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NEW ZEALAND LIMITED

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Electricity Authority

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Response to the Market Making Review: Strengthening Price Discovery in the Forward Electricity Markets - Consultation Paper

1. Introduction

Mercuria New Zealand ("Mercuria") welcomes the opportunity to submit on the Electricity Authority's ("Authority") consultation paper Market Making Review: Strengthening Price Discovery in the Forward Electricity Markets, dated 14 November 2025.

Mercuria is an active participant in the New Zealand electricity market, part of Mercuria Energy Group, one of the world's largest independent energy and commodities groups, active across global wholesale physical and derivative markets in power, renewables, and environmental products. In New Zealand, unlike the large Gentailers, we own no physical generation assets. Our primary roles in the New Zealand market include:

- Buying and selling hedges which results in us providing liquidity and taking on risk on behalf of our customers, such as independent retailers, independent generators, large industrial users, and emerging market entrants.
- Actively trading the forward curve to promote robust pricing and facilitate risk transfer, enabling participants to secure predictable pricing that supports their operational stability and investment decisions.

For example, we enable over-the-counter (OTC) hedge transactions that enable smaller retailers to compete more effectively against larger Gentailers by offering competitive fixed-price contracts to end consumers. Our ability to effectively serve customers and reduce their hedging costs is directly tied to the liquidity in the wholesale market. Mercuria strongly advocates for a liquid, transparent, and competitive forward market, as the forward price curve is used as a benchmark for pricing OTC contracts across the industry and sellers require liquidity to manage the resulting risk. When liquidity in the futures market is thin or artificial, risk management costs rise for all participants, ultimately affecting New Zealand consumers.

Our team collectively has over fourteen years' experience market making NZ Electricity and therefore have strong credentials on which to base this submission.

2. Executive Summary

Mercuria supports the Authority's intent to strengthen price discovery and confidence in the forward electricity markets. However, we have some important points of concern relating to aspects of the proposed changes. Specifically, we do not believe the Authority's analysis regarding market liquidity and volume requirements has best demonstrated that the benefits of the proposed volume change is greater than the costs.

Recent reports, including a September 2025 Cabinet paper, have highlighted that higher prices and insecurity in the market have cost the New Zealand economy approximately $5 billion in lost GDP. In this context, it is critical that regulatory interventions do not inadvertently reduce genuine liquidity and increase hedging costs for New Zealand businesses.

We are concerned about the proposed reduction in baseload volume from 12 MW to 10 MW per contract, as lack of trading reflects lack of remaining volume available due to the majority of trading being market maker to market maker, not a lack of market appetite. This reduction will reduce our ability to provide OTC liquidity, increasing hedging costs for consumers.

Additionally, the current practice of allowing aggressive trades (taking liquidity by hitting other market maker bids and offers) to count towards market making obligations incentivises leads to increased volatility rather than stability and distorts the true picture of market liquidity.

Mercuria proposes alternative settings to deliver greater net benefits to consumers, including retaining existing volume obligations (12MW) while removing the incentives created by the aggressive trading allowances. We also support mandatory market making for super-peak contracts but with higher volumes (10MW) than proposed, and advocate for the development of a separate evening peak product. The extension of baseload futures from three to five years is a positive step that we strongly endorse.

The following sections detail our analysis of current market performance, the aggressive liquidity issues, and our feedback on the specific proposals. Specific suggested amendments to the Electricity Industry Participation Code (Code) to implement our alternatives are provided in Appendix A.

3. Assessment of Current Market Making Policy Settings

The Authority asks whether policy settings have led to an improvement in the availability of risk management contracts and price discovery (consultation questions 1 and 3). Based on our direct experience as an active trader in the ASX futures market, our view is no.

While the initial introduction of mandatory market making in 2020 provided some stability during periods of market stress the codification of aggressive trading as liquidity provision has materially eroded these gains. The Authority's own assessment acknowledges increased volatility (consultation paragraph 4.9) and decreased market depth. In our view, these settings have inhibited development of the market.

3.1. Compliance of Aggressive Liquidity Provision

Passive orders are limit orders placed on the order book at a specified price, where they rest until matched with an incoming order. These orders add liquidity to the market by providing depth, allowing other traders to execute against them or price within the spread, this often results in narrower bid-ask spreads and improved price discovery. Passive strategies prioritize better pricing over immediate execution, making them common among market makers who earn rebates in maker-taker fee models for contributing to market stability (e.g. NASDAQ maker/taker fee structure).

By not crossing the spread, passive orders help maintain efficient markets and reduce volatility. In contrast, aggressive orders are typically market orders or executable limit orders that immediately cross the bid-ask spread to execute against existing resting orders, thereby removing liquidity from the market. These prioritize speed and certainty of execution over price optimisation, often leading to wider spreads and short-term volatility as they consume available depth. Aggressive trading is useful in fast-moving markets but can increase costs due to paying the spread, distinguishing it from passive approaches that build rather than deplete the order book.

In the context of New Zealand's electricity market making scheme, allowing aggressive orders to count toward market making obligations reverses these principles, potentially undermining the goal of enhancing liquidity and price discovery. Under the current Electricity Industry Participation Code, regulated market makers can fulfil requirements by aggressively taking

liquidity, such as hitting bids or offers, which depletes the order book rather than building it, incentivizing volatility and inter-market-maker churn. This contrasts with global best practices in energy and stock markets, where only passive orders are rewarded to ensure genuine depth, and could lead to higher hedging costs for consumers in New Zealand's forward electricity markets if the rules are not reformed.

The example below shows the difference in market liquidity under two different rules: one that counts aggressive orders toward market making duties (left side), and one that doesn't (right side). In this case, an aggressive order from one market maker can set off a series of similar orders from others, as they try to close out positions and avoid risk on that contract. Under the rule that counts aggressive orders, the order book empties out fast, with no liquidity left, which harms how the market works overall. On the other hand, when aggressive orders don't count, market makers still have to post new passive quotes and update prices to meet their requirements, which rebuilds depth and provides better liquidity.

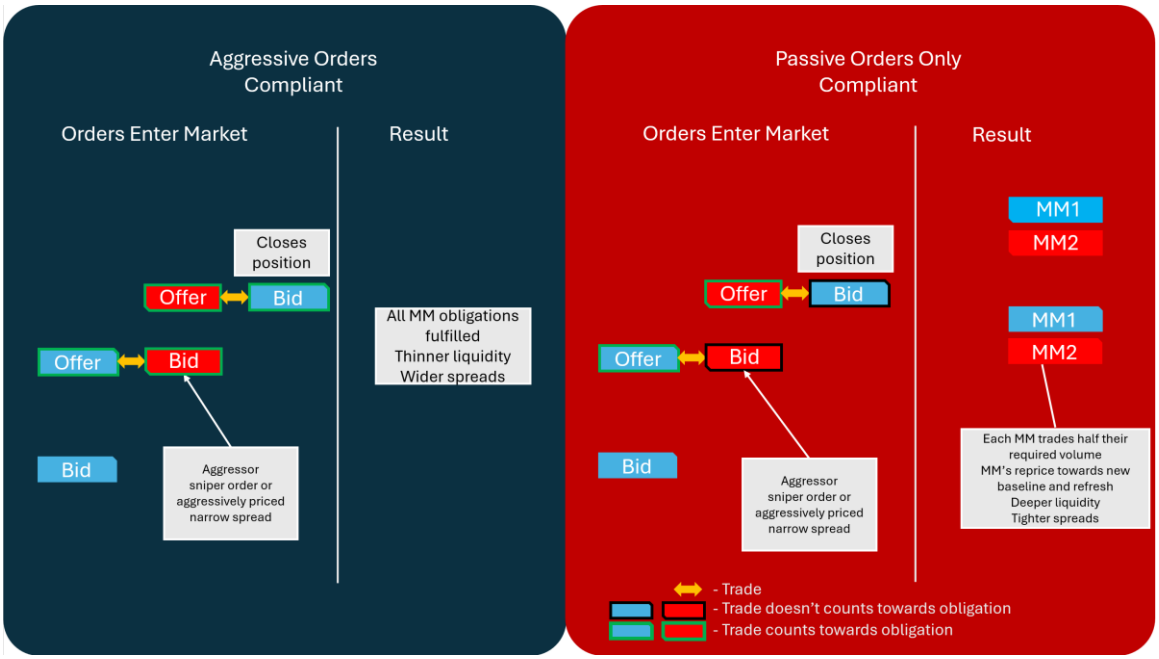

Figure 1: Illustration showing difference in order book under different market-making provisions regarding aggression.

The current approach harms the market through:

1. Increased Volatility: Aggressive trades remove liquidity, pushing prices up or down based on compliance needs rather than fundamentals, introducing additional volatility.
2. Incentive Distortion: Market makers behind on quotas are incentivized to trade against each other, creating "churn" that provides zero utility to independent hedgers.
3. Liquidity Illusion: High traded volumes mask low genuine availability; true liquidity allows natural buyers/sellers to transact with less price movement.

The Authority must reconsider the current position, as this reverses global best practices, confusing consumption with creation. It misaligns incentives, leading to higher volatility and costs, contrary to section 15 of the Act. Correcting this via passive-only obligations, as in other global markets, would reduce volatility and enhance depth. We propose Code amendments to ensure only passive trades count, outlined in Appendix A.

4. Feedback on Proposed Changes to Baseload Volume Requirements

Mercuria strongly opposes the proposal to reduce total baseload offer volume requirements from 12MW to 10MW per contract (consultation questions 13 and 14).

4.1. Observed Market Demand

The Authority argues that current obligations may exceed market demand, but this confuses traded volume with liquidity need. Traded volume appears low because market makers can trade between themselves, with fills counting towards obligations for both parties.

The Authority has acknowledged that market depth has decreased, but it has not undertaken a proper analysis of how the current settings cause this. Allowing aggressive trades to count towards obligations allows market makers to trade with one another to satisfy obligations while providing minimal liquidity to the wider market.

If Market Maker A trades aggressively against Market Maker B, both record volume that counts toward their obligation, effectively double counting volume and providing no liquidity for non-market-maker participants. For example, if all five market makers trade 1.2MW among themselves, the total net volume traded could be as low as 6MW, yet each fulfils their quota.

The Authority is aware of significant market-maker-to-market-maker trading (consultation Appendix C, Part 2), which reduces the effective volume available to independent participants like Mercuria and our customers. A high proportion of market-maker-to-market-maker trading in periods where market makers are involved suggests that traded volume alone may not reflect liquidity available to non-market-maker participants.

The proposed reduction in volume will cut effective availability by 17%. This reduction will likely tighten supply and disproportionately affect independent participants. Over time, this may contribute to an observed reduction in trading activity that reflects constrained access to available liquidity rather than a lack of underlying hedging demand.

4.2. Impact on OTC Pricing

Reducing volumes would impair our OTC liquidity provision, widening spreads and raising customer costs. This reduces the effectiveness of the ASX baseload futures as an OTC benchmark, increasing volatility and hedging expenses, reducing competition and costing consumers, exacerbating the $5 billion GDP impact.

The super-peak costs/benefits are standalone; they may not be a reason for weakening baseload benefits. The Concept report (Appendix D) omits a 10MW scenario, and options failed to consider status quo or fixes like passive only compliance. Mercuria is of the opinion that the Authority has not demonstrated that benefits of reducing the baseload volume outweigh the costs. Maintaining 12MW promotes competition, reliability, and efficiency per section 15 of the Act.

4.3. Alternative Proposal for Baseload Settings

The analysis overlooked maintaining volume while fixing other rules. Mercuria proposes an alternative which scores better on a multi-criteria analysis than the Authority's proposed option:

Mercuria Proposal

- Total Volume: 12MW
- Refresh: Retain
- Volume per Market Maker: 2.4MW (1.2MW initially)
- Aggressive Trades: Exclude from compliance checks

Table 1: Multi-criteria analysis results

Scheme	Late 2010s Settings*	Sep-22 Scheme (Status Quo)	Proposed Scheme	Mercuria Proposal
Total Volume	12 MW	12 MW	10 MW	12 MW
Volume per Market Maker	3 MW	2.4 MW	2 MW	2.4 MW
Initial Volume per Market Maker	3 MW	1.2 MW	1 MW	1.2 MW
Refresh	No	Yes	Yes	Yes
Aggressive Trades Count	No	Yes	Yes	No
Effective Liquidity (if 70% MM to MM)	12MW	7.8MW	6.5MW	12MW
Price Discovery	High	Medium-Low	Low	High
Liquidity Assessment	High	Low	Low	High
Costs	Medium-High	Medium	Low	Medium
Volatility	Medium	High	High	Medium

*Assuming 3% spread, exemptions, and current framework.

See Appendix A for Code amendments.

5. Feedback on Super-Peak Standardised Contracts

Mercuria agrees with introducing mandatory market making for the standardised super-peak contract (questions 5 and 7), as voluntary arrangements are fragile.

5.1. Volume Requirements

The proposed 6MW is insufficient. Monthly volume offered is 12MW vs. ~250MW for baseload futures. We would propose reverting to 10MW from the Issues paper for ~20MW of monthly liquidity, supporting product development and open interest growth over time. Small notional values limit participation in OTC markets due to transaction costs; this is mitigated by having higher volumes available.

5.2. Product Specifications

Mercuria supports the development of an evening peak product (question on product, page 24). This would be useful for retailers and risk management of solar generation.

5.3. Trading Rules on OTC Platform

Aggressive trades should not count towards compliance, as with our proposal for the baseload futures. A regulated market making scheme should ensure market maker liquidity is additive, not subtractive, to liquidity.

6. Feedback on Extension of Baseload Futures Horizon

Mercuria supports extending quarterly baseload from three to five years (questions 10 and 11).

We expect to utilize these for:

1. PPA Support: Pricing long-term agreements for renewables, increasing the availability of financing for independent developers.
2. Retail Hedging: Offering extended fixed-price contracts for budget certainty.

This low-cost change supports competition and reliability. We support the Authority's analysis that benefits will be derived from de-risked forward revenue. This will allow project financing to occur at higher debt levels and thus bring lower cost generation into the market.

7. Conclusion

Mercuria is committed to playing a constructive role in the market and shares the Authority's goal of robust forward markets. However, reducing baseload volumes while retaining structural issues in the scheme will result in thinner, more volatile markets, which is not beneficial for consumers.

We request reconsideration of the cost-benefit analysis, examining the effective liquidity and costs of a 12MW option but where only passive, liquidity making orders count towards compliance. This analysis will show the reduction in volume traded is caused by lack of remaining volume after market maker aggression. Market making compliance should consider only passive orders that rest on the order book, adding liquidity, and not orders that are aggressive and take liquidity.

Summary of Recommendations

1. Do not reduce baseload volume.
2. Exclude aggressive trades from obligations.
3. Increase super-peak volumes to 10MW.
4. Proceed with five-year extension.

Appendix A. Suggested Further Amendments to the Proposed Code Amendment

To implement our proposed alternatives, we suggest the following further modifications to the Authority's proposed amendment in your Appendix A. These build on your drafting, focusing on clause 13.236L and relevant definitions to ensure only passive trades count toward obligations. Amendments are shown with blue for additions and blue strikethrough for deletions relative to your proposed text.

Part 1 – Interpretation

(1) In this Code, unless the context otherwise requires,—

passive trade means a trade executed against a **participant's** own posted quote (i.e., where the **participant** is the liquidity provider whose order is traded by another party).

total required base load volume~~, for the purposes of subpart 5B of Part 13,~~ means 2.4 MW base load equivalent of ~~NZ~~ base load electricity futures, taking into account traded ~~NZ~~ baseload electricity futures across both buy quotes and sell quotes

total traded base load electricity future ~~**NZEF**, for the purposes of subpart 5B of Part 13,~~ means the cumulative total amount of buy **quotes** and sell **quotes** ~~traded by~~ executed as **passive trades** for that **participant** as **base load ~~NZ~~ electricity futures** up to the start of the current volume refresh period in that base load ~~**NZEF**~~ market-making period in relation to the applicable reference **node** (Benmore or Otahuhu) and for the particular month or calendar quarter referred to in clause 13.236L(1) ~~for the participant to which the total traded **NZEF** is being applied~~

[Other definitions remain as proposed.]

Subpart 5B—Hedge market arrangements

13.236L Requirement to quote baseload electricity futures

(1) ~~Subject to subclauses (2) to (5), the~~ A **participant** to whom this clause applies under clause 13.236K must, for a minimum of 25 minutes in every ~~**NZEF**~~ **base load market-making period**, provide **quotes** for a minimum of—
  (a) ~~20~~24 monthly ~~**NZ**~~ **base load electricity futures** for each of the Otahuhu reference **node** and the Benmore reference **node** (being ~~20~~24 buy **quotes** and 20~~2~~4 sell **quotes** for each reference node) for the current month and each of the five months following the current month; and
  (b) ~~20~~24 quarterly ~~**NZ**~~ **base load electricity futures** for each of the Otahuhu reference **node** and the Benmore reference **node** (being ~~20~~24 buy **quotes** and ~~20~~24 sell **quotes** for each reference node) for each calendar quarter that is available for trade on an exchange.

(2) The **participant** must not provide a **quote** under subclause (1) with a **bid-ask spread** that exceeds the greater of 3% or NZ$2. For the avoidance of doubt, where there are multiple buy **orders** and sell **orders** for a particular reference **node** for a particular month or calendar quarter in a **NZEF market-making period**, the requirement in this subclause means the **bid-ask spread** between the

lowest priced buy **order** and the highest priced sell **order** (across those multiple **orders**) must not exceed the greater of 3% or NZ$2.

(3) When providing **quotes** ~~U~~under subclause (1) ~~for each **NZEF market-making period,**~~ the **participant** must ~~provide a quantity of initial **quotes** and (as applicable) **volume refresh** its **quotes** until it has traded the **total required volume** for each of the Otahuhu reference **node** and the Benmore reference **node** in relation to each particular month and calendar quarter as follows~~:

(a) ~~when first placing **orders** at or after the start of the **NZEF market-making period,** the **participant** is required to~~ place an initial buy **order** of at least ~~10~~12 **quotes** in total and an initial sell **order** of at least ~~10~~12 **quotes** in total at or after the start of the **base load market-making period**:

(b) ~~if either initial buy **order** or sell **order** is fully traded then that **participant** must (as applicable)~~ **volume refresh** its **order**(s) such that where the amount of the **total traded base load electricity future ~~NZEF~~** up to that point in time in the **base load ~~NZEF~~ market-making period** is—

(i) ~~10~~12, then at the end of the **volume refresh period** the buy **order** must comprise at least ~~10~~12 **quotes** and the sell **order** must comprise at least ~~10~~12 **quotes**:

(ii) greater than ~~10~~12, then at the end of the **volume refresh period** that **participant** must ensure that the number of **quotes** comprising each of the buy **order** and sell **order** respectively are a minimum of X, where—

*X = ~~2024~~ **quotes** – **total traded** **baseload electricity future ~~NZEF~~***

(c) once the **participant** has traded the **total required base load volume** it may withdraw any remaining **quotes**.