11 April 2025

Sarah Gillies
Chief Executive
Electricity Authority

By email: market.making@ea.govt.nz

The urgent Code change for market-making damaged the market and should be left to lapse

As the Electricity Authority is aware, Haast Energy Trading (Haast) considers that the urgent Code change was harmful to the electricity market, and confidence in the regulator, and agrees with the Electricity Authority that it should be left to lapse (option 1); or preferably withdrawn immediately rather than wait until 12 June. We agree the Authority's analysis does not support making the urgent Code change permanent.

Process matters

If the Authority receives submission opposing option 1, then it should provide for cross-submissions to allow other stakeholders to respond. The Authority's consultation charter makes clear that good practice consultation includes providing for cross-submissions where the issues are complex, there is potential for large financial implications, or the issues are likely to be contentious. All these conditions are met in relation to the changes the Authority made to market-making settings.

Haast's serious concerns about the urgent Code changes remain unchanged

The reasons Haast supports letting the September 2024 urgent Code amendment expire (option 1), include the reasons we opposed the Code amendment:

- E-mail from Phill Anderson (Managing Director, Haast Energy Trading) to Sarah Gillies (CEO, Electricity Authority), Re: Market making performance, 13 August 2024; and

- Letter from Phill Anderson (Managing Director, Haast Energy Trading) to Anna Kominik (Chair, Electricity Authority Board), Re: Concerns Regarding the Decision-Making Process for Market Making Obligations and Code Amendments, 18 October 2024.[1]

Market-making arrangements are essential for the orderly functioning of risk management, particularly when prices are high and volatile. As a financial intermediary who works closely with non-integrated and industrial participants Haast can only repackage the financial products available to us. We warned the Authority that the urgent Code change would be deeply impactful on our customers and their ability to hedge.

The urgent Code change transferred risk from market-makers to parties less well placed to manage market risk. It has been harmful to competition at a time when competition was already in a parlous state and has harmed liquidity in the hedge market.

[11] Both the e-mail and letter are included as part of our submission.

A harmful precedent has been set

While the Authority has recently commented that it "will not be deterred or distracted by the efforts of vested interests hoping to preserve the status quo",[2] the urgent Code change set precedent that the Authority is willing to prioritise the vested-interests of the gentailers over non-integrated players and industrial users. We agree with the Authority that this precedent will create risk of future market participant lobbying.

The precedent also indicates the Authority is willing to favour watering down compliance obligations over enforcement where there is a threat of non-compliance, and profit considerations can justifiably override compliance with regulatory obligations e.g. "The Authority was concerned that market making settings would not be sustainable in a context where the financial losses from market making were likely to exceed any fines that market makers may have received from breaching the Code."[3]

The harm caused by the precedent is made worse by the contradictory explanations of why the amendment was needed. This has resulted in considerable regulatory uncertainty about the conditions under which the Authority would intervene in the market. The independent electricity retailers pointed out a reason that was given publicly/to the media was that "speculation in the market creating volatility" and that speculation was to blame for "reducing liquidity and keeping prices higher for longer",[4] but an Authority Board member categorically stated at the industry webinar that speculation didn't feature in the Board's decision-making. This contradiction has never been explained.

Mercury Energy made it clear there was no need to water down the market-making obligations

Mercury Energy made clear it would meet its market-making obligations.[5] Given Mercury's clear statement that it is unclear why the Authority considered meeting the obligations "would not be sustainable". The Authority should have been upfront about what the other gentailers were claiming.

Haast shares the substantive concerns Mercury raised about the transparency of the process surrounding the Authority decision to adopt the urgent Code amendment.[6]

The consultation paper details why the urgent Code amendment was harmful

While the Authority has put emphasis on analysis of events around and subsequent to winter 2024, and changes it is progressing to strengthen security of supply in coming winters, as factors that "do not support making the urgent Code permanent", it is also clear from the consultation paper that the amendment was a mistake based on information the Authority had at the time.

The Authority has acknowledged the urgent Code amendment transferred risk to parties less well placed to manage market risk, and the increase in spreads favoured market-makers over other participants in the futures market making trading more costly and less efficient, particularly during periods of high prices. The Authority is correct that the wider spread has meant participants face higher transition costs and reduced

[2] Sarah Gillies: Consumer interests front and centre of sector transformation | Electricity Authority

[3] It is prudent for the Authority to consider purported losses from market making in the context of what the Authority euphemistically labels "wider portfolio results". There are two elements. The temporal element reflects that market makers should not necessarily expect market making to be profitable in every half-hour period. The other element which the Authority alludes to is that any notional "losses" should be seen in the context of the benefits of sustained high spot prices for their wholesale businesses and how this has been reflected in financial performances over the past few years.

[4] Commentary provided to media and also included in an Energy News article: e.g. https://www.energynews.co.nz/news/electricity-regulation/165288/futures-intervention-needed-address-speculation-ea.

[5] Mercury Energy, Urgent changes to market making requirements, 15 August 2024. The Mercury letter is included as part of our submission.

[6] Including the unprecedented decision not to record the industry webinar after it had started.

liquidity, making it harder to trade. The Authority has also acknowledged that reduction in market-making activity during periods of market stress threatens competition in the retail market.

The Authority's quantitative analysis that the Code change reduced liquidity accords with the warnings from Haast, traders and other stakeholders at the time the changes were being made.

Much of the Authority's reasoning for letting the urgent Code amendment expire mirrors closely issues that were raised in opposition to the introduction of the Code amendment.

Previous "informal" submissions provide sufficient grounds for allowing the Code change to lapse

It is clear from submissions on the urgent Code change released under the OIA that there were substantive concerns and opposition to the change.

The Authority's observations reinforce the concerns that Haast and other market participants, including Aotearoa Energy, emhTrade, Flick Electric, the independent electricity retailers, Mercuria New Zealand, and Mercury, raised at the time that the urgent Code amendment was made and reinforce that the change should not have been made.

For example, Aotearoa Energy detailed that it has clients that were likely to review their participation in the NZ market as a consequence of the urgent Code change and that the "damage may be permanent" especially given the importance of market making and the changes were drastic and without warning.

Flick Electric detailed that the change reduced liquidity and made prices more volatile. The independent electricity retailers noted the decisions "hurt the ability of market participants to access hedges in the forward market and increase[d] costs and financial risks for participants which is detrimental to competition, efficient operation of the electricity market and the long-term interests of consumers." Mercury submitted that they were "observing a reduction in market liquidity, which is the exact opposite of the intended consequences."

Broader implications for market-making

The experience with the urgent Code amendment – and the Authority's expectation that some market-makers would have withdrawn from providing their services – should be seen as a harbinger of things to come with reliance on voluntary arrangements for shaped hedge products.

The Electricity Authority, Energy Competition Task Force, MDAG etc have all highlighted how important shaped hedge products are for managing spot market risk and competing in the electricity retail market, but the voluntary arrangements mean the market-makers could withdraw the service (to the extent they provide it) unilaterally when it suits them commercially without needing to ask for a Code amendment. This does not provide a sound basis on which independent retailers can rely on to build up a risk management portfolio or to build a customer base.

Haast considers that the review of the role of market-making should include what shaped products are needed (beyond the limited voluntary product) and the efficacy of relying on voluntary arrangements.

Our submissions on hedge market enhancement also detail changes to the market-making arrangements which would be worth revisiting.[7] For example, we have advocated that commercial market-making

[7] https://www.ea.govt.nz/documents/1325/Haast_-_Commercial_Market_Making_Code_amendment_-_submission.pdf

arrangements be used to increase volume (not just displace mandatory market making obligations), spreads should be further narrowed, there should be less exemptions, and penalties for non-compliance should be increased.

Yours sincerely,

Phillip Anderson
Managing Director, Haast Energy Trading

Gmail [redacted]

Market making performance

Phillip Anderson [redacted] 13 August 2024 at 11:36
To: Sarah Gillies [redacted]

Dear Sarah,

I am deeply disappointed by the announcement this morning of a significant relaxation of the market marking requirements.

As a financial intermediary who works closely with non-integrated and industrial participants Haast can only repackage the financial products available to us to make hedges available. We expect this decision to be deeply impactful on our customers and their ability to hedge.

If the performance of the market makers yesterday is a guide to the new regime, the halving of volumes and extreme widening of spreads effectively makes the service of no value to non-integrated players. Spreads yesterday were so great that non-integrated players will be unable to hedge at a price which makes competition viable.

It is difficult to understand why the Authority believes prioritising the interests of the gentailers over non-integrated players and industrial users is appropriate at this time. The Authority could have brought the full weight of the Code to bear to ensure the service continued in a time of market stress, when non-integrated and industrial participants need liquidity the most. I believe the limited competition that remains in the market is at risk of being foreclosed.

This decision appears to have been made without consultation with non-integrated and industrial participants.

The Authority has set a precedent that when times get tough it will buckle to pressure from the gentailers. This further undermines confidence in the Authority as regulator. Confidence which was already at a very low ebb.

I encourage the Authority to reconsider this decision.

Kind regards,

Phill

Phillip Anderson
Managing Director, Haast Energy Trading
[redacted]

[redacted]

18 October 2024

Anna Kominik

Chair, Electricity Authority Board

By email: [redacted]

Dear Anna,

Re: Concerns Regarding the Decision-Making Process for Market Making Obligations and Code Amendments

I am writing to express my deep concerns with the Electricity Authority's decision-making process relating to the relaxation of market-making obligations and the subsequent urgent Code amendment in August and September 2024. After reviewing the Official Information Act (OIA) documents released to Mercury on 19 September 2024, I believe the process fell short in several key areas, which I outline below.

1. **Incomplete Problem Analysis and Root Causes**

The Authority's analysis fails to recognize that much of the observed market volatility stems from the market makers' internal policies—particularly their preference for zeroing positions. These policies are a significant, if not primary, driver of the volatility, yet the analysis does not adequately acknowledge this.

2. **Assertions Without Evidence**

The decision-making documents repeatedly claim, without sufficient evidence, that market makers are doing their best to meet obligations but are constrained by market conditions. However, the reality is that their ability to meet these obligations is largely influenced by their own commercial strategies. The paper seems to accept, without challenge, that profit considerations can justifiably override compliance with regulatory obligations.

3. **Lack of Focus on Enforcement**

The documents show no meaningful discussion of how the Authority could have enforced the Code to ensure compliance. The decision-making process should have considered using the Authority's powers to pressure market makers to meet their obligations, including pointing to potential recommendations that could have been made for interventions by the Minister. The absence of such considerations suggests a reluctance to confront non-compliance.

4. **Overly Optimistic View of the Diminished Service**

The paper asserts that the diminished market-making obligations will still deliver a useful service. However, as market participants, we have experienced firsthand that the weakened service has limited practical utility. It is far from sufficient for supporting non-integrated participants.

5. **Precedent of Bowing to Large Market Participants**

By responding to threats of withdrawal from market makers with a dilution of obligations, the Authority has set a damaging precedent. This signals that the Authority will prioritize the interests of major participants over the Code's integrity and the interests of smaller participants and consumers. This approach undermines confidence in the Authority's role as an impartial regulator.

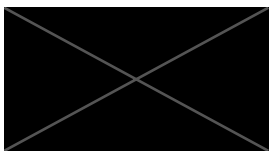
6. **Failure to Protect Market Integrity and Consumers**

The process described in the OIA documents confirms earlier concerns raised in my correspondence with the Authority. The decision-making appears to have been influenced by the interests of large gentailers at the expense of non-integrated participants and consumers. The Authority's response effectively sidelined the needs of smaller players, weakening competition and exposing consumers to increased risks.

I urge the Board to critically reassess the events leading up to the relaxation of the market-making obligations and the Code amendment. It is essential that the Authority restores confidence in its regulatory role by prioritising enforcement, taking a balanced view of market dynamics, and ensuring that future decisions protect market integrity and foster healthy competition.

I look forward to your response and hope that the Authority will consider these points as it moves toward longer-term solutions.

Kind regards,



Phillip Anderson

Managing Director

Haast Energy Trading