

16 June 2020

Jo Thornton
Project Co-ordinator, Hedge Market Enhancements
Electricity Authority
By email to HME.feedback@ea.govt.nz

Dear Jo

Hedge Market Enhancements – Market Making

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority (EA) consultation paper "Hedge Market Enhancements - Market Making" of 21st April 2020 and abbreviated as HME – MM.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. MEUG members have appreciated the opportunity to discuss with the EA team the consultation paper.
4. Responses to questions in the consultation paper follow:

Question	MEUG response
<p>1(a) Has the Authority correctly described the approaches above? If not, please identify any changes to the approach description.</p>	<p>The descriptor "Commercial approach" does not capture the much more active role of the EA relative to the status quo. It is also unclear how the various contracts between the EA, ASX and market makers would work without major changes to the Code to allow the EA to levy and spend new monies in a non-contested arrangement with the ASX.</p> <p>Perhaps the "Commercial approach" and the "Mandated-commercial approach" are the same type of generic approach but at different ends of a new "ASX-EA contract approach"?</p>

¹ URL <https://www.ea.govt.nz/dmsdocument/26664-hme-market-making-consultation-paper> at <https://www.ea.govt.nz/development/work-programme/risk-management/hedge-market-development/consultations/#c18424>.

Question	MEUG response
<p>1(b) Are there any other approaches the Authority should consider? If so, please provide a brief description of the approach and its merits.</p>	<p>No comment.</p>
<p>1(c) Do you have strong preference or strong aversion to any of the approaches outlined? Please explain your reasoning.</p>	<p>Two observations:</p> <ul style="list-style-type: none"> • The prior voluntary approach, that ended when the urgent Code amendment with mandatory backstop provisions came into effect on 3rd February 2020, was found wanting as evidenced by the market making “reliability issue” when the market was stressed²; and • MEUG has an aversion to mandatory approaches to solve policy problems. <p>Accordingly, MEUG’s qualitative preference would be for the EA to prioritise time and resources in developing a decision in August on the preferred approach on either:</p> <ul style="list-style-type: none"> • A voluntary with mandatory backstop approach, i.e. the status quo and variants. • The “Commercial approach” and the “Mandated-commercial approach” that in response to question 1(a) above we group as a new “ASX-EA contract approach.” <p>MEUG suggests there is likely to be little value, that is the costs will exceed the benefits or the net benefit will be materially lower than solutions from the above two groupings of approaches, for detailed consideration of:</p> <ul style="list-style-type: none"> • A voluntary approach. • A mandated approach with transferable providers. • A mandatory approach.

² The “reliability issue” was identified in the Electricity Price Review (EPR) as noted in paragraph B.42, appendix B of the EA consultation paper: “The EPR final report noted that once one market maker leaves the others typically follow, rendering market-making fragile and unpredictable. This was reiterated by many submitters to the HME discussion paper in 2019, and is supported by the data available to the Authority.”

Question	MEUG response
2(a) Has the Authority correctly described the trade-offs above? If not, please identify any changes to the trade-offs.	No comment.
2(b) Are there any other trade-offs the Authority should consider? If so, please provide a brief description of the trade-off and its importance.	<p>Transitional arrangements need to be considered.</p> <p>Transitioning from the status quo that ends on 3rd November 2020 to a new variant of a voluntary with mandatory backstop approach could be as simple as rolling over the existing urgent code provisions. A different and more complex backstop would take time to design and implement and may not be achievable by November 2020. In that case a transition, probably rolling over the existing mandatory backstop, would be needed.</p> <p>Transitioning to an entirely different regime based on a new ASX-EA contact approach would probably require many months and possibly over a year to design and implement. In that scenario also the existing mandatory backstop or similar would need to be kept in place as a transition measure.</p>
2(c) What trade-offs are most valuable to you, and which are the least valuable to you, and why?	Table 1, Summary assessment of approaches against key trade-offs, is a helpful summary to assist discussion at this stage. We look forward to benefit and cost values being assigned to alternative approaches because that will allow a common metric, that is dollars (in NPV terms), to better assess trade-offs.
3(a) Has the Authority correctly assessed each approach against the key trade-offs? If not, why not?	<p>The assessment of “neutral” for the voluntary approach and the key trade-off “can involve markets in design of services” relies on the discussion in [A.11] that ASX futures curves are public goods and “markets tend to supply less than the optimal quantity of public goods.” Futures curves are a public good, but the sale and purchase of futures products is not. Futures curves are information derived from transactions involving private goods. Market making facilitates the trade of those private goods. Therefore, MEUG disagrees with the logic in [A.11] that there is a sub-optimal supply of market making because futures are public goods.</p>

Question	MEUG response
	<p>The information from published futures curves is a public good and there may be a policy question as to whether the information published is optimal or not. Regulatory support to overcome information and knowledge asymmetry with the NZ electricity futures curves is already being undertaken with EA education materials and publication of prices. This supplements the already extensive educational and information provided to interested parties by the ASX.</p> <p>Trading in NZ electricity futures as “private goods” between the existing 4 large vertically integrated suppliers has not clearly incentivised those rivals to raise barriers to considering new products or under-supply because they are also major beneficiaries of those curves being published and therefore it is in their interest to evolve and improve them. As the large 4 vertically integrated generator-retailers were both suppliers and major users of market making services there was active market engagement in settings and processes in the prior voluntary approach. Those were not perfect, but it is not clear the assessment of “neutral” is reasonable relative to a double tick for the Commercial approach when that option is not well defined and therefore it is not possible to make an in-depth analysis of pros and cons .</p>
<p>3(b) If you have identified any changes to the approaches or key trade-offs in questions one and two, please provide your assessment of those approaches and/or trade-offs.</p>	<p>No comment.</p>

5. We look forward to viewing the submissions of other parties and advice by the EA on any new engagement processes before announcements on a preferred approach in August.

Yours sincerely



Ralph Matthes
Executive Director