

13 December 2024

s9(2)(a)

Tēnā koe s9(2)(a)

Your request

Thank you for your request, received on 18 November 2024, under the Official Information Act 1982 (Act) for the following information:

- *“the August 2024 informal submissions on market-making Code changes”*

Information subject to your request

The Authority has identified 10 documents within scope of the request.

The Authority is releasing 8 documents within scope of your request. Some information has been redacted under:

- Section 9(2)(a) of the Act to protect the privacy of natural persons, including that of deceased natural persons
- Section 9(2)(b)(ii) of the Act to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information
- Section 9(2)(ba)(i) of the Act protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

Two documents are being withheld in full under:

- Section 9(2)(b)(ii) of the Act to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information, and
- Section 9(2)(ba)(i) of the Act to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied.

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.

Your rights

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 oiia@ea.govt.nz.

Nāku noa, nā,

A handwritten signature in black ink, appearing to read "Airihi Mahuika". The signature is written in a cursive style with a long horizontal stroke at the end.

Airihi Mahuika

GM Legal, Monitoring and Compliance

From: Tim Hammond <s9(2)(a)>
Sent: Friday, 16 August 2024 4:33 pm
To: Jo Goudie
Cc: Market Making; Tim Dobbs; s9(2)(a)
Subject: RE: Webinar: Urgent changes to market-making requirements

Hi Jo,

Look forward to Monday's discussion. Ahead of that - some thoughts:

Our view is that the following would be useful for ensuring the long term viability of the MM scheme. We feel that:

- (a) The status quo spread requirements should be widened.
- (b) A circuit breaker of some sort is essential - these are in place in many exchanges around the world in a variety of markets, a selection of which were provided in our previous email. This should not be controversial given its widespread application elsewhere.

Proposals

1. **Widening spreads to 5%:** The spread requirement should be changed to 5%, on usual quantity (1.2 MW with 1.2 MW refresh, for total trade size per contract per day of 2.4 MW). We consider that 3% is too low for a market as volatile as NZ Electricity. Widening spreads to 5% should help market makers manage their risk more effectively while still providing reasonable liquidity. We note that the Authority's commercial market maker RFP last year sought proposals on wider spreads and so the Authority will have information on the costs and benefits of greater than 3% spreads.
2. **Daily monitoring and wider spreads for significant price moves:** EA to monitor market on a daily basis. If a contract moves by more than 10% from the previous day's settle, close to close, then wider spreads to be implemented for the following day (for example, 10%) and the market notified. The wider spread will apply to that quarter and the 2 quarters either side of the affected contract(s). Size to be the same. This circuit breaker-like mechanism would be a prudent addition to the market making scheme. It allows market makers (and the broader market) to adjust to increased volatility, allows for the continued provision of liquidity, and accounts for spillover effects on adjacent quarters. The daily review and notification also promotes transparency.
3. **Scorecard approach for obligation fulfilment:** Failure to meet obligations should be treated on a scorecard, rather than binary basis. Under the current system, if an MM fails in 1 contract for a small amount of time at the start of the session, then they have no incentive to stay in the market and provide liquidity for the rest of session. Conversely, currently MMs can effectively provide liquidity for the whole session, and incur substantial costs, only to find out after the event that they have failed to meet the obligation despite their best efforts. A score card approach: improves incentives for market makers to continue providing liquidity even if they've had a small/technical failure, provides a more accurate representation of a market maker's

overall performance and for more nuanced penalties or rewards based on the degree of compliance.

4. **Periodic review of parameters:** There should be a regular review process (e.g., semi-annually) to assess and potentially adjust the scheme parameters based on market conditions and participant feedback.

Email comms are fine I think.

Regards,

Tim



Tim Hammond | Derivatives Manager

Genesis Energy Ltd | Level 6, 155 Fanshawe Street, Auckland CBD 1010

s9(2)(a)



Released under the Official Information Act 1982

From: Mike Boddy <s9(2)(a)>
Sent: Monday, 19 August 2024 2:25 pm
To: Jo Goudie; Market Making
Subject: RE: Webinar: Urgent changes to market-making requirements

Hi Jo,

Unfortunately, we are unable to respond to all questions by email, but we would be happy to discuss further on a call.

s9(2)(b)(ii)

Our view is for the EA to keep obligations as they were but if there are to be changes, we believe adjusting spreads based on price may be a more transparent option. For example, 4% when bid is above \$400, 5% when bid is above \$500 etc. This will keep volume constant as reducing volume in times of stress impacts liquidity, price discovery and can be counterproductive. Instead, a price based spread may allow participants to anticipate better what will happen at what level and reduce the need for complex calculations and requirement for the EA to communicate different settings.

We welcome the opportunity to discuss these views further. Thank you.

Best Regards,
Mike

From: Jo Goudie <s9(2)(a)>
Sent: Friday, August 16, 2024 11:58 AM
To: Market Making <market.making@ea.govt.nz>
Subject: RE: Webinar: Urgent changes to market-making requirements

Apologies – wrong date.

We'd appreciate this feedback by 5pm **Monday 19 August 2024**.

Nga mihi

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

DDI: s9(2)(a)

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.



From: Jo Goudie
Sent: Friday, August 16, 2024 11:41 AM
To: Market Making <market.making@ea.govt.nz>
Subject: Webinar: Urgent changes to market-making requirements

Thank you for either attending the webinar on Thursday, or expressing interest in our recent temporary changes to market making arrangements, and our planned urgent Code amendment.

We have attached the slides we presented in the webinar on Thursday.

As discussed during the webinar, we'd be interested in your views on:

- a) The effect of recent changes to market making in which volume was reduced and spreads widened; and
- b) Potential changes that we might incorporate in an urgent Code change near the end of August, such as:
 - a. What to do in periods under pressure
 - b. Definitions of market stress
 - c. Volumes
 - d. Spreads
 - e. Refresh obligation
- c) Any transition arrangements – which would balance speed with sufficient notice of change.
- d) A preferred way to communicate to parties about a change in market making arrangements when there is an urgent need to make changes.

We'd appreciate this feedback by 5pm Monday 21 August 2024.

Nga mihi

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

DDI: (b) (9)(2)(a)

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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PO Box 10041, Wellington 6143, New Zealand
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s9(2)(b)(ii)

19 August 2024

Electricity Authority
P O Box 10041
Wellington 6143

By email: marketmaking@ea.govt.nz

Dear team

█ does not support the Authority's decision to unilaterally amend the market maker obligations from 8am on Monday 12 August until 23 August 2024 (or for a shorter or longer period advised by the Authority). It is particularly galling that the Authority enabled market makers to trade with market moving inside information in the period until all market participants were informed – via the Market Brief – mid morning on Tuesday 13 August.

We agree with other participants' comments in the webinar that the temporary changes in market making obligations should cease as soon as possible and definitely no later than 23 August.

█ does not support the Authority implementing an urgent Code change by the end of August. We provide the following feedback on the topics requested by the Authority for completeness:

- a. *The effect of recent changes to market making in which volume was reduced and spreads widened*

This change has by definition reduced liquidity and prices are more volatile with a 15% spread.

- b. *Potential changes that we might incorporate in an urgent Code change near the end of August, such as:*

- a. *What to do in periods under pressure*

The issue of what to do in periods of market pressure has been debated numerous times. The Authority's decision and support to make market making mandatory appeared to us to finalise this debate and place reliance on compliance and penalties as opposed to subjective judgements.

- b. *Definitions of market stress*

█ does not support any change to the definition of market stress – again a topic that has been debated many times.

- c. *Volumes*

No comment given our view that market making should return to the obligations in the Code as soon as possible.

d. Spreads

No comment given our view that market making should return to the obligations in the Code as soon as possible.

e. Refresh obligation

No comment given our view that market making should return to the obligations in the Code as soon as possible.

c. Any transition arrangements – which would balance speed with sufficient notice of change.

There were no 'transition arrangements' when the Authority notified only market makers of its decision on Monday 12 August – undermining confidence participants have in the Authority's understanding of this market and the consequences of their actions. It is critical the Authority notify any change to market making obligations to all market participants at the same time.

d. A preferred way to communicate to parties about a change in market making arrangements when there is an urgent need to make changes.

A letter emailed to all market participants is our preference. This demonstrates the importance of the communication. An item in the regular Market Brief (at number 2 in the list) is not the preferred or appropriate communication channel.

e. Other suggestions for an Urgent Code change

An Urgent Code change at this time should be used to amend the penalties for breaching market making Code obligations so that penalties are meaningful and encourage compliance. A penalty is not a penalty if it costs less to breach than being compliant.

The Authority's Market Brief article about this change to market making obligations included a closing statement that "*As previously signalled, we will consult on enduring market-making settings later in the year*". We must have missed this 'previous signal' and encourage the Authority to provide more information about this upcoming consultation (which is not in the Consultation Calendar).

We suggest this consultation should reconsider whether the cost / benefit of contracting a commercial market maker is delivering to expectations.

No part of this submission is confidential.

s9(2)(b)(ii)

s9(2)(b)(ii)

s9(2)(a) & s9(2)(b)(ii)

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Via email to s9(2)(a)

15 August 2024

Anna Kominik
Chair
Electricity Authority

Attention: Anna Kominik

Urgent changes to market making requirements

The Electricity Authority (the Authority) announced on Monday this week that it was making urgent changes to the market making requirements on the forward market traded on the ASX. We were blindsided by these changes.

Mercury makes significant effort to meet our obligations as a Market Maker, including meeting all our contractual and Electricity Industry Participation Code (Code) requirements.

The urgent changes were not signaled, nor were we consulted on them beforehand. We consider that the changes and the way they have been implemented has had, and will continue to have a negative lasting impact on market confidence.

The Authority's rationale for the urgent changes is not entirely clear, but in any event we see no evidence that this intervention has achieved the Authority's stated purpose. In fact, we are observing a reduction in market liquidity, which is the exact opposite outcome to what was intended.

More generally, we consider that Methanex making gas available for generation, which was announced after the urgent changes were introduced, will help reduce pressure on the ASX forward market.

As a result, Mercury considers that the urgent changes should be reversed immediately.

The remainder of this letter outlines the significant concerns Mercury has with the processes under which these urgent changes have come about, including:

- > we were not informed nor consulted prior to the urgent changes being notified; and
- > the Authority's process, including the absence of a clear, transparent assessment that demonstrates the changes are in the public interest, has created uncertainty now and into the future which may have serious consequences.

Mercury was not consulted

On 6 August 2024, Authority staff had a call with the Mercury team to discuss market making. Our understanding from the discussion was that it was check-in to better understand the current market dynamics and to inform the Authority's consultation on market-making settings planned for later this year.

I have been informed by my team that during the meeting we highlighted our commitment to continue market making in accordance with the Code in the current environment. Furthermore, in response to one of the Authority's questions we indicated that having a greater number of market making participants would promote liquidity.

The Authority also indicated that it was planning to have separate discussions with the other Market Makers, so the issues which have driven the Authority to take urgent action, and specific measures that could be adopted, may have been raised after the meeting on 6 August 2024.



While I recognize the tight timeframes the Authority considered it needed to act within, my team would have prioritized making time available to discuss and provide feedback on the identified issues and measures with the Authority's staff before Monday. This lack of consultation prior to making such significant changes is not good practice.

The Authority's process has created uncertainty

The Authority's process has created uncertainty which is likely to be detrimental to the market's performance going forward.

Mercury recognizes the Authority has discretion not to take enforcement action in relation to breaches of the Code, and at times this can be a pragmatic option to adopt. However, the changes to the market making requirements outlined in the Authority's letter, *All Market Makers in the New Zealand Electricity Futures market*, dated 12 August 2024, in our view, amount to a change to the Code.

The Authority can amend the Code under urgency without needing to consult if it "*considers that it is necessary or desirable in the public interest that the proposed amendment be made urgently*". However, this process does not appear to have been followed. In particular, a statement has not been issued outlining why the urgent amendments are needed.

It is not clear if there are any issues with the functioning of the current market that justifies the extent to which the Authority seems to be juggling its powers. The Authority has not laid out a clear, compelling case for this intervention, including:

- > the evidence supporting the Authority's determination that urgent action was necessary or desirable; nor
- > an assessment that demonstrates the urgent changes are in the public interest or achieve the Authority's statutory objective.

While there may be confidential matters the Authority has taken into consideration in its decision making, it is imperative that the Authority shares the relevant information that informs its views on the problems, as well as getting input from sector and industry experts on the appropriate actions that should be taken, if any. At times of heightened market stress this is even more important so that unintended outcomes are avoided.

The Authority stated that the aim of the intervention was to maintain liquidity in the forward market because Market Makers are finding it increasingly challenging to fulfil their obligations to the standard specified under their contractual requirements and the Code. Mercury acknowledges that the market is currently challenging, but as noted above we are committed to continuing Market Making in accordance with the Code.

A market that is efficient will still be challenging from time to time. It is not necessarily an indicator of a market failure, particularly one that would justify such an urgent intervention. A careful analysis of the market, along with consultation, is required to determine whether there is a problem, and if a problem is identified then an appropriate solution. Otherwise, the Authority risks making hasty decisions that raise the possibility of unintended and detrimental outcomes, as presently observed.

The Authority's intervention should be reversed immediately. We request an urgent discussion directly between Mercury and Authority staff to discuss this matter further.

Yours sincerely



Vince Hawksworth
Chief Executive

cc. Sarah Gillies



19 August 2024

Sarah Gillies
Chief Executive
Electricity Authority

Airihi Mahuika
General Manager, Legal, Monitoring and Compliance

Weakened market-making obligations not supported

s9(2)(b)(ii)

consider that the Electricity Authority should reverse its direction to market-makers that it will not enforce clause 13.236L of the Electricity Industry Participation Code and will adopt an urgent Code amendment to codify weaker market-making requirements.

These decisions – as they stand – hurt the ability of market participants to access hedges in the forward market and will increase costs and financial risks for participants which is detrimental to competition, efficient operation of the electricity market and the long-term interests of consumers. Any intervention – particularly through urgent Code amendment – should be aimed at addressing the underlying problems in the market.

If the Authority makes an urgent Code amendment the deviation from current Code settings should be much less severe than it is presently allowing and for a very limited period of time. We note that failure of the commercial market-maker to meet its contractual obligations would have made it easier/less costly for the other market-makers to comply.

The actions are damaging confidence

s9(2)(b)(ii) consider that the Authority's actions are further undermining confidence in the electricity market and in the Authority as industry regulator, or "kaitiaki of electricity".

The Authority's actions make what is already an extremely difficult situation worse for most market participants to the benefit of some of the gentailers.

The Authority says its actions are to maintain liquidity in the forward market even though they reduce liquidity.

The five-fold increase in spreads and halving of volume effectively means market-making will no longer serve as a useful or effective tool for risk management, by large industrial customers, independent electricity generators and independent electricity retailers.¹ The Authority is introducing these changes at a time when risk management/hedging tools are needed more than ever.

There is a lack of transparency in Authority decision-making

The justification for the Authority's decisions appear to be a confused and contradictory mix of suggestions that "market makers are increasingly unable to fulfil their obligations" (notwithstanding public comments made by Mercury Energy), it may be more profitable for some market markers to

¹ See concerns raised by Aotearoa Energy: <https://www.energynews.co.nz/news/electricity-regulation/165203/concern-ea-market-making-moves-may-worsen-futures-trading#comments>.

s9(2)(b)(ii)

disregard their regulatory obligations and not comply with the Code, and intervention is needed due to “speculation in the market creating volatility” and that speculation “reducing liquidity and keeping prices higher for longer”.² Different explanations appear to be being given to different audiences with a Board member categorically stating speculation didn’t feature in the Board’s decision-making.

There is also the broader issue that different market participants were provided market-sensitive information by the Electricity Authority at different times, with the incumbent gentailers notified of the Authority’s decisions well ahead of other market participants, and ahead of the market re-opening. The Authority’s decisions were also made on the basis of discussions with the incumbent gentailers and not other market participants.

The Authority needs to be able to provide assurance it has put in place any necessary systems to ensure a repeat cannot happen.

The Authority needs to be cautious about any precedent it is setting

The Authority should not make Code changes on the basis that particular market participants might not comply with the Code/might find it financially beneficial not to comply. The Code needs to be enforced without fear or favour. If some gentailers are threatening to deliberately not comply with their obligations the Authority should publicly call out such behaviour and make sure other gentailers are not ‘tarnished by the same brush’.

We had previously seen the incumbent gentailer market-makers withdraw from provision of hedging products in response to 2018, and now we are seeing a repeat supported by the Electricity Authority.

The Electricity Authority is essentially rewarding violation of Code obligations and is sending a strong signal such behaviour can be repeated in the future when the market is under stress.

Market conditions are changing

Regardless of the merit or otherwise of the Authority’s actions over the last few days, market conditions are rapidly changing. There was discussion at Thursday’s webinar that some of the pressures used to justify the Authority’s course of action had eased so the Authority would now be justified to cancel the decision.

We consider that the Authority should also investigate the impact the changes/non-compliance has had/is having on the OTC market.

² e.g. <https://www.energynews.co.nz/news/electricity-regulation/165288/futures-intervention-needed-address-speculation-ea>.

Yours sincerely,

s9(2)(b)(ii)

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From: s9(2)(a)
To: Jo Goudie
Subject: RE: Webinar: Urgent changes to market-making requirements
Date: Friday, 16 August 2024 1:26:35 pm
Attachments: [image001.png](#)
[image002.png](#)
[image003.gif](#)
[image004.jpg](#)

Hi Jo,

Responses below in red.

As a sidenote, I have a number of clients that are likely to review their participation in the NZ market. That damage may be permanent, and it will require the Authority to somehow rebuild their confidence that parts of the markets, especially ones are central as market making, won't be so drastically changed without warning.

Cheers,

s9(2)(a)

From: Jo Goudie s9(2)(a)
Sent: Friday, August 16, 2024 11:41 AM
To: Market Making <market.making@ea.govt.nz>
Subject: Webinar: Urgent changes to market-making requirements

Thank you for either attending the webinar on Thursday, or expressing interest in our recent temporary changes to market making arrangements, and our planned urgent Code amendment.

We have attached the slides we presented in the webinar on Thursday.

As discussed during the webinar, we'd be interested in your views on:

- a. The effect of recent changes to market making in which volume was reduced and spreads widened; and

One definite effect that covering risk on basis, that is the spread between OTA and BEN, has become very difficult, if not hazardous, during market making. With 15% spreads, this is magnified by having to cross both the OTA and BEN spread to complete a basis trade.

This wide spreads also increase the risk for any intermediaries in the market, as an erroneous trade will immediately likely be 10 – 15% out of the money. To contextualize this, on 6 lots of Q125 OTA right now, an error closeout would cost \$41k to exit from (assuming a 15% spread). It was a fifth of that previously.

In addition, I have been working orders for customers during MM this week, and again it is extremely difficult to get any sort of volume done. It took manual adjustment constantly throughout the session to simply get even 1mw orders executing, and we ended up having to move the offers lower in order to complete the orders.

- b. Potential changes that we might incorporate in an urgent Code change near the end of August, such as:
 - a. What to do in periods under pressure

- b. Definitions of market stress
- c. Volumes
- d. Spreads
- e. Refresh obligation

The Authority should, at the very least, go back to the previous settings. In my view, if 3 market makers wish to renege on their obligations, then so be it. Any urgent code change should be to ensure the Authority has the sufficient tools to deter this. Electricity markets will always be volatile; the Authority needs to be aware of how penalties/fines/etc stack up against the rough P&L that MM's could be incurring under the market conditions at the time. A \$200k fine might be a lot when the market is trading \$40 - \$50 range with only small movements each day, but a rounding error when it's trading/trending \$100's. The market risk changes, the Code needs to be flexible enough that it gives the Authority the ability to ensure that the "sticks" part of the equation can keep up with changes in market conditions.

As I have noted in earlier communications, 2 market makers under the old criteria is better than 5 under the new criteria. The volume is almost the same, but the spread is tighter and will always foster better price discovery and confidence than the latter.

- c. Any transition arrangements – which would balance speed with sufficient notice of change.
 - There should be no reason these could not be communicated to the market in effectively real-time. Everyone has a smart-phone, just text and email them, a link.
- d. A preferred way to communicate to parties about a change in market making arrangements when there is an urgent need to make changes.
 - Nothing special, email lists and/or SMS blasts would be sufficient.

We'd appreciate this feedback by 5pm Monday 21 August 2024.

Nga mihi

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

s9(2)(a)

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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19 August 2024

Electricity Authority

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

Tēnā koutou,

Feedback on Urgent changes to market-making requirements

We appreciate the chance to provide feedback on the recent urgent Code amendment

The ASX forwards market plays an important role in the functioning of the electricity market. It allows for price discovery, and for parties to manage risk. We recognise that market making is an important feature to improve liquidity and are happy to play our part.

We support the recent urgent changes to the market making requirements made by the Electricity Authority (EA). For the market making obligation to function as intended the EA must have discretion to make changes in rare and exceptional circumstances to protect the integrity and regulatory goals of the Market Making scheme.

As background to our submission, we believe that having regulated Market Makers who are, due to their physical participation in the market, both large suppliers and purchasers of electricity, is a sensible structure that improves both price discovery and market liquidity in a range of market scenarios. However, in times of significant market stress, likely owing to material plant outages or severe shortfalls in energy, the ability for these entities to provide sell side liquidity may be diminished, unless that entity supports this on a speculative basis (which is misaligned from a typical Market Making approach). Our view is that this scenario played out through late July and early August 2024 as New Zealand experienced a significant low inflow sequence and limited firm energy was available.

In response to the matters the Authority sought views on in the email on Friday 16 August:

a. The effect of recent changes to market making in which volume was reduced and spreads widened

In our opinion this served its purpose as an effective circuit breaker for a market that was showing signs of serious disfunction. As per our introductory remarks we believe the market was characterised by a lack of natural sell side liquidity in the weeks leading up to the event, and in addition the regulations and likely behaviour of market makers to extreme volatile market conditions could be assumed and was ultimately predictable, running the risk of being gamed by financial only participants.

b. Potential changes that we might incorporate in an urgent Code change near the end of August:

a. What to do in periods under pressure

The EA should explicitly state that emergency interventions such as the one we have just seen remain open as a tool to be used in exceptional circumstances in the future at the EA's discretion.

b. Definition of market stress

Market stress assessment could be tied to the spread between short and long dated measures of price volatility. In addition, heavily skewed patterns of

market volume over time, average and inside market spread over time, and open/high/low/close trade levels could also be used as supplementary measures of market stress. We think that while describing a set of factors that the EA will consider in its assessment is useful, it will be counterproductive to exhaustively identify either the factors themselves, or the levels of these factors themselves as a definitive description of the state of market stress, and rather prefer that the EA's is able to use discretion and form its own view of market stress.

c. Volumes

Volumes of 12x12 lots remain reasonable in our opinion

d. Spreads

3% spreads on the other hand should be reviewed to determine whether they are fit for purpose in current market conditions, and whether they are likely to be more or less suitable over time. Given the transition that the NZ electricity market is currently going through, and the expected duration of the transition, we feel that 3% represents a material under-pricing of market clearing bid/offer spread.

e. Refresh of obligations

The current refresh obligations are reasonable.

c. Any transition arrangements – which would balance speed with sufficient notice of change

We answer this question in two parts,

i) Return to normal trading:

We suggest progressive normalisation be adopted by the EA when transitioning back from an urgent code amendment to normal parameters. We recommend normalising volumes first, then normalising spreads in multiple steps, assessing market reaction to each incremental change. In this recent case we recommend 15% → 10%, 10% → 5%, 5% → 3%, with multiple trading sessions between each change, and with the EA reserving the right to pause/reverse should market reaction warrant it. We would be open to tighter spreads being enacted in back end contracts earlier if desired. The exact specifics of this we think could be worked through relatively readily.

ii) Enacting emergency changes to trading

When enacted emergency changes to trading we recommend the change is not foreshadowed to market participants to ensure integrity of trading up until that point. Relatively simple changes, like increasing spreads and / or reducing volumes, can be acted on relatively simply and readily by Market Makers.

d. A preferred way to communicate to parties about a change in market making arrangements when there is an urgent need to make changes

We believe that the EA should keep contact details of all registered market participants and that communication via email with follow up video-conference meetings are an effective way to communicate changes. If understood by all market participants, wide and effective communication can be achieved in a short timeframe.

In the future it may be useful for the EA to consider a traffic light system for market conditions as a way of signalling that the EA is scrutinising market conditions/ participant behaviour for signs of disfunction that may require intervention.

Additional feedback

- We would like to see a channel for Market Makers to report concerns where they observe persistent behaviours that are inconsistent with the stated aims of the scheme
- We would like to highlight that while these interim measure have been in place the market has found market clearing spreads on some contracts significantly tighter than the 15% constraint.

Please contact me at s9(2)(a) if you wish to discuss further.

Ngā Mihi,



Tim Boyce
Head of Wholesale Market
Contact Energy.

Released under the Official Information Act 1982

From: Stu Innes <s9(2)(a)>
Sent: Friday, 16 August 2024 11:21 am
To: Market Making
Cc: Jo Goudie; Saki Hannah; Bold MM NZ
Subject: Confidential feedback on guidance and potential rule change

Hi all,

Thanks for the opportunity to provide some comments. The below is provided on a confidential basis.

s.9(2)(ba)(i)

2. Notwithstanding that, we implore the Authority to revert the guidance immediately for the reasons outlined below.
3. We don't consider a rule change is necessary or appropriate.
4. *If* the Authority is going to make a rule change, we suggest the change below.

Interim guidance should be revoked immediately

The EA has explained that it took this measure due to the lack of incentive for RMMs to adhere to the Code. The decision was made based on a perceived choice between no participation or full participation at relaxed levels. The current guidance however, does not create *participation* but rather *attendance*, and **the resultant liquidity is broadly equivalent to having no market makers**.

This is problematic and *urgent* because:

- To continue is to embed the precedent that the Authority will not enforce the Code.
- Such a wide and illiquid curve gives no actionable price transparency. Decisions around NZs backup thermal fuels have a 3 month lead time. s.9(2)(b)(ii)

This decision making process relies on the ability to have clear and hedgeable prices on the futures curve between now and winter next year. These conditions are no longer being met due to the guidelines that have been issued. There is a direct impact between liquidity in the ASX *today* and security of supply in Q1 and winter 2025. The guidelines should be revoked immediately.

- The guidelines have reduced volume (to virtually nil) and increased volatility in the few contracts that do trade. This will have knock-on effects in initial margins and cost and availability of clearing. Clearing participation has been a serious issue for the market very recently and was only just starting to recover.
- The fuel situation has abated dramatically this week with moderate amounts of wind/rain and significant gas reallocation.

Rule change is unnecessary

The Authority has made an assumption that certain RMMs will cease to adhere to the Code regardless of the consequence (presumably RMMs communicated this to the EA). We find it implausible that they would follow through with such threats because:

- The CEO of one RMM has, this week, stated that the EA should revoke the guidelines immediately.
- The CEO of another RMM has, this week, stated that we need stability and not to discourage that with ill-informed regulation. He called for calm and made assurances that the market will resolve the situation.
- The costs to RMMs of Code breaches far exceed the magnitude of the fine or penalty that the Rulings Panel may impose. There are significant additional costs in the form of reputational damage and political risk that would be incurred by RMMs if they chose to breach the Code. These far outweigh the cost of market making in our view.

Furthermore, if the CMM were to breach their contractual obligations, they can be replaced, and there are interim measures that could be taken s.9(2)(ba)(i)

while longer term arrangements are made.

Even in the highly unlikely event that the RMMs do follow through on their threats, at that point, lower service levels could be negotiated (perhaps after penalties have been imposed).

Any rule change should address the issue

The current rule set was meticulously designed and extensively consulted on following similar periods of market stress in 2018 and in 2021. The rules are there to ensure that there is liquidity in times of stress. The actions taken have reduced liquidity to virtually nil (equivalent to if there were no market makers). This is exactly the situation the Code is there to protect against.

If the Authority is genuinely concerned that RMMs do not have adequate incentive to adhere to the Code, then the only changes that should be made are changes to directly address those incentives. This could be achieved by adding a clarifying clause 13.236K(3) which states that:

For the avoidance of doubt, each NZEF market-making period in which a participant fails to comply with the requirements set out in clause 13.236L shall be considered a separate and distinct breach of this Code.

There is a compelling argument that this clarification is not necessary and it is already the case that any given day would constitute a separate breach, however the Authority has come to the conclusion that if continued failure to quote were to occur there would be a

maximum penalty of \$2m. Once it is clear that the maximum penalty is in fact \$2m *per day* the Authority can be confident that incentives will be aligned.

Such a clarifying clause is an appropriate change to make under urgency with little consultation. A redesign of the market making scheme, changing the fundamental premise that it will provide high levels of backstop liquidity in times of stress, is not.

As always, we appreciate the opportunity to provide input, please feel free to reach out to discuss any aspect of this further. We genuinely hope the situation can be resolved quickly and in an enduring manner as the forward markets are critical to all three limbs of the Authority's statutory objective.

Regards,

Stu

Stuart Innes
CEO & Co-founder

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