



06 August 2013

Submissions
Electricity Authority
PO Box 10041
Wellington 6143

Dear Sir/Madam

Consultation Paper - Within Island Basis Risk: Proposed Approach

NZX Limited welcomes the opportunity to provide feedback on the aforementioned consultation paper. As part of our role as Clearing Manager for the wholesale electricity market, we see firsthand a need to reduce within island basis risk as part of the overall development of the industry, and see this as a sensible next step in reducing price risk for those within the industry.

Please find attached to this letter responses to the questions asked as part of the consultation document. There are certain questions and issues within the document where NZX wish to provide further commentary, as below:

1. We wish to reiterate our support for the Electricity Authorities proposed solution being the multi-point FTR option. We believe that this option provides the best opportunity of leveraging off existing system infrastructure and product understanding to provide a mechanism for participants to insulate themselves of basis risk. It is seemingly the natural progression for the previously introduced two-node FTR market and removes the opportunity that a different risk mechanism such as Locational Risk Allocation could counteract what is already in place.
2. For reasons of simplicity and consistency of implementation we are broadly in support of a full point-to-point configuration. Furthermore this approach provides FTR participants with additional flexibility in their risk management strategies.
3. We do however caution the industry on some of the adverse effects of a point-to-point design. On the basis that all nodes which are considered to have "considerable" or "moderate" value within the document were implemented, there would be 9 nodes and 72 different combinations. With option and obligation product types for each combination, there could potentially be 288 different products per month, all of which would require daily pricing and valuation monitoring from participants and service providers alike. Once the full 24 month product range is released, it is not unreasonable to think there could be thousands of live products at any one time. We believe that this number of products would substantially add to the complexity of monitoring for participants which in turn could reduce some participant's appetite for the tool.
4. With 3) in mind, and in order to reduce the number of products or nodal combinations to a manageable level, NZX would not be adverse to implementing either a hybrid point-to-point/radial configuration or fewer additional nodes if

other participants favoured this and there was sufficient information available to select efficient nodal combinations.

Please feel free to contact me if you wish to discuss our submission in greater detail.

Yours Sincerely

Warwick Small
Clearing Analyst
NZX Energy

Number	Question	Response
Q1	Do you agree that the Authority has characterised the problem of WIBR correctly? If not, how could the problem be better described?	Yes, We agree it has been described adequately.
Q2	Do you agree that these four options are an appropriate shortlist? If not, are there other options that should be considered?	Yes, the four options are an appropriate shortlist.
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 agree that these options need not be considered at present.
Q4	Do you agree that the two-node hybrid option has been characterised correctly? If not, how could it be better described?	We are happy with the description of the option. We would have welcomed more commentary on the interaction between FTR and LRA and greater detail as to how each product individually would be funded. As an example, what would happen to LRA in case of FTR revenue inadequacy?
Q5	Do you agree that the three-node FTR option has been characterised correctly? If not, how could it be better described?	We would have welcomed greater elaboration of benefits of point-to-point, and whether LCE funding would be split point to point or be used as a general pool.
Q6	Do you agree that the three-node hybrid option has been characterised correctly? If not, how could it be better described?	Yes, Agree that it has been described adequately. If this approach is to be taken further, we believe further consideration will need to be given to the methodology of allocating rental amounts to different geographical areas.
Q7	Do you agree that the multi-node FTR option has been characterised correctly? If not, how could it be better described?	Yes, Agree that it has been described adequately

Q8	Do you agree that all four high-level options are feasible? If not, why not	We are comfortable all options are feasible. That said, given the current uncertainty with respect to Transmission Pricing methodology and its potential impact on rental allocation, it could be argued that not all options are currently advisable.
Q9	Do you agree that all four options would avoid distortion to price signals? If not, why not?	We would be concerned that price signals may be distorted in case of LRA's. That said, these pricing signals may already exist so all four options may reduce the current level of distortion.
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>With respect to other criteria, we believe a key aspect missing is that of wider financial implications of decisions made. In particular:</p> <ol style="list-style-type: none"> 1. How does each option affect a participant's capital requirements and allocations? 2. How does each option affect the ability to manage market risk? 3. How does each option interact with and improve existing market risk mechanisms?
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?	Yes
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?	Given information at hand, this point is indeterminate at the present.
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?	In the interests of using reduced locational price risk to encourage retail competition we favour the introduction of a further seven nodes (HAY and those with considerable and moderate value in Figure 3). This is on the basis that reconfiguration auctions are available to efficiently redistribute underutilised allocations.

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?	We agree that in case of multi-point FTR's the new FTR points should be nodes. While there is demonstrated separation between node and hub, especially within the East Cape example, we question the logic in weighting prices to nodes away from the main population/usage.
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?	As per our attached cover letter, we generally support the adoption of point-to-point versus radial. We do note however that point-to-point may lead to greater participant monitoring requirements given associated exponential growth of the accompanying data. This complexity may not be helpful in encouraging participation in the market.
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, we agree that if multi-point FTR are selected it should include both options and obligations.
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?	We are broadly in favour of expansion as described in the roadmap. We do note that the introduction of Pole 3 may change the long run dynamics of locational price risk. Therefore we would consider it prudent to wait for the ongoing impact of Pole 3 to be known prior to making material expansion decisions. Furthermore, we believe it sensible to consider all available options at the time prior to the "Design and implement LRAs centred on each FTR point" step.
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?	Given the relatively low cost in introducing new nodes into the FTR Market, we are comfortable with expansion and compression based on participant demand. Once nodes have been introduced, a trial period and minimum volume criteria could be useful in keeping product numbers manageable.