

Financial Markets Conduct Bill Exposure Draft Consultation

Submission to the
Ministry of Economic Development



This submission by Contact Energy Limited (“Contact”) responds to the Ministry of Economic Development’s release of an exposure draft of the Financial Markets Conduct Bill.

We confirm that we have no objection to the Ministry publishing this submission on the Ministry's website.

For any questions relating to our submission, please contact:

Simon Hope | Regulatory Affairs Manager

Contact Energy | DDI: 04 496 1521| Mobile: 021 228 3876

Introduction

As both an energy retailer and a listed company, Contact has a keen interest in the Financial Markets Conduct Bill (the "Bill") and welcomes the opportunity to present its views to the Ministry. We will submit more fully on the Bill during the select committee process but want to take this early opportunity to highlight one issue for your consideration.

Should the Bill apply to physically settled spot market transactions?

The recent undesirable trading situation and subsequent investigations by the Electricity Authority have highlighted a number of possible issues in the way electricity customers purchase their energy on the electricity spot market. In particular, that some electricity customers are buying on the spot market without fully appreciating the risks of doing so. Contact submits that these issues should be considered in the drafting of the Bill, because similar risks exist for customers dealing in the electricity spot market as exist for customers purchasing in other investment markets, particularly where customers are entering into futures contracts in addition to facing spot market exposure.

Take, for example, the following products:

- (a) Spot electricity supply – the customer pays the spot market price for electricity;
- (b) "Capped" spot electricity supply – the customer pays the spot market price for electricity, up to a maximum cap; and
- (c) "Financial caps" – the customer pays the spot market price for electricity, but has an accompanying "cap" (usually from a different company) that reimburses the customer if the spot price exceeds the cap.

The arrangements described at paragraphs (b) and (c) above have approximately the same economic effect. However, under the current Securities Markets Act regime, capped supplies (paragraph (b)) are usually not futures contracts (as they are "deliverable"), whereas financial caps (paragraph (c)) are futures contract and subject to regulation. This seems anomalous to us, and is further compounded by the fact that arguably the riskiest arrangement is uncapped spot electricity supply (paragraph (a)), which is clearly not a futures contract.

On our reading of the Bill, arrangements (b) and (c) would be treated consistently if physically settled electricity transactions were considered derivatives under the new regime. This would both resolve the regulatory arbitrage between deliverable and non-deliverable transactions, and may well result in more informed decision making by electricity customers. Accordingly we believe it is appropriate that physically settled spot market transactions be treated as derivatives.

Please note we would be happy to discuss any matters raised by our submission or the impact of the Bill on electricity transactions.