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Submissions
Electricity Authority
PO Box 10041
Wellington 6143

Via email: submissions@ea.govt.nz

Mighty River Power Limited
Level 14, 23-29 Albert Street
Auckland 1010
PO Box 90399
Auckland Mail Centre
Auckland 1142

Phone: +64 9 308 8200
Fax: +64 9 308 8209
www.mightyriverpower.co.nz

DDI: +64 9 308 8200
Direct Fax: +64 9 308 8209

Within-island basis risk: proposed approach – consultation paper

The Electricity Authority is seeking views on its preferred approach to introduce a multi-point Financial Transmission Rights (FTR) regime to address within-island basis risk.

Mighty River Power supports in-principle the suggested move toward a point-to-point, multiple node FTR market. However, before the Authority considers implementing its preferred design option, two issues require resolution:

1. Ensuring existing FTR products are fit for purpose and consistent with the high level policy objective of facilitating increased retail competition.
2. Providing further clarity around the technical details of a multi-point FTR market.

FTRs and retail competition

The primary policy objective of the FTR market is enable greater retail competition by providing an effective hedge against basis risk where there are material capacity constraints. Liquidity and firmness are essential features of an effective hedge product.

The current policy settings of the FTR market reduce the effectiveness of FTRs as a hedge against which a significant retail position could be taken either from existing or new entrants.

While it is beyond the scope of the current consultation process, the lack of liquidity and firmness of existing FTR products should be addressed prior to any subsequent expansion of the market. The exponential increase in complexity associated with the Authority's proposed approach will also potentially impact particularly on new retail entry, which suggests the merits of a staged approach should also be considered.

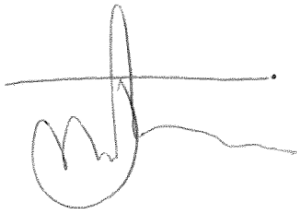
Implementation Details

Mighty River Power supports a workshop or further consultation to discuss in more detail the technical aspects of how the point-to-point, multi-node FTR proposal would operate in practice. The consultation document currently does not provide sufficient detail to enable Mighty River Power to take an informed view on the Authority's preferred design option and we would value the opportunity to discuss the proposed detail directly.

Further comments are provided to the consultation questions as an attachment to this letter.

Please direct any queries on this submission to myself on nick.wilson@mightyriver.co.nz or 09 580 3623.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Nick Wilson', written over a horizontal line.

Nick Wilson

Senior Market Regulatory Advisor

ATTACHMENT: RESPONSES TO CONSULTATION QUESTIONS

Q1 Do you agree that the Authority has characterised the problem of WIBR correctly? If not, how could the problem be better described?

Yes.

Q2 Do you agree that these four options are an appropriate shortlist? If not, are there other options that should be considered?

While the four options are appropriate, we consider the first priority for the development of the FTR market should be to address the liquidity and firmness of existing FTR products to improve their value as a hedging product prior to taking a decision on expanding to a more complex multi-node market.

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. We reiterate our position outlined in Q2 regarding other priorities for the development of the FTR market.

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

Q8 Do you agree that all four high-level options are feasible? If not, why not?

While all options are potentially feasible we consider implementing a hybrid regime of FTRs and Loss Rental Allocations would not be desirable. We support retaining a pure FTR approach.

Q9 Do you agree that all four options would avoid distortion to price signals? If not, why not?

Yes. We support the Authority continuing to monitor the market to provide confidence that positions held in the FTR market are not resulting in undesirable incentives within the spot market. FTR positions should remain in the public domain, which allows all participants to form a view of the risk that held FTR positions may have on influencing spot market behaviour.

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?

In terms of importance, Mighty River Power ranks criterion 1 – 5 as of relatively equal importance. However, the distinction between managing lower North Island risk against managing risk in any other part of the grid is more likely subject to each individual retailers load in the lower North Island versus load elsewhere. Therefore we suggest that criterion 2 and 3 are effectively one in the same.

The consultation document notes that the reason for introducing any of these options is to ultimately enhance competition. Therefore, the options that would enhance retail competition would appear to be more attractive, and should be ranked higher. We consider this lends further support to FTRs as they are tradable, forward looking and more valuable for new entrants.

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?

We believe multi-node FTRs best promote the Authority's objective, however, we consider there could be potentially smaller long term benefits for consumers if the implementation of multi-point FTR market is rushed.

Mighty River Power is concerned that the significant reduction of FTR capacity resulting from planned transmission outages leads to much uncertainty in the ability to procure a sufficient volume of FTRs to cover risk exposures. In the near term we consider the focus should be on enhancing revenue adequacy and improving the methodology for assessing FTR capacity during relevant transmission outages, such that FTR capacity is maximised.

Unless FTR products offer an effective hedge to all forms of basis risk they are unlikely to be an attractive option for existing and new entrant retailers and therefore lead to

appreciably more competitive outcomes in the market.

In addition, the competition objective reinforces the notion that FTR nodes should be located near larger load or generation hubs where there is sufficient grid capacity such that FTR capacity is not restricted by transmission outages.

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?

Based on the Authority's analysis, the multi-point FTR appears to provide the most net benefit.

However, the point-to-point FTR trading system will have significant cost implications (in terms of employee commitment) that increase substantially as nodes are added. This is due to the time and effort required to manage the number of FTR products being offered and a requirement for more thorough technical analysis to understand the increasing complexity involved in solving the FTR auction.

The Authority should satisfy itself that this increased complexity would not impact on the net benefit of its preferred proposal or on the ability for new entrants to reasonably participate in the market.

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?

Mighty River Power considers the following criteria to be important in deciding where to add new FTR points.

1. Competition. To enhance competition, the FTR points should be located close to major load and/or major generation hubs.
2. FTR capacity. FTR points should not be located at nodes that will have large FTR capacity restrictions as a result of transmission/transformer outages. For this reason we suggest locating FTR nodes on 220kV buses, or as close to a 220kV bus as possible.
3. Tradability. The ability to buy or sell a particular path in a secondary market is an important aspect of the FTR market design and will allow participants to build or reduce positions outside of auctions.

For reasons above, we suggest the Redclyffe (110kV) is more appropriate than Gisborne as an FTR point as it is located close to Napier, would be less affected by transmission outages. It is also behind a common Hawkes Bay import constraint on the Redclyffe transformers which would also affect the Gisborne region.

We also suggest either TRK0111 or TGA0331 for the Hawkes Bay.

Under the proposed point-to-point system, complexity increases dramatically as additional nodes are added. Before deciding on the number and location of the new FTR nodes, we strongly support the Authority fully outlining how the point-to-point system would work via a workshop or further consultation. The current consultation document is lacking in important detail around the actual workings of the point-to-point FTR model to enable Mighty River Power to offer anything other than in-principle support at this stage. In summary, we advocate for the following locations:

Otahuhu	OTA2201
Wairakei	WRK2201
Hawkes Bay 110 kV	TRK0111/TGA0331
Redclyffe	RDF0331
Stratford	SFD2201
Haywards	HAY2201
Benmore	BEN2201
Islington	ISL2201
Invercargill	INV2201

Other possible locations:

Bunnythorpe	BPE2201
Stoke	STK2201
West Coast	GYM0661

However, as outlined above the additional complexity from adding more nodes needs to be clearly understood before considering any additions.

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?

Yes.

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?

In principle we support point-to-point as it likely offers the best solution for hedging from one grid point to another. However, the downside of this flexibility is an increase in complexity and potentially a weak secondary market for some FTR products.

As outlined in question 13, the consultation document does not sufficiently cover the workings of the point-to-point FTR model, and the additional complexity from being able to trade any pair of FTR point's needs to be fully understood via a workshop or further consultation before a final decision be taken.

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?

Yes, options and obligations would be highly desirable.

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?

Yes, the roadmap appears to be logical though we would support an interim step that focuses on addressing the current liquidity and firmness of existing products to improve their value as a hedging product prior to taking a decision on expanding to a more complex multi-node market. We also support the continuation of FTRs as the preferred mechanism for addressing locational price risk.

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?

The criteria outlined in the consultation document are valid.

In terms of removing a FTR node, we suggest that the level of trading be weighted more in favour of primary, variation and reconfiguration auctions over the levels of secondary trading.