19 September 2024

s9(2)(a) [redacted]

[redacted]

Tēnā koe s9(2)(a) [redacted]

Thank you for your request, received by the Electricity Authority (Authority) on 22 August 2024, under the Official Information Act 1982 (Act) for the following information:

1 *Copies of all information it holds regarding the assessment of the 12 August and 20 August changes/guidance being in the public interest.*

2 *Concerns over market participant behaviour… Mercury requests the Authority to make available to it copies of all information it holds regarding that review and the outcomes of that review, including information regarding the Authority's concerns.*

The information requested would include, emails, meeting agendas/minutes/files notes, notes of phone calls, discussion papers, briefing reports prepared by or for the Authority in relation to the two matters.

The Authority has identified 16 documents within the scope of the requests.

The Authority intends to release 15 documents in full or part, with redactions clearly marked where required. One document is withheld in full as it is legal advice.

Request 1:

The Authority has identified 12 documents in scope for request 1, one of which is legal advice and is withheld. Of the 11 documents released information has been redacted:

(a) under section s 9(2)(a) of the Act to protect the privacy of natural persons (staff telephone numbers and emails)

(b) under section 9(2)(h) of the Act on the ground of maintaining legal privilege

(c) under s 9(2)(b)(ii) of the Act as release would be likely to unreasonably prejudice the commercial position of the person

(d) under section 9(2)(g) of the Act to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between employees of the Authority.

We also provide the following context relevant to your request 1. As set out in letters to market makers of 12 and 20 August 2024, the Authority decided to use its discretion not to take enforcement action in relation to breaches of 13.236L of the Electricity Industry Participation Code 2010. Such decisions must be made in accordance with our compliance strategy and enforcement policy and other compliance documents that make up the compliance framework we operate within. The compliance strategy and enforcement policy can be found on our website here https://www.ea.govt.nz/code-and-compliance/strategy-policies/.

Relevant factors set out in these documents include:

(a) We select interventions we think will have the most effect on achieving our outcomes, considering risk, and the likely consequences of non-compliance occurring.

(b) From time to time, we will develop specific compliance plans or programmes for specific parts of the electricity sector. Typically, these will be driven by our understanding of changes in risk profiles and the need to respond to problems with a more targeted approach than is provided by our general regulatory and compliance activities.

(c) We consider whether market impact may result in disruption of orderly trading.

(d) Compliance interventions consistent with the law, the public interest, and the Authority's policies.

Request 2:

The Authority has identified four documents within the scope of the request two. This includes two excel sheets. One Excel sheet is split into six pdfs reflecting the different tabs. The second Excel sheet is in one pdf incorporating three tabs.

Of the 4 documents released

(a) in the document entitled 'First round of meetings with RMMs – first week of Aug', information has been redacted under s 9(ba)(i) of the Act as the information is confidential and release would prejudice the supply of similar information and there is a public interest in receiving such information and under s 9(2)(b)(ii) of the Act as release would be likely to unreasonably prejudice the commercial position of the person

(b) in the same document, information relating to a conversation with Mercury is released under section 24 of the Act (release of personal information of corporations) and will not be proactively released

(c) in the trade data Excel sheet:

  (i) information identifying other persons (other than Mercury) has been redacted under s 9(2)(b)(ii) of the Act as release would be likely to unreasonably prejudice the commercial position of the person

(ii) the information referring to Mercury is provided to you under section 24 of the Act

(iii) we do not intend to proactively release the trade data Excel sheets given the public interest is likely to be small (given the size and format) and the internal emails explain relevant aspects of the underlining information.

I am satisfied, in terms of section 9(1) of the Act, that the need to withhold the information referred to above is not outweighed by other considerations that render it desirable, in the public interest, to make the information available.

We are intending to proactively release the redacted information provided to you in response to request 1 and 2, except for the trade date Excel sheets and the information provided to you under section 24 of the Act (as noted above).

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

If you wish to discuss this decision with us, please feel free to contact us by emailing oia@ea.govt.nz.

Nāku noa, nā,

Airihi Mahuika

Airihi Mahuika

GM Legal, Monitoring and Compliance

Beth Goodwin

From:	Jo Goudie
Sent:	Friday, 9 August 2024 9:42 am
To:	Saki Hannah; Phil Bishop; Andrew Millar; Kirsty Hutchison
Cc:	Naghmeh Kargozar; Lee Saunders
Subject:	URGENT - Request to consider urgent relief for market makers

Kia ora koutou,

[redacted] s9(2)(g)

Current Exemption Levels
Two on 0, two on 1.

Contact Energy Limited	0
Genesis Energy Limited	1 → 0
Mercury NZ Limited	2
Meridian Energy Limited	2 → 1
Vivienne Court Trading Pty Ltd	1

Causes of the Exemptions
Market making performance: Market making performance - Tableau Cloud
Increasing numbers of exemptions are because of "fails converted".

Row Labels	Total Sum of Planned Exemptions	Total Sum of Fail converted
202309	1	7
202310	4	6
202311	5	5
202312	2	5
202401	1	7
202402	1	6
202403	1	12
202404	1	9
202405	2	11
202406	1	6
202407	2	15
202408	0	11

Fails converted means the market maker showed up to trade, but failed to meet requirements, typically based on the time requirement, across all contracts. I don't have the data to hand, but this could as stringent as one contract by a millisecond.
The features of the market that create this time pressure are more complex to resolve and would more appropriately be addressed through consultation

[redacted] s9(2)(g)

[redacted]

I request this is considered urgently to implement in the market – ie today, or Monday at the outside. Please advise if this is achievable – legally and practically.

Nga mihi

Jo

.

Jo Goudie (she/her)
Principal Analyst – Policy – Wholesale Markets

[redacted]

I am sending you this email at this time because it suits me. I don't expect you to respond or action this email outside your own working hours.

ELECTRICITY AUTHORITY
TE MANA HIKO

Level 7, AON Centre, 1 Willis Street
PO Box 10041, Wellington 6143, New Zealand
www.ea.govt.nz

Beth Goodwin

From: Jo Goudie
Sent: Friday, 9 August 2024 12:48 pm
To: Lee Saunders; Saki Hannah
Subject: The Why. - Urgent Urgent approach

The forward market, traded on the ASX, is an essential part of risk management for electricity participants. Unability to access hedges/insurance in this market will increase costs and financial risks for participants and this will adversely affect consumers.

The problem
This market is currently experiencing stress due to high underlying physical conditions. The Authority has observed that market makers are increasingly unable to fulfil their obligations to the standard specified in the Code. Financial conditions are such that it may be less costly to default on their obligations than to continue to market make. Defaulting on obligations will reduce or eliminate price discovery and liquidity in the market and therefore create an inability of participants to access hedges.

The solution
Widening spreads will enable market makers to reduce the costs of providing liquidity and price transparency. This will allow the market to remain functional for the benefit of long term consumers.

Jo Goudie (she/her)
Principal Analyst – Policy – Wholesale Markets

s9(2)(a) [redacted]

I am sending you this email at this time because it suits me. I don't expect you to respond or action this email outside your own working hours.

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Beth Goodwin

From: Sarah Gillies
Sent: Saturday, 10 August 2024 11:13 am
To: Anna Kominik; Lana Stockman; Allan Dawson; Erik Westergaard; Paula Rose; Cristiano Marantes
Cc: Board Secretary; Rachel Brown; Mark Herring; Airihi Mahuika
Subject: E-resolution - response by 12pm Sunday 11 August
Attachments: e-res for Market Making 9 Aug.docx

Kia ora koutou

Action
Please review the **attached** e-resolution and **reply to all** with your vote **by 12 noon on Sunday 11 August 2024.**

Reason for e-resolution
This matter cannot wait until the next Board meeting because market makers in the ASX Futures market are indicating that they will be unable to fulfil their obligations to the standard specified under their contractual requirements and in the Code. Staff consider it important to maintain liquidity in the market while further medium and longer term solutions are created.

[redacted] Out of scope

Ngā mihi
Sarah

Sarah Gillies (she/her)
Chief Executive

[redacted] s9(2)(a)

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Level 7, AON Centre, 1 Willis Street
PO Box 10041, Wellington 6143, New Zealand
www.ea.govt.nz

I choose to work flexibly and send emails outside normal office hours. No need to respond to my emails outside yours.

From: Rachel Brown s9(2)(a) [redacted]
Sent: Friday, August 9, 2024 10:18 PM
To: Mark Herring s9(2)(a) [redacted]; Sarah Gillies s9(2)(a) [redacted]; Saki Hannah s9(2)(a) [redacted]; Jo Goudie s9(2)(a) [redacted]
Cc: Peter Taylor s9(2)(a) [redacted] Lee Saunders s9(2)(a) [redacted]; Nicole Gagnon s9(2)(a) [redacted]; Naghmeh Kargozar s9(2)(a) [redacted]; Airihi Mahuika s9(2)(a) [redacted]; Katie Bunker s9(2)(a) [redacted]; Aileen Gallagher s9(2)(a) [redacted]
Subject: RE: E-resolution for Market Making

Thanks Mark.

Jo and I have updated the e-resolution with some suggested amendments. We have:

- Added more context
- Explained why this is consistent with the Authority's statutory objective.
- Added a delegation for the Chair to amend the time period (provided it doesn't extend past 30 August)
- Tightened up the delegation to the Chair of the Compliance Committee
- s9(2)(h) [redacted]

I also attach a covering email for you to use. Please ensure you use Board member's EA email addresses and copy Katie, Sarah, Aileen, me, Airihi on the email.

Sarah will need to approve the e-resolution so I have changed the time for response to midday Sunday (given this won't be going out until tomorrow). I think it would be worth Saki looking this over in the morning too, if possible, given his involvement to date.

I hope this helps. Feel free to call me tomorrow if you want to discuss anything.

Thanks

Rachel

Rachel Brown
Senior Legal Counsel

[redacted]

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PO Box 10041, Wellington 6143, New Zealand
www.ea.govt.nz

ELECTRICITY AUTHORITY
TE MANA HIKO

Electricity Authority Board **E-Resolution: 065/2024**

Subject:	Proposed guidance to market makers
Authors:	Jo Goudie, Saki Hannah, Mark Herring
Date:	10/08/2024
Board response requested by:	11/08/2024

1. Recommendations

1.1. It is recommended the Board

(a) **agree** that the Authority will soften its stance on market making spreads in line with the draft guidance in Appendix A

(b) **delegate** authority to the Chair to approve the informal guidance to market makers and the time period for which it will apply (provided any extension past 30 August will need further consideration by the full Board)

(c) **delegate** authority to the Chair of the Compliance Committee to make decisions about enforcement action relating to breaches of Subpart 5B of Part 13 of the Code while the period of softening referred to in Appendix A applies

(d) s9(2)(b)(ii) [redacted]

2. Background

2.1. The electricity futures market, traded on the ASX, is an essential part of spot price risk management for electricity industry participants.

2.2. This market is currently supported by:

(a) market-making services provided through regulation by New Zealand's four largest electricity generator-retailers: Contact Energy Limited, Genesis Energy Limited, Mercury NZ Limited and Meridian Energy Limited (Regulated Market Makers); and

(b) commercial market-making services provided by Vivienne Court Trading Pty Ltd (VivCourt).

2.3. The futures market provides two important functions. Price transparency (ie, indication of the future price of electricity) is important for investment decisions. Liquidity (ie, the availability of hedging volume (MWh)), which is insurance for electricity price risk available to any party at an agreed price. Market makers perform a vital function in both these functions. The service is specified with an agreed spread and volume while being out of the market for no more than 5 minutes. They also have 5 “exemptions” available over a rolling 20 trading days.

2.4. The futures market is currently experiencing stress due to fuel supply issues impacting spot market prices.

2.5. Market-making has been very challenging for a number of weeks. During that time, market makers have increasingly been failing to meet obligations despite best efforts to be compliant. As of 9th August 2024, two regulated market makers have 0 exemptions remaining, and the remaining two have 3 exemptions between them. s9(2)(b)(ii) [redacted]

2.6. For regulated market makers, a failure to market make for 3 or more separate occasions in a period of 90 days will make them subject to the Code under 13.236K to 13.236N and any subsequent lapses from obligations will result in a breach of the Code.

2.7. Staff are concerned that it is now less costly to default on their obligations rather than to continue to market make. The withdrawal of market makers from futures market will reduce or eliminate price discovery and liquidity in the electricity futures market. Participants will be unable to reliably access hedges on the exchange and this will increase operating costs. Participants will also be unable to estimate the future costs of electricity.

2.8. An inability to access spot price risk management in this market will likely increase costs and financial risks for participants and such costs could be passed on to electricity consumers.

2.9. Staff consider that widening the allowable spread between a market maker’s bid and offers will reduce the impact of current conditions and enable market makers to manage the costs of providing liquidity and price transparency.

2.10. Staff have engaged with the market makers over the past week to understand the underlying drivers of their market behaviour and what might enable provision of market making that is sustainable in the short term.

2.11. A number of the market makers suggested changes to the market making settings in order to mitigate the challenges currently being experienced. The most impactful change that can be implemented by market makers at short notice is to increase the spreads within which market maker trading is required to occur.

2.12. The other change proposed is a decrease in available volume. This will reduce market makers’ exposure to the daily price changes, while being sufficient to maintain liquidity for hedging in the stressed market environment.

2.13. Staff consider that this change would be consistent with the Authority’s statutory objective because it promotes efficient operation of the futures market with sustainable liquidity and price transparency for the long-term benefit of consumers.

2.14. Staff are proposing the following changes to the current settings be communicated to market makers via an industry call (more detail is provided in Appendix A):

(a) Increasing spreads from 3% to 15%

(b) Reducing volume requirements from 24 lots on each side (24 buy lots + 24 sell) to 12 lots on each side (12 buys + 12 sells)

2.15. Further medium and longer term changes are being developed at pace and include the creation of different spread and volume requirements at different levels of price and/or volatility. Staff expect that these would form the basis of an urgent code change for regulated market makers and a parallel contract variation for the commercial market maker. These will be discussed with the Board once further developed.

2.16. These changes are likely to require 2-3 weeks to implement due to complexities in both legal drafting and required software changes to the market making portal (and associated testing).

2.17. s9(2)(h) [redacted]

3. Next steps

3.1. Following Board approval, staff will:

(a) Finalise the draft guidance in Appendix A and seek approval from the Chair

(b) Set up an industry call on Monday 12 August (or Tuesday 13 August if unexpected delays are experienced) to provide verbal guidance and allow for questions. The timing of this call would be at 11am, allowing time to adjust trading algorithms prior to trading opening at 3:30pm.

(c) Continue work on sustainable medium and longer term settings as mentioned in paragraph 1.16.

s9(2)(b)(ii) [redacted]

4. Attachments

4.1. The following appendices are attached to this paper:

- Appendix A Draft guidance to Market Makers

Board Reponses	Agree/Disagree Recommendation	Date
Anna Kominik		
Allan Dawson		
Lana Stockman		
Paula Rose		
Erik Westergaard		
Dr Cristiano Marantes		

Appendix A Draft guidance to Market Makers

The following draft guidance is proposed to be shared with market makers:

The forward market, traded on the ASX, is an essential part of risk management for electricity participants. An inability to access hedges/insurance in this market will increase costs and financial risks for participants and this will adversely affect consumers.

The forward market is currently experiencing stress due to underlying physical conditions impacting prices in the spot market. The Authority is aware that market makers are increasingly unable to fulfil their obligations to the standard specified under their contractual requirements and in the Code. Financial conditions are such that it may be less costly to default on their obligations than to continue to market make. Defaulting on obligations will reduce or eliminate price discovery and liquidity in the market and create an inability for participants to access hedges. The immediate risks are likely to be mitigated by widening spreads, at least in the short term, to reduce the impact of current conditions and to enable market makers to manage the costs of providing liquidity and price transparency.

Having regard to the considerations set out above, and in the public interest in ensuring reliable supply in and the efficient operation of the electricity industry for the long-term benefit of consumers, we have decided to use our discretion not to take enforcement action in relation to breaches of cl 13.236L of the Electricity Industry Participation Code 2010 by participants required to comply with the Subpart 5B of Part 13 of the Code between now and 23 August 2024 (or for such shorter or longer period advised by the Authority), conditional on those participants:

(a) under cl 13.236L(1) a;
  - *ensuring quotes is a minimum of 12 lots of buy orders and 12 lots of sell orders for each of Otahuhu reference node and Benmore reference node for the current month and each of the five months following the current month;*

(b) under cl 13.236L(1) b;
  - *ensuring total quotes is a minimum of 12 lots of buys orders and 12 lots of sell orders for each of Otahuhu reference node and Benmore reference node for each calendar quarter that is available for trade on an exchange;*

(c) under cl 13.236L(2)
  - *ensuring that quotes provided do not have a bid-ask spread that exceeds 15% or $10;*

(d) under cl 13.236L(3) a;
  - *ensuring that initial orders at or after the start of the market-making period are minimum quotes of 6 buy quotes and 6 sell quotes;*

(e) under cl 13.236L(3) b;
  - *ensuring that if the initial buy or sell order is fully traded then participants must volume refresh the order with a minimum of X = 12 quotes – total traded NZEF*

(f) otherwise complying with the requirements of the Code.

12 August 2024

All Market Markers in the New Zealand Electricity Futures market

[Via email]

Urgent changes to market making requirements

The forward market, traded on the ASX, is an essential part of risk management for electricity participants. An inability to access hedges/insurance in this market will increase costs and financial risks for participants and this will adversely affect consumers.

The forward market is currently experiencing stress due to underlying physical conditions impacting prices in the spot market. The Authority is aware that market makers are increasingly unable to fulfil their obligations to the standard specified under their contractual requirements and in the Electricity Industry Participation Code 2010 (Code). Financial conditions are such that it may be less costly to default on their obligations than to continue to market make. Defaulting on obligations will reduce or eliminate price discovery and liquidity in the market and create an inability for participants to access hedges. The immediate risks are likely to be mitigated by widening spreads and reduced lot size, at least in the short term, to reduce the impact of current conditions and to enable market makers to manage the costs of providing liquidity and price transparency.

Having regard to the considerations set out above, and in the public interest in ensuring reliable supply in and the efficient operation of the electricity industry for the long-term benefit of consumers, we have decided to use our discretion not to take enforcement action in relation to breaches of cl 13.236L of the Code by participants required to comply with the Subpart 5B of Part 13 of the Code between now and 23 August 2024 (or for such shorter or longer period advised by the Authority), conditional on those participants:

(a) *under cl 13.236L(1)a;*

- *ensuring quotes is a minimum of 12 lots of buy orders and 12 lots of sell orders for each of Ōtāhuhu reference node and Benmore reference node for the current month and each of the five months following the current month;*

(b) *under cl 13.236L(1)b;*

- *ensuring total quotes is a minimum of 12 lots of buys orders and 12 lots of sell orders for each of Ōtāhuhu reference node and Benmore reference node for each calendar quarter that is available for trade on an exchange;*

(c) *under cl 13.236L(2)*

- *ensuring that quotes provided do not have a bid-ask spread that exceeds 15% or $10;*

(d) *under cl 13.236L(3)a;*

- *ensuring that initial orders at or after the start of the market-making period are minimum quotes of 6 buy quotes and 6 sell quotes;*

(e) *under cl 13.236L(3)b;*

- *ensuring that if the initial buy or sell order is fully traded then participants must volume refresh the order with a minimum of X = 12 quotes – total traded NZEF* *(f) otherwise complying with the requirements of the Code.*

Jo Goudie, Principal Analyst – Policy – Wholesale Markets, is contacting relevant members of the trading teams of all market makers in the New Zealand Electricity Futures market to arrange a call to discuss how these new requirements will apply.

Note that this call will only discuss these new requirements and nothing else.

Nāku noa, nā,

Airihi Mahuika

General Manager – Legal Monitoring & Compliance

cc Anna Kominik, Chair, Electricity Authority
Sarah Gillies, CEO, Electricity Authority

WEBINAR
Urgent changes to market-making requirements

Responding to a market under pressure– August 2024

ELECTRICITY AUTHORITY
TE MANA HIKO

House rules for the call

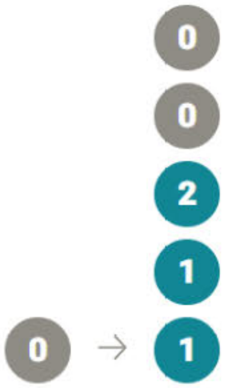
- Please activate mute & keep your cameras off
- If you have questions, please use the chat box.
- The discussions today will only focus on the new urgent market making requirements and on no other market activity.
- The Authority notes that we are only discussing the urgent changes put in place on Monday on a temporary basis and the proposed urgent Code amendments that we are considering to support the market.
- We will provide a recap of these urgent changes.
- We are seeking feedback on those changes and thoughts on other actions the Authority may consider, but
    - There will be no discussion of other activity, and
    - No agreement is being made by market makers collectively on the approach.
- Questions should only be regarding the new urgent requirements.

Context

- Trading ASX contracts produces the most useful and widely used forward price curve– the current price at which electricity can be bought and sold for future time periods.
- The futures market also provides an avenue for wholesale market participants to manage their wholesale market price risk.
- The presence of market making services contributes to the production of the forward price curve and the management of price risk.
- We are looking at an urgent code change to be undertaken later in August and we are seeking views now on the shape of this at this webinar.
- For today's discussion:
    - We are conscious that our communications could have been better through this process. Our goal is to improve how the process runs from here
    - There will be a wide range of attendees – so we will all need to be mindful to capture the range of views as diverse as the attendees.
    - Your contributions here will also give us some options to table for both the urgent Code and the enduring market-making settings consultation later in the year.

The indications were that a number of market makers were unable to meet their contractual and code requirements

- The futures market provides two important functions:
  - **Price discovery** which is essential for driving investment in electricity generation and storage.
  - **Liquidity** which gives the ability for participants to continue to hedge their spot price risk.
- The forward market is currently experiencing stress due to underlying physical conditions impacting prices in the spot market.
- Indications are that high prices may continue for a number of weeks.
- **The indications were that a number of market makers were unable to meet their contractual and code requirements. [See next slide]**
- The Authority was concerned that market volatility is increasing the cost of market-making to the point that market makers might be less motivated to meet their Code requirements.
- If futures market is not available, participants may be unable to reliably hedge their exposure to spot price risks. This may:
  - increase operating costs and financial risks,
  - reduce confidence in the market, which would be difficult to reinstate when it lapses, and
  - increase entry barriers for smaller market participants.
- This would be detrimental to consumers if participants lose confidence in the market and make less optimal operational decisions as a result of reduced information availability.



Market maker exemption levels as at 9 August 2024

Summary of urgent changes to market-making requirements

- **To ensure liquidity & price discovery, urgent changes to market-making requirements will apply for a limited period.**
- We decided to **exercise our discretion not to take enforcement action** in relation to some breaches of cl13.236L of the Electricity Industry Participation Code 2010 between 12 August and 23 August (or for such shorter or longer period advised by the Authority) provided certain conditions are met. The conditions are set out in our guidance.
- **Total volumes reduce**
  - *under cl 13.236L(1) a and 13.236L(1) b*
    - Total volumes will drop from 24 lots to **12 lots**
    - Monthly and quarterly products to be traded remain the same
- **Spreads widen**
  - *under cl 13.236L(2)*
    - Maximum bid-ask spread changes from 3% to **15%**, or
    - Changes from $2 to **$10**
- **Refresh feature remains in place but with reduced volumes**
  - *under cl 13.236L(3) a*
    - Initial minimum lots changes from 12 lots to **6 lots**
  - *under cl 13.236L(3) b*
    - The change in total lots 24 lots to **12 lots** is reflected in the calculation of compliant refreshed volumes
- **Apart from the above, you must continue to comply with all other requirements of the code.**

Interim solution – Urgent Code Change

- As a regulator where we need to act we will based on evidence, even if that action is not popular with all parties.
- We have a commitment to a liquid and vibrant market and are progressing with changes towards developing an enduring solution.

- The Code sets the rules of market making. Under the urgent code amendment, we are considering the impact of
    - What to do in periods under pressure
    - Definitions of stress
    - Volumes
    - Spreads
    - Refresh obligation
    - Any transition arrangements
    - Anything else?

ELECTRICITY AUTHORITY
TE MANA HIKO

THANK YOU

Minutes of the meeting of the Board

Held on 20 August 2024 at 9:00am
Level 7 AON Centre, 1 Willis Street, Wellington

Board members: Anna Kominik (Chair), Allan Dawson, Lana Stockman, Paula Rose, Erik Westergaard, Cristiano Marantes

Apologies: Nil

[redacted]

Out of scope

Out of scope [redacted]

5. Market making

5.1. The GM Market Policy provided a presentation that was not included in the Board books and is now included in these minutes. He gave an overview of the previous week and current market conditions.

5.2. s9(2)(h) [redacted]

5.3. There was a discussion about the timing of the proposed Code change, the risk of slippage, current market conditions and the risk of conditions worsening again. The Board discussed taking a phased approach to rolling back the changes and reasons for continuing to exercise discretion until the end of the week.

5.4. There was a discussion about the industry feedback on the changes and the proposed content of the urgent Code. s9(2)(b)(ii) [redacted]

5.5. Staff described the trading behaviour they have observed for the various market makers and there was a general discussion about the risks and incentives for the market makers (regulated and commercial). There was a discussion about the various regulators and their roles in relation to monitoring trading behaviour.

5.6. The Board agreed that communication would be important and that a staged approach needed clear messaging that the market would return to normal next week and that urgent Code was scheduled shortly.

5.7. The Board:

(a) **noted** that guidance to market makers on how the Authority would be exercising its enforcement discretion was communicated to market makers on 12 August 2024.

(b) **approved** changing the levels at which enforcement action would be considered appropriate from 15% spreads to 8% spreads and total lot size each side from 12 lots to 18 lots, with this change being applicable from 21 August 2024

(c) **delegated** authority to the Chair and Allan Dawson to finalise and approve the communications informing the market makers of the changed levels referred to in 5.7(b)

(d) **agreed** that levels would be expected to return to normal on 26 August 2024

(e) **delegated** authority to Chief Executive in consultation with the Chair to approve and execute variations to the following:

(i) s9(2)(b)(ii) [redacted]

Out of scope [redacted]

20 August 2024

All Market Participants in the New Zealand Electricity Futures market

[Via email]

Update to guidance regarding temporary market making requirements

Background

I refer to my letter dated 12 August 2024.

The forward market, traded on the ASX, is an essential part of risk management for electricity participants. An inability to access hedges in this market will increase costs and financial risks for participants and this will adversely affect consumers.

In the lead up to 12 August the forward market was experiencing stress due to underlying physical conditions impacting prices in the spot market and several market makers were increasingly unable to fulfil their obligations to the standard specified under their contractual requirements and in the Electricity Industry Participation Code 2010 (Code).

My earlier letter provided guidance on the Authority exercising its discretion not to take enforcement action on a temporary basis in relation to the failure to meet those contractual and Code requirements (12 August guidance), subject to certain conditions being met.

The Authority assessed that the 12 August guidance was in the public interest in ensuring reliable supply in, and the efficient operation of, the electricity industry for the long-term benefit of consumers. The Authority stated this guidance would apply between 12 and 23 August 2024 (or for such shorter or longer period advised by the Authority).

On 12 August (prior to trading in the ASX New Zealand electricity futures market) the ASX advised relevant participants that, with immediate effect from that day's trading, the ASX incentivised scheme scheme would align with the amended settlings as per the 12 August guidance.

Updated guidance

Since the change in requirements was introduced market conditions have changed. Market makers are now consistently meeting their obligations and wholesale prices have fallen from the highs experienced in the week commencing 5 August 2024.

The Authority intends to remove the 12 August guidance to reflect these different circumstances. In the interests of reliable supply and an efficient market, the Authority considers a staged approach is appropriate as follows:

- As advised in my letter of 12 August, the temporary guidance on the exercise of our discretion will end as at close of trading on 23 August 2024.
- From 26 August 2024 the requirements under the Code for market makers will be enforced.
- We will work with ASX to ensure that their requirements align.
- For the trading sessions on 21 to 23 August 2024 (inclusive) the discretion not to take enforcement action will be subject to the following changed conditions:

  (a) under cl 13.236L(1)(a);

    - *ensuring quotes are a minimum of **18 lots** of buy orders and **18 lots** of sell orders for each of Ōtāhuhu reference node and Benmore reference node for the current month and each of the five months following the current month;*

(b) under cl 13.236L(1)(b);

- *ensuring total quotes are a minimum of **18 lots** of buys orders and **18 lots** of sell orders for each of Ōtāhuhu reference node and Benmore reference node for each calendar quarter that is available for trade on an exchange;*

(c) under cl 13.236L(2)

- *ensuring that quotes provided do not have a bid-ask spread that exceeds the greater of **8%**, or **$6**;*

(d) under cl 13.236L(3)(a);

- *ensuring that initial orders at or after the start of the market-making period are minimum quotes of **9 buy quotes** and **9 sell quotes**;*

(e) under cl 13.236L(3)(b);

- *ensuring that if the initial buy or sell order is fully traded then participants must volume refresh the order with a minimum of X = **18 quotes** – total traded NZEF*

(f) otherwise complying with the requirements of the Code.

We have undertaken a review over the last week into market participant behaviour and this has raised some concerns. We will be continuing to monitor this behaviour closely.

We are progressing an urgent Code amendment to provide a more enduring solution for times of market stress and will keep the market updated on p ogress.

Nāku noa, nā,

Airihi Mahuika

General Manager – Legal Monitoring & Compliance

cc Anna Kominik, Chair, Electricity Authority
Sarah Gillies, CEO, Electricity Authority

Urgent changes to market-making requirements

Market stress – August 2024

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House rules for the call

- Please activate mute
- Keep your cameras off
- If you have questions, please use the chat box.
- The discussions today will only focus on these new requirements and on no other market activity:
    - The Authority notes that we are only providing Market Makers (as the relevant industry participants) an update on changes that we are making on a temporary basis and proposed Code amendments that we are considering to support the market.
    - We are informing market makers of these changes.
    - There is no agreement otherwise being made by market makers collectively on the approach.
    - Questions should only be regarding explaining these new requirements.

Market making is vital to promoting competition in the electricity market

- The futures market provides two important functions:
  - **Price discovery** which is essential for driving investment in electricity generation and storage.
  - **Liquidity** which gives the ability for participants to continue to hedge their spot price risk.
- The forward market is currently experiencing stress due to underlying physical conditions impacting prices in the spot market.
- Indications are that high prices may continue for a number of weeks.
- The Authority is concerned that market volatility is increasing the cost of market-making to the point that market makers might be less motivated to meet their Code requirements.
- If futures market is not available, participants may be unable to reliably hedge their exposure to spot price risks. This may:
  - increase operating costs and financial risks,
  - reduce confidence in the market, which would be difficult to reinstate when it lapses, and
  - increase entry barriers for smaller market participants.
- This would be detrimental to consumers if participants lose confidence in the market and make less optimal operational decisions as a result of reduced information availability.

Urgent changes to market-making requirements

- **To ensure liquidity & price discovery, urgent changes to market-making requirements will apply for a limited period.**
- We have decided to **exercise our discretion not to take enforcement action** in relation to some breaches of cl13.236L of the Electricity Industry Participation Code 2010 between now and 23 August (or for such shorter or longer period advised by the Authority) provided certain conditions are met. The conditions are set out in our guidance.
- Changes **will take effect from today's trading session**.
- The urgent changes will be **distributed as guidance** and will come **through email**.
- The changes will **be in place initially until 23 August 2024**.
- The Authority **may reduce or lengthen the duration of these urgent changes** and will **give you notification** to that effect if required.
- Authority staff have considered **workability** for both Authority compliance monitoring and participant trading systems given:
    - the **urgency** of the situation, and
    - the **complexity** of underlying systems.
- It may be that you are **unable to update your trading systems** in time for today's trading session. In this event we **apologise** for the impact this might have on you. We note that **trading with your prior settings will remain compliant** under these urgent changes to market making requirements.

Summary of urgent changes to market-making requirements

- The guidance will override the below. Please consult the guidance to confirm the approach.
- **Total volumes reduce**
  - *under cl 13.236L(1) a and 13.236L(1) b*
    - Total volumes will drop from 24 lots to **12 lots**
    - Monthly and quarterly products to be traded remain the same
- **Spreads widen**
  - *under cl 13.236L(2)*
    - Maximum bid-ask spread changes from 3% to **15%**, or
    - Changes from $2 to **$10**
- **Refresh feature remains in place but with reduced volumes**
  - *under cl 13.236L(3) a*
    - Initial minimum lots changes from 12 lots to **6 lots**
  - *under cl 13.236L(3) b*
    - The change in total lots 24 lots to **12 lots** is reflected in the calculation of compliant refreshed volumes
- **Apart from the above, you must continue to comply with all other requirements of the code.**

What's next – Interim Solution

- An **interim solution**:
  - Staff will develop an **urgent code change** to give **regulatory certainty** for market makers.
  - The proposed Code change will **replace the current guidance** which currently **applies until 23 August 2024**.
  - We anticipate completing the proposed urgent code change in **late August.**
  - This may or may not have settings similar to what is taking effect today.
  - It may be **more complex** to apply to trading systems. Staff will endeavour to **right-size** the settings.

- Staff have been having conversations with individual market makers with respect to sustainable market making settings.
  - **Thank you** for your candour in these conversations.
  - This will help us design the **interim settings in proposed urgent code change**.
  - It will also give us some options for the **enduring market-making settings consultation later in the year**.
- Staff are also looking at **order and trade data** to evaluate the causes of **large market movements**. This will assist in developing any **enduring market-making settings**.

Our Ask

- This guidance has been **developed with speed** to relieve pressures on market makers.
- The trading behaviour observed during this period may inform any subsequent settings changes under consideration.
- If you see suspicious trades that could amount to **market manipulation**, please report immediately to ASX Compliance.
    - In particular, **orders that do not seem to reflect a genuine intent to trade**.
- Please consider if your trading behaviours are **contributing to excessive volatility** in this market.

An opportunity for questions about the new requirements

Questions should be about the new requirements and on no other market activity.

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THANK YOU

Market-making guidance

Board meeting – 20 August 2024

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Purpose

- Staff are seeking to:
  - Update the Board on a proposal to shorten the period of exercise of our market making enforcement discretion to reflect changes in market conditions. This will take effect from trading on Wednesday 21 August 2024.
  - Request approval by the Chair and delegation for signing by the CEO of Variation Letter that amends the:
    - end date of the Standstill Agreement; and
    - commercial market making (CMM) agreement to align with the temporary exercise of our discretion
  - Update the Board on:
    - Our approach to develop an urgent Code amendment to allow for different settings in times of market stress
    - Responses to our webinar and feedback from market makers
    - Observations of trading behaviour
    - Discussions with other potential market makers
  - Note delegations are already in place for these matters.

Recommendations

- **The Authority will no longer exercise enforcement discretion applying the guidance issued on Monday 12 August (Guidance),** which was subject to certain conditions being met (Conditions).

- The Conditions set out in the guidance were:

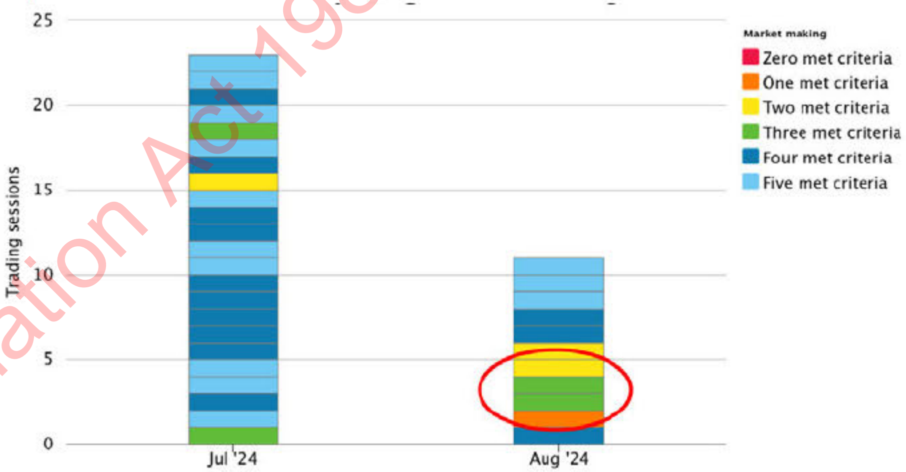
    - (effective from trading on 12 August) all regulated market makers (RMMs) were able to use wider 15% spreads and smaller minimum total lot size of 12 each side

    - reflected in changes to ASX market making agreements and a (still verbal) agreement with the commercial market maker (CMM).

Market conditions 8th August 2024

- By the end of trading on the 8th of August the failure of the market makers to participate was already reducing liquidity in the market.
- Three market makers had used up all their exemptions and one was not trading due to the financial risk involved.
- Prices were extremely high with large daily price moves (ie, Settle vs Settle t-1) – this meant that financial costs associated with daily provision of market making services were also high.
- The trade-off for participants between providing services and any potential penalties was clear.

Snapshot from emi.ea.govt.nz 15 August – note red circle on period of concern 5-9 August



Snapshot from marketmaking.ea.govt.nz 8 August 2024

Contact Energy Limited	0
Genesis Energy Limited	1 → 0
Mercury NZ Limited	2
Meridian Energy Limited	2 → 1
Vivienne Court Trading Pty Ltd	0

Snapshot from ASX End of Day – Enerlytica Report 8 August

CONTRACT	OTAHUHU				
	Settle $/MWh	Last $/MWh	Last vs Settle $/MWh	Settle vs Settle t-1 $/MWh	Vol Lots
MONTHS Aug 2024	▼ **709.55**	700.00	-9.55	-10.45	64
Sep 2024	▼ **466.30**	460.00	-6.30	-51.35	102
Oct 2024	▼ **305.20**	320.00	+14.80	-59.80	74
Nov 2024	▼ **276.60**	290.00	+13.40	-50.95	90
Dec 2024	▼ **228.40**	249.50	+21.10	-9.60	73
Jan 2025	▼ **233.75**	247.20	+13.45	-24.75	60
Feb 2025	▼ **282.35**			-16.25	
Mar 2025	▼ **324.10**			-18.65	

The Authority put in place informal guidance

- The Guidance sets out how the Authority would exercise its enforcement discretion in response to market conditions. The Conditions reflected the level at which enforcement action would still be appropriate.

- The risk was enforcement action would further increase non-performance by market makers causing negative market impacts (contrary to the public interest).

- The factors considered were consistent with the Authority's compliance strategy and enforcement policies.

- The Chair was delegated to approve the Guidance including "the time period for which it will apply" (but any extension past 30 August needed further Board consideration).

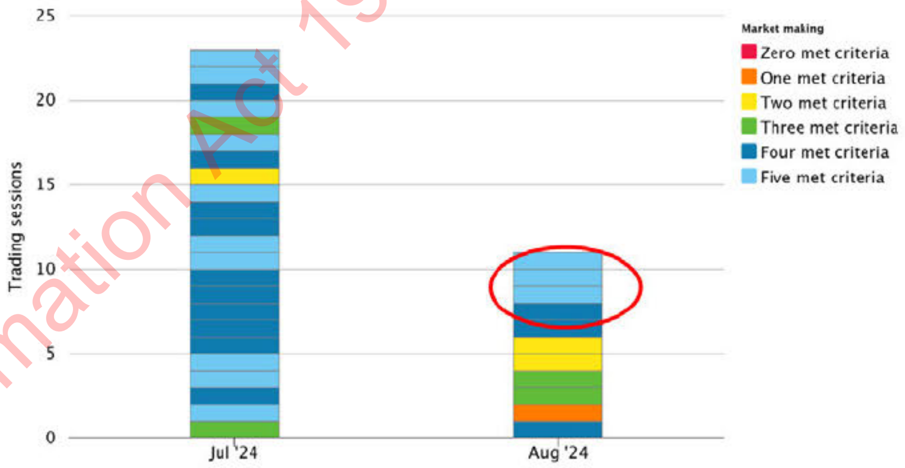
s9(2)(h)

[redacted]

Market conditions – 15th August 2024

- Market conditions have stabilised and market makers are consistently meeting their obligations.
- By the end of trading on the 15th of August all market makers had recovered at least one exemption. Three market makers recovered a further exemption on the 19th August 2024.
- Prices are reduced, though still high. Large daily price moves (ie, Settle vs Settle t-1) may still occur as spot electricity outcomes influence the fair value of the products.
- The trade-off for participants between providing services and any potential penalties is less clear than it was previously.

Snapshot from emi.ea.govt.nz 15 August – note red circle on period of evaluation 12-16 August



Snapshot from marketmaking.ea.govt.nz 15 August 2024

Contact Energy Limited	1
Genesis Energy Limited	1
Mercury NZ Limited	2
Meridian Energy Limited	1
Vivienne Court Trading Pty Ltd	1

Snapshot from ASX End of Day – Enerlytica Report 15 August

CONTRACT		OTAHUHU				
		Settle $/MWh	Last $/MWh	Last vs Settle $/MWh	Settle vs Settle t-1 $/MWh	Vol Lots
MONTHS	Aug 2024	▼ 521.35	520.00	-1.35	-67.75	20
	Sep 2024	▼ 305.15	305.00	-0.15	-53.40	85
	Oct 2024	▼ 235.60	234.95	-0.65	-11.00	120
	Nov 2024	▼ 198.65	198.10	-0.55	-1.45	12
	Dec 2024	▼ 176.65	176.15	-0.50	-6.30	38
	Jan 2025	▼ 185.40	187.00	+1.60	-2.00	14
	Feb 2025	▼ 214.20			-1.85	
	Mar 2025	▼ 245.90			-2.15	

The change in market conditions no longer requires enforcement discretion

- Due to the change in market conditions staff consider it appropriate to remove the guidance on exercise of our market making enforcement discretion, with effect from Wednesday 21st August 2024.
- Returning to pre-8 August arrangements will support the ongoing and effective operation of market making.
- Staff are also working on:
  - an urgent Code change that will provide certainty in the short term; and
  - an enduring solution to stressed-market conditions should they occur in the future (see next slide).

Our approach to an urgent Code amendment

- The urgent Code amendment will consider changes to market-making settings that may relieve stress in trading.
- Triggers for use of these stress provisions may include:
  - A price measure (if so, what level),
  - A measure of trading volatility.
- Potential relief provisions may include:
  - Focus on the front periods (ie, first 2 or 4 Quarters and Months),
  - With modified spread and/or volumes.
- We are giving careful thought to how to avoid any potential gaming by participants.
- We have sought feedback from traders on what an appropriate structure might be (for verbal update).
- The urgent Code is intended to be in place for late August.
- This will give regulatory certainty to participants in the short-medium term for what might happen in stressed periods.
- We will consult fully on a permanent Code amendment for enduring market-making settings later this year.

Verbal Update
- Post – Webinar Feedback & and feedback from market makers

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Verbal Update
- Trading behaviour observations

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THANK YOU

Beth Goodwin

From:	Jo Goudie
Sent:	Sunday, 18 August 2024 9:48 am
To:	Doug Watt; Airihi Mahuika
Cc:	Dean Yarrall; David Irwin; Naghmeh Kargozar; Usama Farooq; Saki Hannah; Kirsty Hutchison; Andrew Millar; Lee Saunders
Subject:	Trading behaviour of concern - ASX

Hi Doug and Airihi,

[redacted] s9(2)(g)

The behaviour may be detrimental to the market as a whole as it relates to volatility and margin costs, as well as the effect on the costs of market making for both regulated and commercial providers. The variables that make it damaging is the depth (number of lots relative to the daily market maker provision) and breadth (>10 products) of the sweeps relative to the size of the market.

<u>**Glossary – for the purposes of the below.**</u>
"sweep" – where a large order is made to trade with all available volume in a product. Not in itself problematic.
"broad sweep" – where that sweep is undertaken across a number of products, typically executed in the same instant, but could be undertaken in 2 step process as necessary to capture the refreshed volume in the market maker obligation. Problematic to a degree, as the sweep itself and the response from the other market makers consumes available liquidity for all participants.*

"sweeper" – the participant placing the order
"inventory" – positions held by a participant, both buys and sells

<u>**How sweeping extracts value from the market**</u>
The success of a sweep leverages the market maker obligation as they must put volume back in quickly at an appropriate price level. If there has been a sweep on the buy side, this drives market makers to place orders higher. If there has been a sweep on the sell side, this drives market makers to place orders lower.
There are intrinsic valuation relationships between the products time periods. A buy sweep on Q3-2024, for example, implies more risk for the winter and drives prices higher in most other Q3, and also affects Q4s.
However, the value of the sweep can only be realised by trading it (buy low, sell high).

<u>**Problem statement**</u>
Broad sweeps are problematic for the market as the sweep and the reaction of the market makers to the sweep consumes volume
The Sweeper profits when they are undertaken with a reversal of direction in a subsequent sweep.

<u>**Broad Sweeps (affecting > 10 products) were undertaken by a participant**</u>
There is only one participant undertaking broad sweeps of this size since July 2023. This is the **Sweeper**.
Focussing only on behaviour since 1 July 2024.
These broad sweeps were executed on:
2 July 2024 – 12 products – Buy – Months of 2024 both nodes – Quarters of Benmore 2026 & 2027
3 July 2024 – 13 products - Buy – mainly Quarters at Otahuhu 2025 and 2026
4 July 2024 – 16 products – 11 x Buy – front three months both nodes
- quarters Q1 and Q2 both nodes 2025 2026

3 x Sell - Q4s both nodes, 2025 2026 2027
24 July 2024 – 10 products – Sell –quarters both nodes 2026 and 2027
1 August 2024 – 15 products – Buy Quarters 2024 2025 2026

An example of how the sweeper is profiting – Benmore Q3 2024

Sells are negative.

26 July – net Sell 35 lots @ ~$429

1 Aug – net buy 72 lots @ ~$481

➔ you can see the resultant lift in price in subsequent trades

8 Aug – net sell 36 lots @ $523

ContractCode	EEU2024F	Contract size
		Threshold
Row Labels	**Sum of Vol**	**Average of TradePriceDollarsPerMegawattHour**
23/07/2024	21	438.9
25/07/2024	12	439.8833333
26/07/2024	-35	429.1583333
29/07/2024	0	417.525
30/07/2024	-13	454.925
31/07/2024	-12	462.4333333
1/08/2024	72	481.4833333
5/08/2024	-24	565.5
6/08/2024	-1	569.65
7/08/2024	-12	543.675
8/08/2024	-36	523.5
9/08/2024	-12	511.9
12/08/2024	-12	478.65
13/08/2024	6	450
15/08/2024	-2	409
16/08/2024	-2	395

A critique

At a high level, picking a price level and accumulating positions to this effect is acceptable or even desirable in a market, even at scale.

The potential problem with this behaviour is the resultant volatility that occurs from any broad sweep. Market makers seek to manage their risk handed to them as a result of the sweep on the day with a range of measurement tools such as stop loss (exit a position to avoid incurring additional portfolio losses) or delta hedging in associated products. If there is no products left to manage risk, market makers may withdraw their orders to manage their portfolio risk limits set by their trading participant. This can cause them to fail their obligations and subsequent days offer prices to rise even higher the next day.

Ultimately volatility increases costs for both market makers and participants as it relates to provision of liquidity for margins posted with their clearer and the ASX. It will also increase costs for the provision of market making on a commercial basis.

The Sweeper may argue that they need to move "inventory". I've not seen a great deal of portfolio movement in these trades over the time period in question, though acknowledge due to time I've had to confine my search to a short period.

- When a sweeper executes a sweep, market makers have who are traded have fulfilled half their obligation for the day.
- The market makers will then seek to offset their risk in other products with other market makers. In doing so they consume the remainder of their market maker obligation.

Jo Goudie (she/her)
Principal Analyst – Policy – Wholesale Markets

s9(2)(a) [redacted]

I am sending you this email at this time because it suits me. I don't expect you to respond or action this email outside your own working hours.

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