

18 October 2022

OPEN LETTER TO MARKET PARTICIPANTS

Notice of information request and request for feedback on proposed scope

In recent months some market participants have faced restrictions on their ability to access exchange traded New Zealand electricity futures. As those market participants seek alternative risk management arrangements, some parties have suggested to the Authority that counterparties are either refusing to deal, or refusing to deal on reasonable terms, with affected parties. The Authority has received no firm evidence of this behaviour to date. The Authority intends to request information from market participants to better understand the legitimacy of these claims, and the nature and extent of any potential problem.

Exchange-traded futures are fundamental to the efficient functioning of the electricity markets, both as a risk management tool and for providing an indication of future prices.

The Authority is aware that a provider of access services for New Zealand electricity futures has placed significant restrictions on the services they offer at short notice to the market, and that there is no viable alternative provider for some market participants at present. This will be detrimental to the ability of affected market participants to manage risk and may ultimately lead to poorer outcomes for consumers.

The disruption to exchange-traded futures has resulted in a greater focus on the off-market transactions of bilateral electricity hedge contracts, which are an alternative risk management tool for market participants.

Restrictions on access services are heavily influenced by global energy markets and solutions are best facilitated by the Australian Securities Exchange (ASX), which is currently the only provider of exchange-traded futures. However, the Authority considers every market participant has a vital role to play in navigating this period of uncertainty, given the importance of access to risk management tools and future prices to participants' and consumers' confidence in the market.

The Authority would be very concerned (and would respond accordingly) if a market participant was to arbitrarily take advantage of the situation and subsequently cause harm to consumers. The Authority also acknowledges that suppliers have a legitimate right to protect their commercial interests, and that it is the responsibility of all participants to manage their own risks.

The Authority needs assurances that there are no undue frictions in off-market transactions preventing smaller market participants from accessing hedge contracts. It is critical for the Authority to obtain better oversight of off-market transactions, understand what potential frictions may exist, and how these could be overcome.

Context

Market participants requiring an off-market transaction typically issue a request for proposals (RFPs) to other market participants in search of the best available agreement to satisfy their risk management requirements.

These RFPs typically involve contract for differences (CFDs) in one of two forms:

- **Over-the-counter (OTC)**– an OTC is a type of off-market transaction between market participants which involves a bilateral agreement for an electricity derivative.
- **Exchange for physical (EFP)** – an EFP is a type of off-market transaction between market participants which involves the switching (or exchanging) of an OTC derivative for an exchange-traded derivative.

Without access to exchange-traded futures, market participants have a greater reliance on off-market transactions for risk management. If the appropriate risk management cannot be obtained from off-market transactions, market participants may have increased exposure to electricity spot prices.

Next steps

The Authority's proposed scope of the information required is detailed in Annex One. The Authority is aware of the commercial sensitivity of the information gathered and will take the necessary measures to keep it confidential.

The Authority is seeking feedback from market participants on its proposal, in particular:

- whether the extent of the scope of information detailed in Annex One is considered to be sufficient and, if not, in what way; and
- what additional areas (if any) should be provided for, and in what level of detail.

Feedback is to be provided by email to Info.Provision@ea.govt.nz before 5pm Tuesday 25 October 2022.

The Authority intends to finalise its request for information from market participants next week.

Please do not send any RFP information to this email directly. The Authority will provide instructions next week on how RFP information should be submitted via the Authority's 'Information Provision Portal'.

For further questions, please contact Tom Georg, Manager – Wholesale Market Policy (tom.georg@ea.govt.nz).

Yours sincerely

Andrew Doube
General Manager, Market Policy

Annex One: Scope of information required

Summary information

Market participants will be requested to provide a summary of key RFP details.

Sent RFPs

- date sent
- sent to (organisation name – participant code Home - Electricity Authority Participant Register (ea.govt.nz))
- response received (include date if yes)
- proposal provided (yes/no)
- proposal accepted and contract executed (yes/no)
- contract type (EFP/OTC)
- hedge type (baseload, non-baseload (include relevant time periods ie peak, weekend etc))
- contract start date
- contract end date
- contract price (NZD \$/MWh)
- volume (MW)
- location (eg HAY2201)
- basis for expected pricing
- considerations for acceptance/rejection
- all economic terms that are material to determining valuation
- disclosed on hedge disclosure site (yes/no)

Received RFPs

- date received
- received from (organisation name – participant code Home - Electricity Authority Participant Register (ea.govt.nz))
- date responded (provide reason if not)
- proposal provided (yes/no)
- proposal accepted and contract executed (yes/no)
- contract type (EFP/OTC)
- hedge type (baseload, non-baseload (include relevant time periods ie peak, weekend etc))
- contract start date
- contract end date
- contract price (NZD \$/MWh)
- volume (MW)
- location (eg HAY2201)
- basis for pricing provided
- all economic terms that are material to determining valuation
- disclosed on hedge disclosure site (yes/no)

Contract information

Market participants will be requested to provide all RFPs received, sent and corresponding responses since 1 August 2022 to date.

This may continue on a monthly basis.