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Carl Hansen
Electricity Authority
2 Hunter Street
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By email: submissions@ea.govt.nz

Dear Carl

Support expansion of the FTR market

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Electricity Authority on the consultation paper "Within-island basis risk: proposed approach".

Genesis Energy agrees with the definition of within-island basis risk ("WIBR") in the paper. WIBR is a material risk for market participants and as such, it can be a limit on retail competition in a particular region. Having effective market tools to manage this risk should, in our view, enable more aggressive retail competition across New Zealand.

We also consider that the Authority's narrowing of possible solutions to expansion of the current FTR market is sensible. This evolutionary option is likely to be the most cost-effective method of providing tools for managing WIBR risk.

However, we have two concerns with the proposed approach:

- **Any expansion of the current FTR market will need more capacity.** In our view, the current approach to available capacity is too conservative for even the current inter-island FTR market – let alone an expanded intra-island FTR market. Failing to address this capacity problem will, at best, limit the effectiveness of an expanded FTR market. At worse it will enable any *status quo* regional price risk to be entrenched.

- **Objective criteria needed for establishing new FTRs.** This criteria needs to be established before any new nodes are selected for an expanded FTR market. We suggest that any new FTR node should be designed to benefit retail competition in a given area or region. Furthermore, it should ensure that sufficient capacity is available for it to be an effective WIBR management tool.

We discuss these issues in more detail below. Our answers to the specific questions in the paper are set out in the Appendix to this letter.

Any expansion of the current FTR market will need more capacity

The New Zealand transmission grid is “long and stringy”. As such, transmission constraints or outages on key parts of the network can have a significant impact on capacity. The effect of outages on the inter-island FTR market is an example of the potential impact. The market set-up had not anticipated the impact that planned HVDC outages would have on FTRs. Without a change to the current plan, the outages would reduce the available capacity to zero for the entire month of an outage. Whilst some participants (notably those who receive LCE payments) would have still received a benefit from this – most would be faced with having a zero value FTR during these periods. This effectively removes any ability for the FTR to hedge locational price risk during an outage period.

The solution adopted by the FTR manager is to take a conservative estimate of the available capacity during an outage. We do not consider that this approach provides the optimum level of capacity for an effective inter-island FTR market¹. However, for an expanded FTR market, we consider the implications are likely to be more drastic. This is because such outages are (a) likely to occur more frequently due to the increased number of dependent assets; and (b) likely to require increased capacity on the HVDC link (as most FTRs are likely to be from South Island load/generation to North Island load/generation).

Other lessons from the inter-island FTR market.

There are also a number of issues that any development of an expanded node-to-node FTR market will need to address:

- In our view, there has been significant analysis on the importance of the HVDC on the intra-island FTR market. However, the same level of analysis has not been completed on the importance, or significance of transmission outages between the proposed new intra-island FTR nodes.

¹ Genesis Energy letter to the FTR manager “Changes to address HVDC outage issues” 21 June 2013

- Secondary trading will be more important in an expanded FTR market. The current inter-island FTR market has yet to properly establish a transparent secondary trading market. There are a number of, in our view, relatively minor changes that could be made to the current FTR allocation plan to better enable a secondary trading market.² These include requiring price disclosure and establishing the ‘bulletin board’ as suggested.

Objective criteria for new FTR nodes

Criteria must be established *before* expanding the FTR market

Genesis Energy supports the Authority’s suggestion that objective criteria be developed for adding new FTR nodes and removing existing FTR nodes.³ However, the paper suggests a number of new nodes in the absence of such an objective criteria. We consider this identification of possible nodes is a useful example of potential new nodes. In particular we consider that a number of the suggested nodes will assist grow retail competition in the market – such as the Islington for Christchurch/Upper South Island. But, nonetheless, we have strong concerns with creating any new FTR nodes, without first establishing objective criteria for selection.

It is important that any expansion of the FTR market is undertaken in a transparent manner. This provides certainty to current and future market participants as to how and when the market could be expanded. This certainty in approach should, in our view, be established at the start. To do so retrospectively risks including nodes that may not provide the necessary market improvements.

New criteria

The paper suggests two potential criteria for establishing new nodes. We agree with these criteria. But we suggest that two further criteria are needed:

- **There is sufficient capacity in the FTR market for new FTRs.** Reflecting the concerns raised above.
- **The level of retail competition at the node or region.** Ultimately, better WIBR management should be a driver for better retail competition across

² Genesis Energy letter to FTR manager “Support timely implementation of FTR market” 14 May 2012

³ Paragraph 6.2.6 of the paper

New Zealand. We suggest that the provision of a new FTR node should be linked to the level of retail competition in a given region.

The approach to non-Code amendment processes

The Authority has suggested that an expanded FTR market can be achieved without any code amendment process. We do not consider that the lack of a statutory requirement to consult should lead the Authority take a less considered approach, or that the sector should not be properly consulted on these changes. The Authority's instruction to the FTR manager will set the tone for establishing new FTR nodes. Even non-binding (?) recommendations from the Authority on new FTR products are likely to be persuasive to the FTR manager.⁴ Therefore, care must be taken to ensure that the recommendations have been properly thought through and considered. We are concerned that making any such recommendations, without first considering and discussing the objective criteria with the sector, will lead to inconsistent approach to establishing new FTRs.

If you would like to discuss any of these matters further, please contact me on 04 495 3340.

Yours sincerely



Jeremy Stevenson-Wright

Regulatory Affairs Manager

⁴ Ibid Paragraph 5.1.2

Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
Q1: Do you agree that the Authority has characterised the problem of WIBR correctly? If not, how could the problem be better described?	Yes. However, the characterisation emphasises the lower North Island risk. We suggest that it is also important to recognise the intra-island risk present in the upper and lower South Island.
Q2: Do you agree that these four options are an appropriate shortlist? If not, are there other options that should be considered?	At this point in time we consider the options are appropriate. However, we agree with the Authority that it is important that any preferred option not forestall future market development changes.
Q3: Do you agree that the four options in Table 2 need not be considered at this stage? If not, which of them should be considered and why and what other options should be considered and why?	Yes.
Q4: Do you agree that the two-node hybrid option has been characterised correctly? If not, how could it be better described?	Yes.
Q5: Do you agree that the three-node FTR option has been characterised correctly? If not, how could it be better described?	Yes.
Q6: Do you agree that the three-node hybrid option has been characterised correctly? If not, how could it be better described?	Yes.
Q7: Do you agree that the multi-node FTR option has been characterised correctly? If not, how could it be better described?	Yes.

QUESTION	COMMENT
Q8: Do you agree that all four high-level options are feasible? If not, why not?	See our response to Question 2 above.
Q9: Do you agree that all four options would avoid distortion to price signals? If not, why not?	Yes.
Q10: Do you agree that the criteria in Table 7 are reasonable and roughly equal in priority? If not, why not? Should other criteria relating to competition, reliability or efficiency be considered?	<p>We generally agree with the criteria in Table 7. However, we suggest the following changes:</p> <ul style="list-style-type: none"> • Criteria 1 and 6 are essentially the same. We suggest that these criteria be combined under a new Criteria 1. This would provide due recognition of the importance of active competition (particularly the threat of new entrants) in the electricity market. • Criteria 2 and 3 both refer to specific types of WIBR that should be managed by any preferred approach. We agree with this assessment. However, we consider that both of these types of WIBR are actually part of removing WIBR as a potential barrier to competition. The focus on the Lower North Island is understandable, but our own view, the Upper/Lower South Island also have WIBR issues. • Criteria 5 refers to the need for a flexible approach to managing WIBR. We agree with the sentiment that the preferred approach should be adaptable to take account of changes in the market over time. However, participants also need to have certainty (to the extent that this is possible) as to how these changes will occur.

QUESTION	COMMENT
<p>Q11: Do you agree that the multi-point FTR would promote the Authority’s statutory objective most effectively? If not, why not, and which option do you think would most support the statutory objective?</p>	<p>The purpose of this paper is to “establish options”. Therefore we consider that, as outlined in the paper, further work is needed to properly establish whether the “multi-point FTR” will meet the Authority’s statutory objective.</p>
<p>Q12: Do you agree that the multi-point FTR would produce a greater net benefit than any of the other options? If not, why not, and which option do you consider would produce the greatest net benefit?</p>	<p>We agree that the multi-point tariff is likely to produce greater net than the other three options. However, as noted above, further work is needed to properly articulate and quantify the potential costs and benefits of this option (we would suggest this should be in comparison with the second-best choice).</p> <p>In particular, we are concerned that not enough consideration has been given to the inter-relationship between the current inter-island FTR capacity and expansion of the market. We are already concerned that the FTR manager is too conservative in establishing the available inter-island capacity⁵. We anticipate that this capacity problem will be a significant limitation on expansion to more nodes.</p>
<p>Q13: If the decision is to proceed with the multi-point FTR, which FTR points do you consider should be added at this point, and why?</p>	<p>As per our cover letter, we consider that the Authority needs to establish criteria for selecting new FTR nodes. This criteria needs to be established before any expansion of the current FTR market.</p> <p>In particular, we suggest that the new nodes at STK, HWB, and GIS should be evaluated against this objective criteria.</p>
<p>Q14: Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTR points should generally be nodes rather than hubs? If not, why not?</p>	<p>Yes. On the balance of the information provided, we consider that a nodal approach is preferable. This is because a enables better alignment with specific retail positions.</p>

⁵ See Genesis Energy comments to the FTR manager on the proposal to xxx

QUESTION	COMMENT
<p>Q15: Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTRs should be point-to-point rather than radial? If not, why not?</p>	<p>Genesis Energy prefers a point-to-point FTR approach for the following reasons:</p> <ul style="list-style-type: none"> • Due to its simplicity (e.g. one purchase), a point-to-point FTR model is likely to be easier for new entrants to understand and interact with. A point-to-point approach is simpler because it allows smaller competitors to hedge directly between their desired price points. Under the radial system, users would need to purchase / build all legs of a hedge to get the same level of cover. • We believe this option also gives the most flexibility for traders of FTR. <p>However, as noted in our cover letter, we consider that any expansion of the current FTR market will need to address the significant capacity issue present in the current FTR inter-island market.</p>
<p>Q16: Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTR products should include a full selection of options and obligations? If not, why not?</p>	<p>Yes. We consider that any expanded FTR market should have a full complement of option and obligation FTR products available.</p>

QUESTION	COMMENT
<p>Q17: Do you agree that, if the decision is to proceed with the multi-point FTR, the Authority should proceed according to the roadmap set out in Figure 7? If not, how should the Authority proceed?</p>	<p>We suggest that consultation will be required on a detailed multi-nodal proposal. It is unclear whether the roadmap anticipates any further interaction with the current FTR-user group, or with the wider market stakeholders.</p> <p>As per our cover letter, we consider that the Authority needs to first establish the objective criteria for adding new FTR nodes. The Authority should also undertake a detailed net benefit assessment of any final proposal.</p>
<p>Q18: Do you agree that, if the decision is to proceed with the multi-point FTR, the Authority should develop objective criteria for adding and removing FTR nodes in future years? What should be taken into account in developing these criteria?</p>	<p>We strongly support the Authority developing an objective criteria for identify new FTR nodes (and for decommissioning existing if needed).</p> <p>However, as noted in our cover letter, we consider that this criteria needs to be established via consultation with the sector, and as part of any expansion of the current FTR market.</p> <p>We presume that any removal will be transitioned over time to avoid any unreasonable costs on participants.</p>