MAJOR ELECTRICITY USERS' GROUP

21 September 2007

Jenny Walton
Electricity Commission
By email to info@electricitycommission.govt.nz

Dear Jenny

Submission on proposed disclosure of contract information

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission") *Consultation paper on the disclosure of risk management contract information*, published 10 August 2007. MEUG appreciates the effort by the Commission to consider submissions on the initial August 2006 discussion document and the time given by Commission staff and advisors to discuss some of the details of this more recent paper and the workshop held 11 September.

2. MEUG support policies that will improve information to increase confidence by purchasers and mitigate concerns about market power risks. Improving consumer confidence will lead to improved risk management and therefore lower aggregate supply costs. The benefits of mandating information disclosure also need to be weighed against the new regulatory compliance costs, the risk of harming innovation and the risk of unwittingly disclosing information that will promote rather than reduce market power. As long as it remains difficult to identify the extent of any sustained market power, MEUG support an incremental and cautious approach to regulatory intervention with the current market structure. Overall the proposal in the consultation paper is a good compromise between these various factors.

3. Note that in parallel to seeking incremental improvements to the existing market design, MEUG has and continues to suggest a fundamental review of the strincture is needed including the regulatory and governance framework.

4. Members of MEUG have been consulted in the preparation of this submission. Some members of MEUG will also be making separate submissions.

5. Detailed answers to the eleven questions in the consultation paper are set out in the appendix. These include several fine-tuning suggestions rather than fundamental changes.

6. The most important design issue involves the trade-off between the benefit of disclosing as much information as possible to assist the market as a whole better manage risk versus the risk to individual buyers or new small entrant sellers of having information disclosed that will allow their risk management strategy to be identified by parties that have market power to exploit that information. The proposal manages this trade-off in two ways:

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a) First, very long contracts are recognised as being be-spoke and the terms and conditions of such customised contracts as not being relevant to the great majority of contracts (probably greater than 95% of all contracts entered into). The proposal provides for contracts greater than 10 years to not have to disclose price and zone but disclosure is required of quantity and term. Disclosure of the latter two items is useful to the market in estimating over time a view on the aggregate level and maturity dates of contracts held.

b) Second, contracts less than 10 years are likely to be of a more standardised and comparable format. These are split into two groups:

   i) Those that are less than 2 years are required to have all details released, ie price, zone, quantity and term. The consultation paper assumes that the number of contracts disclosed that fall within the 2 year contract term within each of the 14 zones will be reasonably large and therefore there will be very little risk of individual parties being identified; and

   ii) Contracts with a term between 2 and 10 years have an option not to disclose the exact contract term, an option to normalise prices and zone to Haywards GXP and not to disclose actual quantity if greater than 30 MW. These options were included because it was expected the number of contracts that would be disclosed might be relatively small within some of the 14 zones and therefore there might be a risk of individual parties being identified.

7. The table below summarises the proposal:

Risk management contract disclosure design in consultation paper:

Attribute disclosed:	Standard or "comparable" contracts		Be-spoke contracts
Price	Full disclosure	Option to disclose to HAY	No disclosure
Zones (14)	Full disclosure	Option to disclose to HAY	No disclosure
Quantity	Full disclosure	> 30 MW, option to disclose "> 30 MW"	Full disclosure
		< 30 MW, Full disclosure	
Term	Full disclosure	Option to disclose ">2 & <10yrs"	Full disclosure
Term:	< 2 yrs	> 2 to < 10 years	>10 years

8. In discussions with the Commission and as mentioned at the Commission workshop the following aspects of the proposal in the consultation paper may result in undesirable outcomes:

a) Providing options for contracts between 2 and 10 years to mask details of quantity and term would undermine the benefit of allowing the market to better estimate over time the aggregate level and maturity dates of contracts held. Therefore as an alternative full disclosure for all contracts of quantity and term should be considered.

b) However if full disclosure of quantity and term were accepted, this may increase the likelihood of individual purchasers being identified. Even without this change MEUG was concerned that in some zones some participants would be identifiable. Two ways to reduce the risk of individual consumers being identified are first, to reduce the number of zones from 14 to the 4 zones used for transmission pricing. Second, to have all prices normalised to a single reference node in each of those 4 zones.

9. Adopting these changes leads to an alternative design as summarised in the table below. This alternative design is similar to but not exactly the same as that discussed at the Commission workshop on 11 September:

Risk management contract disclosure "alternative" design with MEUG modification:

Attribute disclosed:	Standard or "comparable" contracts	Be-spoke contracts
Price	Full disclosure normalised to single node in relevant zone	No disclosure
Zones (4)	Full disclosure	Full disclosure
Quantity	Full disclosure	Full disclosure
Term	Full disclosure	Full disclosure
Term:	< 10 years	>10 years

10. The one difference between the Alternative Option tabled by the Commission at the workshop and the modified alternative in the table above is the EC propose no disclosure of zone for contracts with a term exceeding 10 years whereas MEUG suggest the zone for those contracts should be disclosed.

11. MEUG also support the proposal in the discussion paper of party's to seek a dispensation from the disclosure requirements.

12. One of the issues discussed at the workshop were the pros and cons of requiring non Market Participants to disclose summarised contract information. The recent announcement by ANZ Bank that they have started trading on energyhedge makes this a topical issue. As stated at the workshop MEUG does not support requiring non Market Participants to publish summarised contract information. The entry of ANZ Bank is an indicator the market is maturing and other parties view the risk of market power affecting their position as being less than in prior year. This is good news for the market and consumers. It doesn't seem sensible to be considering imposing a regulatory burden on these new entrants. Note that any energyhedge transactions between ANZ Bank and a Market Participant will be covered by the disclosure requirements.

Yours sincerely

Ralph Matthes
Executive Director

Appendix

	EC question	MEUG comment
Q1	Do you agree with the Commission's proposed approach to the disclosure of Options, as described in 3.4.4?	Agree with proposed approach.
Q2	Do you agree with the Commission's proposed approach of limiting the disclosure of contract term to two years or greater? Do you agree with only disclosing term and quantity for contracts that are longer than ten years?	MEUG support the alternative option suggested at the Commission workshop on 11-Sep with the MEUG modification that zone be disclosed for all contracts as summarised in the table in paragraph 9 of the covering letter to this submission.
Q3	Do you agree with the Commission's proposed approach to the disclosure of contract quantity?	MEUG support the alternative option suggested at the Commission workshop on 11-Sep with the MEUG modification that zone be disclosed for all contracts as summarised in the table in paragraph 9 of the covering letter to this submission. In disclosing contract quantities MEUG suggest: 1. For FPVV contracts the consultation paper (paragraph 3.4.20) suggests sellers disclose a notional quantity "provided it is determined on a reasonable basis." Rather than leave to the discretion of the supplier which methodology to use, there are likely to be benefits if the Commission or the industry were to facilitate development of a voluntary common methodology. 2. For CfDs that have a flat quantity profile the disclosure of a single quantity per trading period number is sufficient. For CfDs that do not have a flat profile, there is uncertainty over what quantity number needs to be disclosed. MEUG suggest some clarity is needed to describe the quantity number(s) that should be disclosed. MEUG suggest there may be merit in having the following three quantity values published for each CfD: • The average quantity per trading period. For CfDs that only apply to parts of the day, those trading periods that do not apply would not be counted; • The maximum quantity specified in the contract for any single trading period; and • The minimum quantity specified in the contract for any single trading period. For "flat" CfDs these three quantities would be the same. If these three quantity values were disclosed then there would be no need to have the column titled "profile" in the information published (refer figure 3 on p47).
Q4	Do you agree with the Commission's proposed approach to the disclosure of contract location?	MEUG support the alternative option suggested at the Commission workshop on 11-Sep with the MEUG modification that zone be disclosed for all contracts as summarised in the table in paragraph 9 of the covering letter to this submission.
Q5	Do you agree with the Commission's proposed approach of using a time weighted average disclosure of contract price?	Agree with normalising contracts using a time weighted average price rather than a load weighted average price. While the latter would also be interesting to know, the simplicity of just disclosing the time weighted average price is sufficient at this stage. In this same section of the paper (refer paragraph 3.4.38) is a proposal to use an average losses factor of 6.3% to convert FPVV contracts where the point of sale is within a distribution company to an equivalent value at the nearest GXP. If just 4 zones are adopted then there may be value in using 4 different loss factors calculated each year based on information required to be disclosed by Electricity Lines Businesses pursuant to the Information Disclosure Requirements grouped into the relevant zones. This would be

		more accurate for each zone but would still overstate the actual loss factor because those loss factors include losses for high and low voltage customers. Whatever loss factor(s) are finally agreed they need to be published along with how they were derived so that interested parties can substitute their own assumptions if they wish. MEUG also suggest there would be a benefit if the voltage at the point of sale for FPVV contracts or point of obligation for financial derivatives were disclosed. For example there may be a material difference between prices struck for contracts at 110 kV versus contracts settled for trades at 11 kV. For parties analysing disclosed information it would be useful to distinguish contracts at different voltages because they may then apply different loss factors to those different contracts.
Q6	Do you agree with the Commission's proposed approach to the <u>disclosure of trade date</u>?	Agree with the proposal that the exact trade date of the commencement of the contract be published.
Q7	Do you agree with the annual declaration and audit process described above?	The self certification declaration (paragraph 3.4.78) is agreed provided only Market Participants that are sellers of risk management contracts are required to have Directors sign a declaration. Making this an obligation only on sellers is consistent with the obligation to post the contract details with the EC for publication. This will require a change to draft rule 15.1 of Part K.
Q8	Do you agree that the Information System Is the most appropriate location for the publication of contract information?	Yes, provided the Information System becomes more accessible to the public.
Q9	Do you broadly agree with the proposed publication format displayed in Figure 3?	Yes. In addition MEUG suggests adding: 1. More information on contract quantity as suggested in point 2. in the answer to question 3 above; 2. Disclosure of the voltage at which the point of contract applies as suggested in the answer to question 5 above; and 3. A flag on whether the energyhedge ISDA is used as discussed in the text below. MEUG suggest a new column could be added reporting whether the contract uses the "standard financial derivative contract" that the parties to Energyhedge have agreed to use since 1 January 2007. The "standard financial derivative contract" comprises: • The 2002 ISDA Master Agreement; and • A standard Schedule 2 to the 2002 ISDA (refer http://www.energyhedge.co.nz/docs/isda.pdf) Note that the confirmation sheet that forms part of such contracts will differ for each contract. The value of asking if the standard 2002 ISDA and Schedule 2 adopted by energyhedge are being used is it will allow the market to understand if that contract is becoming widely accepted or not as the foundation for financial derivatives.
Q10	Do you believe that there is benefit in basic graphing functionality as displayed in Figure 4?	Most purchasers above the minimum contract level of 25 MW would benefit from having some basic graphing functionality. There would probably be value in having some end user input when considering how the information could be summarised or graphed for the benefit of end users.
Q11	Do you agree with the Commission's cost benefit assessment?	The proposal is likely to have a positive NPV because: • The costs are probably relatively low and certain as set out in the EC paper; whereas • The benefits of improved risk management practices and hence better use of resources by suppliers and consumers are likely to be significantly higher. MEUG agree estimating benefits is difficult however the EC analysis is a reasonable approach.