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Voluntary market-making does not work

Haast Energy Trading (Haast) urges the Electricity Authority to immediately require mandatory market-making for the super-peak hedge product. Ensuring there is sufficient liquidity for market participants to have confidence prices are efficient is essential for the orderly functioning of hedge markets in highly vertically-integrated markets such as New Zealand electricity.

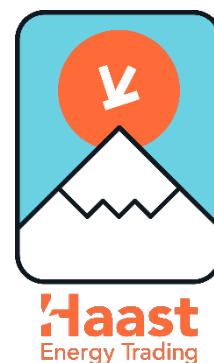
The absence of a well-functioning hedge market has meant the wholesale electricity market is risky and costly to participate in resulting in higher barriers to entry, lower competition, and ultimately higher prices than would be expected in workably competitive markets. We have seen this play out over the past 5 years with the exit of record numbers of small retailers and industrial users, reduced switching rates, and rapid price rises.

As a financial intermediary who works closely with non-integrated and industrial participants Haast can only repackage the financial products available to us. Absent regulation, parties with significant market power have little incentive to make adequate hedge products available. In contrast to the markets the gentailers dominate, barriers to entry in the markets for risk repackaging are low and have recently seen an influx of new competitors. If the Authority gives participants the confidence that access to key wholesale products is enduring and liquid, this market will continue to attract capital and efficiently repackage credit and risk to increase competition in wider wholesale and retail markets.

Regulated market making of both base-load and super-peak hedge products will deliver the certainty financial players need to attract capital and enable them to create a wide variety of products tailored to their clients' needs. A single base-load product is not sufficient to enable significant risk repackaging, but the addition of a liquid super-peak contract will significantly expand the range of products which are possible. If liquid wholesale products are provided which cover the key risk dimensions of energy and flexibility, efficient credit and customised products via repackaging will follow. This has the benefit that the Authority does not need to try and develop regulated hedge products that can cater for every different participant's preferences. The Authority should have confidence that financial intermediaries will deliver the diversity of products demanded if a platform of liquidity in key products is developed.

Gentailer incentives don't align with voluntary arrangements

The Authority should not expect self-sustaining liquidity in a market that is approximately 90% vertically-integrated and where the main suppliers of hedge products have significant market power. The failure of the Singapore market following the removal of market making schemes serves as a sobering example of this. The incumbent gentailers are incentivised to remove liquidity from the market as it lessens the competitive threats they face, and they will rationally do so if they perceive regulatory threat from the Authority diminishes or is weak. The Electricity Authority and Commerce Commission have both detailed these gentailer incentives.



The Authority, for example, has commented “competition issues can arise where vertical integration is combined with market power. Competition can be harmed where a vertically integrated firm, with at least some degree of market power in one of the markets in which it operates, can leverage its position at one level of the supply chain to benefit its operations at another level of the supply chain.”

The Commerce Commission has similarly observed “that a gentailer will naturally prioritise supply of Shaped Hedges to its retail arm over supply of these products to other parties”¹ and gentailers must “weigh up the extent to which it is in their interest to provide their competitors with products that might allow them to compete more effectively against them. To the extent that selling hedges would give a gentailer’s rivals a competitive advantage, the gentailer might be incentivised not to sell hedges, even if their price – relative to spot price – were to increase.”²

Voluntary arrangements have failed and will continue to fail

The gentailers have already been given ample opportunity to provide adequate access to hedge products under voluntary arrangements and have failed to do so. Even with the heightened regulatory scrutiny they have been under with the Energy Competition Task Force, the market for super-peak products remains shallow.³

Continuing to put faith in voluntary arrangements would further delay resolution of long-standing liquidity and product access problems in the hedge market.

The situation is acknowledged by Mercury who, as one of the market-makers, has seen other gentailers withdrawing from supply (2024) when Mercury didn’t consider this to be necessary or justified, and has provided a much higher share of the voluntary super-peak product than other gentailers (Contact and Genesis). Haast welcomes Mercury’s support for mandating the super-peak product. Haast also agrees with the ‘Baldwin’ Expert Panel that the Authority should depart from the MDAG recommendations and go straight to mandated arrangements.

Furthermore, the continuation of a voluntary scheme will undermine investment from financial intermediaries who may see the Authority’s half-hearted commitment to liquidity as too big a risk and instead decide to allocate capital elsewhere. Continued investment from these firms is essential to enable efficient credit and risk repackaging.

Free rider problems

There is no discussion in the consultation about what would happen if one or two of the gentailers acted in good faith, but the others did not. This would seem a highly plausible scenario given current experience, and the differing views amongst the gentailers about regulation of shaped products.

This could result in a rapid collapse of voluntary provision of shaped products if the gentailers acting in good faith became frustrated at bearing most of the cost because of free riders. If the Authority adopts a voluntary approach, it should address this proactively and ensure all gentailers are engaging in the market in an equitable way.

Settings for the super-peak product

¹ Commerce Commission) Statement of Issues relating to Contact Energy’s proposed acquisition of Manawa Energy, para 185.

² Commerce Commission) Statement of Issues relating to Contact Energy’s proposed acquisition of Manawa Energy, para 62.2.

³ There has been some improvement in availability and pricing, with the product trading at prices closer to baseload (having fallen from over 100% to now circa 40%), but these improvements are based on a comparison with an extremely poor starting point.



Haast considers that the Electricity Authority should move straight to mandatory market-making for the super-peak hedge product, with a focus on ensuring there is sufficient hedge product liquidity for market participants to have confidence prices are efficient:

- The Authority should increase the volume of hedge products that market-makers are required to provide. As a starting point, the Authority should target 50% of the ASX futures obligations on a capacity basis but account for the fact it only runs 1 day for every 10 the ASX market is open. This means that 1.2 MW plus a 1.2 MW reload for baseload ASX futures, equates to 6 MW plus a 6 MW reload for super peak if targeting 50% of the liquidity of ASX futures on a fortnightly basis.
- Spreads should be narrowed for both the super-peak product and existing base-load products. The benefits from lowering spreads from 5% to 3% for base-load products are clear. The increased volume and open interest are a direct result of this. As noted by the Authority, "Narrow spreads indicate high liquidity and low transaction costs, and will maximise the net benefit to the market and to consumers."
- The Authority should move to daily ASX market making with the same MW settings as the baseload futures as soon as possible. In the interim the OTC window should be regulated with the same parameters (see discussion below).

Haast recommends the ASX over OTC

ASX contracts are not listed yet, so the Authority should start with OTC as an interim arrangement which could be implemented immediately and move to ASX as soon as possible.

Financial players have rapidly entered the market in recent years as evident from the large and diverse attendance at the recent Auckland Energy Trader Forum. The Authority should have confidence that this group will deliver competitive repackaging including transforming standardised ASX contracts into customised OTC structures, and the associated credit management.

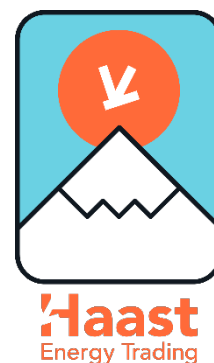
The transparency, standardised credit, and anonymity of the ASX makes this the platform of choice for the base-load and flexibility market making obligations.

Credit demands can be used to restrict market access in OTC markets. In our experience some large gentailers make unreasonable and out of market credit demands and are inflexible in credit arrangements. Some insist on inefficient and poorly targeted credit mechanisms and ignore mitigating risks. In credit negotiations gentailers often present take-it-or-leave-it offers which can only be made from a position of market power.

An enduring solution that relies on OTC markets is likely to suffer from on-going issues with regards to gentailer credit policies restricting access to hedge markets. The Authority must recognise it is in the gentailers interest to adopt such positions and they will rationally do so. To avoid this the ASX should be preferred as an enduring solution.

Implications of the proposed HFO

If the Huntly Firming Option (HFO) is authorised by the Commerce Commission, the Authority should implement stronger, wider market making obligations. This approval would represent a structural step down in expected liquidity in flexibility products and should be offset by obligations which the Authority is best



placed to implement. Haast recommends the Authority liaise with the Commerce Commission over the following Haast recommendations:⁴

- “...require the gentailers to market-make listed quarterly call options across the front 3 years on the ASX at the Benmore and Otahuhu nodes with strike of \$250 /MWh. Quotes should be maintained within a maximum 5% bid-ask spread, with volumes of 5 MW and a 5 MW reload, during a fortnightly trading window.”
- “...enforceable liquidity obligations requiring each HFO counterparty (including Genesis) to offer standardised hedge products to non-affiliated parties on an ongoing and non-discriminatory basis. This should be complemented by specific market-making obligations ... to deliver transparent, tradable firming products usable by independents.”

Concluding remarks

Haast does not consider that the Authority proposals are sufficient to ensure a liquid and efficient hedge market or for independent generators, retailers or large users to be able to ensure they are financially viable and can manage their wholesale risks. The proposals do not give sufficient confidence to financial firms that liquidity will be high and enduring and investment in risk repackaging in New Zealand is compelling.

There is clear and substantial evidence that problems in the hedge market are harming competition, and a key reason why competition has stalled or deteriorated. These problems have already gone on for far too long. NZ Inc cannot afford the luxury of a ‘wait and see’ approach with the Authority testing whether a light-handed approach will work before moving to the next stage of regulation. Vector sums up this state of affairs well:⁵

In 2020, we noted that after more than two decades of waiting for a liquid forward market to emerge, it was time for the Authority to act. Five years on, with little progress, the case for change is even stronger, and more urgent, for New Zealand’s consumers.

Yours sincerely,

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⁴ https://comcom.govt.nz/_data/assets/pdf_file/0032/368717/Haast-Submissions-on-Statement-of-Preliminary-Issues-13-August-2025.pdf

⁵ <https://blob-static.vector.co.nz/blob/vector/media/vector-2025/202505-vector-sub-ea-level-playing-field.pdf>