

11 October 2016

James Flexman
Wholesale Markets Manager
Mercury NZ Ltd
Private Bag 92008
Auckland Mail Centre
Auckland 1142
James.Flexman@mercury.co.nz

By Email

Dear James

Implementation of a Central North Island Financial Transmission Right (FTR) hub

Thank you for your letter of 26 August 2016 in which you requested the implementation of a Central North Island (CNI) FTR hub. We note that your request was supported by letters from other interested parties. As foreshadowed by my email response to Nick Wilson on 26 August 2016, we have given your request careful consideration and this letter sets out our planned course of action.

UNI voltage stability issues create increased risk of price separation between UNI and CNI

We note your concerns around potential Upper North Island (UNI) voltage stability issues constraining power flow from the CNI to the UNI. We agree that these UNI voltage stability issues could lead to price separation between the CNI and the UNI at times of high demand, resulting in locational price risk between the CNI and the UNI. Our initial analysis shows your request for a CNI FTR hub has merit. A new FTR hub at Whakamaru (WKM) could substantially increase the volume of FTRs available at Otahuhu (OTA). This would provide a substantial improvement in the ability of participants to manage locational price risk in the UNI, through both improved hedge instrument availability and the provision of hedge instruments which better match locational price risks between the CNI and the UNI.

Additional FTR hubs are unlikely to be available for winter 2017

You requested that a CNI FTR hub be added in time for use in winter 2017. We have been working with the FTR manager and the clearing manager to determine what would be required to make a prompt but informed decision to add one or more new FTR hubs. This includes considering the Authority's current work programme and determining the steps required to take possible new hubs to consultation.

As a result, we have decided to instruct the FTR manager to start work immediately on the industry engagement required to consult on adding one or more FTR hubs to the FTR allocation plan. This consultation will include the option of adding a CNI FTR hub. Once consultation is complete, the FTR allocation plan (if amended following consideration of submissions) will be presented to our Board for approval.

We understand that adding an additional CNI FTR hub is a relatively straightforward process for the FTR manager. However, the implementation of additional FTR hubs involves a considerable amount of work for the clearing manager, both in terms of software development, and new analysis to determine and prepare key inputs such as initial margins and daily settlement prices.

As a result, if a decision is made to add a CNI FTR hub, it is likely to be available some time during the second half of 2017.

Alternative options exist to manage locational price risk

We realise a CNI FTR hub might be the most direct means of managing locational price risk. However, we encourage you to continue to use existing risk management products, such as HAY to OTA FTRs, and also to consider the value of trading ASX cap products that are due to become available in advance of winter 2017 to manage your locational price risk.

We will keep you updated as we work through the consultation and possible implementation processes required to add one or more new FTR nodes.

Additionally we will be making your original letter, this response, and the letters supporting your request, available on our website.

In the meantime feel free to contact us with any questions you may have on this issue.

Yours faithfully

A handwritten signature in dark ink, appearing to read 'John Rampton', written over a light blue horizontal line.

John Rampton

General Manager Market Design