



Electricity Authority Hedge Market Research

A Qualitative and Quantitative Study – Preliminary Results

April 2014

Methodology

- > Online survey
 - > 69 selected respondents
 - > 39 responses
- > 30 one-on-one depth interviews
 - > Probing selected survey responses
- > Survey respondents:
 - > 12 generator/generator-retailers (gentailers)
 - > 9 large purchasers
 - > 7 medium purchasers
 - > 6 small purchasers
 - > 5 others – distribution and independent purchasing agents
- > Fieldwork 12th March – 28th April (still open)

Contents

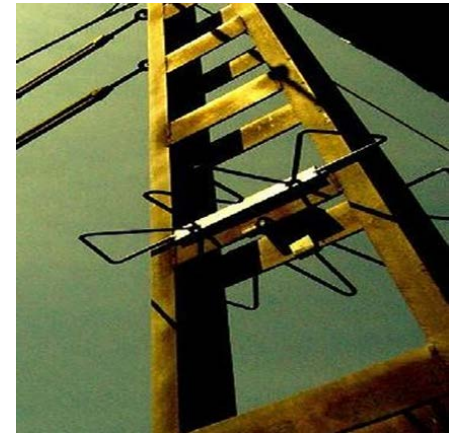
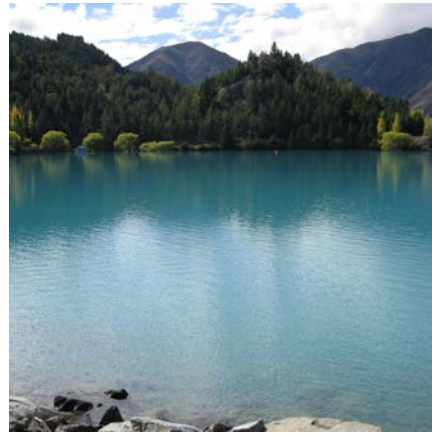
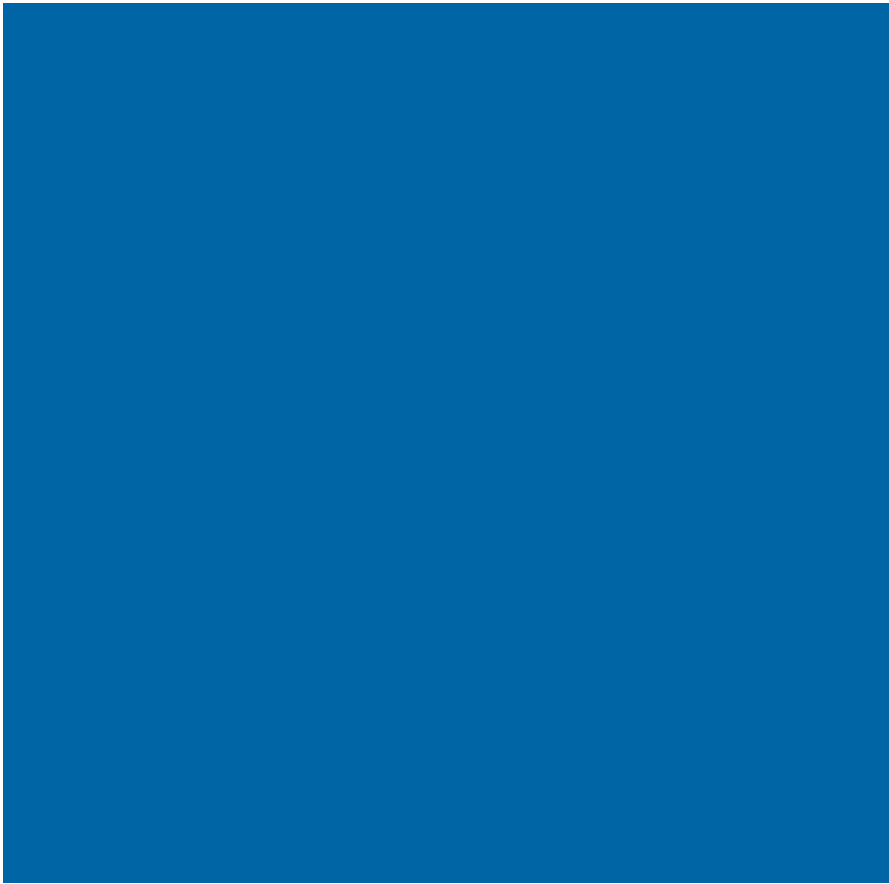
Competitiveness of the market

Factors limiting competition

Improving competitiveness

Other industry issues

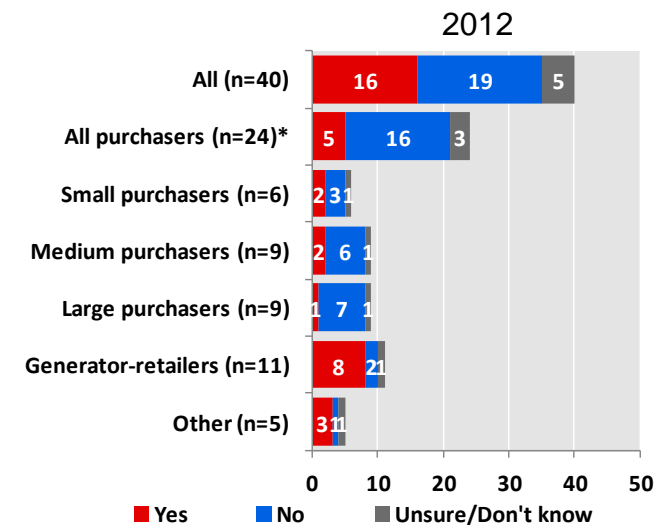
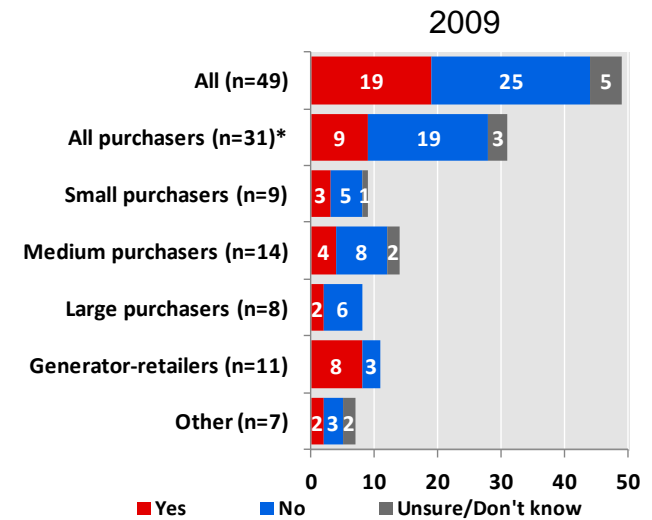
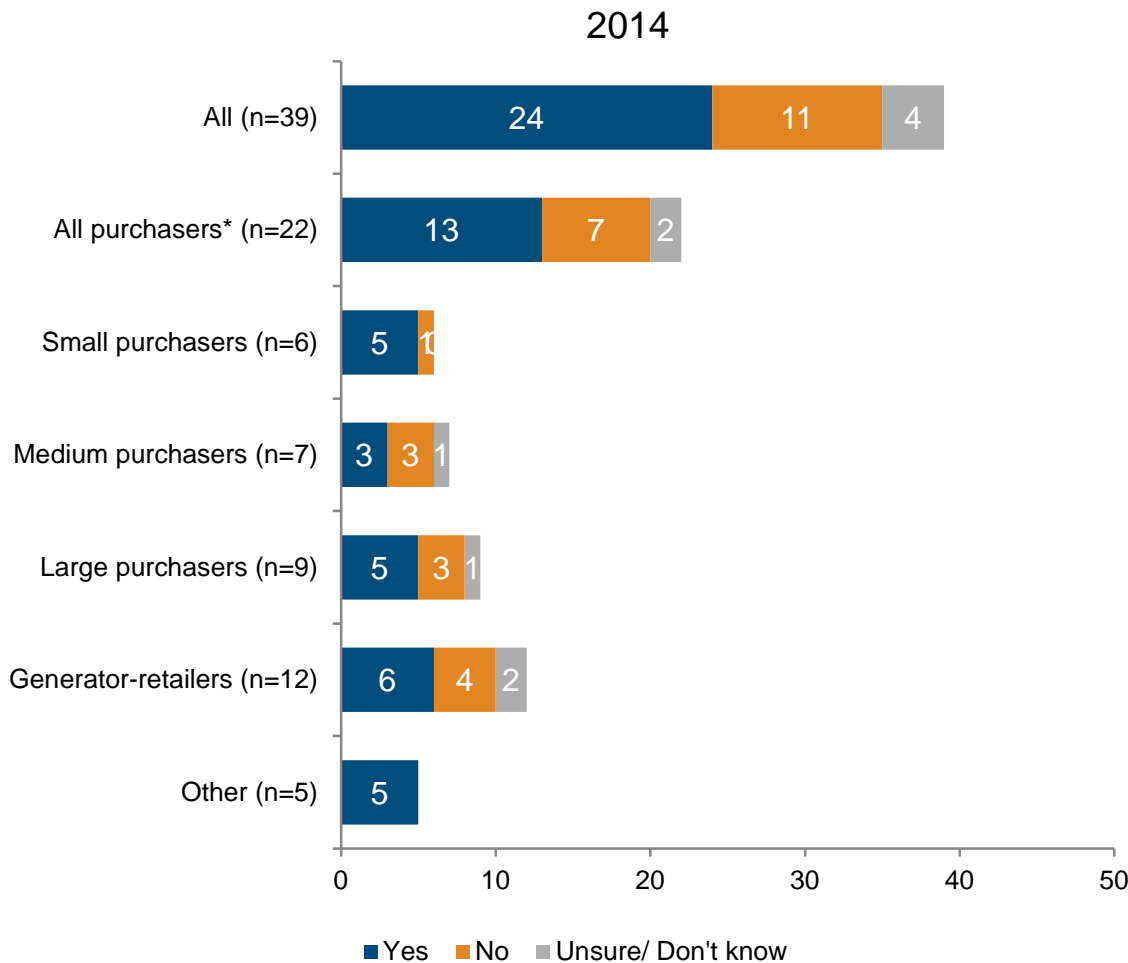
Summary



Competitiveness of market

Competitiveness

Do you believe a competitive electricity contracts market (hedge market) currently exists in New Zealand?



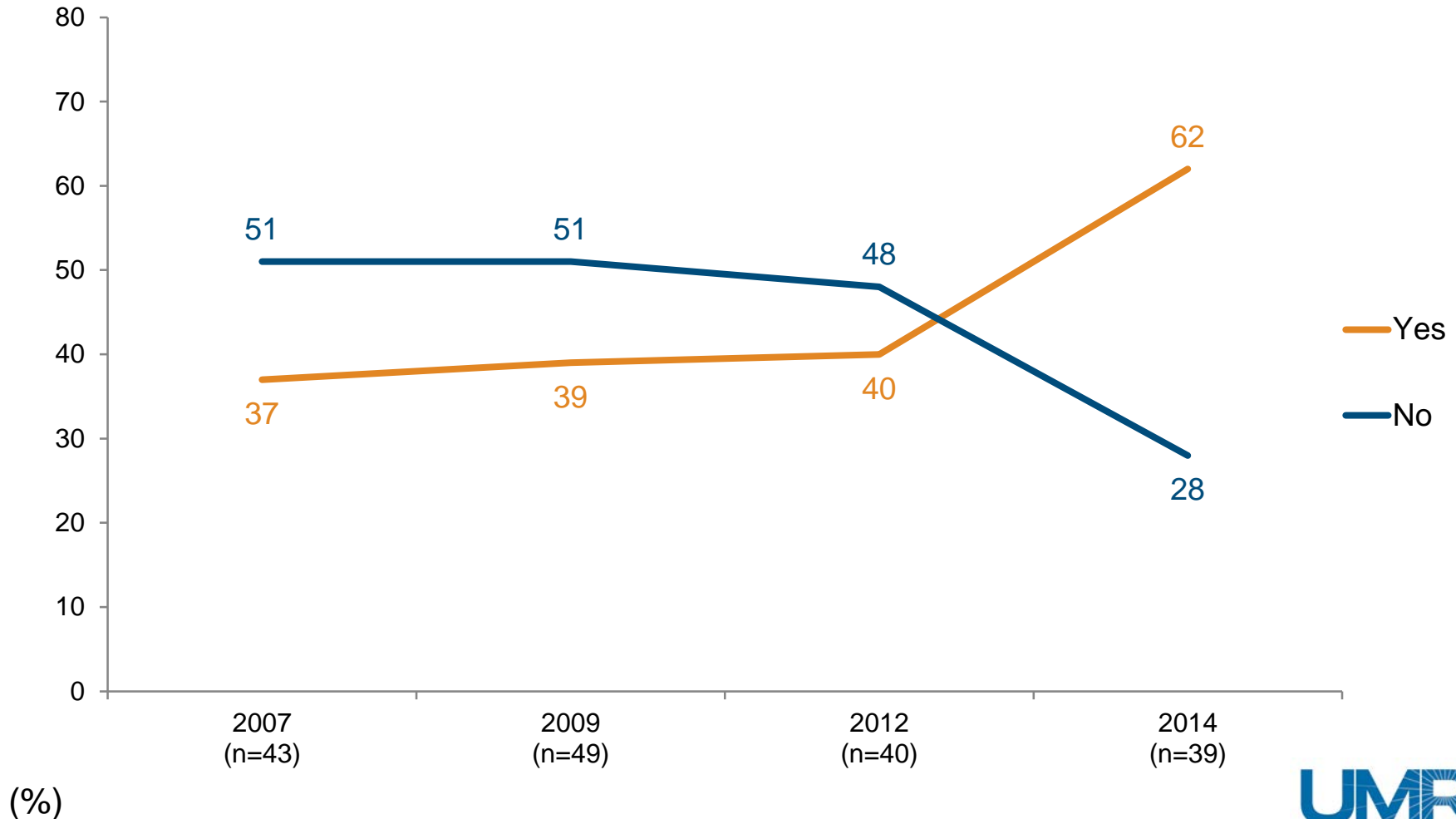
(n)

*All purchasers excluding Generator-Retailers

Competitiveness since 2007

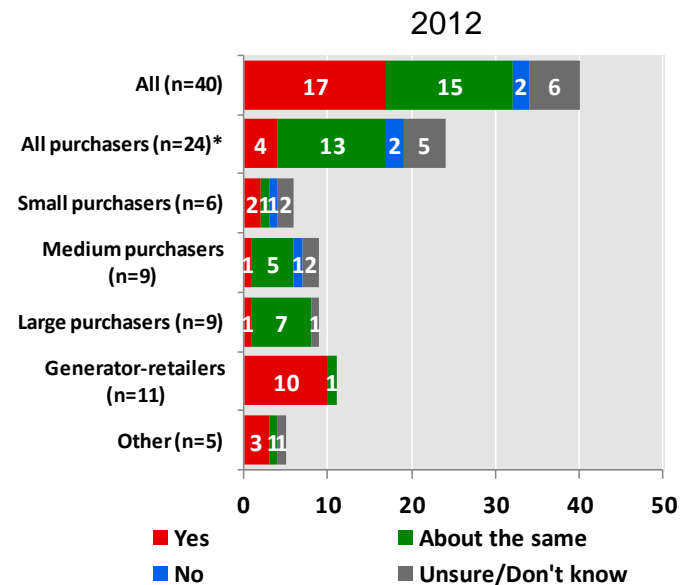
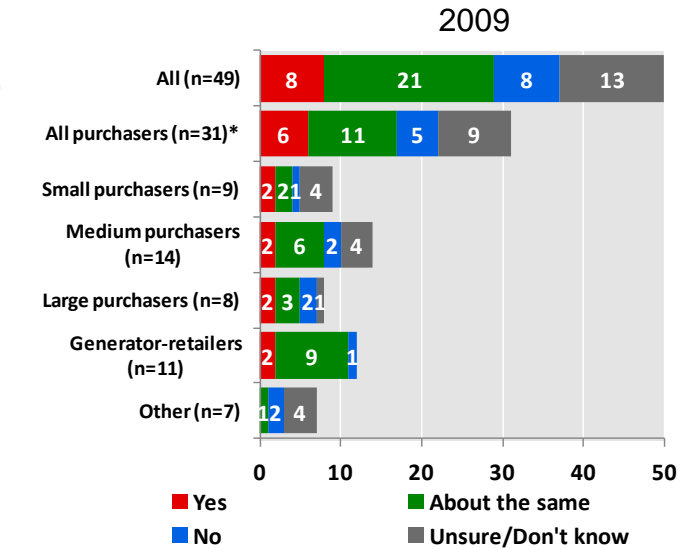
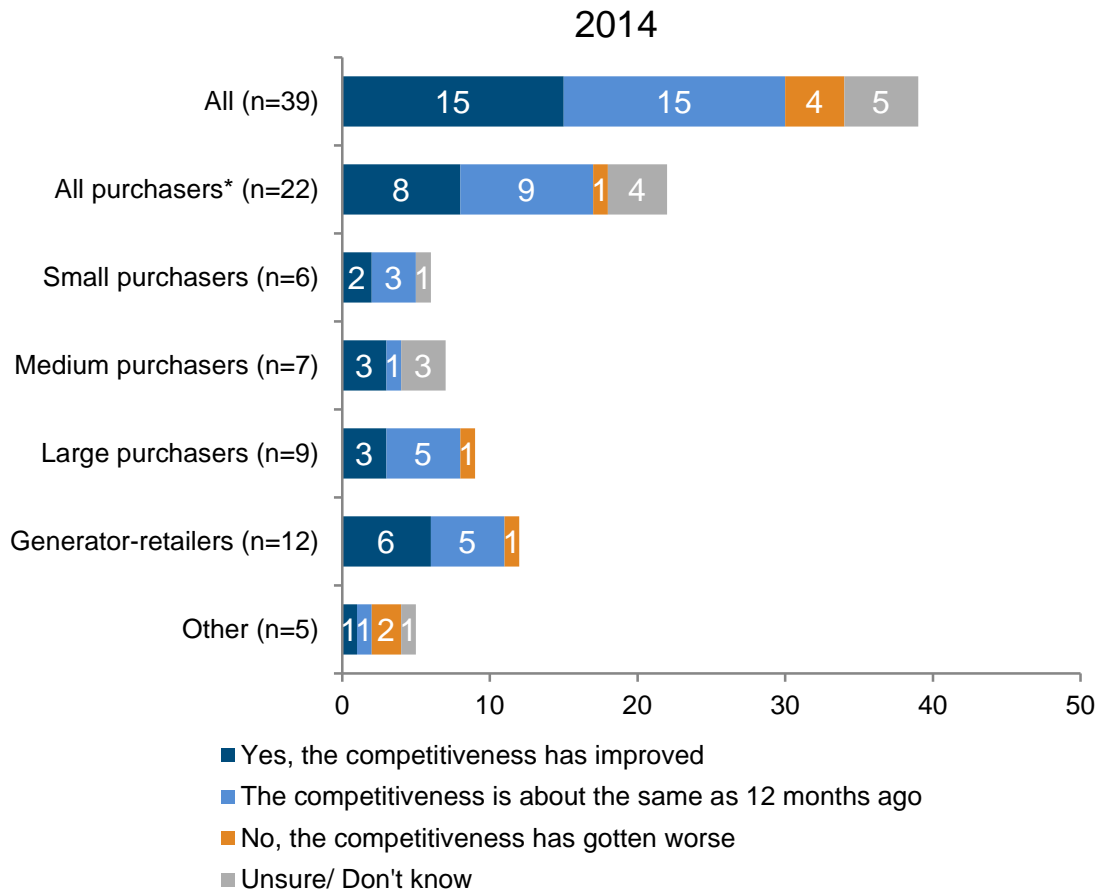


Do you believe a competitive electricity contracts market (hedge market) currently exists in New Zealand?



A third see improvements in past 12 months

Do you believe the competitiveness of the electricity contracts market (hedge market) has improved over the past 12 months?



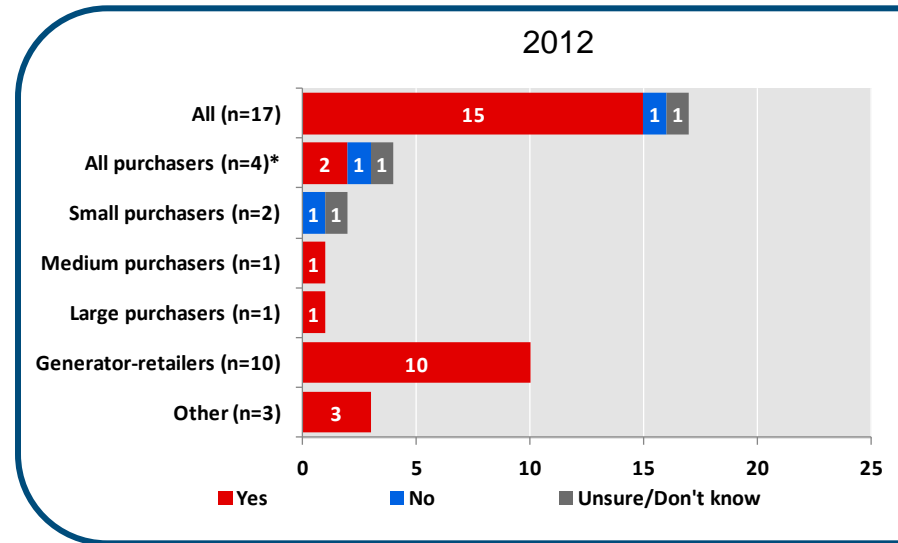
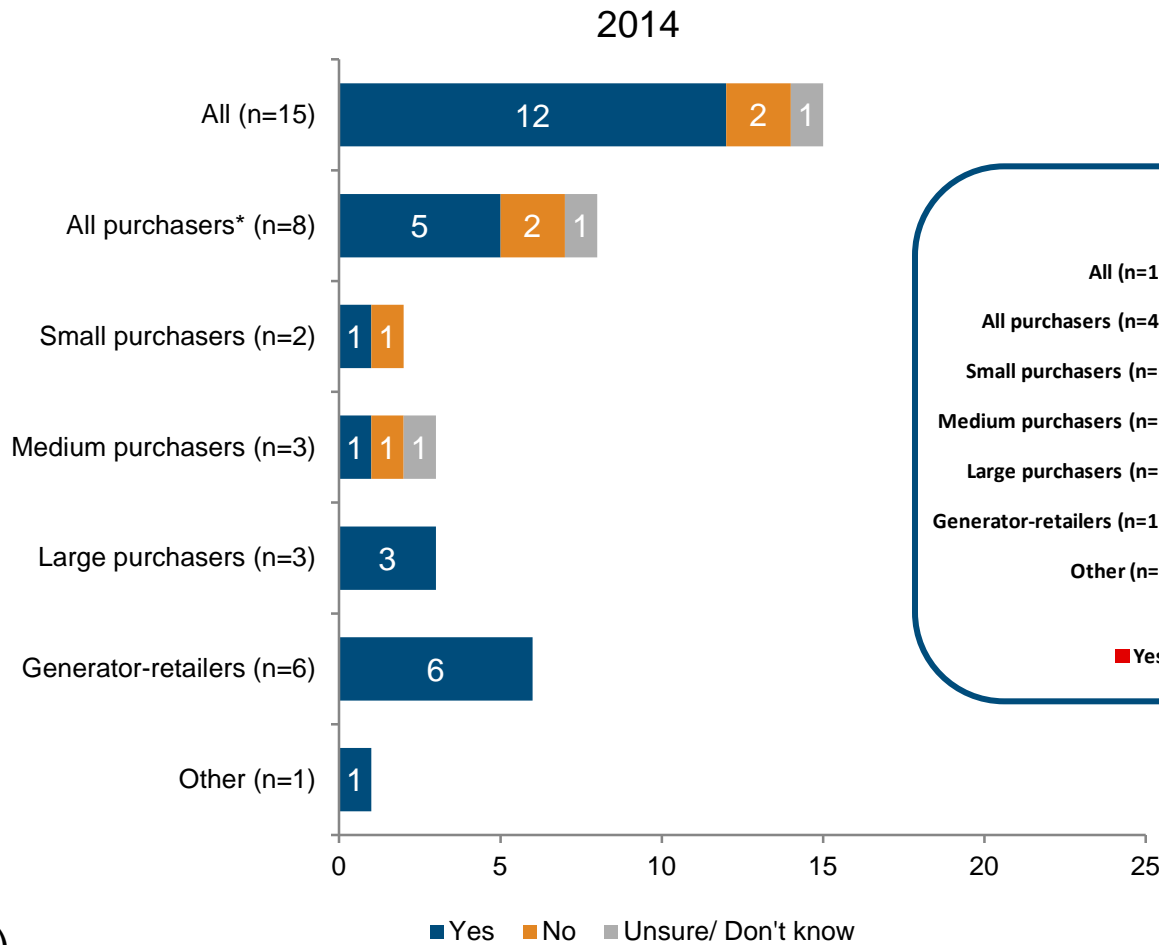
(n)

*All purchasers excluding Generator-Retailers

Effect of ASX derivatives



Do you believe the availability of ASX electricity derivatives has been a significant contributor to this improvement?



(n)

*All purchasers excluding Generator-Retailers

Other reasons competitiveness improved

- > Increase in level of trading, more liquid, more mature
 - > OMF as market maker, increased volumes
- > ASX resulted in greater transparency, good indication of prices
- > Introduction of FTRs
- > Narrower spreads
- > Asset swaps taken some volatility out of pricing

Evidence of competitiveness

- > Increase in trading activity – number of transactions, ASX tracks pricing
- > Increased liquidity, price transparency
- > More willingness from both purchasers and sellers
 - > Narrower spreads, more offers, better pricing, varied offers
- > Feedback from purchasers
- > Plenty of supply (can't always sell)
- > Comparison with international pricing

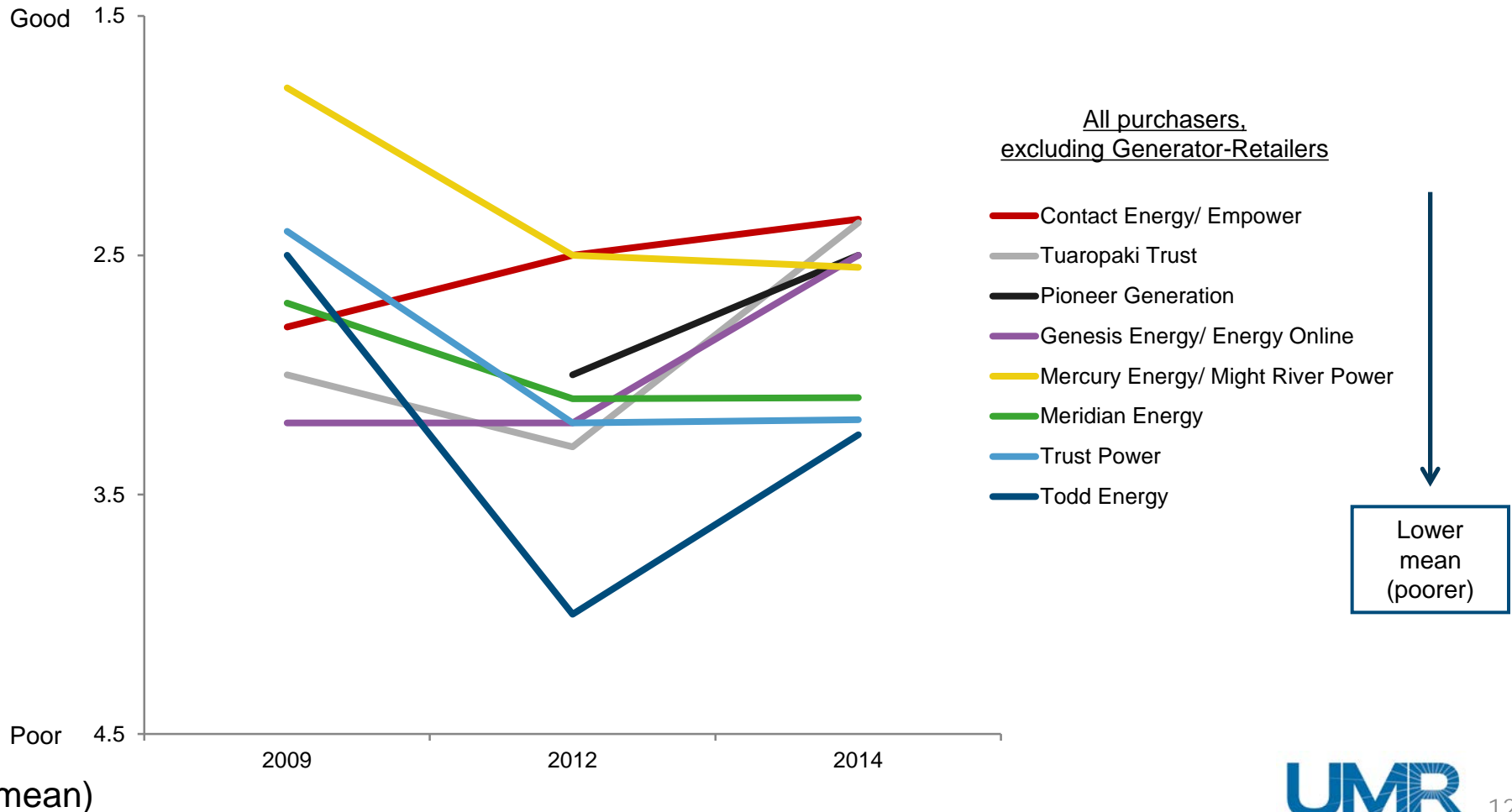
Evidence of lack of competitiveness

- > Margin between spot and hedges too wide
- > Not liquid/ thin – compared to other financial markets
 - > Only small percentage of physical market traded
- > No confidence pricing guideline is meaningful, its volatile and margin between ASX and OTC hedge is large
- > Financial institutions reluctant to enter market
- > Market power – some gentailers reduce capacity to manipulate markets
 - > Sometimes only a few or none quote, alternatively quote high

Hedge seller ratings

In your personal experience please rate the following parties on their hedge seller performance.

Tracked mean: 2009 – 2014
(1='very good', 5='very poor')

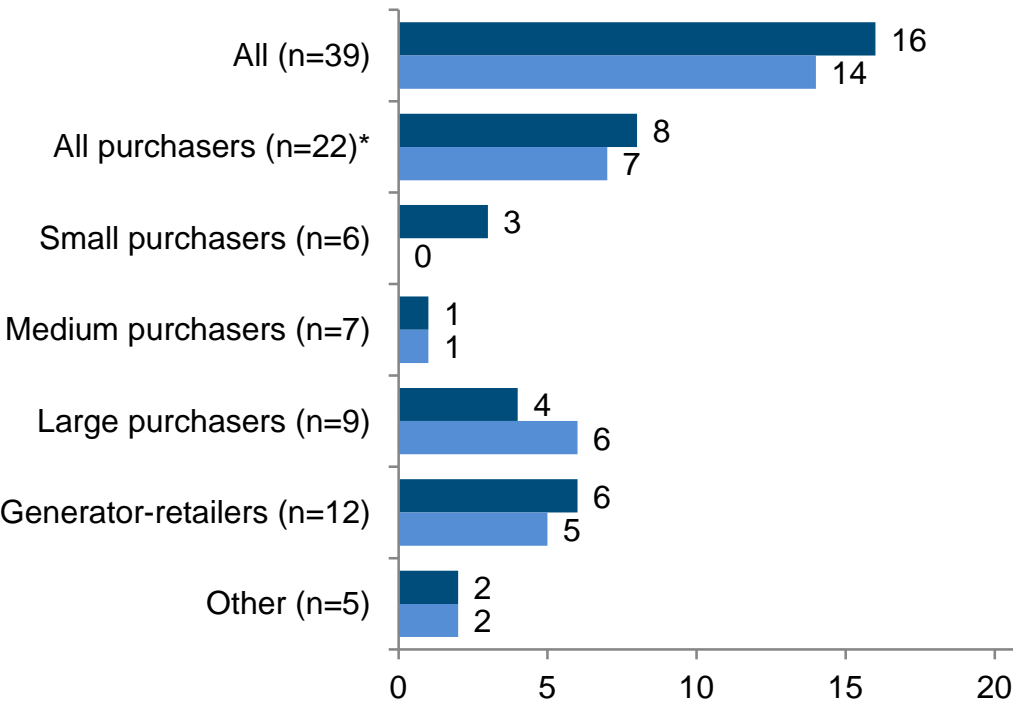


*Results exclude unsure responses

Views on competitiveness of the process

On a scale of 0-10, where 0 means not confident at all and 10 means very confident, how confident are you that the following are competitive?

2014 Summary: total competitive (7-10)

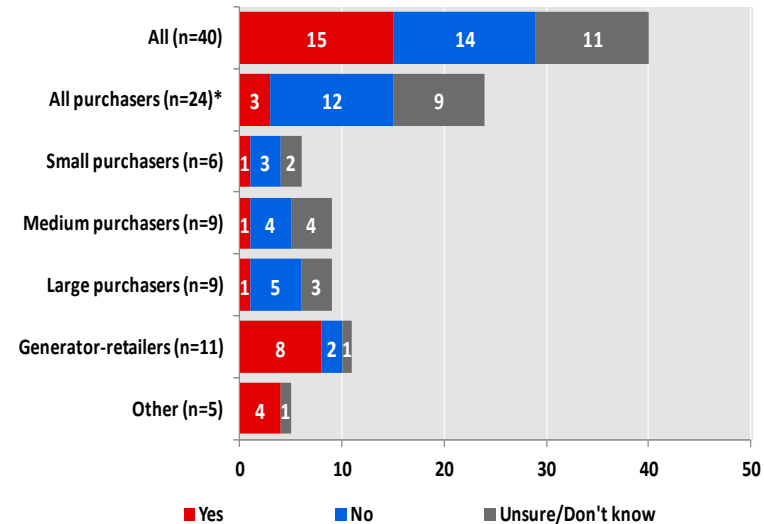


■ The process for establishing bilateral electricity contract prices
 ■ The process for establishing ASX electricity derivative prices

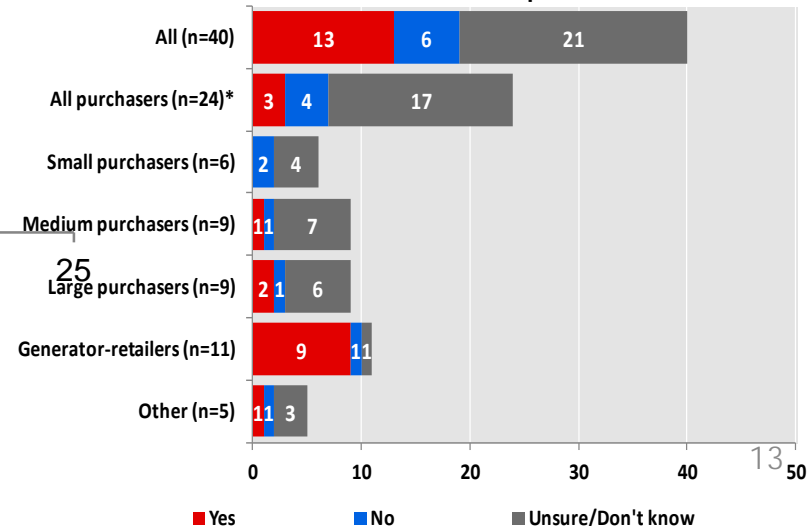
(n)

*All purchasers excluding Generator-Retailers

2012 Results – Bilateral process



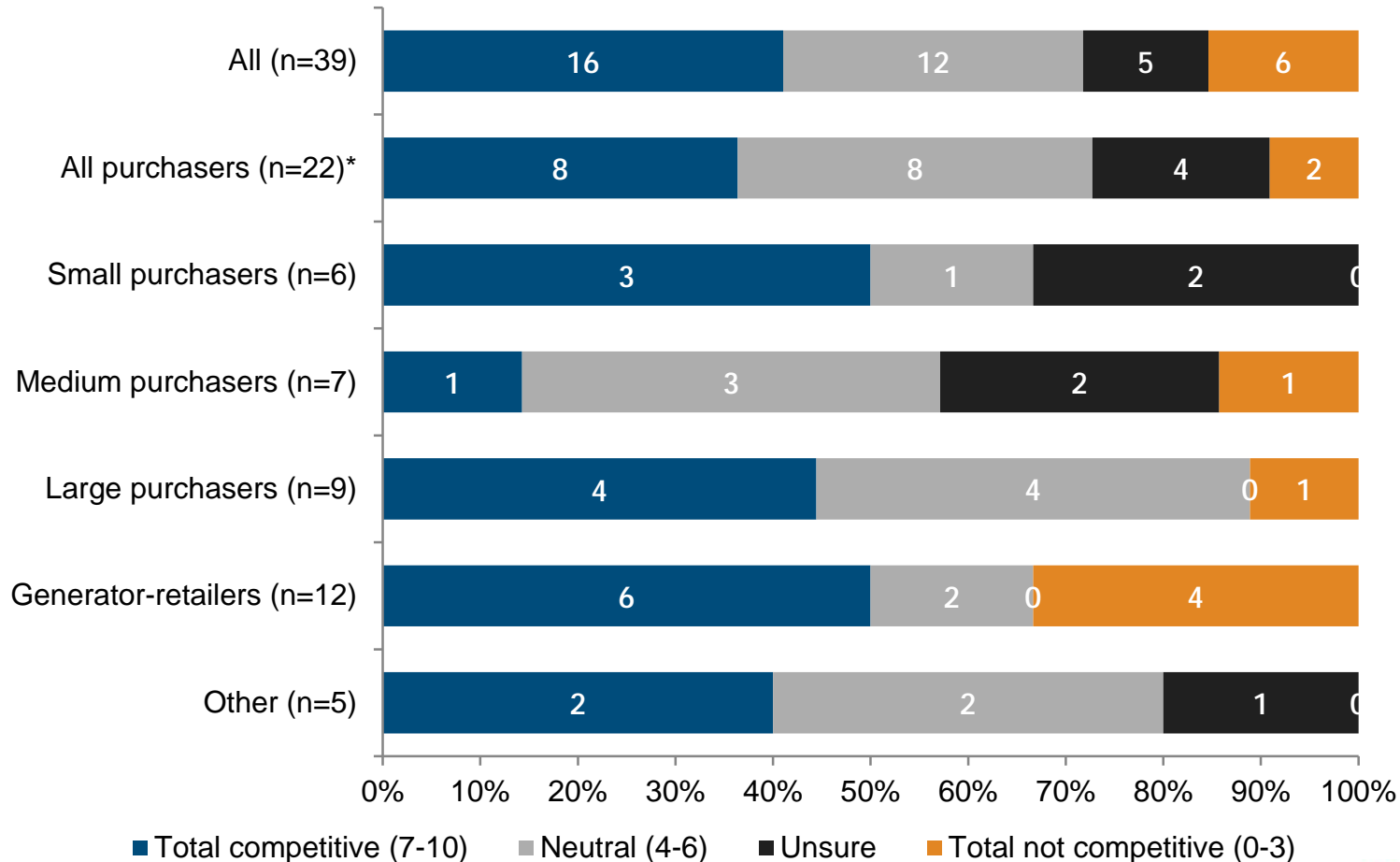
2012 Results – ASX process



Process for establishing bilateral electricity contract prices



On a scale of 0-10, where 0 means not confident at all and 10 means very confident, how confident are you that the following are competitive?



(%)

*All purchasers excluding Generator-Retailers

Process for establishing bilateral electricity contract prices

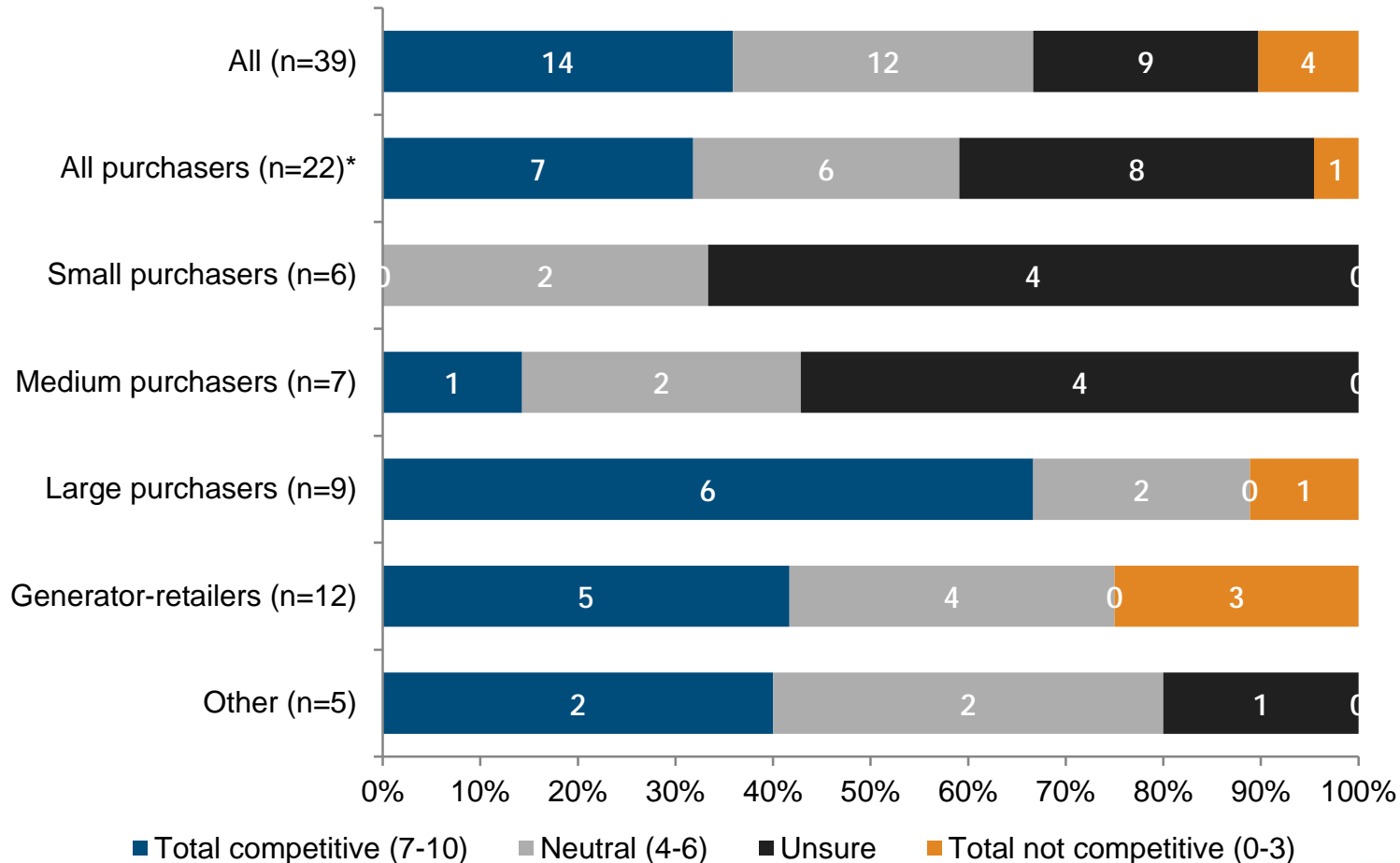
- > Reasons competitive
 - > More participation
 - > More products
 - > Feedback on pricing
 - > Narrow spreads
 - > Number of offers
 - > ASX pricing guideline

- > Reasons not competitive
 - > Limited number of offers
 - > Sometimes no offers
 - > High margins compared to other markets
 - > 'Take it or leave it' attitude
 - > Price high if don't want to offer
 - > Some locations problematic

Process for establishing ASX electricity derivative prices



On a scale of 0-10, where 0 means not confident at all and 10 means very confident, how confident are you that the following are competitive?



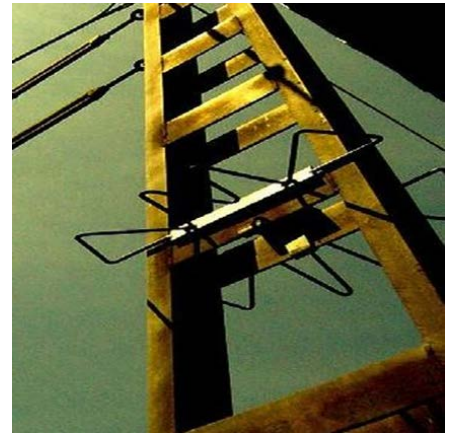
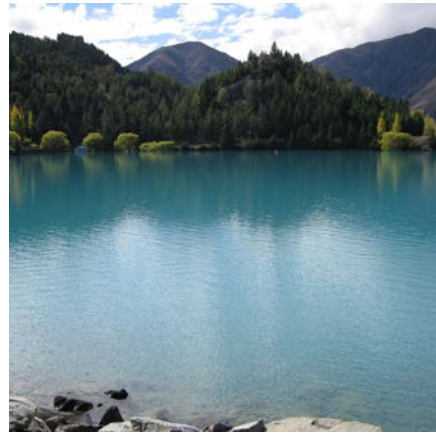
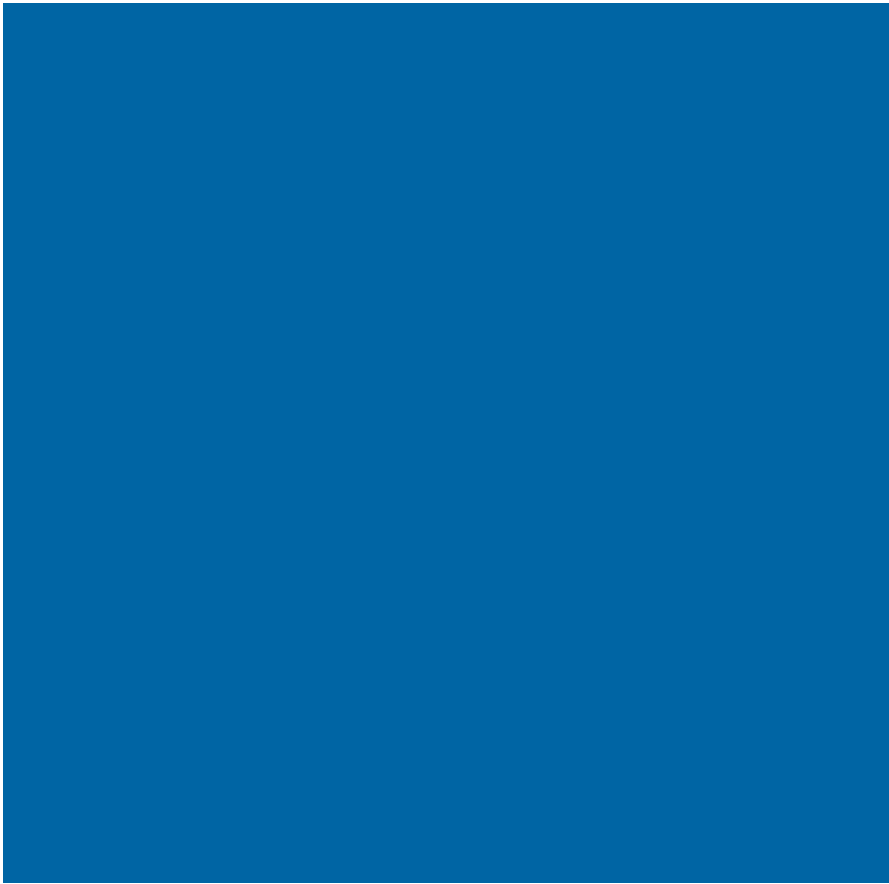
(%)

*All purchasers excluding Generator-Retailers

Process for establishing ASX electricity derivative prices

- > Reasons competitive
 - > Market making agreements in force
 - > Maturing market
 - > Align with view of where prices should be – consistent and not at a premium

- > Reasons not competitive
 - > Lack of volumes
 - > Need more market makers
 - > Not an indication of OTC pricing
 - > Too volatile
 - > Significant barriers to entry



Factors limiting competition

Factors limiting competition

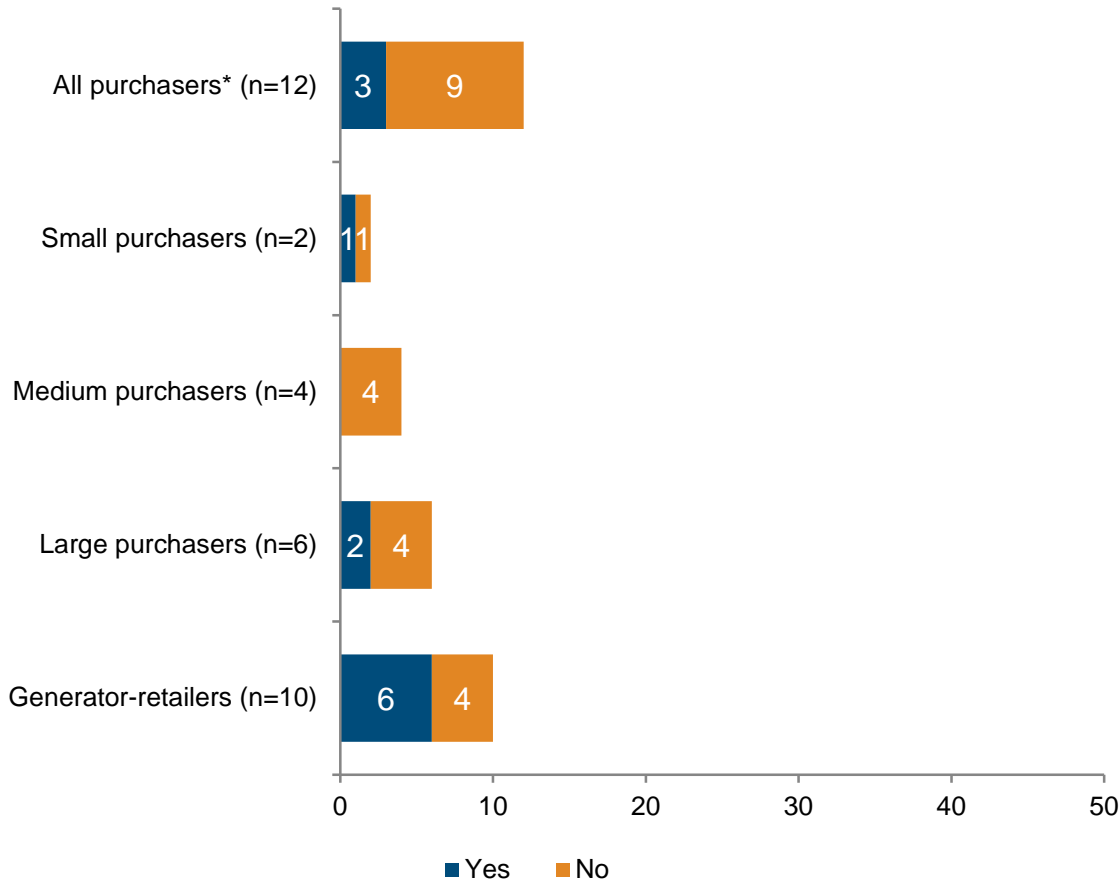
- > Lack of liquidity
 - > Lack of purchasers, financial intermediaries trading
 - > Small a percentage of physical market traded (resulting from vertical integration)
- > Number of lines companies – with different terms, conditions and pricing
- > Complex market and increasing complexity
- > Smaller number mentioned location risk and duration an issue

Location not as much of an issue

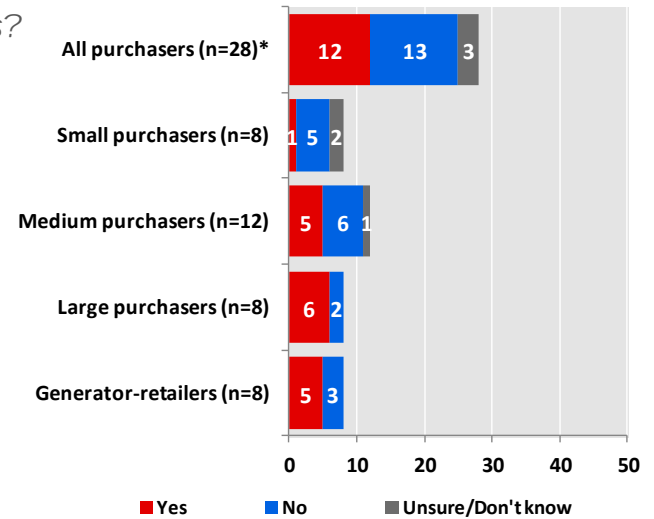


Have you had difficulties getting prices for hedges at some locations?

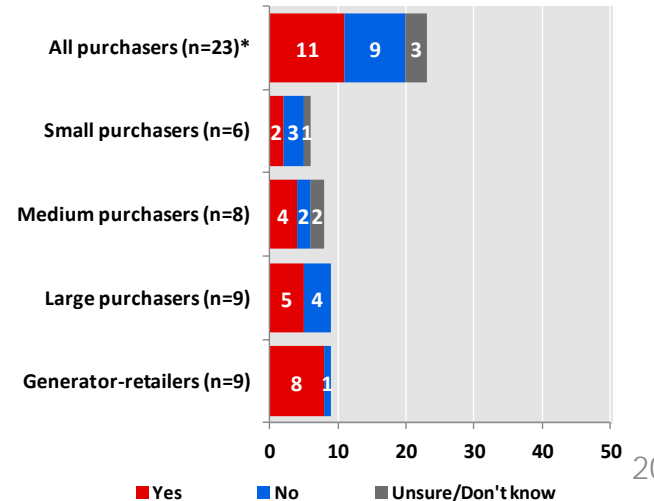
2014



2009



2012



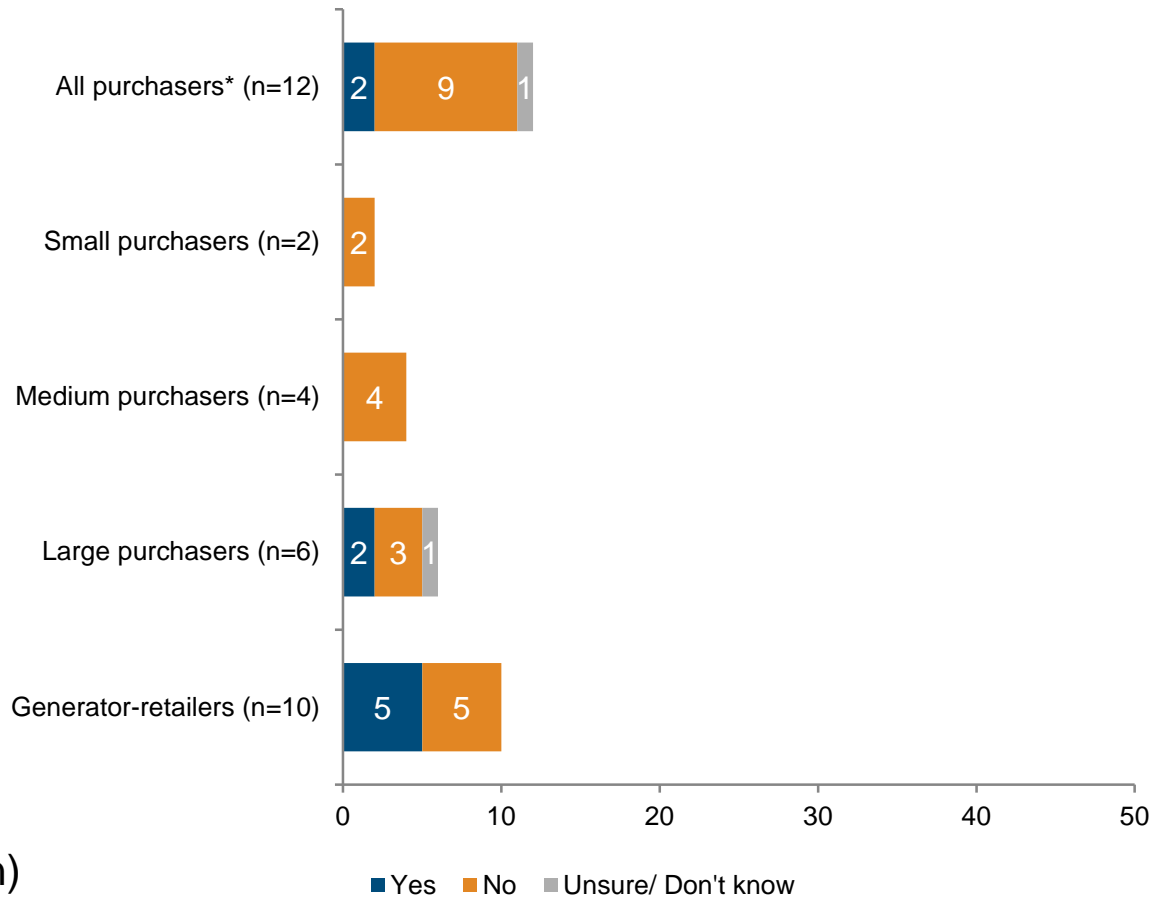
(n)

*All purchasers excluding Generator-Retailers

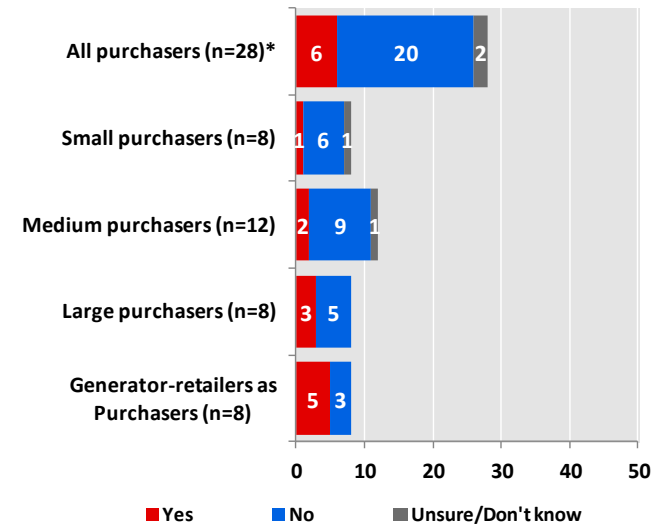
Majority buy at preferred locations

Have there been situations where a lack of offers has meant that you had to purchase hedges at locations other than your preferred locations?

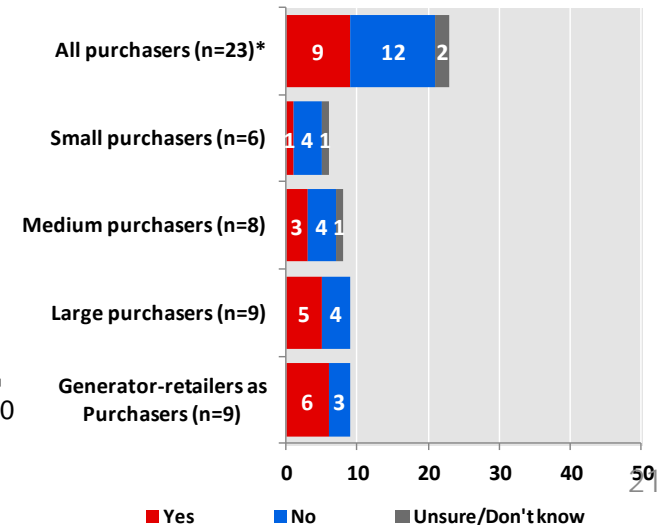
2014



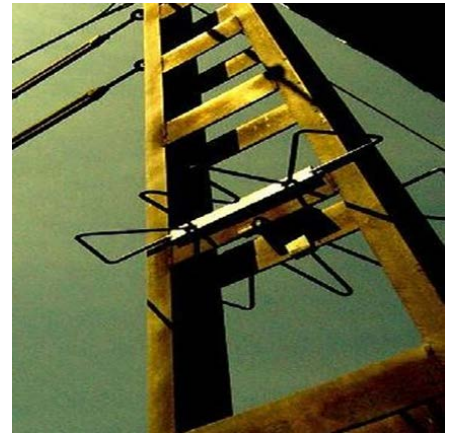
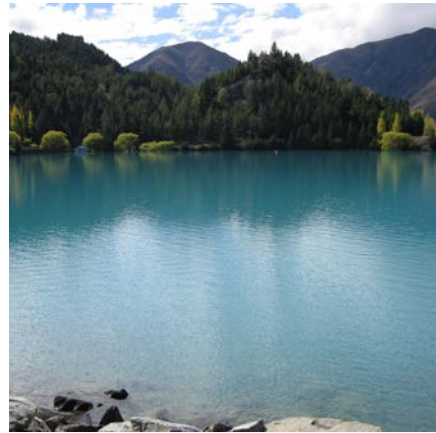
2009



2012



*All purchasers excluding Generator-Retailers



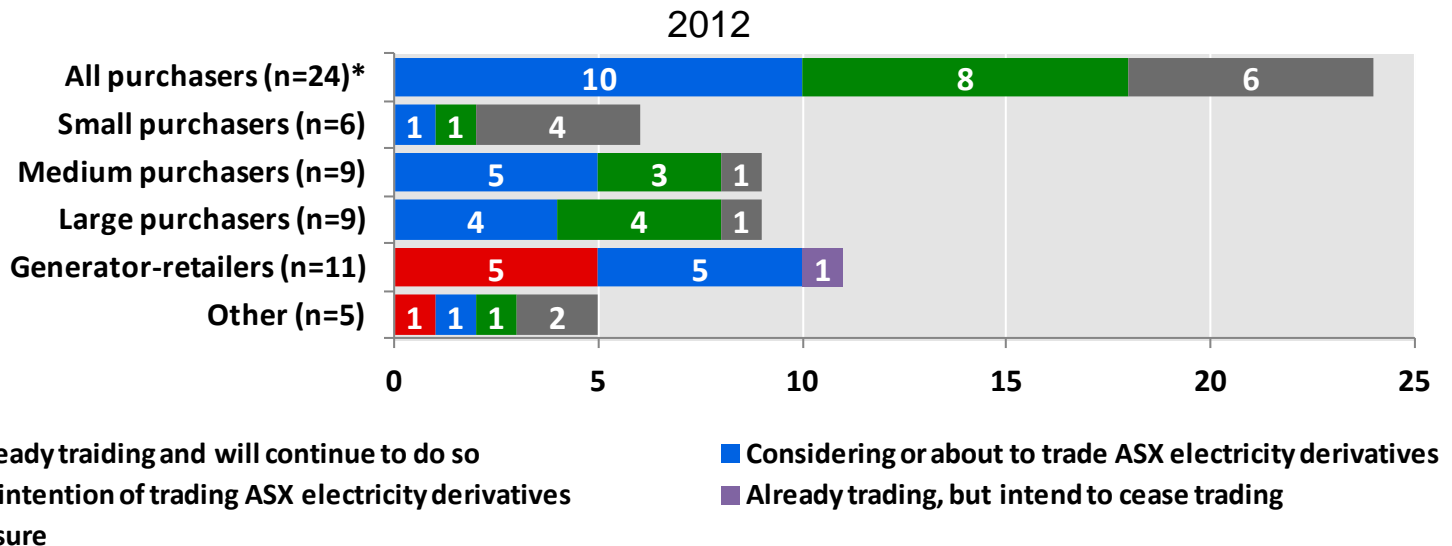
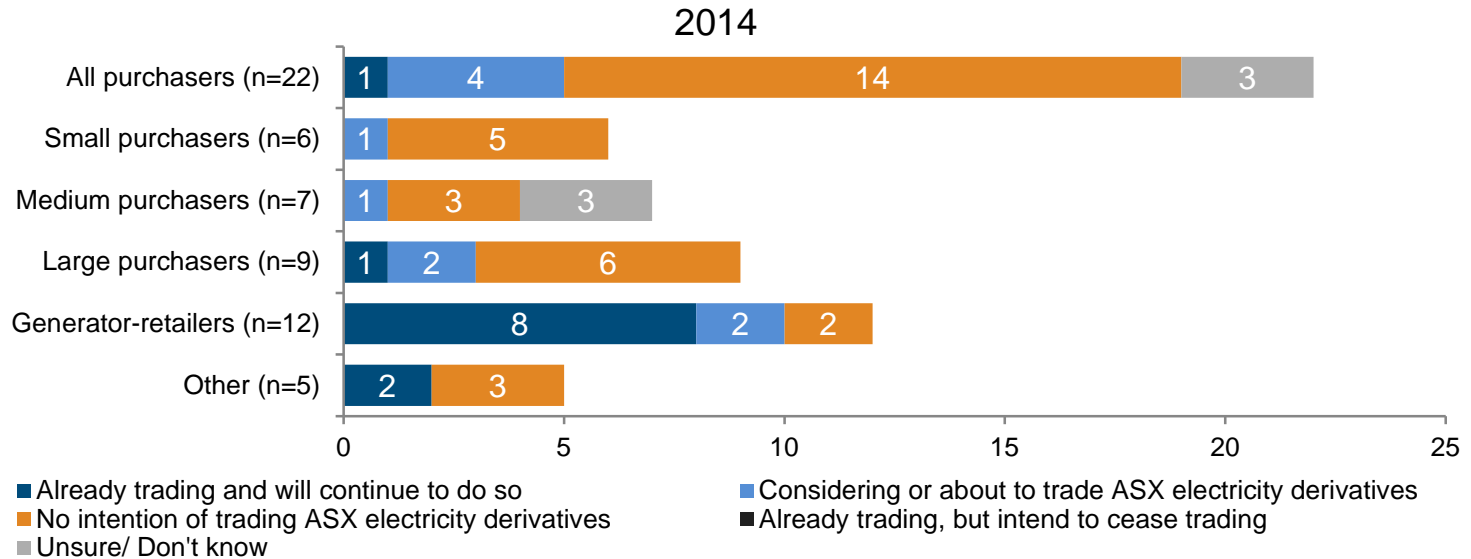
Improving competitiveness

Main suggestions

- > Increase liquidity
 - > Need more market makers (other parties made to participate)
 - > Increase percentage of physical supply to be traded/ disclosure of transfer pricing/ splitting of generators and retailers
- > Reduce barriers to entering ASX (initiatives around prudentials)
- > Encourage more intermediaries, financial institutions to participate
- > Introduce more products to manage risk (more FTRs, peak products, smaller contract sizes)
- > Improved disclosure and transparency

ASX intentions

Which ONE of the following best describes your position on trading ASX derivatives?



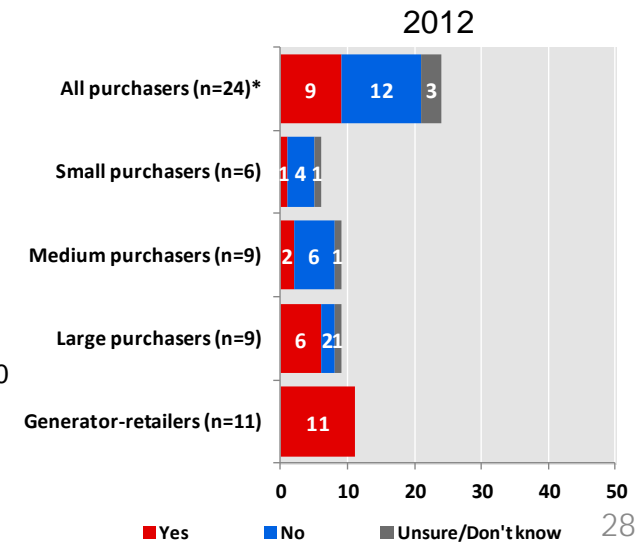
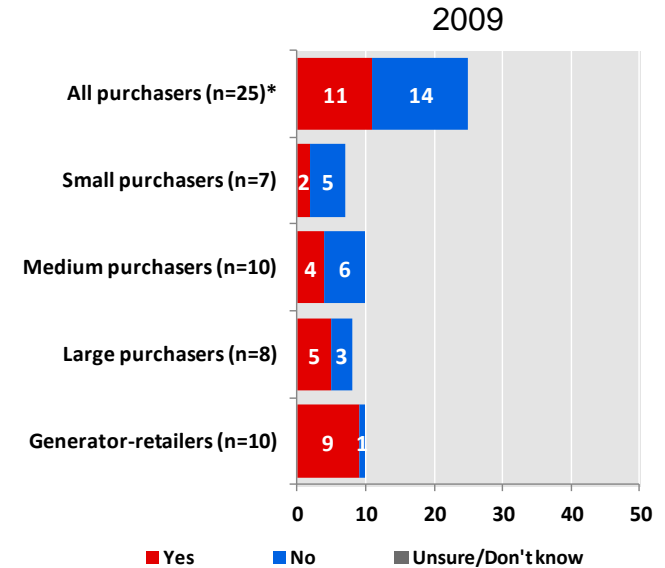
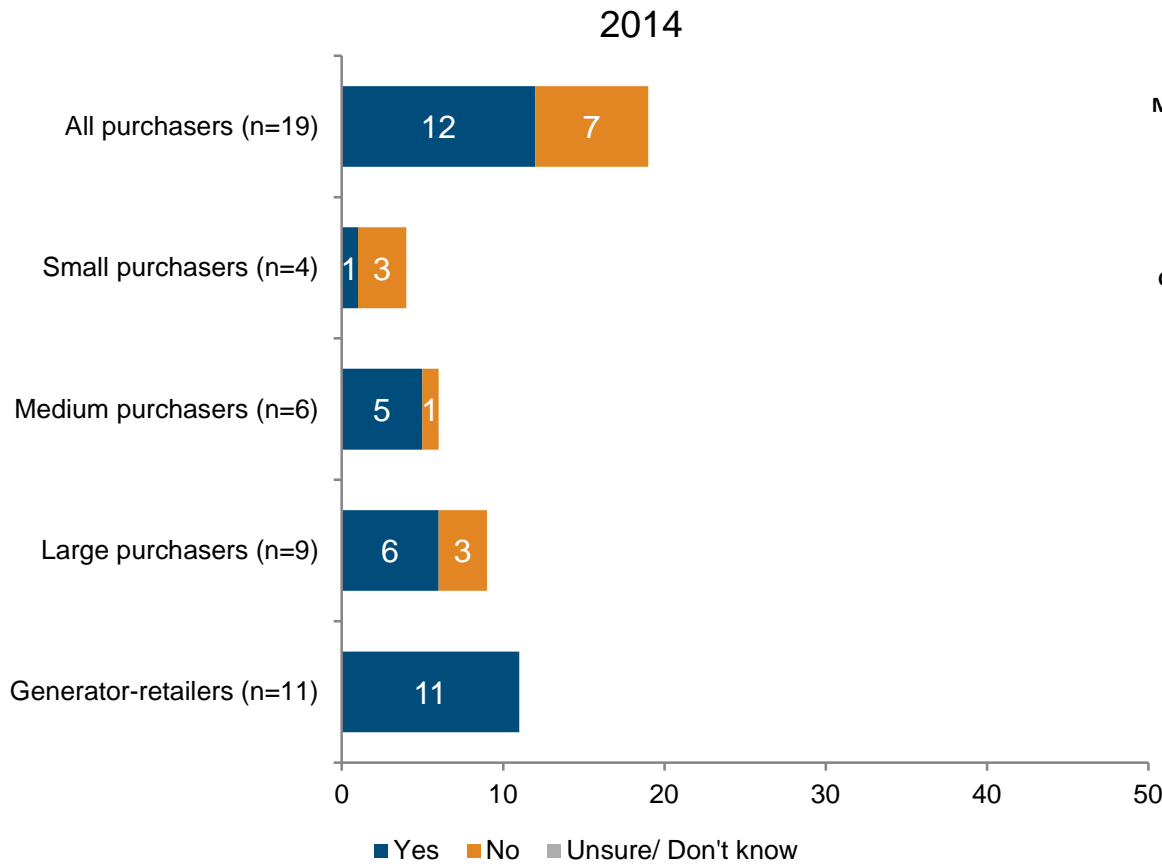
*All purchasers excluding Generator-Retailers

Entering market

- > Lack of products – location, peak load
- > Ability to post credit/ need for capital
- > Need resourcing, expertise
- > Understanding by senior management

Degree of Risk Management

Do you have a risk management policy that guides your electricity price risk management?



(n)

*All purchasers excluding Generator-Retailers

Initiatives to improve hedge market

- Contribution of Initiatives

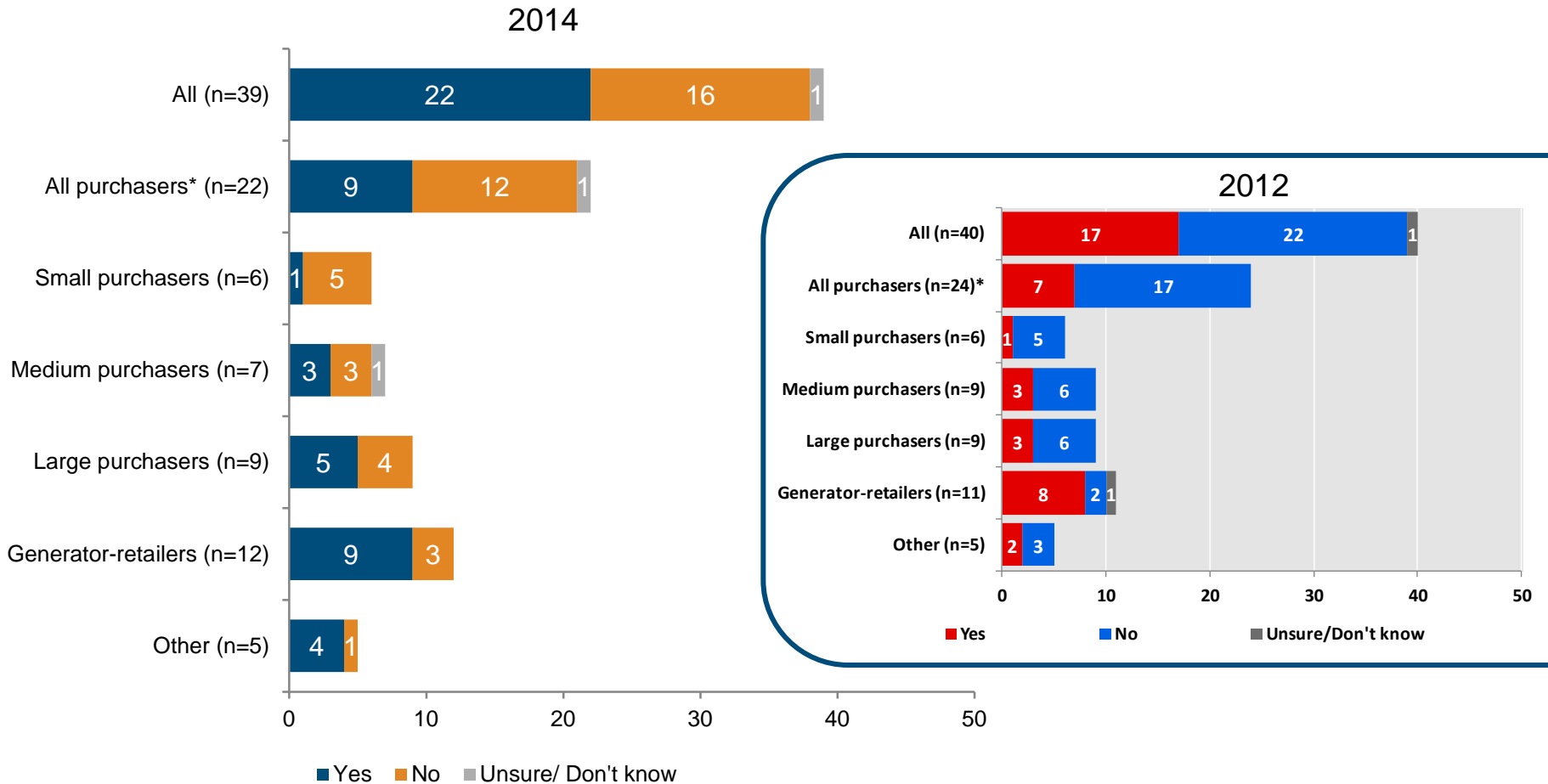
Please rate the initiatives in terms of how highly you think they will contribute to promoting hedge market liquidity: very high, high, average, low, very low.

(VERY HIGH + HIGH) – (LOW + VERY LOW)		
	2014 Total Net Useful (n=39)	2012 Total Net Useful (n=40)
Introduction of new ASX futures and options products	19	-
Improved publication of outage and fuel data	14	13
Wholesale market information disclosure obligations	10	-
Risk management website (www.electricitycontract.co.nz)	7	1
Additional Financial Transmission Rights (FTRs) locations	0	1
Support for a standardised model master agreement	-1	3
Promotion of training and advisors	-1	-1
Publication of education booklet	-9	-12
Stress testing disclosure regime	-12	-12

Electricity Hedge Contract Website



Do you use the Electricity Hedge Disclosure (www.electricitycontract.co.nz) website?



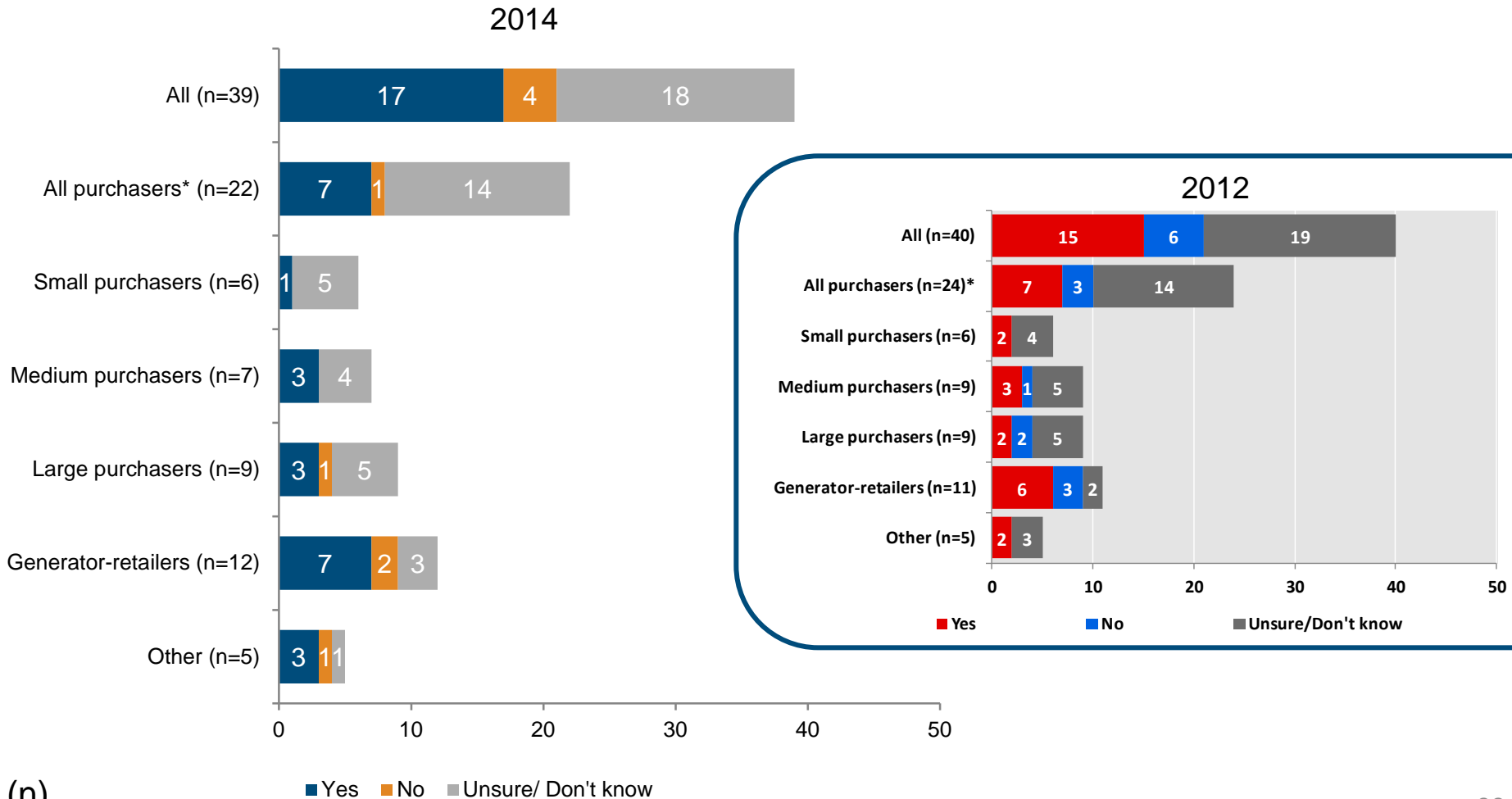
(n)

*All purchasers excluding Generator-Retailers

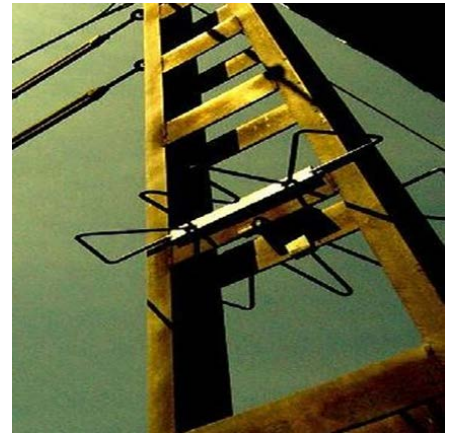
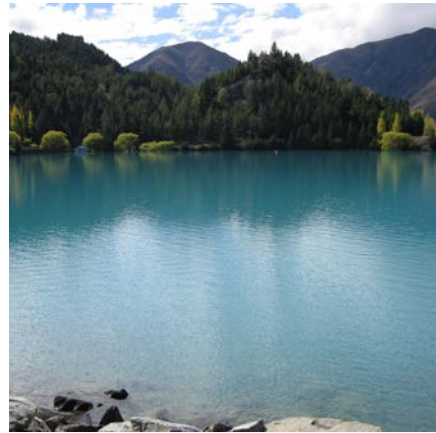
Electricity Hedge Contract Website



Is the Electricity Hedge Disclosure website still required given the ASX electricity derivative forward price curve is now available?



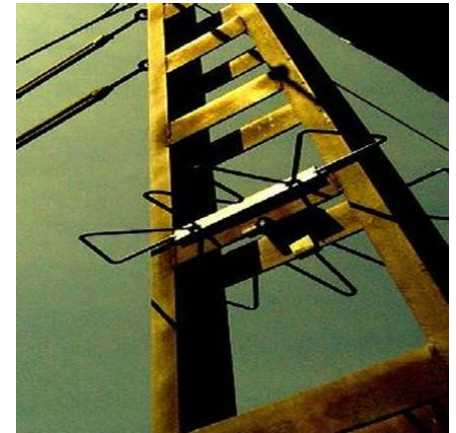
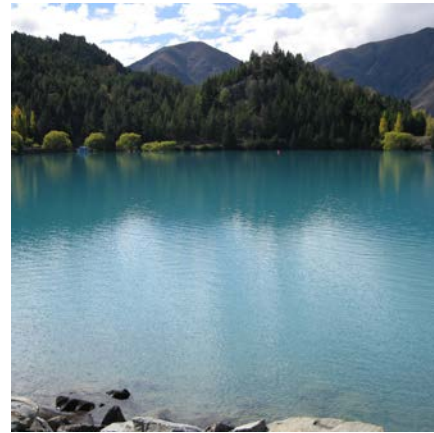
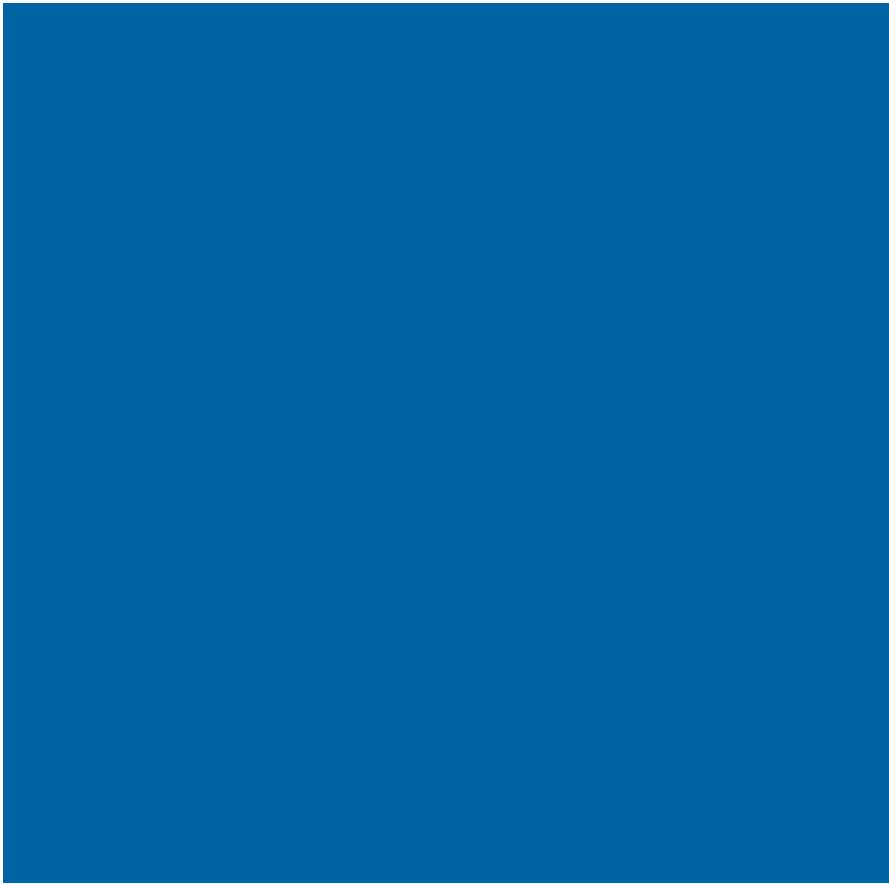
*All purchasers excluding Generator-Retailers



Other industry issues

Industry issues

- > Impact of NZ Power
- > Improve reputation of industry – contribution, quality of system
- > Future focus of the Authority
 - > Keep refining current system, backward step to change
 - > Issues around transmission pricing
- > Notification of outages (mainly related to lines companies)
- > Price transparency
 - > Confusion over lines charges – need transparent billing and/ or public education
- > Increasing costs
 - > Transpower, lines companies
- > Number of lines companies – need for standardised system agreements and data
- > Industry overly complicated, jargon filled, hard to find clear information
- > Future of Tiwai Point



Summary

Summary

- > Competition
 - > Improved perceptions of competitiveness since 2012 (and over past 12 months)
 - > Less polarised views but can still be improved
 - > But cooling off of purchaser intent to enter ASX
- > Key issues for purchasers
 - > Differences between hedge and spot prices
 - > Lack of liquidity
 - > Lack of communication around outages
 - > One or two only get a few offers/ problems at some locations

Summary (cont)

> Solutions

- > Increase liquidity - more market makers, greater percentage of physical supply sold
- > More products to manage risk
- > Encourage more participants (intermediaries, purchasers), reduce barriers to entry (improve prudential arrangements)
- > Improved disclosure

> Other issues

- > Uncertainty over NZ Power
- > Focus of the Authority
- > Price transparency
- > Increasing line/ Transpower costs
- > Number of lines companies – with different agreements, pricing
- > Market complexity – understanding of senior management