

## **Hedge Market**

**- Disclosure of risk management contract  
information proposal**

## **Industry Briefing**

**11 September 2007**

# Purpose of presentation

- Provide an overview of the consultation paper
- Outline some of the key design issues covered within the consultation paper
- Summarise the benefits described within the consultation paper
- For you to discuss issues with the Commission
- For the Commission to get initial feedback in advance of receiving formal submissions

# Suggested process

- Commission to give presentation
- Commission will follow up on any questions that it cannot answer today
- Commission will take a note of any concerns raised today, and requests that these be repeated in written submissions, to ensure correct interpretation

# Key Terminology

<b>Term</b>	<b>Definition</b>
<b>CfD</b>	Contracts for differences
<b>Forward price</b>	A forward price is the price today at which two parties are willing to settle a transaction at some time in the future.
<b>Forward price curve</b>	The forward price curve is the price today at which parties are willing to settle a transaction at a series of dates in the future.
<b>FPVV</b>	Fixed-price variable-volume (a type of physical electricity contract)
<b>Historic Contract Curves</b>	Historic contract curves are the prices at which parties have settled transactions at a series of dates in the past.

## Physical Market

The purchase and sale of physical electricity

### Spot price contracts

Prices established via the spot market for electricity, also referred to as spot price or floating price

#### Spot market

Clearing Manager (CM) purchases from generators and sells to retailers and large consumers

#### Spot agents

Purchases (by consumers) from another party (ie retailers)

### Fixed price variable volume contracts (FPVVs)

Typically purchased by small to medium sized electricity purchasers

#### Simple Tariff

Anytime (the same tariff across all time zones)

Managed Hot Water

Day/Night

Etc

#### Time of Use (TOU) rate

Prices are fixed within each TOU period but vary between TOU periods

Variable volumes, based on actual consumption within each TOU zone

### Power purchase agreements (PPAs)

Specialised physical contracts

Typically at fixed prices and linked to the physical characteristics of plant (either consumption or generation)

## Derivatives Market

Does not include the purchase of physical electricity, but is a financial settlement based on the spot price

Derivatives may be traded over-the-counter (OTC) or via an exchange

### Contracts for differences (CfDs)

The difference between an agreed price (fixed price) and the spot price (floating price)

### Options

Such as caps (calls), floors (puts) and combinations of these

Risk management market

Key: Wholesale Market

Retail Market

# Objectives of the proposal

The objective of the proposal is to address two of the five key issues identified by the HMDSG.

1

The lack of robust information available to risk management market participants

Very limited information about volumes, prices, or other terms. No robust forward price curve. Weak historic price curve

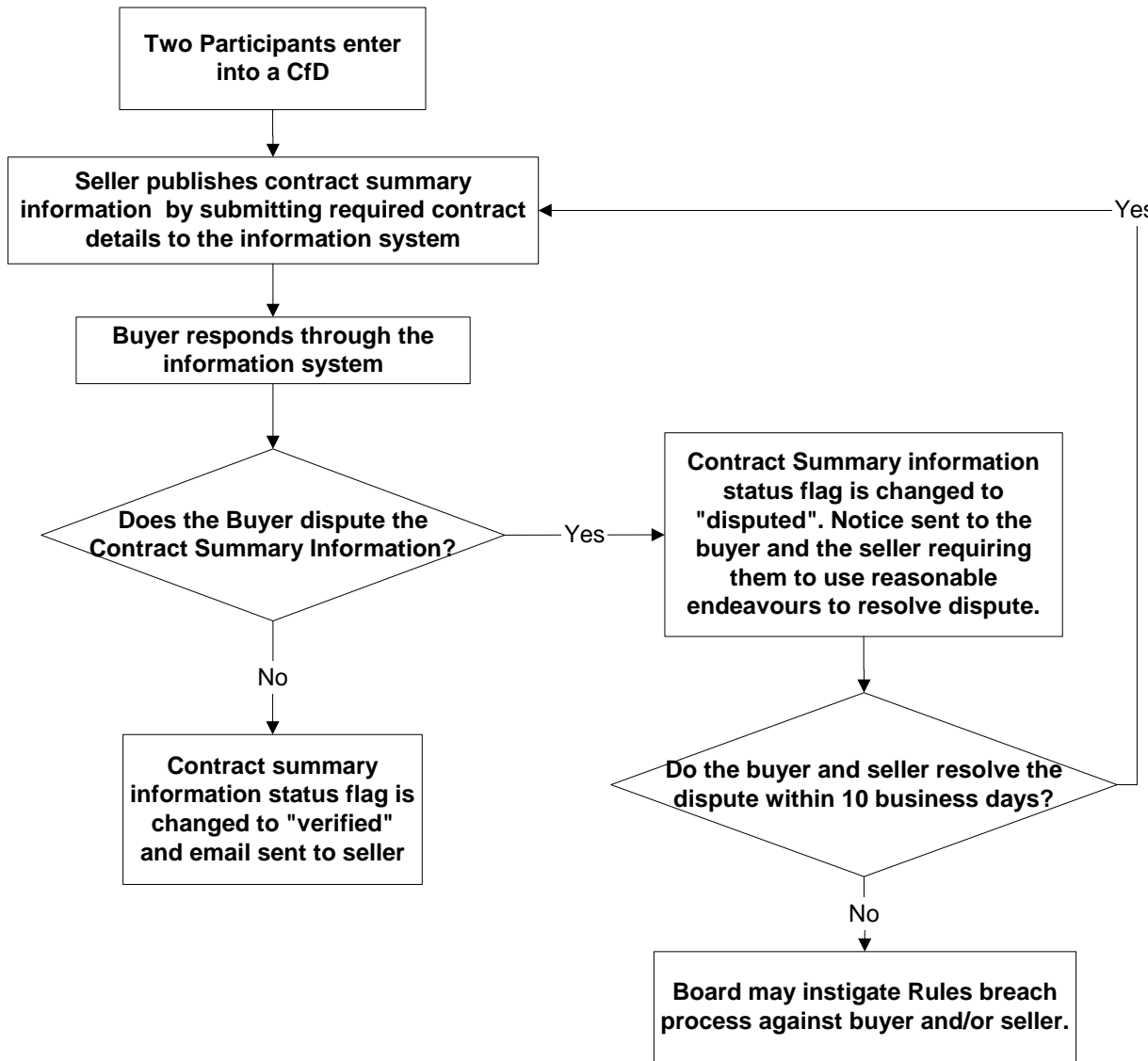
2

General lack of confidence in the competitiveness of the risk management market

Difficult to know if well founded (wider Commerce Commission investigation). Lack of transparency a key problem

Consideration has also been given to the issues raised during the original consultation process.

# What is the process for disclosing information?



Simplified example of the proposed process for the disclosure of a Contracts for Differences (CfD)

# Principles for the development of the disclosure criteria

- Maximise the level of contract information that is disclosed to the market.
- Protect all participants anonymity
- Develop a scheme that is robust as the market evolves

# How will Participants anonymity be protected?

## Criteria for disclosure of contract information for Contracts for Differences and Fixed-Price Variable-Volume Contracts

	Criteria	Term	Quantity	Price	Zone (1-14)
Term and quantity	Greater than 10 years	Full disclosure	Full disclosure	No disclosure	No disclosure
	Longer than 2 years but less than 10 years	Requirement to disclose with the option of disclosure being "longer than two years but less than 10 years"	Requirement to disclose with the option of disclosure being "greater than 30MW"	Requirement to disclose with the option of disclosure being the normalised price to Haywards	Requirement to disclose with the option of disclosure being at Haywards
Term, quantity and price information	All other contracts	Full disclosure	Full disclosure	Full disclosure	Full disclosure

Any party who believes that disclosure of a contract under the Proposal would reveal their identity would be able to apply for an exemption under the Regulations.

# How will the information be displayed?

No.	Trade Date	Quantity (MW)	Grid zone area	Grid zone description	Effective Date	Termination Date	Term	Price (\$/MWh)	Contract Type	Profile	Provision S1-5	Status
1	25/03/2007	5MW	1	Northland	1-Jun-07	1-Jun-09	2 years	\$74.50	CfD	Flat	No	Verified
2	25/03/2007	1MW	1	Northland	1-Jul-07	1-Oct-08	1 years, 3 months	\$73.00	CfD	Variable	No	Verified
3	25/03/2007	0.5MW	5	Hawkes Bay	1-Oct-07	1-Jul-08	9 months	\$72.50	CfD	Flat	Yes	Verified
4	25/03/2007	10MW	6	Taranaki	1-Nov-07	1-Dec-07	1 months	\$75.00	CfD	Variable	No	Verified
5	25/03/2007	1MW	2	Auckland	1-Jul-07	1-Jul-09	Longer than 2 years but less than 10 years	\$79.25	FPVV	-	Yes	Disputed
6	26/03/2007	1MW	2	Auckland	1-Jul-07	1-Oct-08	1 years, 3 months	\$71.75	CfD	Flat	Yes	Verified
7	26/03/2007	0.3MW	2	Auckland	1-Jul-07	1-Apr-09	1 years, 9 months	\$78.00	FPVV	-	Yes	Verified
8	26/03/2007	Greater than 30MW	8	Wellington	1-Jul-07	1-Jul-09	Longer than 2 years but less than 10 years	\$68.50	CfD	Flat	No	Verified
9	26/03/2007	10MW	6	Taranaki	1-Oct-07	1-Oct-08	1 years	\$75.00	CfD	Flat	No	Non-verified
10	26/03/2007	5MW	12	West Coast	1-Jul-07	1-Jul-09	2 years	\$73.45	CfD	Flat	No	Verified
11	26/03/2007	200MW	8	Wellington	27-Mar-07	30-Mar-07	3 days	\$64.25	CfD	Flat	No	Verified
12	26/03/2007	-	3	Hamilton	1-Jan-08	1-Jul-09	1 years, 6 months	\$72.50	FPVV	-	No	Unverified
13	27/03/2007	2MW	9	Nelson	1-Oct-07	1-Oct-08	1 years	-	Option	-	-	Verified

Standardised Contract  
 Schedule 1: Adjustment  
 Schedule 2: Force Majeure  
 Schedule 3: Suspension  
 Schedule 4: Special Credit Clause  
 Schedule 5: Levies / Tax Pass Through

Note – This is a simplified example of the likely operational system

## Application of the Rules and compliance

- Risk management contracts involve Participants (as defined in the Rules) and non-participants, such as purchasers of FPVV contracts, banks and electricity speculators
- No way, under the current Regulations, to enforce the disclosure requirements against a non-Participant
- If one of the counterparties is a Participant they must disclose the relevant contract details
- If neither of the counterparties is a Participant, then no contract disclosure would be required. These situations should, however, be rare, so that the number of contracts that are undisclosed is small.

# How will this benefit the market?

Four key benefits:

1. More accurate and timely assessment of market offers
2. Better informed policy-making

Objective

1

3. Increased confidence in the risk management market
4. More efficient use of standardised CfDs

Objective

2

# Timeline

<b>Key Milestones</b>	<b>Target Dates</b>
Paper published for consultation	10 Aug 2007
Submissions close	21 Sept 2007
Submissions reviewed	Nov 2007
Board approval of rule changes	Dec 2007
Rework proposal (if required)	Feb 2008
Contract disclosure rule changes to the Minister	Mar 2008
Rules gazetted	Mar 2008
Effective date for disclosure of contract information rules	April 2008

# Next Steps

- Make submissions
  - Consultation documents are available on the Commission's website
  - Refer to the questions in the consultation papers
  - Don't forget to note things you agree with



# Alternative option

Under this option the number of Zones will be reduced from 14 to 4. These revised zones will be Upper North Island, Lower North Island, Upper South Island and Lower South Island.

	Criteria	Term	Quantity	Price	Zone UN/UL/US/LS
Term and quantity	Greater than 10 years	Full disclosure	Full disclosure	No disclosure	No disclosure
Term, quantity and price information	Less than 10 years	Full disclosure	Full disclosure	Requirement to disclose with prices normalised to a node within the zone	Full disclosure