

Proposed Code amendments for FTR reconfiguration auctions

Summary of submissions

4 May 2014



Executive summary

Participants in the New Zealand wholesale electricity market are exposed to the risk of unpredictable variations in the spot price of electricity between different nodes throughout the country. The introduction of financial transmission rights (FTRs) between Otahuhu (OTA) and Benmore (BEN) has been introduced to assist participants in the New Zealand wholesale electricity market to manage spot price risk between the two islands.

The Electricity Authority (Authority) is tasked by its statutory objective to promote competition, reliability and efficiency for the long-term benefit of consumers. The Authority considers that the introduction of reconfiguration auctions will improve the efficiency of the FTR market by assisting participants to manage risk, with consequential benefits to consumers once this efficiency is passed through.

The Authority has consulted on Electricity Industry Participation Code 2010 (Code) amendments to implement reconfiguration auctions and received five submissions.

The consultation paper asked whether submitters agreed that the Code amendments were necessary, viable and consistent with the Authority's statutory objective. Submitters unanimously agreed with this view.

Several submitters suggested minor modifications to the wording of the draft Code amendments.

Following consideration of submissions, the Authority has concluded that the proposed Code amendments are consistent with its statutory objective.

The Authority will proceed to finalise the draft Code (incorporating suggestions from participants) and publish a separate Gazette notice detailing the finalised Code amendment, which will come into effect from 1 November 2014.

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1 Purpose of this report

- 1.1 Participants in the New Zealand wholesale electricity market are exposed to the risk of unpredictable variations in the spot price of electricity between different nodes throughout the country. The introduction of FTRs between Otahuhu (OTA) and Benmore (BEN) has assisted participants in the New Zealand wholesale electricity market to manage spot price risk between the two islands.
- 1.2 On 10 March 2014, the Authority published a consultation paper titled “Proposed Code amendments for FTR reconfiguration auctions”¹, which proposed Code amendments to enable proper implementation of FTR reconfiguration auctions.
- 1.3 FTR reconfiguration auctions allow participants that hold FTRs to offer them for sale into an FTR Auction.
- 1.4 This means that reconfiguration auctions allow participants to adjust their positions over time, which improves the flexibility of FTRs, and therefore the efficiency of the FTR market in providing locational price risk management.
- 1.5 The key difference between reconfiguration auctions and the existing secondary trading process for FTRs is that reconfiguration auctions will allow existing FTRs to be transformed into different types of FTR based on the demand by bidders in the auction.
- 1.6 The consultation period closed at 5pm on Tuesday, 8 April 2014. This paper summarises the feedback received in submissions and outlines the Authority’s response.

¹ Available from <http://www.ea.govt.nz/development/work-programme/wholesale/ft-development/consultation/#c10944>

2 Overview of submissions

- 2.1 The Authority received five submissions, from the parties listed in Table 1.

Table 1 List of submitters

Number	Submitter
1.	Contact Energy (Contact)
2.	Meridian Energy (Meridian)
3.	Energy Market Services (EMS)
4.	Trustpower (TRUS)
5.	Mighty River Power (MRP)

Source: Electricity Authority

- 2.2 The consultation paper asked seven questions:

Q1. Do you agree with the Authority's assessment that an amendment to the Code is necessary for the proper functioning of FTR reconfiguration auctions?

Q2. Do you consider that the Authority has correctly assessed the costs and benefits of the proposed Code amendment?

Q3. Do you agree that the proposed Code amendment will have positive net benefits?

Q4. Do you consider that the Authority has considered an appropriate range of alternatives?

Q5. Do you agree with the Authority's assessment of the apparent alternatives?

Q6. Are there other alternative approaches that you consider should have been assessed in this section?

Q7. Do you agree that with the Authority's assessment that the proposed Code amendment meets the requirements of Section 32 of the Act?

- 2.3 Submitters were unanimously in support of the proposed Code amendments.
- 2.4 Of those submitters that included qualifications to this support, themes were as follows:
 - (a) Suggested changes to specific words or terms used in the draft Code, to improve clarity and consistency with the rest of the Code.
 - (b) Comments echoing the Authority's view that the quantitative cost-benefit analysis was subject to high levels of uncertainty.

3 Summary of specific questions

- 3.1 This section briefly summarises responses to each of the questions posed in the consultation paper. General comments that do not relate to a specific question are summarised in Section 4. Because the majority of the responses to consultation questions were one word answers we have chosen to present this information in a table (see Table 2, below). Specific comments are then detailed in the commentary below.

Table 2: Summary of submission responses

	Question	Contact	Meridian	EMS	Trustpower	MRP
Q1	Do you agree with the Authority's assessment that an amendment to the Code is necessary for the proper functioning of FTR reconfiguration auctions?	Yes	Yes	Yes [with comment]	Yes [with comment]	Yes
Q2	Do you consider that the Authority has correctly assessed the costs and benefits of the proposed Code amendment?	Yes	[Agree, see comment]	Yes	Yes	[Agree, see comment]
Q3	Do you agree that the proposed Code amendment will have positive net benefits?	Yes	Yes	Yes	Yes [with comment]	Yes
Q4	Do you consider that the Authority has considered an appropriate range of alternatives?	Yes	Yes	Yes	Yes	Yes
Q5	Do you agree with the Authority's assessment of the apparent alternatives?	Yes	Yes	Yes	Yes [with comment]	Yes
Q6	Are there other alternative approaches that you consider should have been assessed in this section?	No	No	No	No	No
Q7	Do you agree that with the Authority's assessment that the proposed Code amendment meets the requirements of Section 32 of the Act?	Yes	Yes [with comment]	Yes	Yes [with comment]	Yes

Question 1 - Do you agree with the Authority's assessment that an amendment to the Code is necessary for the proper functioning of FTR reconfiguration auctions?

3.2 Trustpower supported their agreement with discussion of the value of considering prudential impacts:

"Trustpower believes that there is a need to consider Prudential when a participant is selling an FTR. Since FTR's are a Locational Price Risk management tool, it is likely that selling an FTR will increase the risk on a portfolio, and therefore increase the level of Prudential that should be lodged with the Clearing Manager."

Authority's Response: Trustpower's comment is aligned with the concern that the Authority had identified and is the main reason behind the changes to the Clause 13.244. The Clearing manager has recently reviewed and separately consulted on its prudential methodology and has made some changes to incorporate reconfiguration auctions.

3.3 EMS included comments on Code drafting in their response to this question. These comments are addressed in section 4.

Question 2 - Do you consider that the Authority has correctly assessed the costs and benefits of the proposed Code amendment?

3.4 Meridian provided more detailed discussion of costs and benefits:

"Meridian considers the Authority's estimate of costs for participants may be low.

We appreciate the Authority's attempt to quantify the benefits of the proposal, although we agree with the Authority's statement that the accuracy of this assessment may be limited.

In general, however, we agree there are likely to be net benefits from the proposal."

3.5 MRP echoed the difficulty in estimating benefits of reconfiguration auctions:

"The qualitative and quantitative benefits provided by reconfiguration auctions are difficult to estimate, however, we agree that the proposal will likely have significant benefits that would far outweigh the estimated costs."

Question 3 - Do you agree that the proposed Code amendment will have positive net benefits?

3.6 Trustpower provided a comment in relation to another matter that is discussed in section 4.

Question 4 - Do you consider that the Authority has considered an appropriate range of alternatives?

3.7 No specific comments were received for this question

Question 5 - Do you agree with the Authority's assessment of the apparent alternatives?

3.8 Trustpower commented that:

"The only reasonable alternative in our opinion is to focus further on Secondary FTR trading. The amendments to the code should not prohibit this happening, and may increase liquidity in related markets as there will be greater price discovery, and an increase in the volume of FTR's offered in auctions."

Authority Response: The Authority agrees with Trustpower that reconfiguration auctions will enhance, rather than replace or prevent the existing secondary auction process.

Question 6 - Are there other alternative approaches that you consider should have been assessed in this section?

3.9 No specific comments were received for this question

Question 7 - Do you agree that with the Authority's assessment that the proposed Code amendment meets the requirements of Section 32 of the Act?

3.10 Meridian agreed subject to suggested drafting amendments.

3.11 Trustpower agreed and added:

"In particular, there should be gains to competition and efficiency in the electricity industry, and participants are able to manage their portfolio to an optimal level."

4 Other comments received in submissions

- 4.1 Meridian recommended the following changes to the draft definitions in Part 1:

FTR acquisition cost means—

- (a) the amount a **participant** must pay or be paid in respect of the acquisition of an **FTR** in an **FTR auction**; or
- (b) if an **FTR** has been assigned by the first holder of the **FTR**, the amount that becomes payable under clause 13.249(3); or
- (c) if an **FTR** has been sold in an **FTR reconfiguration auction**, the amount of the existing **FTR acquisition cost** minus the **FTR reconfiguration amount**.

FTR reconfiguration auction means an **FTR auction** that allows a holder of an **FTR** to offer all or part of the **FTR** for sale

FTR reconfiguration amount means the amount the **participant**, who ~~offered~~ sold an ~~offered~~ reconfigured **FTR** in the **FTR reconfiguration auction**—

- (a) is entitled to be paid for the **reconfigured FTR**, if the amount is positive;
- (b) is obligated to pay for disposing of the **reconfigured FTR**, if the amount is negative

Authority's response: Code drafting has been revised to take this suggestion into account.

- 4.2 MRP made the following Code drafting suggestion:

Current drafting

13.242A FTR manager to reduce the capacity of offered FTRs after reconfiguration FTR auction

The FTR manager must

- a) reduce the capacity of an offered FTR by the capacity of the reconfigured FTR that relates to the offered FTR; and
- b) adjust the FTR acquisition cost for the offered FTR by subtracting the FTR reconfiguration amount of the reconfigured FTR from the FTR acquisition cost of the offered FTR.

Proposed drafting

13.242A FTR manager to reduce the volume (MW) of FTRs following FTR reconfiguration auction

The FTR manager must

- a) reduce the volume (MW) of a FTR by the cleared volume (MW) of an offered FTR that has cleared in a FTR reconfiguration auction; and
- b) adjust the FTR acquisition cost for the reconfigured FTR by subtracting the FTR reconfiguration amount of the offered FTR that has cleared in a FTR reconfiguration auction from the FTR acquisition cost.

Rationale

- Capacity is generally understood to be a term for the amount of FTRs able to be sold in an auction (not a measure of a FTRs volume). 'Capacity' should be replaced with 'volume'

- Offered FTRs are defined in the document as FTRs offered into an auction. To become a reconfigured FTR, the offered FTR must clear in a FTR reconfiguration auction.
- In the FTR register, FTR volume is defined in MW.

Authority's response: Code drafting has been revised to take this suggestion into account

4.3 EMS made the following comments in regard to the defined term **"reconfigured FTR"**

"We believe the term "reconfigured capacity" is preferable to "reconfigured FTR" as it more accurately describes the outcome of the process."

"The reason for that is that the part of an offered FTR that is sold at auction will not necessarily transform into a single new FTR that correlates exactly to the sold part. In other words, this definition isn't describing a particular FTR but rather FTR capacity that will transform into one or more new FTRs. The term "reconfigured FTR" would be more appropriate to describe the part of the offered FTR that is left over rather than the part that is sold."

Authority's response: This was considered in the original Code drafting and the Authority is satisfied that the meaning is sufficiently clear, and that the term 'reconfigured capacity' does not provide additional clarity in the context in which it will be used by most parties.

4.4 EMS also made the following comment in respect of 13.244

"We are a little confused by the inclusion of 13.244, as proposed, which creates an obligation under the Code, however the preamble to this change (paragraph 3.1.7) clearly states that this is for a potential future requirement. Would this Code change not create an immediate obligation that must be complied with?"

Authority's response: EMS are correct that the Code change creates an immediate obligation that must be complied with. The Authority understands from discussions with EMS and the clearing manager that under the current prudential methodology, no specific or additional actions will be required by EMS in order to comply with the Code obligation. The Authority regrets any miscommunication in the consultation paper regarding this point.

4.5 Trustpower made the following comments in regard to the auction price discovery process:

"Trustpower notes the clarification that the EA is proposing to include in this submission regarding the timing of when FTRs are created. We welcome this clarification due to the confusion that it has caused. This however was not the fundamental driver for the query. Our fundamental concern, which is not directly relevant to this submission, is that the Industry was consulted and accepted the market price clearing methodology. The FTR Manager then deemed it acceptable to change this methodology and not consult on it, with the justification that there is no alternate, and that participant behaviour will not change materially. In our opinion how prices are determined in an auction is one of the corner stones to any market, and we still raise our concerns around the process undertaken."

“As mentioned above, the clarification in the Code of when FTR are created is welcome. This however was not the fundamental driver for the query. Our fundamental concern, which is not directly relevant to this submission, is that the Industry was consulted and accepted the market price clearing methodology. The FTR Manager then deemed it acceptable to change this methodology and not consult on it, with the justification that there is no alternate, and that participant behaviour will not change materially. In our opinion how prices are determined in an auction is one of the corner stones to any market, and we still raise our concerns around the process undertaken.”

Authority’s response: The market price clearing methodology is outside the scope of this consultation. Trustpower are advised to submit a Code amendment proposal if they wish to see changes made to the FTR market clearing price methodology.

4.6 Meridian made the following general comment in support of the amendments:

“We support the introduction of FTR reconfiguration auctions as a means of increasing the tradability of FTRs. We consider FTR reconfiguration auctions will improve the liquidity, operation and efficiency of the FTR market.”

4.7 Trustpower made the following general comment in support of the amendments:

“Trustpower is satisfied that the proposed amendments are beneficial to the FTR market and will increase the efficiency of the market. We support the inclusion of adding Offered FTR’s in the Prudential check. Since FTR’s are a Locational Price Risk management tool, it is conceivable that selling an FTR could increase the risk on the seller’s portfolio, and therefore increase the amount of Prudential that a participant should lodge with the Clearing Manager.”

4.8 MRP made the following general comment in support of the amendments and highlighting a need for urgency:

“Mighty River Power supports the introduction of reconfiguration auctions as part of the 2014 FTR allocation plan. While we appreciate the opportunity to provide more detailed feedback on the implementation of reconfiguration auctions, our key concern is that the allocation plan is implemented as soon as practically possible.

There are a number of other core FTR market enhancements contained in the allocation plan that will improve the value of FTRs as a hedging product to market participants and increase competitive outcomes. We are concerned the current delay to Allocation Plan until October or November could be extended further due to protracted consultation which will in turn reduce the time and resources available to take forward further market enhancements.

“We request that market participants be made aware of any potential delays or approvals to allocation plan as soon as practically possible.”

Authority’s response to 4.6, 4.7, 4.8: The Authority thanks parties for these supportive comments, notes their contents, and considers that no further response is required.

5 Outcomes and next steps

- 5.1 Following consideration of submissions, the Authority has concluded that the Code amendments should be implemented largely as proposed. Minor drafting changes have been included.
- 5.2 The Authority will therefore formally Gazette the Electricity Industry Participation (FTR Reconfiguration Auctions) Code Amendment 2014 on Thursday 15 May 2014, to come into effect on 1 November 2014.