknown, needs to be weighed against the efficiencies brought about by demand and generation responding to nodal price signals, either in a short term operational sense or in a longer term investment sense. Marginal pricing should encourage market participants to optimise offer and bid behaviour in order to minimise losses and constraints in real time. In the longer term marginal pricing should incentivise efficient investment in response to loss and constraint signals between demand side management, generation on one hand, and transmission investment on the other. It is important to note that transmission investment is now regulated under Part F of the EGRs. To fully assess the efficiency of the HMDSG options a comprehensive review of how the allocation of loss and constraint rentals interacts with other aspects of Part F will be necessary. The review would include the affect of the transmission pricing methodology, any policy that is formulated with regard to transmission alternatives and the impacts of different rental allocation regimes on the operation of the real time market.This integrated view to policy development is discussed further in the Appendix, section 6.1. **Implementation time** Transpower is of the view it is more important to pursue an option that is optimal in terms of promoting efficient signals at both an operational (productive efficiency) level and an investment (dynamic efficiency) level, rather than one that can be most quickly implemented.
44.	Agree	Trustpower	Yes, TrustPower considers the evaluation criteria applied are appropriate

Question 4: Do you consider the Group has correctly identified and described an appropriate range of potential initiatives in Sections 6 and 7 of this Technical Paper? If not, please outline any additional initiatives you believe the Group should have considered.

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
45.	Agree	Carter Holt Harvey	Yes
46.	Agree	Comalco	Yes
47.	Agree	Contact	Yes, Contact considers that the range of initiatives is appropriate.
48.	Disagree	ENA	• Hedge markets ENA is of the view that the development of a more visible market place or exchange for bilateral or forward contracts should be considered further and not dismissed because it doesn't enjoy the support of the generator/retailers. It does not appear that the Steering Group has fully considered an appropriate range of potential initiatives. • FTRs ENA is of the view that the auctioned FTRs and the hybrid (allocated) FTRs are appropriate initiatives to be considered in addressing the Government's policy objective. The Steering group note that "the LRA initiative is embryonic as relatively little time has been available to it compared to the amount of domestic and international effort put into developing FTR markets and products over the years The LRA initiative is put forward in an effort to overcome the impasse on FTRs but further work would be required to finalise the regime. " There is not enough analysis of the LRA to satisfactorily compare it with FTRs. The Steering Group acknowledges, "the hybrid FTR initiative provides more efficient long term location signals for all consumers than the LRA initiative"14 and "a key advantage of auctioning FTRs is that they preserve the efficiency of spot price signals for small consumers and price taking consumers". With the powers the Commission has there is no impasse. Any initiative with respect to FTRs should meet the policy objectives and take into account the relationship between FTRs and full nodal pricing. The policy objective is not to effect the most expedient allocation of loss and constraint rentals. It does not appear that the Steering Group has properly described an appropriate range of potential initiatives.
49.	Agree	EMS	EMS believes that an FTR product is the most appropriate mechanism to manage

Question 4: Do you consider the Group has correctly identified and described an appropriate range of potential initiatives?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			transmission price risks. Alternative options such as FTRs should be considered by neutral parties that do not have a commercial interest in the eventual outcome.
50.	Unclear	Energy Link	No comments to make
51.	Agree	Genesis	Genesis agrees with the range of potential initiatives considered by the HMDSG.
52.	Agree	King Country	We have no comment on the range of potential initiatives.
53.	Agree	Meridian	Meridian submits that the HMDSG has identified and described a range of potential initiatives that are both substantial and wide ranging. Meridian further considers that the preferred HMDSG initiatives represent a reasonable package that should promote efficient and effective price risk management among participants in the electricity market.
54.	Agree	MEUG	Yes. It was beyond the scope of the HMDSG to consider structural changes to the existing market. The possible alternative market designs that might be more advantageous to NZ and the need to have an independent review to assess those options has been raised directly by MEUG with both the government and EC.
55.	Agree	Trustpower	Yes, TrustPower considers the group has identified and described an appropriate range of initiatives.

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper? If not, please outline the initiatives you consider are more appropriate and describe the benefits they deliver, with particular reference to the policy objectives.

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
56.	Agree	ANZ	Many of the initiatives recommended by the group represent solutions that are simple to implement yet will go a considerable way towards increasing transparency in the energy market. Overall I strongly support the initiatives presented by the HMDSG, I do have some concern at both the complexity and the timeframe for implementation of the Locational Rental Allocation initiative. I agree with the HMDSG that the LRA initiative represents one of the greatest potential improvements to existing market arrangements proposed by the group. It has often been cited that one of the major barriers to new entry in the New Zealand Electricity Market is the complexity of the full nodal pricing model and the inability to manage locational risk. While the LRA proposal potentially addresses the current inability to manage locational risk, it does not reduce the perceived complexity of the nodal pricing model, nor does it incentivise new participants with no physical exposure to offer derivative products at “noncore” nodes (on the basis that proposed LRA’s are proportional to the load purchased by retailers/end users then those derivative traders who purchase physical load will potentially be in an advantageous position to offer locational hedges over those derivative traders who do not purchase physical load given that they will receive LRA revenue). Given the complexity of the proposed LRA initiative (and the importance of solving the locational risk issue in removing potential barriers to competition), perhaps a simpler alternative would be to restrict the number of nodes subject to marginal loss pricing to the core grid, with average losses applied to outlying nodes. This effectively mimics the PJM “hub and spoke” model and creates a similar outcome to the LRA initiative while avoiding additional computational complexities. Importantly it does not differentiate exposure to locational risk on the basis of a participant’s physical electricity exposure due to the removal of the requirement for an allocation mechanism.
57.	Agree	New Zealand	Generally, we are in favour of all the HMDSG’s preferred package of initiatives as outlined

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
		Steel	in the paper, except for the section on LRAs, which we feel needs more work done on it. In particular, we are very much in favour of the compulsory web-based publication of the key terms and conditions of all contracts.…..relating to electricity traded by those that consume above a specified quantity of electricity in a year as explained in Section 8.2.1. The publication of the details within (ideally) 48 hours of each contract being signed (as stated verbally at the Auckland Industry Briefing) has our specific support also.
58.	Agree	Carter Holt Harvey	Yes, the preferred package of initiatives as listed in the seven bullet points in paragraph 84 of the Overview Paper. In particular, the compulsory publication of key terms and conditions of all contracts is a strongly supported. Carter Holt Harvey believes consideration should be made to identify the actual node that a trade is executed (rather than a region as the prices within the defined regions can vary considerably. Furthermore, to allow greater transparency of how the market is performing it would be desirable to have the names of the generators writing the hedges identified. The timeframe for implementing this initiative seems very long. (Three months ought to be plenty). In terms of progressing the work relating to EnergyHedge, given the plans of Meridian Energy to develop their own forward market independently of EnergyHedge it would seem appropriate that the work on further developing EnergyHedge be fast-tracked to cater for the objectives of Meridian Energy (assuming these are supported by the wider industry). Having more than one hedge trading platform in a market the size of NZ is ludicrous. The proposal for allocating loss and constraint rentals using the LRA approach looks positive although my understanding of the benefits of this over other options is limited. However, from a consumers perspective, having a passive system in place would be preferable to a system which required participation in a monthly auction and an in depth understanding of electricity flows so that a view can be adopted regarding the likely location and extent of transmission constraints on the system and how they will impact a particular site. For a company like Carter Holt Harvey which has manufacturing sites located all across the country the complexity of this would be considerable and understanding this would require a considerable amount of someone’s time. If the need for this can be eliminated by an alternate (but equally effective) option then this would

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			obviously be preferred.
59.	Disagree	Comalco	No – Comalco disagrees with the proposal to implement contract disclosure as defined and the LRA needs a lot more work. This is discussed in more detail below in our response to question 6.
60.	Agree	Contact	Yes, Contact agrees with the preferred package.
61.	Agree	ENA	ENA supports initiatives a, b, c, d and f. a. Regular survey; b. Publication of contract details; c. Centralised publication of information; d. Model master agreements; e. EnergyHedge development; f. Understanding risk management; and g. Locational rental allocation. ENA has significant reservations about initiatives e and g. In both cases we do not agree that they satisfactorily address the Government's stated policy objectives. Secondly, as solutions they appear limited and unduly orientated towards outcomes that suit the generator/retailers[18]. It is not clear that either initiative is necessarily in the best interests of consumers (both large and small). Alternatives to the proposed solutions do not appear to have been fully examined in that light from the paper as presented.
62.	Unclear	EMS	EMS recommends the following:

[18] The membership of the Steering Group did not include representatives of small consumers, Transpower, Lines companies or aspiring stand-alone retailers.

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

Row No.	Agree/ Disagree / Unclear	Stakeholder	Comment
			• That FTRs be compared with the final LRA design on a like-for-like basis by parties that have no commercial interest in the outcome; • That the LRA design proposal **includes** a closed tender process as part of the allocation AND that the once allocated via that tender, the LRA be a tradable instrument either on the primary or secondary market. • That the EC consider mandating an exchange based trading platform
63.	Disagree	Energy Link	As described in section 2 the HMDSG's objectives do not align with the objectives set out for the hedge market in the GPS. If we were to accept the HMDSG's objective then we would add to or modify the preferred package as follows: • Losses and constraints rentals used to reduce surplus at source – refer to section 7.1; • Development of a model master physical supply agreement to work in tandem with the model master ISDA hedge agreement – refer section 3.5. If, however, the objectives in the GPS were accepted, than a radically different package of initiatives would be required including: • Reducing the impact of vertical integration through measures such as corporate separation of retailers (e.g from generation, lines or other) or detailed disclosure rules; • Development of an exchange traded set of forward and/or futures contracts at key nodes; • Losses and constraints rentals used to reduce surplus at source- refer to section 7.1; • Development of a model master physical supply agreement to wotk in tandem with

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			the model master ISDA hedge agreement – refer section 3.5.
64.	Agree	Genesis Energy	Genesis Energy supports the preferred package. However, this support must be read in the context of the comments outlined in paragraphs 20-28 of the attached report.
65.	Agree	King Country	King Country Energy is generally in agreement with the preferred package of initiatives although we do not fully support the assigned priorities. • Publication of key contract terms and conditions is strongly supported as proposed. • Development of the EnergyHedge platform certainly has some potential but we are not sanguine over the chances of making the proposal work. We have attempted in the past to seek access secondhand but there has been no support by any party in this endeavour. • Locational rental allocation is a very positive approach and we support this strongly. We also believe that it is essential for this to be operated on a gross basis to maintain equity. • The model master agreement is all but complete and would be a good simplification. • Outage and fuel information is definitely a low priority for the wider audience. • As addressed earlier the promoting of greater understanding is important but should be part of a wider market initiative not just the price risk area. • Regular surveys will have some merit for a time but we believe that annually is too frequent and will lead to rapid loss of interest in contributing.
66.	Agree	Meridian	Meridian generally supports the preferred package, subject to further refinement, and consideration of the points raised below. • *Publication of Contract Details* The HMDSG proposes that parties who enter into risk management contracts exceeding 10GWh per annum publish details of their agreements. It is proposed that contract sellers would have the obligation to post their contract details

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			on a website specified by the Commission and purchasers would have an opportunity to dispute the accuracy of the details. The details published would include contract quantities, prices, reference nodes, duration, start and end dates, and other key terms and conditions. Contract counterparties would not be required to be identified. This initiative would require the Commission to implement rules specifying the details to be disclosed, when they have to be disclosed, who is required to disclose those details, where the details are to be published, and processes for monitoring and enforcing compliance with these requirements. Meridian generally supports the intent behind the initiative to publish contract details as that it should improve the amount of information disclosed to the marketplace and therefore improve participant's ability to manage risk. However, Meridian suggests that further detail is required to ensure that the benefits of the initiative are realised (and outweigh the potential costs). In particular Meridian would like to see further detail on compliance and additional consideration of competition and contract law as part of any Commission process referred to in Meridian's answer to question three above(the HMDSG notes these issues but is not expansive on the detail). Meridian comments on each of these issues below. **Compliance Cost** Meridian considers that compliance costs may arise in two general areas: 1. The registering of the contract by the seller (and confirmation by the buyer); and 2. Commission enforcement of any rules requiring publication. The process and timeframe for contract registration is likely to be relatively straightforward for standardised contracts but could be more complex for tailored arrangements. Likewise enforcement should be straightforward for standard contracts. Both compliance and enforcement could be complex for tailored arrangements for a number of reasons including: differing interpretation by buyer and seller, the large quantities of energy

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			expected to be sold, the term of the deals, confidentiality provisions, the materiality of the commercial and competitive positions of the counterparties and the likelihood that counterparties could be determined even if names are not published. While Meridian suggests that there are answers to the above problems, it raises the issues so that they are effectively managed in any proposed implementation and the costs and benefits of compliance are taken into account. **Competition Law** In relation to competition law principles, the HMDSG notes that *"the main risk is in regard to the disclosed information facilitating collusive behaviour among market participants. This risk is considered negligible, as the competition regulators will also have more information with which to monitor participant behaviour."* Meridian is unsure that the Commission can deal with the collusive issue so lightly. The Commerce Commission has recently considered a similar issue, the release of wholesale market offer and bid information. It is similar to release of contract information in that it improves the timeliness of information getting into the marketplace. It raises different issues in that release of offer and bid information occurs after it has been used for commercial purposes whereas if contract information is released, it is likely that details will be available to the wider market before the contract comes into effect. In the case of wholesale market bid/offer information release, the Commerce Commission's key concerns were the potential for increased tacit collusion versus the pro competitive effects of disclosure. As noted by the HMDSG, the same or similar issues exist here. Again this is likely to be a larger concern for tailored arrangements but Meridian recommends that any proposal is developed with the Commerce Commission and that emphasis is placed on the competing outcomes of tacit collusion versus improving competition.

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			Contract Law Meridian notes that any proposal will also need to give consideration to contract law. The Commission needs to consider how it will treat the number of historical and future long-term contracts that have confidentiality clauses in place. The parties to these existing contracts are very unlikely to want this information disclosed and it would be a large step for the Commission to force the release of information for existing arrangements. . Therefore, Meridian believes that consideration should be given to excluding historical contracts from the disclosure rules. Finally, in recognition of the above issues Meridian submits that the Commission enter into additional consultation on the publication of contract information before it is implemented • *Further Development of energy*Hedge *Services* Meridian generally supports development of *energy*Hedge as proposed by the HMDSG. Meridian also suggests that the HMDSG should have considered increasing the minimum *energy*Hedge volumetric requirements above and beyond the existing minimum of a ¼ MW, quarter year contract for the following three years. By way of example only Meridian suggests that the minimum volume requirement should increase to at least four ¼ MW, quarter year contracts for the following three years. The rationale for this proposal is that the *energy*Hedge style of market is similar in concept to the rationale that supports interbank forex markets. Those markets have minimum dollar commitments, in the order of millions or tens of millions, made by each of the participants presumably to assist position management. *Energy*Hedge does not have these types of commitment Obviously this is an issue that must be considered by the owners of *energy*Hedge (of which Meridian is one). Meridian will be making this suggestion formally to the other owners of *energy*Hedge and would appreciate feedback from the HMDSG, other industry

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			participants and the Commission on the benefits or otherwise of this proposal. • *Model Master Agreement* Meridian supports the development of the model master agreement. Meridian notes that the industry is already moving towards this on its own accord. Meridian considers that this will facilitate increased standardisation and transparency across the industry. • *Centralised web-based publication of planned outage and fuel stock information by the Commission* Meridian supports the web based publication of planned outages and the levels of fuel stock. Meridian notes that this already takes place on a limited and voluntary basis as part of the Published Outage and Co-ordination Process (POCP). For this to be effective the Commission will need to implement rules specifying the details to be disclosed, when they have to be disclosed, who is required to disclose those details, where the details are to be published, and processes for monitoring and enforcing compliance with these requirements. Meridian submits that these issues are similar to those discussed above relating to Disclosure of Contract Information bullet above and should likewise be developed further by the Commission. • *Greater purchaser understanding of electricity price risk management* Meridian believes that these proposals will promote greater purchaser understanding of electricity price management Meridian believes that the explicit hedging of electricity price risk should lead to a more efficient market over time.
67.	Agree	MEUG	MEUG agree with the preferred package as listed in the seven bullet points in paragraph 8.4 of the Overview Paper and repeated below in bold text. Any supplementary comments MEUG have to each of the proposals are also listed:

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<table>
<tr><th>Row No.</th><th>Agree/ Disagree / Unclear</th><th>Stakeholder</th><th>Comment</th></tr>
<tr><td></td><td></td><td></td><td>The compulsory web-based publication of the key terms and conditions of all contracts entered into by parties that consume above a minimum level of electricity per year.
MEUG supplementary comments: Designing a table to capture summary information on shorter term financial derivatives is likely to be easier than for very long duration contracts. The difference is because shorter duration contracts are likely to be more standardised whereas very long duration contracts are likely to be more be-spoke.
For example in summarising price terms shorter duration contracts may be as simple as specifying a single price per trading period for the term of the contract. That contract price formula can be summarised as the time weighted average price. Regulations to accommodate that formula are relatively easy to draft. If the price varies over time with an escalation factor then the summary information might only cover the opening (time weighted) price for the period until the first escalation and then flag a “yes” to the question “is there escalation in the contract?”
For very long duration contracts escalation formula can be very complex, the contract might have pause and review provisions and the contract is likely to be in a form that cannot be traded out of or sold to a third party. Typically these types of contracts are for the most electricity intensive industries in NZ producing goods for export markets. The issue of commercial confidentiality then becomes a factor because if international competitors or international customers of those export industries have access to electricity cost information they can use that against the interests of the NZ business and hence affect the welfare of NZ. Therefore there may be merit in considering for very long duration contracts some commercial sensitive information such as certain pricing terms, should be excluded from the mandatory disclosure provisions.
The EC could consider various generic definitions to separate those end consumers whose contracts would be summarised as proposed by the HMDSG and those end consumers whose contracts would not be fully disclosed. For example the EC could set a 15-year maximum time frame and any contracts longer than that would have less information disclosed. An end user that had contracts longer than 15 years would therefore publish some information on those long duration contracts but not the same as </td></tr>
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			that required for contracts of less than 15 years. If that same company also had some shorter duration contracts, then those contracts would be disclosed in the full summary format. In summary mandatory disclosure requirements should aim to maximise the public benefit and minimise private costs. Most transactions are relatively short and will fit the example of the disclosure format in paragraph 85 of the Overview Paper. The cost of those parties complying with the mandatory disclosure requirements will be modest but the public benefit to promote understanding of the market and foster competition and innovation is high. With very long duration be-spoke contracts the nature of the contract is more a very long-term partnership. There are few such long-term partnerships to date and few are likely in the future. Having to require those types of arrangements to disclose key information may be costly to those companies because of the value of that information to their international competitors and customers. However, their disclosure may have little public benefit due to the highly tailored nature of the contracts. • **The Commission inviting the current owners of the web-based electricity contracts trading platform, EnergyHedge, to further develop its services**. MEUG supplementary comments: MEUG suggest the emphasis should be on the EC facilitating the owners of energyhedge to develop that trading platform. Facilitation could take the form of helping to advertise to the industry the platform exists through to understanding and helping to remove any barriers to the platform owners extending the services provided. The EC should also keep an open mind about facilitating other service providers that might be considering starting other open and transparent trading platforms[19]. • **Development of a mechanism to hedge AC transmission costs by changing the allocation of loss and constraint rentals**.

[19] For example EMS has recently announced they were considering using their very successful future and options product in Australia in NZ. This specific proposal might not fit the NZ environment, but the EC should keep an open view of facilitating platforms that will help promote competition.

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			MEUG supplementary comments: The LRA option is a very high level conceptual idea. On the basis of the LRA concept it appears to have some merits and some downsides compared to the hybrid FTR option. MEUG support further work to improve our knowledge of the LRA concept so that a more detailed comparison with alternatives can be made. While the HMDSG papers use the FTR hybrid as the counterfactual, MEUG suggest that for the purpose of the Commission assessing and proposing any regulations or rules to implement LRA, a much wider suite of alternatives will have to be considered. These would include the hybrid FTR (per the GPS) and a range of other FTR variants. One alternative that should also be considered is the status quo. MEUG note that there is no point in simply changing from the status quo if there is no efficiency gain. The HMDSG papers are a useful first step in assessing what factors need to be considered. However a more robust cost-benefit analysis methodology will be needed if specific rules or regulations are proposed. The issue of a robust cost-benefit analysis approach and the need to quantify perceived benefits and costs was noted in reply to question 3 above. • **Support from the Commission for the development jointly by consumers and retailers of a model master agreement for the purchase and sale of financial contracts relating to electricity**. • **Centralised web-based publication of planned outage and fuel stock information by the Commission**. MEUG supplementary comments: There is a wealth of data on planned outages (ie Red Spider and proposed Outage Protocol as part of proposed change to regulate Interconnection services). The problem for most TOU consumers is it isn't worthwhile having dedicated resources to monitor this data to anticipate problems whereas suppliers can and do have dedicated resources to analyse the data. What would help is if some of the data on key outages were converted to graphical form to provide a high level view of near and long term outages – this would provide an early warning for interested parties who could then interrogate the data in detail if needed.

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			MEUG accept automating this to provide a high level view isn't straight forward and there would have to be the usual caveats about the graphs not necessarily being comprehensive. However even given those limitations it would be a much better outcome for the majority of TOU consumers who do not have the time and systems to analyse outage data. The Commission already publishes some fuel stock information on the security of supply web pages. The only major omission that could be included is useable snow pack. • **The Commission promoting greater purchaser understanding of electricity price risk management**. MEUG supplementary comments: All possible means to facilitate the market developing industry training protocols should be explored, ie the Commission should be wary of becoming the funder of training that the market would otherwise have developed itself. • **A regular survey of electricity market participants to ensure improvements in hedging are on track**. MEUG supplementary comments: A survey say 6 months after publication of contract details would be most useful because the reaction to the market to the value of that change could be compared to the UMR survey in 2005. This is different from the Overview Paper proposal that a survey be conducted in September 2006 (paragraph 191).
68.	Agree	Mighty River Power	Mighty River Power notes that we broadly agree with the package of initiatives produced by the Steering Group. <u>Publication of key terms and conditions</u> Mighty River Power supports the publication of terms and conditions of all hedge contracts (i.e. contracts for differences (CfD), forward price variable-volume contracts (FPW) and variants) by those that consume above 10 GWH per year.[20] In respect of the table illustrating how contract details might be presented,[21] we note

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			that the volume column is blank in respect of the example FPVV contracts provided. To make the table more useful to participants we consider that FPVV contracts include a notional quantity, i.e. an approximation of volume (this could be as simple as total MW hours per annum over the number of hours in a year). We acknowledge that it is not possible to provide an exact volume for a FPVV contract, but providing a notional quantity would assist participants in being able to manage price risk. Mighty River Power recommends that the Electricity Commission accept the Steering Group's proposals to publish key terms and conditions of all hedge contracts (above 10 GWH per year) <u>Development of EnergyHedge</u> Mighty River Power recommends that the Electricity Commission accept the Steering Group's proposed initiatives in respect of EnergyHedge. <u>Development of mechanism to hedge AC transmission costs</u> Mighty River Power considers the Steering Group's assessment and comparison of the Locational Rental Allocation (LRA) initiative with the hybrid Financial Transmission Rights (hybrid FTR) initiative is well considered and thought out. Mighty River Power agrees that the LRA initiative should be preferred. We consider the hybrid FTR initiative should be discarded. Mighty River Power agrees that the hybrid FTR initiative would involve considerably more costs than the LRA initiative. We underline the following points made by the Steering Group: a) The hybrid FTR initiative requires that the Electricity Commission or some other regulatory agency make decisions on which part of the grid have adequate levels of competition. As noted by the Steering Group this "process is likely to be controversial and tme-consuming".[22] The

Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			corollary of which is increased cost. i b) The hybrid FTR initiative requires far greater participation from participants than the LRA initiative.[23] c) The pass-through obligations are far more straight forward in the LRA initiative, which uses the Clearing Manager to directly allocate HVAC rentals to spot market purchasers. The hybrid FTR initiative requires obligations to be placed on, among others, Electricity Lines Businesses to pass HVAC rentals to their customers in proportion to transmission charges. <u>Support for a model derivative master agreement</u> Mighty River Power recommends that the Electricity Commission accept the Steering Group's proposal for a model (voluntary) derivative master agreement.29 We are pleased to advise that this initiative is already working. Mighty River Power executed the first model derivative master agreement in September 2006. <u>Centralised publication of outage and fuel information</u> Mighty River Power recommends that the Electricity Commission accept the Steering Group's proposal for publication of outage and fuel information to facilitate the operation of the electricity risk management market (subject to the qualification that commercially sensitive material be excluded). 58. We note that, as we understand it, what is being recommended is that public sources of information be pulled together. We support this, but would not support any move to publish information belonging to participants that is commercially sensitive. In particular, the contract prices for gas or coal is commercially sensitive; the release of which would likely cause Mighty River Power commercial damage.

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<tr><td></td><td></td><td></td><td><u>Education and market surveys</u>

Mighty River Power acknowledges that there is a lack of understanding on the part of many buyers in respect of electricity risk management. Accordingly, Mighty River Power supports the Electricity Commission's initiative to develop and provide information programmes about the market and to publish the availability of risk management training programmes.</td></tr>
<tr><td>69.</td><td>Unclear</td><td>Transpower</td><td>Transpower believes that there are a number of outstanding issues with the LRA proposal that need to be clarified before it can be evaluated. Although it is not Transpower's aim to advocate the introduction of the FTR, it is useful to show the trade-off between the concepts of LRA and the FTR mechanism.

<table>
<tr><th>LRAs</th><th>FTRs</th></tr>
<tr><td>Relatively simple for consumers to administer</td><td>Experience in trading required to administer FTRs effectively</td></tr>
<tr><td>Allocates loss and constraint rentals back to the area affected by binding constraints – but in doing so masks investment incentives</td><td>Provides clear investment incentives</td></tr>
<tr><td>Limited scope for trading</td><td>Trading enhances efficiency and liquidity</td></tr>
<tr><td>Basic level of concept development only</td><td>Internationally tested and developed</td></tr>
<tr><td>Limited understanding of effects in real world operation</td><td>Well understood effects in real world operations</td></tr>
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<tr><th>Row No.</th><th>Agree/ Disagree / Unclear</th><th>Stakeholder</th><th>Comment</th></tr>
<tr><td></td><td></td><td></td><td><table><tr><td>Dampens nodal price signals</td><td>Compatible with nodal price signals</td></tr><tr><td>Significant wealth transfers</td><td>Limited wealth transfers</td></tr></table>
However, a hedging mechanism is only one part of the picture. Transpower recommends that the implementation of any hedging mechanism into the wholesale market is performed as part of an integrated investigation into efficient market design.</td></tr>
<tr><td>70.</td><td>Agree</td><td>Trustpower</td><td>Yes, TrustPower agrees with the preferred package outlined in the technical paper.</td></tr>
<tr><td>71.</td><td>Agree</td><td>Unison</td><td>Having reviewed the consultation paper, Unison views the Commission’s preferred package of initiatives as being a move in the right direction. We agree that the overarching policy objective should be to promote a well-functioning hedge market (which exhibits liquidity and transparency), and generally regard the Commission’s initiatives as facilitating that.

However, there are three issues on which we wish to comment specifically:

Allocation of Loss and Constraint Rentals

The initiative regarding the “Development of a mechanism to hedge AC transmission costs by changing the allocation of loss and constraint rentals;” we consider flawed insofar as it bundles together costs. In this way, it does not detail the individual marginal costs and thus doesn’t provide accurate pricing signals.

Length of Contracts

We agree that moving from 3-5 year contracts is a positive step but think that a market which had no longer term contracts (5 years out to 10 years), and had the ability to conduct secondary hedge training, would provide better signalling for prices and therefore investment.

Market Evolution</td></tr>
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Question 5: Do you agree with the preferred package described in Section 8 of this Technical Paper?

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			In addition, we consider that given the light quantity of trading to date in the New Zealand market, the historical situation did not necessarily provide accurate or complete indicators for improvement. We ask the Commission continues to recognise the dynamic nature of the evolving market.
72.	Disagree	WPI	WPI considers that the provision of information on hedge contracts will assist those negotiating new arrangements. The provision of information may go some way towards redressing the current imbalance between suppliers and purchasers in hedge contract negotiations. However, WPI has significant concerns regarding the extent of disclosure contained in the preferred package. As with other major electricity consumers WPI operates in internationally competitive markets. The price and terms of electricity supply can be commercially sensitive and should not be disclosed to competitors. WPI considers that the Commission considers these issues very carefully before implementing such a disclosure regime.

Question 6: The Group identified two initiatives in the preferred package that, in its view, would make the biggest difference in improving existing market arrangements: disclosure of contract information and changing the allocation of loss and constraint rentals. Please describe your views on the practicality and acceptability of these initiatives.

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
73.	Agree.	Carter Holt Harvey	Carter Holt Harvey agrees that these are two very important initiatives and ought to be the top priorities as they are likely to offer the greatest degree of improvement to the current situation. The disclosure of information should be implemented as soon as possible and need not take as long as outlined in the Paper. Making changes to the allocation of loss and constraint rentals is a longer term initiative due to it being a more complex issue and one that is less well understood. As outlined above the level of competition is also of considerable interest to Carter Holt Harvey but this is likely to be improved if there was a requirement to disclose contract information.
74.	Disagree	Comalco	**Disclosure of Contract Information** Under this requirement, the key details of all contracts above GWh per year would be published on a website. The details to be published include: date of agreement, quantities, price, region, start and end date, price escalation, force majeure terms, suspension terms, treatment of any carbon charge, inclusion of taxes/levies. Comalco regards this information as commercially very sensitive. As electricity is NZAS' single biggest cost by far, disclosing the price would enable our competitors and our customers to easily obtain critical information about the smelter's cost structure, which could then be used to undermine NZAS' competitive position. NZAS' contracts are so large and long-lasting, in relation to other South Island contracts, that upon disclosure, it would be immediately clear to whom they related. Anonymity is not possible. Additionally, the value of disclosing a long-term contract such as NZAS' to improving information in the short-term hedge market is questionable. Given the nature of potential

Question 6: Please describe your views on the practicality and acceptability of disclosure of contract information and LRAs

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			escalation clauses in a long-term contract, it would be very difficult to ascertain the future price payable, within any reasonable margin of error, beyond the very near-term. For these reasons, the proposal (as Comalco understands it) is not acceptable. **Locational Rental Allocation** The GPS is quite explicit in paragraph 78 about the expectation that the Commission should oversee the development of FTRs to enable market participants to manage transmission loss and constraint risks. The proposed LRA is a long way short of an FTR. The papers state that the proposed LRA would facilitate more efficient management of transmission and electricity price risks. However, the proposed LRA is a reallocation of the existing loss and constraint rentals, using a different methodology, which provides greater financial compensation to those in constrained areas. It is hard to see such an expost reallocation significantly improving the management of price risks. The proposed LRA is essentially introducing a locational component to the allocation of the HVAC loss and constraint rentals. Comalco supports stronger locational signals and considers that if it is practical to do this for allocating loss and constraint rentals, then it must also be practical to do this for the allocation of HVAC interconnection asset costs in the transmission pricing methodology. There are strong linkages between the allocation of rentals and transmission pricing. Transpower currently allocates the loss and constraint rentals to those parties who pay transmission charges. In the case of the HVAC assets, this minimises distortions to nodal price signals and provides a benefit to those who pay the cost of the transmission system. However, the Group's LRA proposal is to now allocate the loss and constraint rentals to wholesale market purchasers. This is a significant wealth transfer from off-take customers to retailers who pay nothing for the transmission system. This proposed reallocation is inconsistent with the Group's proposal to continue allocating the HVDC rentals to the South Island generators who pay for the cost of those assets.

Question 6: Please describe your views on the practicality and acceptability of disclosure of contract information and LRAs

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			Comalco supports introducing a greater locational component into the allocation of loss and constraint rentals, but only if that is mirrored in a greater locational component for the allocation of interconnection asset costs in the transmission pricing methodology. Comalco does not support the allocation of the HVAC loss and constraint rentals to wholesale market purchasers. Retailers do not pay for the transmission system and such an allocation distorts nodal price signals. Comalco considers that the benefits of the LRA proposal are overstated. Much more work needs to be done on the proposal (and the transmission pricing methodology) before it, or a derivative, could reasonably be implemented.
75.	Agree	Contact	<u>Disclosure of contract information</u> Contact agrees that compulsory publication of contract information would be a feasible, practical way of supplying more information on risk management market activity to market participants. We note that this is an unusual characteristic of an over the counter (OTC) market, but we support this proposal. <u>Loss and Constraint Rental Allocation</u> Changing the allocation of loss and constraint rentals will be a more complicated proposal to implement, but Contact considers that the proposal has merit and is worth pursuing. From our perspective, the debate is not between Locational Rental Allocation (LRA) and Financial Transmission Rights (FTRs). Rather, the choice is between the status quo – returning the rentals to users across the system – or pursuing an alternative allocation method that will provide a hedge against AC transmission costs. The LRA mechanism will address the lack of basis risk instruments by redistributing the loss and constraint rentals to the electricity purchasers who face the highest nodal price differences. It thus appears to be a practicable alternative that will alleviate many of the industry criticisms of previous FTR proposals, and we therefore consider that LRAs would

Question 6: Please describe your views on the practicality and acceptability of disclosure of contract information and LRAs

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			have a higher chance of successful implementation than FTRs. At the same time, implementation of LRAs does not foreclose options for other instruments like FTRs to be developed in the future, if demand for them exists. Contact considers that an improved allocation methodology would bring benefits to the wholesale market, in terms of enabling the management of locational price risk. We support this proposal.
76.	Disagree	ENA	ENA welcomes the enhanced disclosure of contract information. That seems to be consistent with Government's policy objectives and in the interest of consumers. ENA remains of the view that as long as we have full nodal pricing an efficient FTR that preserve the nodal price signal is appropriate. As it stands, the full nodal pricing model in place in New Zealand remains flawed without an efficient FTR alongside it. If the Commission agrees to a simplistic LRA mechanism that undermines the effectiveness of full nodal pricing they should simultaneously address the inevitability that without the full benefits of full nodal pricing it should be abandoned. The development of an FTR that augments full nodal pricing is consistent with the Government policy objective. We are unconvinced by the consultation paper that the proposed LRA product achieves this. We are of the view that the FTR should be fully considered by the Electricity Commission to see if modifications to it could result in a product that achieved the government's policy objectives and was practicable for the New Zealand context.
77.	Agree	EMS	EMS partially agrees with the two identified initiatives that potentially will have the greatest benefit to the market. These being information disclosure AND information availability, and the development of a transmission risk hedge product, provided that the hedge conforms to the comments outlined above.
78.	Disagree	Energy Link	We acknowledge the attractive features of the LRA proposal. However, the real issue is not how to distribute the pool surplus but how to reduce the surplus at source. We believe

Question 6: Please describe your views on the practicality and acceptability of disclosure of contract information and LRAs

Row No.	Agree/ Disagree/ Unclear	Stakeholder	Comment
			there are many ways that this could be achieved. In the first instance, we note that many of the most 'notorious' examples of constraints occur due to very short term and infrequent, perhaps even unique, outages. [See Eenrgylink submission for full description of alternative options]
79.	Disagree	Genesis	Genesis Energy disagrees with the HMDSG prioritisation for the reasons outlined in paragraphs 29-31 of the cover report. 29. These solutions are, in Genesis Energy's view, mutually reinforcing and aimed at addressing reasonably clearly identified market failures. Given this, Genesis Energy considers that all of the initiatives should be afforded the same implementation priority. 30. In particular, the HMDSG report does not make any mention - nor is Genesis Energy aware of any constraints such as time or resources - of implementing the preferred package of initiatives. Therefore, Genesis Energy does not agree with categorising the initiatives into priority levels nor does it agree with the categorisation itself. For example, Genesis Energy maintains that the relative severity of the information failure identified and the high likelihood of 'bang-for-buck' means that raising the awareness of electricity risk management is just as pivotal for the successful implementation of the package of preferred initiatives as the other information-based initiatives. The HMDSG argues that the package is highly linked and integrated and Genesis Energy concurs with this assessment. It logically follows, therefore, that the initiatives should be implemented as a coherent whole, and not fragmented into component parts. 31. This does not, of course, mean to imply that the initiatives may not have different final implementation dates. The sheer diversity of proposals (from a survey through to the new LRA methodology) suggests that different implementation dates are highly likely. It does mean, however, that the initiatives should (to the greatest extent possible) be seen as a package and developed simultaneously as such, and not fragmented into separate issues which are dealt with in isolation of each other. Genesis Energy suggests that this integrated approach is more likely than not to reveal the strong synergies between the initiatives and ensure that their collective benefits are maximised.

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80.	Agree	King Country	The two preferred initiatives are definitely the highest priority items and should be given urgency.
81.	Agree	MEUG	These two initiatives are important but MEUG would see the development of the forward curve (energyhedge) and voluntary standard ISDA as necessary components of a minimum package. The proposals on improving outage and fuel information flows, improving risk management expertise within the industry and further Commission surveys appear to have value but are not necessary. Refer answer to question 5. above for comments on these two proposals.
82.	Agree	Meridian	Meridian submits that there are practical challenges to be overcome to implement the proposed initiative. These challenges are set out in Meridian's answer to question five above but to summarise they are the development of compliance and enforcement mechanisms, and further work to demonstrate that the benefits of the initiative can be realised particularly for tailored arrangements (above and beyond the costs). Meridian also submits that the Commission must take competition and contract law issues into account in its deliberations. Meridian is committed to improving current levels of information disclosure and to practically resolving these issues through the Commission process. Meridian does not have enough information to realistically form a view on the proposed allocation of loss and constraint rental proposals. At this time we are only able to make the following general points: • Mechanisms that allocate loss and constraint rentals to those that are exposed to those risks are an improvement on existing arrangements; • Parties that have physical and financial exposures need to be treated consistently. The financial transmission right (FTR) proposal allows parties to manage exposures by selecting and purchasing instruments that are consistent with expected exposures. However, there are complex issues that must be overcome

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			before it could be put into effect; • It is not clear whether the locational rental allocation (LRA) proposal would allocate rentals to those exposed to the risks. Meridian suggests that the Commission continue to refine both the FTR and LRA proposals and enter into further industry seminars and consultation as a next step to moving forward particularly as the HMDSG suggests that any proposal would take three to four years to implement. In conclusion, Meridian agrees the preferred package of initiatives developed by that group should together, provide a foundation for efficient and effective price risk management among participants in the electricity market. However, Meridian suggests that voluntary implementation of the package is preferable to proposing regulation at this time and that the Commission should further refine and consult on the contract disclosure and allocation of loss and constraint rental initiatives.
83.	Disagree	Norske Skog	However we do agree that increased transparency is desirable, however we have some concerns regarding the compulsory publication of the key terms and conditions of contracts. It is our view that there are relatively few significant players in the NZ electricity industry and it would be quite easy to identify counter-parties from volume and location information. This may be a material commercial disadvantage to large electricity purchasers such as ourselves. Some of the Commission's conclusions hinge on non-disclosure of counter-parties, and as we have pointed out this is by no means guaranteed. Perhaps anonymity could be enhanced by subtle refinements such as removal of location information and adjustment of prices by long-run location factors. Based on our current level of understanding we are not convinced that LRAs offer any advantages to the status quo (Transpower passing on the loss and constraint rentals to its customers). It seems to us that LRAs are simply another allocation methodology leading to wealth transfers that will benefit some at the cost of others . In addition we think the LRA approach has significant weaknesses concerning the choice of reference node and

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			treatment of losses. We are well aware of the concerns throughout the industry about locational risks and the need for long-term transmission hedges of some form. We wish to comment that hybrid FTRs and LRAs water down nodal pricing signals. The same thing could be achieved by simply reducing the number of pricing nodes, and implementing fixed losses from these nodes to all other locations. Whilst this might be considered beyond the brief of the HMDSG we don't think it is necessarily, since consideration of FTRs and LRAs would have similar consequences. We believe that transmission price risks come about due to abuse of market power behind transmission constraints and occasionally from spring washers. Both of these problems would be significantly reduced by reducing the number of pricing nodes. This may lead to other effects such as constrained on and off instructions to generators. It is not clear if few nodes would lead to a more efficient outcome than many nodes. It is also not clear (at least to us) that LRAs or some similar allocation method of rentals would lead to a more efficient outcome than the status quo. We make this comment because it seems logical to us that rentals belong to the asset that created them, in this case the national grid. However the current rental allocation to Transpower's customers does little to attenuate the abuse of market power that has been prevalent in the NZ electricity market, and could therefore also be argued to be inefficient. In the absence of demonstrable improvements to economic efficiency no changes to market design should be implemented. Our view is that there is much more work to do in this area before any approach can be singled out as a preferred option.
84.	Agree	Transpower	Transpower has the following comments to make on the two key initiatives: **Disclosure of contract information** Transpower is in agreement with the concept to make information readily available to all parties on the same basis. The HMDSG has already highlighted the main risk of potential collusive behaviour. If this can be satisfactorily addressed by this initiative it would make it a sensible one to progress further.

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			LRAs - Allocation of loss and constraint rentals The LRA is the initiative about which Transpower has most concerns. These concerns are included in section 3.3 and in the Appendix of the submission.
85.	Agree	Trustpower	TrustPower is strongly in support of both of these initiatives. In the case of contract disclosure, TrustPower endorses the view of the HMDSG that in order for parties to have confidence there needs to be far greater transparency. We would not be uncomfortable if the proposal was modified to require the node at which contracts are struck to be published instead of a geographic region. We would also be comfortable with the transaction day being displayed as apposed to month or quarter. In the case of LRAs, TrustPower is strongly supportive of this initiative in particular as it provides a practical solution for a broad range of market participants looking to manage there locational risk. In addition to the comments provided in the body of this letter, TrustPower would also like to endorse the principle of allocating rentals based on gross rather than net load. We believe the use of net load would distort investment signals for retailers or loads looking to develop generation in the same area in which they have load.
86.	Disagree	WPI	Regarding the disclosure of contract information, WPI's comments are provided in our comment on question 5. Regarding the LRA proposal WPI does not consider that the proposed arrangement improves WPI's ability to manage transmission loss and constraint risks. The proposal appears not to satisfy the requirements of the current Government Policy Statement on Electricity Governance. The LRA proposal is in effect a reallocation of transmission rentals and as such will create a wealth trabsfer. The LRA proposal would therefore create winners and losers. The basis for creating this situation and an analyis of the potential impact on Transpower' s customers is not clear. The current allocation of transmission rentals is based on sound economic priciples which

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			consider the integrated effects of transmission pricing and capacity and the wholesale electricity market. The LRA tinkesr with the rental allocation for questionable benefits. WPI considers that, as a payer of transmission charges it is appropriate that we receive the benefits that transmission capacity provides. We consider that the Commission' s decisions on the transmission pricing methodology and in particular the allocation of interconnection investment costs are inconsistent with the LRA proposal that will allocate rentals to those that do not directly pay for transmission. WPI considers that the Commission should consider the wider implications of the LRA proposal and undertake a review of its decisions on transmission pricing and transmission contract counterparties.
87.	Disagree	Vector	Vector believes the papers provided do not clarify the extent to which the recommendations on LRA's meet the Government's policy objectives. The working group appears to have defined its own objectives. Nor is it clear whether the working group has considered the implications of changing existing arrangements and the flow-on impacts on distribution pricing and compliance with the existing distribution threshold regime. Given its recent experience in this area, Vector would recommend the Commission pay close attention to any change in regulatory incentives relative to the electricity threshold regime, and highlight them accordingly. Vector has some concern over the working group's apparent move away from the issue of liquidity, which Vector believes is one of the fundamental issues - as identified in the Government's GPS. Vector does not support any move toward mandatory forward prices at this stage, but does support monitoring of forward hedge arrangements, so that the situation can be clearly monitored. Vector has concerns over the implications of an industry working group, after a two year period, provisionally recommending an alternative to FTR's with little substantial analysis, and a substantial degree of reservation on the extent of its own recommendations. It

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			appears from the outside that consideration of transmission hedges has been carried out in an ad hoc manner and without the robust analysis such a topic deserves. Vector recommends that the Commission considers this issue and resolves a clear direction for the industry to avoid further regulatory uncertainty.