

26 November 2021

s9(2)(a)

Dear s9(2)(a)

Thank you for your request, received on 11 February 2021, for the following information under the Official Information Act 1982 (the Act):

"I am requesting all correspondence and reports both internal and external relating to the Authority's decision to pause operational enhancements to the FTR market as outlined by the letter from Andy Doube on 26 January 2021.

In particular I am interested in the Authority's decision-making process and what issues from submissions it decided warranted this action. I am also interested in any correspondence with external parties that attempted to influence the Authority's decision."

On 09 March 2021, the Electricity Authority (Authority) declined your response under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Act. The Authority considered at the time that release of information in the infancy of its decision-making process would inhibit the effective conduct of public affairs through the free and frank expression of opinions.

The Authority's intention was to release the relevant material to all market participants once it had completed its scoping work and as part of the policy development review. Since that time, the Authority has faced a number of market events including the:

- security of supply challenges from winter 2021;
- wholesale market review; and
- events related to the 09 August supply interruption, including an allegation of an undesirable trading situation.

These events have had significant resourcing implications for the Authority, with resources moved away from the planned scoping and policy development work.

The Authority has made the decision that the scoping and policy development work will now be deferred until 2022. The Authority acknowledges that, in light of this deferral, it is now time to release the information you have requested.

The Authority has identified the following documents within the scope of your request.

Correspondence with Meridian Energy Limited (Meridian) (unpublished).

- Letter to Electricity Authority from Meridian, 08 October 2020
- Draft open letter from Electricity Authority, 10 November 2020
- Letter to Electricity Authority from Meridian, 09 November 2020

Correspondence with Genesis Energy Limited (Genesis) (unpublished).

- Letter to Electricity Authority from Genesis, 04 September 2020
- Draft open letter from Electricity Authority, 10 November 2020
- Letter to Electricity Authority from Genesis, 17 November 2020

Submissions to the FTR manager Hub consultation.

- Meridian Energy Limited.
- Genesis Energy Limited with redactions made by them pursuant to section 9(2)(b)(ii) and section 9(2)(a) of the Act.
- Contact Energy Limited with redactions made by them pursuant to section 9(2)(b)(ii) of the Act.
- emhTrade Limited.
- Haast Energy Trading Limited with redactions made by them pursuant to section 9(2)(b)(ii) of the Act.
- Smartwin Energy Trading Limited.

These documents are attached to this letter.

Also of relevance, are:

- a) meeting minutes and internal correspondence relating to the decision to pause work on the two consultations and operational enhancements to the FTR market. These are being located, reviewed, and collated and will be provided to you once this work is completed, which we are expecting to be no later than 24th December 2021; and
- b) submissions to the Authority's August 2020 consultation on removing Schedule 14.3. These are available on the Authority's website: [Consultations — Electricity Authority \(ea.govt.nz\)](https://www.ea.govt.nz/consultations).

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

If you wish to discuss this decision with us, please feel free to contact us by emailing OIA@ea.govt.nz.

Yours sincerely,



Andrew Doube
General Manager – Market Policy

8 October 2020

James Stevenson-Wallace
Chief Executive
Electricity Authority – Te Mana Hiko

By email: james.stevenson-wallace@ea.govt.nz
Copy to: andy.doube@ea.govt.nz; tim.street@ea.govt.nz

Dear James

Request for review of the Financial Transmission Rights (FTR) market

Introduction

1. I write to you because I do not think the FTR market is working as intended and consider there to potentially be significant costs to New Zealand consumers as a result. I ask that the Electricity Authority review the performance of the FTR market and consider any necessary improvements.

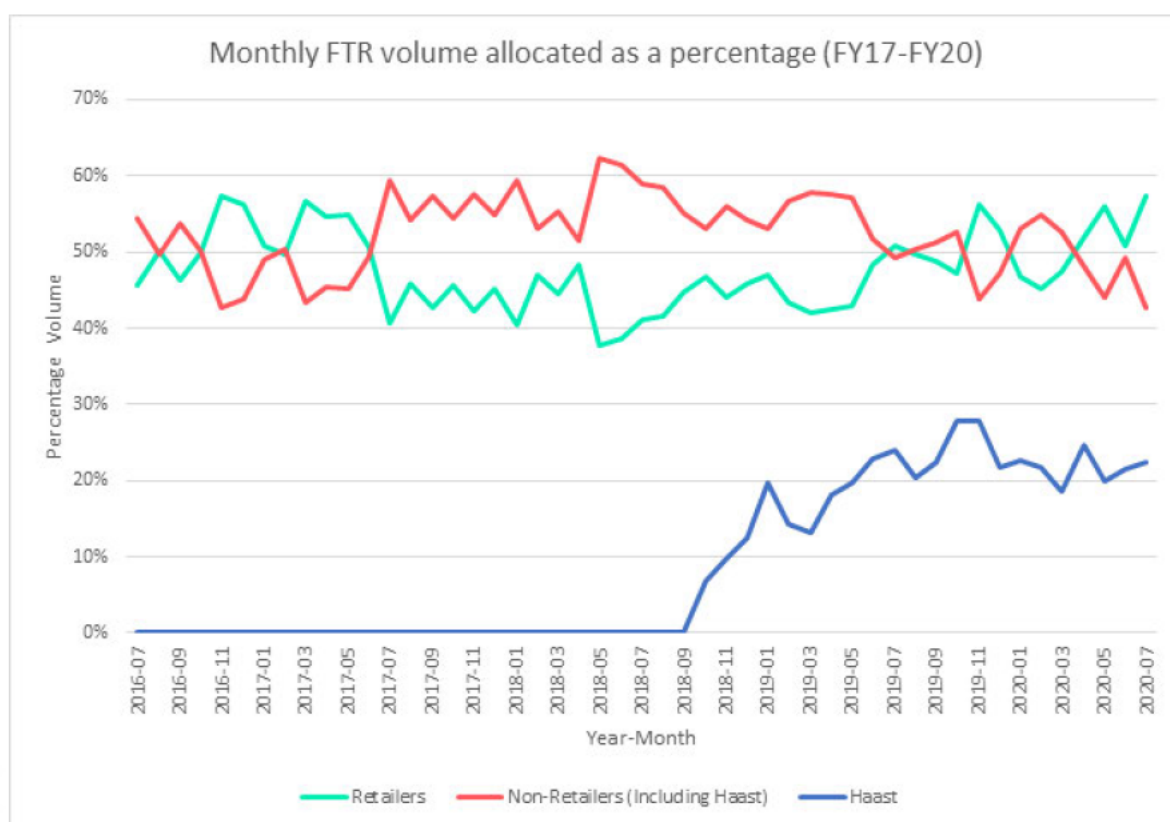
Background on the FTR market

2. The FTR market was established and designed to assist wholesale electricity market participants to manage their locational price risk. At the time the primary purpose was to enable generator retailers to manage the locational price risk associated with generating in one location and retailing in another. FTRs could also be used by other wholesale market participants, for example a non-integrated retailer could manage locational price risk between a location where they have retail customers and another location where they are hedged (generally the Benmore or Otahuhu nodes). The purpose of FTRs in either case was to efficiently reduce risk for physical participants and therefore ultimately reduce the costs of providing electricity to New Zealand consumers.
3. As you will be aware, the FTR market is not like other hedge markets where the volume of transactions is determined by the willingness of participants to buy and sell at the prices available, and where the settlement of a hedge results in the transfer of value between participants themselves. FTRs are entirely different – transactions are via an auction platform created by the Authority and a finite volume of instruments are auctioned. Those FTR instruments already have intrinsic value because of the way the market is funded, not only by buyers at auction but also by physical transmission customers and consumers. Trading of FTRs outside of auctions is insignificant in scale.
4. A significant portion of FTR settlement is funded by loss and constraint excess (LCE). LCE is the surplus created in the wholesale electricity market once purchasers have been invoiced and generators have been paid. This arises because losses and constraints mean the price paid by retailers and other purchasers at grid exit points is higher than the price paid to generators at injection points.

5. A calculation in Schedule 14.3 of the Code determines how much LCE should be diverted away from transmission customers and instead go to FTR purchasers upon settlement. As the FTR market has grown the extent of LCE used for settlement has increased. This would not be noteworthy if LCE money were retained by physical market participants hedging their locational risk thereby reducing the cost to provide electricity to New Zealand consumers. However, that is not the case.

The impact of speculation on the FTR market

6. The extent of speculation in the FTR market should be of concern to the Authority. On average, physical participants (retailers) make up 48% of the total FTR volume allocated over the past four financial years. Non-retailers (speculators) make up 52% of the Market. Haast Energy Trading alone accounts for between 20% and 30% of total FTR volumes (prior to September 2018, I understand that Haast traded via a broker).



7. It is our view that these high levels of speculation are of no benefit to the market or to consumers and in fact, these levels of speculation are arguably detrimental. Because the FTR market is auction based, speculators do not add liquidity – FTRs are a finite pool and thus unlike other products, speculators are not adding liquidity through origination of products, all speculation does is reduce the number of FTRs available for physical participants to hedge locational price risks. Speculation also directly extracts capital from the LCE pool, which is a surplus from the physical market that would otherwise be allocated within the physical market and passed on to transmission customers and end consumers. It seems that the Authority has allowed these levels of speculation to evolve and indeed enabled it in order to increase overall participation in the nascent FTR market, without considering the broader detrimental effects of speculative activity in an artificial market that is funded by transmission customers and New Zealand consumers.
8. To understand the direct cost to transmission customers and consumers one must understand who is purchasing FTRs and benefiting from the reallocation of LCE. As shown below, in the last four financial years \$165.7 million from the LCE pool was used to settle FTRs.

FTR market FY17-FY20	
FTR Auction Income	\$392,619,362.04
FTR Payments	\$558,350,739.85
LCE used to settle FTRs	-\$165,731,377.81

9. Over the last four financial years, of the total \$165.7 million of LCE used to settle FTRs, \$62.1 million (37%) was allocated to non-physical participants. The value of LCE used to settle FTRs represents the profit made by these speculators over and above FTR purchase costs. In the last four financial years Haast Energy Trading alone has made \$17 million from FTRs net of purchase costs, i.e. funded entirely by LCE that would otherwise have been paid to New Zealand transmission customers and passed on to New Zealand consumers. Below is a list of non-physical participants along with the revenue they have derived from LCE in the last four financial years.

Participant	Total Revenue from LCE (FY17-FY20)
Haast Energy Trading	\$ 17,118,156.53
Macquarie Group	\$ 1,117,006.67
MMAE	\$ 97,142.79
OMFM*	\$ 43,591,237.83
Smartwin Energy Trading	\$ 190,072.96
	\$ 62,113,616.79

* Note that OMFM may act for a mixture of physical and non-physical participants.

10. In addition to the direct costs as a result of lost LCE, speculation in the FTR market also reduces the availability of the finite number of FTR instruments and drives up the cost of FTRs therefore limiting the ability of physical participants to manage their locational risk or increases the cost of doing so. This has significant consequences for physical market participants and will cost New Zealand consumers in the long term. As the Authority has noted, effective management of locational price risk is important, because it supports:
- Wholesale and retail market competition: Parties are more likely to operate in regions that are subject to locational price risk if they can manage the associated price risk in a straight-forward manner.
 - Reliability and efficiency. Parties that have a clear view of the risks and can manage them well, can make better decisions about how to operate their assets, and where, what, and when to invest in new assets.

These issues are not unique to New Zealand

11. In other parts of the world consumers and regulators are slowly waking up to the problems posed by FTR speculation. The Consumer Advocates of the PJM States (CAPS) is a non-profit organization in the United States whose members represent over 65-million consumers in the 13 PJM States and the District of Columbia. Recent work by CAPS highlighted the problems when congestion revenues like LCE are not returned to physical participants and observed that:¹

“...under the current market design, it is primarily financial traders who end up holding the majority of FTRs. Instead of financial traders supplying a hedge to load, these traders buy the

¹ <https://www.pjm.com/-/media/committees-groups/task-forces/afmtf/2020/20200429/20200429-item-08-analysis-of-pjm-arr-ftr-market-design-and-reform-options.ashx>

hedges themselves because they are a profitable speculation. This is the exact opposite of what should prevail in a successful hedging market.”

12. The work by CAPS explores a range of policy options to address the concern including “not funding payments to FTR traders using revenues from the spot electricity market”. In New Zealand a simpler option might be to limit speculative activity that serves no consumer benefit.

Interaction with other policy proposals

13. The issues with the FTR market may soon become more pronounced because of other actions taken by the Authority
14. The Code does not currently prohibit the management of locational price risk by generators using their physical assets and generation offers. However, the Authority’s recent preliminary undesirable trading situation (UTS) decision suggests the Authority may increasingly look for a means to intervene in such situations, even in the absence of a clear prohibition. While Meridian disagrees with this approach, the point I am making here is that if the Authority were to prohibit the management of locational price risks through generation offers then it is likely that:
 - a. the frequency and severity of locational price risks would increase;
 - b. physical participants would have fewer options to manage locational price risks;
 - c. demand for FTRs would increase;
 - d. the LCE required to settle FTRs would increase; and
 - e. the reallocation of LCE from transmission customers and consumers to FTR speculators would increase.
15. Meridian questions whether this would be a good outcome for consumers and suggests that the Authority should undertake a detailed review of the FTR market prior to any attempts to implement wholesale market reform whether by formal Code change or a more ad hoc tool like a UTS decision.
16. The Authority has also recently agreed to new guidelines for the transmission pricing methodology (TPM). The guidelines require Transpower to cease using regional coincident peak demand pricing and only allow a targeted congestion charge to remain in place for a transition period. Meridian supports this change; however, I note that in the event the new TPM drives greater use of the grid during peak periods, the risk of congestion and therefore locational price risks may also increase.

Next steps

17. Given the above, I ask that the Authority prioritise a market performance review of the FTR market over the last four financial years and consider whether the FTR market and involvement of speculators in that market have delivered, and will deliver in future, outcomes that are in the long term interests of consumers.
18. I would be very happy to discuss this letter with you in person and appreciate your consideration of the issues identified. In any event, I would appreciate a response from the Authority in terms of how you intend to action my request per this letter.

Yours sincerely



Neal Barclay
Chief Executive

10 November 2020

Open letter in response to a request for a review of the market for Financial Transmission Rights (FTRs)

The Authority has recently received two letters covering the same issues with the FTR market one from Meridian Energy Limited and one from Genesis Energy Limited.

This is an open letter by way of response.

The primary concern raised in both letters is that participants that do not face locational price risk have been purchasing FTRs in significant volumes, a form of speculative trading activity. The letters argue that this limits the options available to participants to manage locational price risk, which is contrary to the Authority's statutory objective with respect to promoting competition in the electricity industry for the long-term benefit of consumers.

We note firstly that Haast—used as an example in both letters—does have locational risk to manage by way of its association with Electric Kiwi, so its use as an example is not correct. To the best of our knowledge the current makeup of FTR users is as shown in Table 1. The approximate share of LCE allocated to FTR pay-outs over the period January 2019 through September 2020 is also shown. Since we don't know OMF's client makeup, at most 25.5 per cent of this could be going to entities with no other involvement in the NZ electricity market.

While speculative activity has increased the demand for FTRs and conceivably raised the acquisition cost for FTRs, acquisition costs of FTRs are still on average less than the pay-out for FTRs—see Figure 1 below. This situation is contrary to many other risk management markets where hedge products typically trade at the expected pay-out or at a premium to that pay-out.

Examining this data more closely shows that FTR profitability has recently been trending downwards. Figure 2 shows the average monthly FTR profitability (together with the cubic regression curve) and the monthly generation weighted average price (GWAP). Over the first two to three years of the FTR market, profitability trended downwards. This may have been partly a reflection of generally lower spot prices from early 2015 to early 2017—due to the effect of losses, locational price differences are positively correlated with the underlying energy price.

Since late winter 2017, spot prices have generally been higher, leading to generally higher FTR pay-outs. Profitability initially trended upwards over 2017 and 2018. However, profitability appears to have been trending downwards over 2019 and 2020 even though spot prices have generally remained elevated. This is likely due to expectations of higher spot prices and FTR pay-outs catching up with observed prices— we would expect acquisition prices to adjust over

time to reflect changing expectations about future pay-outs. However, as FTRs can be purchased up to 24 months ahead this adjustment may take some time to work its way through to payouts.

The Authority does not believe that the evidence presented in these letters—that Haast Energy Trading has been winning a significant proportion of auctions—is reason for concern. Further, the evidence does not show Haast “cornering” the market for FTRs as stated by Meridian.

To the extent that Haast’s participation (and that of other speculators) has the effect of increasing the price of FTRs to closer to their value (and Figure 2 suggests this is happening), its actions reduce the amount of reallocated LCE. This means less capital “syphoned off” and less profit for speculators. If there were no speculation in the FTR market—or speculation was discouraged—more LCE would be “syphoned off” and the beneficiaries of this would be physical players such as Meridian and Genesis.

As with other electricity derivatives such as ASX exchange traded products, there is both the hedging value of the risk management products themselves and the value of the associated forward price curve. For FTRs, speculators can enhance the robustness of the forward price by moving the price paid for FTRs closer to value. Since most of the speculators both buy and sell FTRs, they will also help to increase liquidity.

At this time we remain of the view that the best way for physical parties to increase their share of the FTR market, so as to better manage their locational risk, is to increase participation and bid prices in FTR auctions. This will increase prices to closer to value, reduce the LCE used to settle FTRs, and reduce the returns to speculation.

For more background on the FTR market, see:

<https://www.ea.govt.nz/assets/dms-assets/22/22503Overview-of-the-FTR-market.pdf>

Yours sincerely

A handwritten signature in black ink, appearing to read 'J. Stevenson-Wallace', with a stylized flourish at the end.

James Stevenson-Wallace
Chief Executive

Table 1 FTR profits from January 2019 to September 2020

Participant Type	FTR Participant	Profit	Profit Share
Gentailer	Meridian	\$17,916,947	21.3%
	Mercury	\$14,907,579	17.7%
	Contact	\$8,224,307	9.8%
	Trustpower	\$882,136	1.0%
	Genesis (Hedging) ¹	\$259,375	0.3%
	Pioneer Energy ²	-	0.0%
	subtotal	\$42,190,344	50.2%
Broker	OM Financial ³	\$20,432,497	24.3%
Retailer/Speculator/ASX	Haast Energy Trading	\$19,170,757	22.8%
Speculator/Gentailer	Genesis (Speculating) ¹	\$1,834,354	2.2%
Solely FTR Speculator	Smartwin Energy Trading	\$908,099	1.1%
	MMA Energy	\$118,041	0.1%
	The Three Tasters ²	\$ -	0.0%
	subtotal	\$1,026,140	1.2%
Retailer	Switch Utilities	-\$207,241	-0.2%
Speculator/ASX⁴	Macquarie Equipment Finance	-\$399,594	-0.5%

¹ Genesis's FTR trading is split between hedging and speculation.

² Pioneer Energy and The Three Tasters have not been trading FTRs long enough to calculate a profit/loss.

³ Several firms trade FTRs through OM Financial(OMF) as a broker rather than directly. We understand these are a mixture of retainers and speculators, some of whom may also trade hedges on the ASX or over the counter.

⁴ ASX indicates that the entity also trades futures on the ASX.

Figure 1 FTR acquisition cost compared to payouts

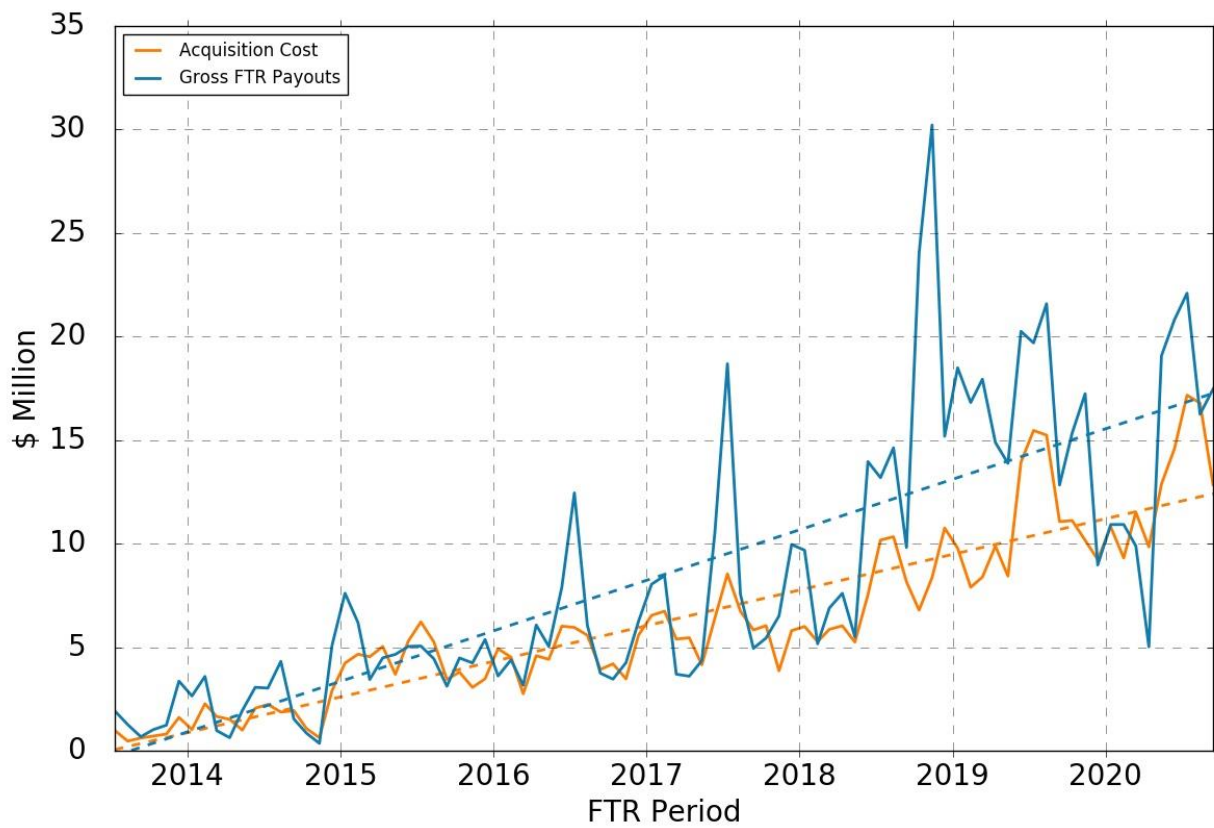
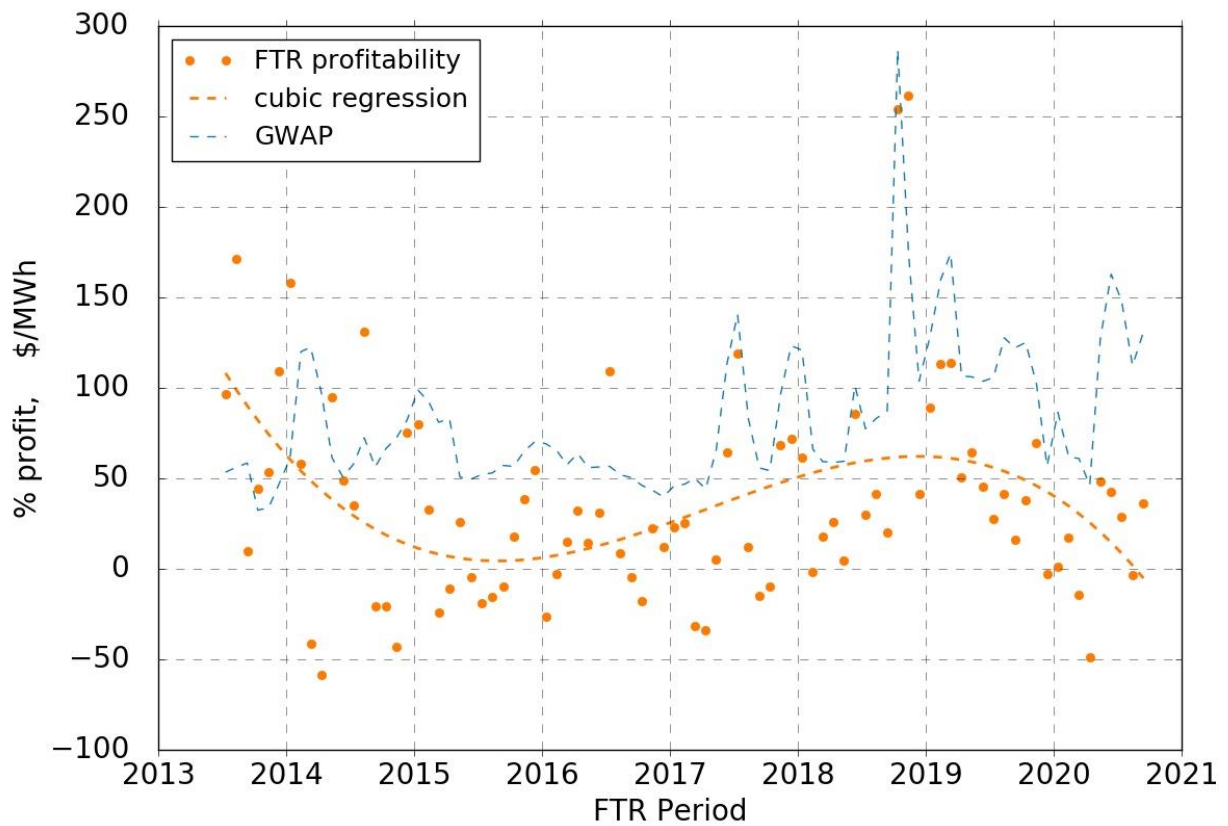


Figure 2 Aggregate FTR profitability compared to spot price



9 November 2020

James Stevenson Wallace
Chief Executive
Electricity Authority - Te Mana Hiko
Level 7, Harbour Tower, 2 Hunter Street
PO Box 10041
Wellington 6143

Dear James

Thanks for your open letter. Thanks also for your indication that you intend to publish your letter tomorrow along with the letter we sent to you. We ask that when you do publish those letters you ensure you include this one too. We'd be grateful if you could correct prior to publication, your incorrect assertion that Meridian stated Haast was cornering the FTR market. We didn't say that as a brief review of our previous letter will confirm.

Based on your letter we are not sure if The Authority has understood the true nature of our concern and our request of The Authority. As we understand it, Haast does not have locational price risk to manage in the sense of risk to which it is itself actually exposed. It may assist other parties to manage their locational price risks but that is not the same thing. According to the Authority's participant register it is neither a generator, nor a retailer nor a purchaser of electricity from the clearing manager. We are aware of its association with Electric Kiwi but our assessment is that, based on the volume of FTRs it purchases, it is most likely that only a small proportion of Haast's trading is done on behalf of Electric Kiwi. In addition, your own letter at pages 2 and 3 twice describes Haast as a 'speculator' in FTRs so it's a little hard to understand how you could reasonably dismiss Meridian's use of the same term to describe Haast as 'not correct.' We would be grateful if you could clarify what you mean.

Transmission customers that would otherwise receive LCE are paying for the FTR proceeds received by all parties, including the profits made by non-physical participants like speculators. For Meridian's part, as a significant transmission customer the proceeds we receive from FTRs are largely offset by a loss of LCE payments as a transmission customer. The same cannot be said for speculators like Haast. To the extent physical participants are hedging actual risks and defraying the cost of delivering services to customers then benefits are likely to flow through to consumers in the long term. Again, the same cannot be said for FTR purchases by non-physical participants. The profits made by speculators in the FTR market are leakage from the physical market to the detriment of consumers of at least \$20 million per annum, possibly much more.

Your letter fails to address the key point in relation to FTRs which is that there is a finite quantity of them available at each auction. This is contrary to the ASX and most other markets where there is an unlimited supply of products on offer and the only limitation is provided by the market participants' collective willingness to trade them (i.e. how much risk capital are they willing to allocate). Further the EA has suggested that physical participants should be using the limited number of these instruments more directly to hedge risk. If they are being picked up by speculators, physical participants cannot do that. Further although you list each of the participants on page 3 of your letter as making profits from the FTR market, the reality is that for physical participants, the proceeds from FTRs offset the physical exposures and costs they face in the electricity market. To repeat, only speculators in FTRs are making profits in the sense that page 3 of your letter implies.

Meridian's experience is that when we come to FTR reconfiguration auctions there is often no volume available for certain FTR branches. In that scenario it is irrelevant what the bids are – the volumes are simply unavailable. We believe the Authority should be undertaking an analysis of the volume of FTRs available and who has secured this volume (and the extent to which physical parties seeking to secure FTRs find there is no auction capacity available).

Finally, your letter does not address at all the matters we raised and evidence cited by consumer advocates in the USA that a FTR market in which financial traders end up holding a large portion of available FTRs results in the exact opposite of what should be happening in a successful hedging market. The short point is that the presence of speculators means that there is leakage from the physical market in the sense of FTR proceeds which are unavailable to be recycled back to the payers of transmission costs – predominantly consumers (via distributors or directly if grid connected) and South Island generators - in the form of LCE payments. Unlike consumers and South Island generators, speculators like Haast do not contribute to transmission costs. Given the numbers you present on page 3 of your letter we would be grateful if you could consider this.

It seems to Meridian that current FTR market speculation is unlikely to be working in the best interest of consumers and we repeat our request that the Authority prioritise a market performance review of the FTR market over the last four financial years and consider whether the FTR market and involvement of speculators in that market have delivered, and will deliver in future, outcomes that are in the long term interests of consumers.

Yours Sincerely

A handwritten signature in blue ink, appearing to read 'Neal Barclay', is positioned above the printed name and title.

Neal Barclay
Chief Executive



Genesis Energy Limited
The Genesis Energy Building
660 Great South Road
PO Box 17-188
Greenlane
Auckland 1051
New Zealand

T. 09 580 2094

4 September 2020

James Stevenson-Wallace
Chief Executive
Electricity Authority
Harbour Tower, Level 7
2 Hunter Street
WELLINGTON

By email: james.stevenson-wallace@ea.govt.nz

Copy to: tim.street@ea.govt.nz

Dear James,

Request for review of the market for Financial Transmission Rights (FTRs)

Introduction

The Electricity Authority (**Authority**) established Financial Transmissions Rights to address the objectives of section 42 of the Electricity Industry Act 2010. FTRs are intended to help electricity market participants manage the locational price risk associated with generating energy in one location and retailing energy in another location.

In its Market Performance Review of the high price event on 2 June 2016, the Authority noted the importance it placed on hedge markets, particularly the FTR market, to a well-functioning electricity market. The Authority preferred that participants used financial products like FTRs as the principal means of managing their locational risk, stating that using generation offers in the electricity spot market to reduce price differentials between nodes diminished the value of these products.

We write to you because the FTR market is not working as intended.

Against the backdrop of regulatory uncertainty concerning the use of generation offers to manage locational price risk, participants who do not face locational price risk have been acquiring FTRs in considerable volumes. This limits the risk management options available to generator-retailer participants who face this risk and is contrary to the Authority's statutory

aim to promote competition in the electricity industry for the long-term benefits of consumers.

We set out below our concerns and suggested actions that the Authority may wish to consider taking in relation to these.

Regulatory uncertainty and cornering of the FTR market

The recent Market Development Advisory Group (**MDAG**) consultation paper on changes to the High Standard of Trading Conduct (**HSOTC**) provisions in the Code states that generator-retailer participants take a portfolio approach to their assets and exposures when offering generation into the spot market. This includes bidding that considers the effects of transmission constraints.¹

The Authority's decision on the 2 June 2016 high price event and its preliminary decision on the November/December 2019 undesirable trading situation (**UTS**) claims, show that in some circumstances, the Authority does not favour participants using generation offers to cover portfolio risk. Instead, it expects participants to manage this risk using financial risk management products (such as ASX NZ electricity futures, FTRs or over-the-counter derivatives) or retain the risk and bear the cost if it crystallises.

Using financial products to manage locational risk is, however, challenging as:

- (a) There is considerable uncertainty concerning the circumstances when generator-retailers can use their generation offers to manage transmission constraints.
- (b) Although FTRs are a useful risk management tool in theory, in our experience they have been unavailable at terms that make them an effective or cost efficient option.

(a) Regulatory Uncertainty

The Authority cites Meridian's use of its generation offers to manage its locational price risk across the HVDC as a factor in determining that activity during the period 3 December to 18 December 2019 constituted a UTS².

The Authority had previously advised Meridian that it disapproved of structuring offers to manage locational price risk in relation to the 2 June 2016 high price event and associated HSOTC investigation³. In advising Meridian of the Authority's decision to discontinue its investigation, the Authority's Chair Dr Brent Layton wrote:

¹ Concept Consulting "Review of impact of trading conduct enforcement action on spot prices", August 2019 found that instances of inter-island price separation have not changed substantially since 2017.

² Preliminary UTS decision, at 2.9 (c) and throughout.

³ Electricity Authority decision on alleged 2 June 2016 breach of Code clause 13.5A(1) by Meridian Energy Limited <https://www.ea.govt.nz/dmsdocument/22114-4-may-2017-meridian-energy-limited>

...the Board warns Meridian that it does not expect a repeat of Meridian's trading conduct on 2 June 2016 in the future and Meridian's performance in that regard will be closely monitored. Any further non-compliance will almost certainly result in a higher-level intervention.⁴

While Meridian (and the market at large) may be considered to have been notified of the Authority's position on the use of offers to manage basis risk, it is better to govern participants' actions through 'black letter' regulation rather than informal instructions. Specific rules could have been introduced in the 24 months between the June 2016 incident and the December 2019 UTS events. While the HSOTC rules are under review and may be amended to address the matter, this does not assist market participants who need to manage locational risk now, and in an effective and cost-efficient way.

The Authority's view on Meridian's use of generation offers to prevent the Aviemore-Benmore ("AVI_BEN") circuits from binding after the Islington Livingston circuit was lost due to flooding shows the regulatory uncertainty:

...the Authority's view is that managing the circuit between Aviemore and Benmore in a conservative way was appropriate given the particular set of circumstances Meridian faced. In particular, the flood during December was a significant event that Meridian had to manage within its resource consent conditions. Block dispatch is an important part of this management.⁵

The Authority's position can be summarised as: "it is unacceptable to structure offers to manage transmission constraints, except when the Authority determines it is acceptable, which will be made clear ex-post". This is not a workable standard in practice. Further, the Authority states that structuring offers to manage the AVI_BEN constraint is acceptable in part because there is no FTR available between the Aviemore and Benmore nodes. However, Genesis experience is that the existence of FTRs does not guarantee their availability or make them an effective or cost-efficient risk management option.

(b) Availability of FTRs

The value of the FTR market to risk management is diminished if one or more participants corners the supply of FTRs. This has been a frequent occurrence, with Haast Energy Trading (**Haast**) gaining large volumes of FTRs in each FTR auction even though they do not have locational risk to manage.

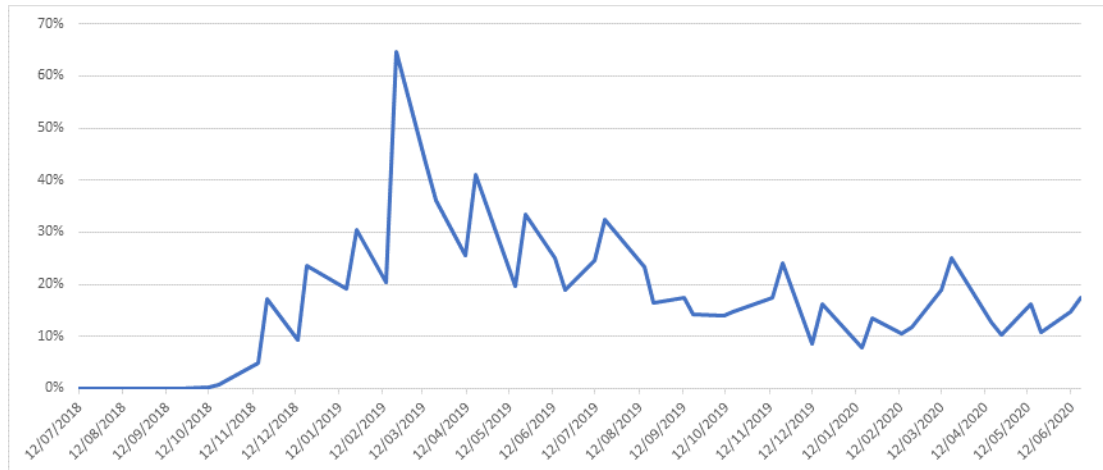
⁴ 8 May 2017 – Letter from Chair to Meridian Energy re: trading conduct on 2 June 2016
<https://www.ea.govt.nz/dmsdocument/22116-8-may-2017-letter-from-chair-to-meridian-energy-re-trading-conduct-on-2-june-2016>

⁵ Preliminary UTS decision, at 13.13.

As shown below, Haast has consistently acquired a significant proportion of FTRs – at times, almost 80% of available FTRs. This raises issues of market integrity and confidence.

Haast FTR Market Share (Total Spend) per Auction⁶

All FTR contracts

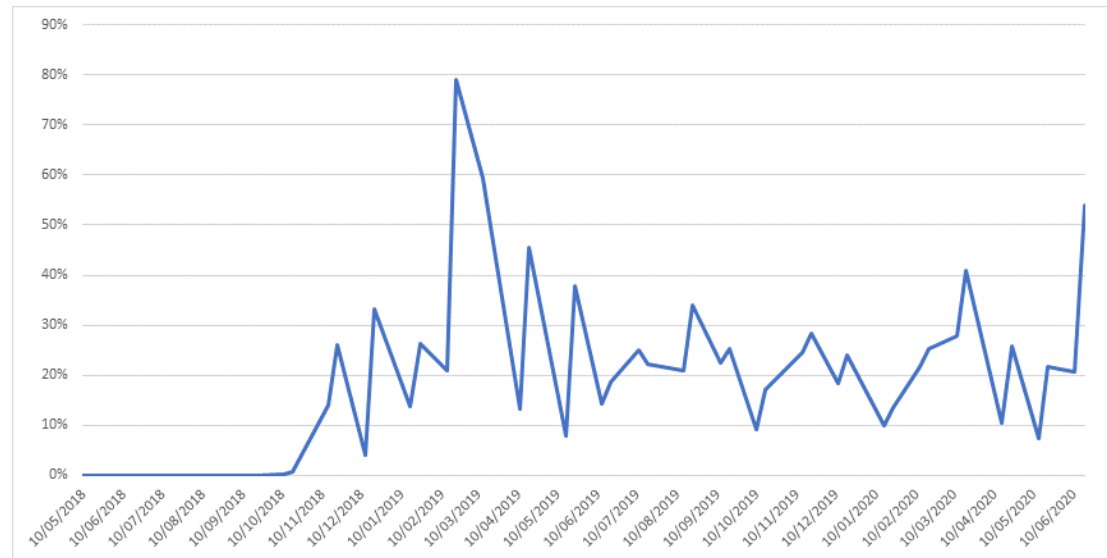


South island length (BEN/ISL, BEN/KIK, ISL/KIK)



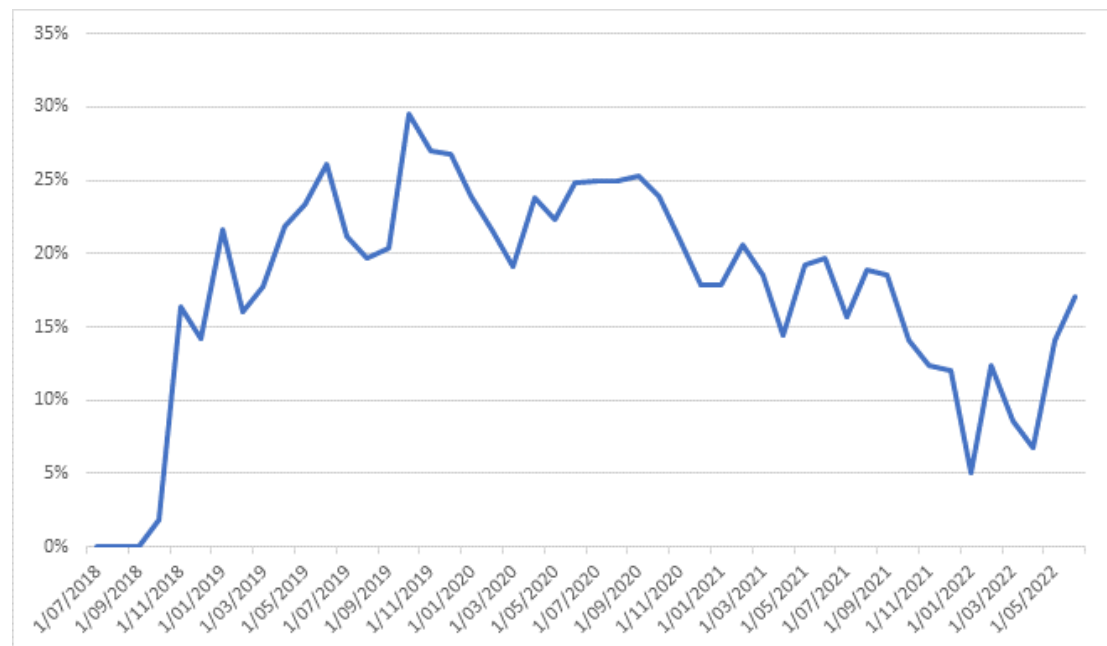
⁶ From registry records.

North island length (WKM/OTA)



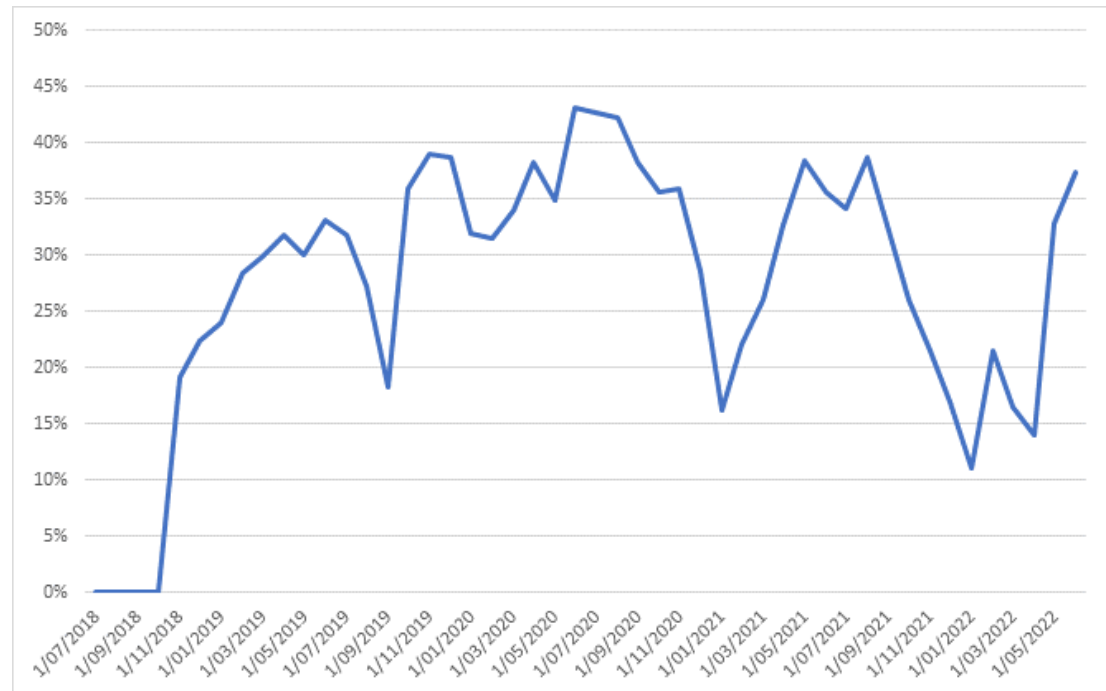
Haast FTR Market Share per Settlement Month⁷

All FTR contracts

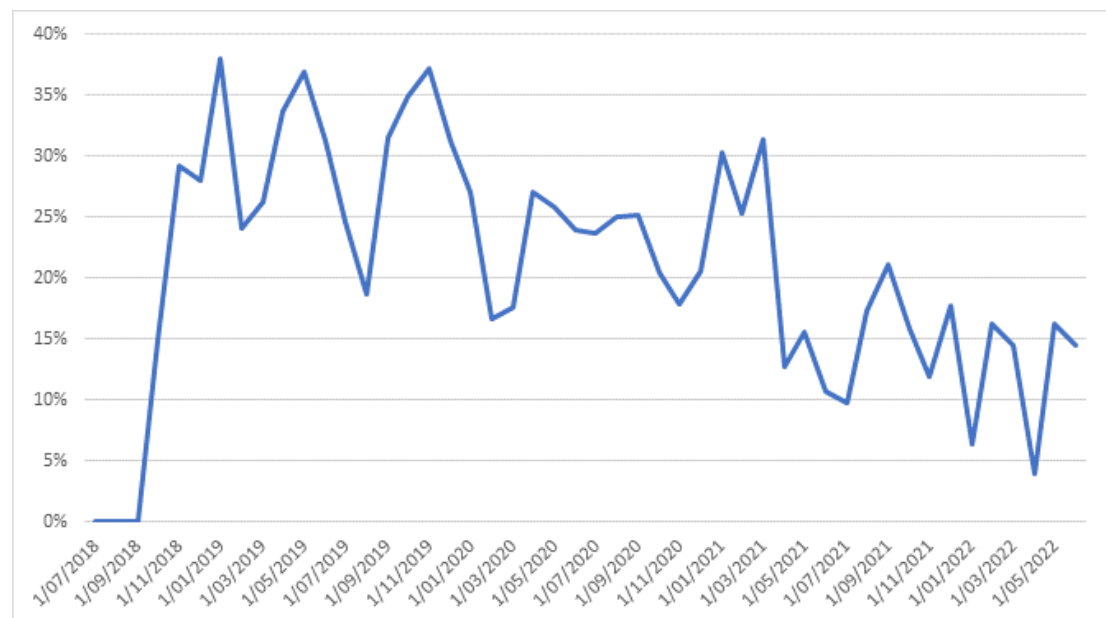


⁷ From registry records.

South island length (BEN/ISL, BEN/KIK, ISL/KIK)



North island length (WKM/OTA)



This evidence is consistent with the findings of the Authority's 2019 post implementation review of the FTR market. The review identified that FTR products sometimes trade at

auctions at prices far higher than they settle which allows those who have cornered the market for these FTRs to “make significant profits from time to time”.⁸

The Authority regarded this trading behaviour as “astute” rather than problematic or anti-competitive, stating that:⁹

This enables astute traders to make significant profits from time to time, which may lead to accusations that the FTR market merely exists as a money-making scheme for speculators who have no presence in the physical electricity market.

But in fact, such trading activity serves a market making role, likely increasing the liquidity of the FTR market, since it increases the likelihood that physical participants will be able to adjust their FTR holdings at a reasonable price as their circumstances change.

Genesis disagrees with this view:

- (a) Speculative behaviour reduces the availability of FTRs to those who need them. The accumulation of FTRs by speculators adversely impacts the ability of integrated generator/retailers to manage their locational risk and can leave the structuring of generation offers as the only economically rational option despite the regulatory uncertainty discussed above. Speculative trading of FTRs that has this result, whilst profitable for skilled actors, does not improve the competitiveness of the wholesale or retail electricity markets.
- (b) We have not seen evidence of any “market making” or trading activity leading to increased liquidity. Given that the procurement process is via an auction for a fixed supply – more participants reduce the available FTR capacity for existing ones, rather than increase it. The only benefit of speculators, which we see, is if they were to actively trade FTRs on a secondary market. But this is not the case. There have only been a few occasions where FTRs have traded outside of the auctions, or where we have seen capacity sold back in a subsequent auction. Moreover, it is reasonable to expect that participants holding a surplus of FTRs would be reluctant to on sell them at acceptable prices in circumstances where generator-retailers would be seeking cover at short notice (for example, in response to unexpected transmission outages or other supply disruptions).

We observe that:

- (a) Speculative activity can be a useful feature of price discovery and liquidity in mature markets. But such activity with the issues described above, in a nascent

⁸ Post implementation review of the FTR Market, November 2019 at 10.40 - 10.42 (<https://www.ea.govt.nz/monitoring/enquiries-reviews-and-investigations/2019-2020/post-implementation-review-of-the-ftr-market/>).

⁹ Ibid.

FTR market, hinders rather than furthers the objectives of establishing the FTR market.

- (b) Unlike other risk management products such as ASX listed NZ electricity futures, FTRs are partially funded by all retailers and generators through the loss and constraint excess reserves. The FTR market was not intended to allow this capital to be siphoned off by speculators.
- (c) A recent survey commissioned by the Authority found that:¹⁰
 - (i) No large consumers purchase FTRs to manage price differences, between the hubs at which energy hedges are available, and the nodes at which they take supply.
 - (ii) There was no evidence of market participants entering new generation areas as a result of the availability of FTRs.
 - (iii) There was no evidence that generator-retailers have changed their offer behaviour as a result of FTRs. This could be a result of the price of FTRs or insufficient FTRs being available to cover the relevant exposure.

The speculative activity and acquisition of FTRs in large volumes by a single participant is unlikely to improve any of these outcomes.

- (d) Since the Authority's fieldwork for the post implementation review of the FTR market was completed in December 2017, the problematic behaviour has intensified, damaging our confidence in the utility and integrity of the FTR market.
- (e) Where markets have been cornered by speculators, regulators were ultimately forced to act to restore confidence in these markets.¹¹

Request for market performance review and investigation of Code compliance

Given the above, Genesis asks that the Authority:

- (a) Undertake a market performance review of the FTR market during the period from 1 January 2018 to date, considering in particular, whether the trading behaviour of Haast or any other market participant has had an adverse impact on the ability of the FTR market as presently designed to:

¹⁰ UMR "Perceptions of Financial Transmission Rights Research Report" December 2017 (<https://www.ea.govt.nz/monitoring/enquiries-reviews-and-investigations/2019-2020/post-implementation-review-of-the-ftr-market/>).

¹¹ For example, Hunt Brothers (silver), Sumitomo (copper), Fenchurch Capital Management (US ten-year treasury bonds in the 1990's),

- (i) provide mechanisms to help wholesale market participants manage price risks caused by constraints on the national grid as contemplated by section 42(2)(c) of the Electricity Industry Act 2010;
 - (ii) realise the benefits/intended outcomes identified when the FTR market was first introduced; and/or
 - (iii) achieve the Authority's statutory objectives.
- (b) Investigate whether the trading activity of Haast or any other market participant in the period from 1 January 2018 to date complies with the Code and FTR auction and assignment rules.
- (c) Work with the Financial Markets Authority to confirm to all FTR market participants what the conduct obligations for participants in the FTR market are, and how these are being monitored and reported on.
- (d) Consider (or request that the Market Development Advisory Group consider) how the FTR market could be improved, including whether there should be limits to the amount of FTRs that can be acquired by a single participant.¹²

We note that the FTR manager is considering adding up to 5 new FTR hubs and suggest that the Authority take action before further FTR hubs are added.

If any of these actions reveal that FTRs, expressly designed as a risk management product, are being exploited for private benefit, to the detriment of effective and cost-efficient risk management by other participants, or that participant conduct has otherwise adversely affected the utility or integrity of the FTR market:

- (a) The Authority may wish to consider whether this constitutes a UTS under clause 5.1(2)(c) of the Code (unwarranted speculation or an undesirable practice) and act accordingly to address this.
- (b) As the FTRs are financial products under the Financial Markets Conduct Act, the Authority may wish to raise the matter with the Financial Markets Authority.

¹² For example, threshold limits are used by the London Metals Exchange to prevent a participant from acquiring a dominant position in the copper market.

Conclusion

There is regulatory uncertainty concerning how generator-retailer participants can use spot price offers to manage locational risk. While the Authority's preference is for participants to use FTRs as the principal means of managing this risk, participants who do not face locational price risk have acquired FTRs in large volumes as a speculative profit-oriented play. In some instances, almost 80% of the available FTRs were acquired. This behaviour limits the use of FTRs as a risk management option for participants with locational risks to manage. The effective cornering of the FTR market, and the impact on FTRs as a risk management option threaten the utility of FTRs and ultimately, confidence in the FTR market. We ask therefore that the Authority acts swiftly to investigate and assure market participants that the FTR market is functioning effectively and as intended.

Yours faithfully

GENESIS ENERGY LIMITED

A handwritten signature in blue ink, appearing to read 'Williams', with a stylized, cursive script.

Warwick Williams

Senior Regulatory Counsel and Group Insurance Manager



Genesis Energy Limited
The Genesis Energy Building
660 Great South Road
PO Box 17-188
Greenlane
Auckland 1051
New Zealand
T. 09 580 2094

17 November 2020

James Stevenson-Wallace
Chief Executive
Electricity Authority
Harbour Tower, Level 7
2 Hunter Street
WELLINGTON

By email: james.stevenson-wallace@ea.govt.nz

Dear James,

**Re: Open letter in response to request for review of the market for Financial
Transmission Rights (FTRs)**

Thank you for the advance copy of your open letter responding to our request that the Electricity Authority (**Authority**) carry out, among other things, a performance review of the FTR market.

Response to proposed open letter

We would be grateful if the Authority could clarify the following matters:

1. *How the Authority concluded that Haast has locational risk based on its association with Electric Kiwi.*

While we understand that Haast and Electric Kiwi have shareholders in common, that does not mean that Haast has locational risk. They are separate entities with distinct business activities, with Haast registered as a trader and Electric Kiwi as retailer under the Code, and each having registered as a FTR participant.

2. *What proportion of the amounts attributed to Haast in "Table 1 FTR profits from January 2019 to September 2020" (**Table 1**) relate to its speculative activities and what relates to its "Retailer" activities.*

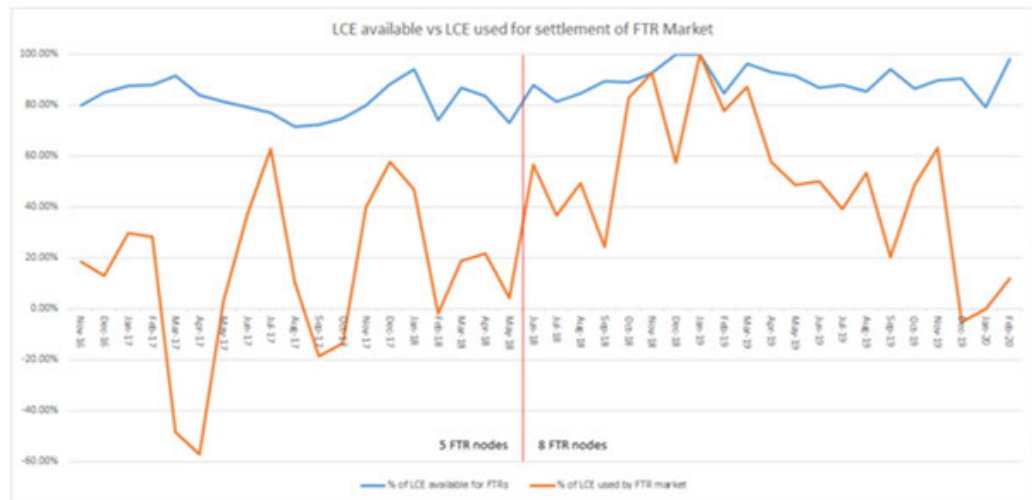
Our high level estimate is that Electric Kiwi has an equivalent load per trading period of around 38MW in the North Island and 16MW in the South Island. We have seen Haast purchase between 1300MW – 1700MW of transmission capacity per trading period (typically 20-30% of the market total) and routinely purchase up to 300MW on individual transmission paths. Even if Haast and Electric Kiwi are treated as a single entity (as the Authority appears to be suggesting but which we disagree with), this indicates that the vast proportion of the profits attributed to Haast arise from speculation. We would be grateful for the Authority's view on how its analysis compares.

3. *We disagree with the characterisation of “profit share” in Table 1 and the statement at page 3 of the open letter, that “more LCE would be “syphoned off” and the beneficiaries of this would be physical players such as Meridian and Genesis”.*

In our letter to you, we used the phrase “siphoning off” to describe the concept that where speculators receive FTR payments, this has the effect of LCE leaving the market and unavailable to physical participants like generators and direct connect customers to offset their costs of participating in the physical market. We note that if most of the amounts relating to OMFinancial and Haast in Table 1 of your letter are attributed to speculation, then circa \$40m of LCE has been paid to speculators over the last 15 months and not available to physical participants. We question whether this is in the best interests of the market and the long term benefit of consumers, given that where their costs of participating in that market cannot be offset, the commercially rational outcome would be those costs will be passed onto consumers.

We also observe that around 60% of available LCE on average is used to fund FTR settlements as shown in the table below.

Figure 1: Graph of LCE available for settlement of FTR market vs LCE used in settlement of the FTR market



Source: Electricity Authority

Notes: A negative % of LCE used by FTR market means auction income exceeded FTR payments and transmission customers received a payment that exceeded the LCE.

If the proportions set out in Table 1 of your letter were applied to the FTR market over the same period, then this would translate to around 30% of available LCE being siphoned off by speculators since 2016. These are material sums.

It would be helpful if the Authority could please explain:

- (a) How it reached the conclusion that more LCE being siphoned off would benefit generators such as Genesis and Meridian.
- (b) How the material leakage of LCE to speculators is a desirable outcome and in the long-term interests of consumers.

4. *Speculators providing liquidity to the FTR market.*

The Authority makes this statement in your letter, and has done so previously as referenced in our 4 September 2020 letter. Our experience is the opposite. We understand that others have had similar experiences. Please would the Authority share the evidence and analysis that support these statements.

5. *Issues identified in the last FTR market performance review and survey.*

In our 4 September 2020 letter, we referred to findings in the Authority commissioned survey. These included that:

- (a) No large consumers purchase FTRs to manage price differences, between the hubs at which energy hedges are available, and the nodes at which they take supply.
- (b) There was no evidence of market participants entering new generation areas as a result of the availability of FTRs.
- (c) There was no evidence that generator-retailers have changed their offer behaviour as a result of FTRs.

We asserted that the speculative activity and acquisition of FTRs in large volumes by speculators were unlikely to improve any of these outcomes. Can the Authority please advise whether it disagrees with this assertion?

6. *Requests made in our 4 September 2020 letter.*

We appreciate you responding to our request for a market performance review. We also asked that the Authority consider several other matters, including providing clarity on conduct obligations for participants in the FTR market, and how these are being monitored and reported on. Please would the Authority formally respond to the requests set out in paragraphs (b), (c) and (d) on page 9 of our 4 September 2020 letter.

Current FTR voting framework facilitates speculation not hedging

Finally, it seems that the Authority and the FTR manager wish to continue with the proposal to add additional FTR hubs, which will effectively double the size of the FTR market. We have raised concerns with the current voting framework with the FTR manager, and given the matters raised in our 4 September 2020 letter and this letter, wish to do so directly with you.

In choosing the new FTR hubs, each registered FTR market participant is entitled to one vote. Consequently, participants with no or very little locational risk have the same relative voting power as those who face significant locational risk.

For example:

- (a) If Haast is treated as Electric Kiwi as set out in your letter, Haast effectively has double the voting power of all other FTR market participants.
- (b) Similarly, small participants (e.g. there is one participant whose total FTR purchases is \$8,000 worth of FTRs) who have no retail load have the same relative voting power as other participants who have significant loads.

As a result, the current voting framework will result in FTR hubs with very little retail load, such as Kikawa in the South Island and Bream Bay in the far North, being added to the market.

These hubs are only useful for speculative trading and would exacerbate the issues discussed above and in our 4 September 2020 letter. Accordingly, the current framework can (and if the current FTR hubs proceed, will likely) facilitate further speculation, and outcome which is inconsistent with the principal purpose of FTRs and the FTR market.

Any market review should therefore also assess whether the current voting framework is fit for purpose given the objectives of the FTR market, and if not whether an alternative structure based on proportionality would be more appropriate.

Conclusion

We remain concerned that the FTR market is not functioning as intended and reiterate our request for a market performance review. We also request that the scope include the voting framework for the reasons set out above.

We have no concerns with this letter or our 4 September 2020 letter being published, and ask that you include this letter with your proposed open letter.

Yours faithfully

GENESIS ENERGY LIMITED

A handwritten signature in blue ink, appearing to read 'Williams', with a stylized initial 'W'.

Warwick Williams

Senior Regulatory Counsel and Group Insurance Manager

12/11/2020

FTR Manager

By email: ftrmanager@ems.co.nz

Costs and benefits associated with the possible introduction of four addition FTR hubs

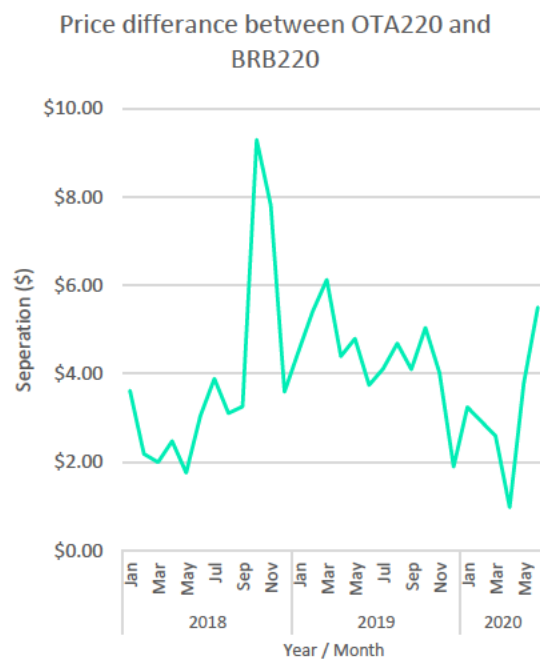
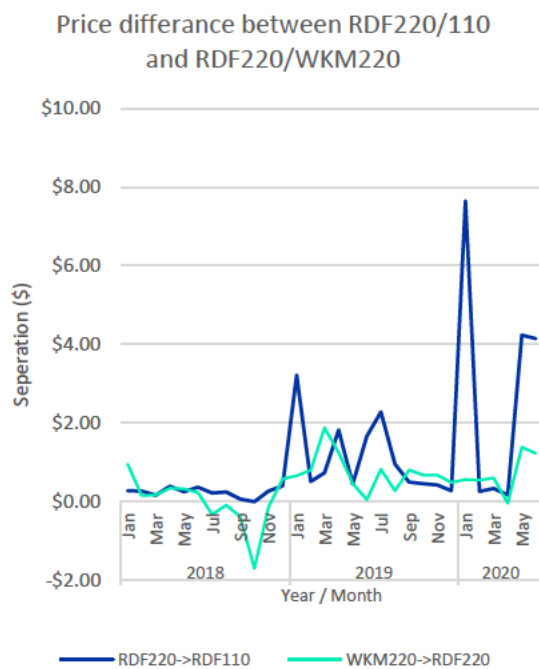
Please find below Meridian Energy's views on the possible addition of four new FTR nodes (SFD220, BRB220, RDF110 and EDG220) to the FTR market.

Costs

Meridian expect the initial IT costs of adding additional FTR nodes to be \$35k. We do not expect a significant increase to ongoing operational costs.

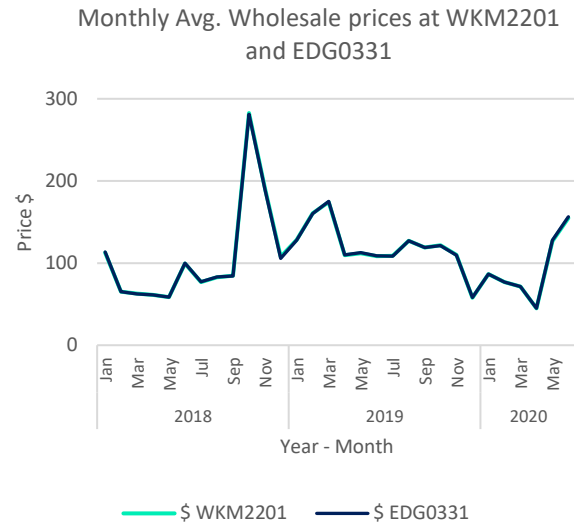
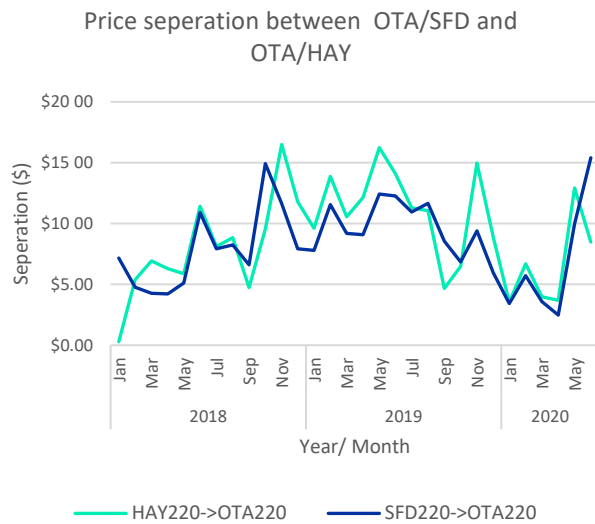
Benefits

Meridian believes the RDF110 and BRB220 nodes would provide physical participants with better price risk management for demand in Hawkes Bay and Upper North Island. Currently there are no FTR products that provide access to these areas. FTR nodes that are closer to load centres provided better risk management, RDF110 would provide us additional benefit over the current RDF220 node as constraints across the interconnector results in significant price difference between RDF220 and RDF110.



An FTR Hub at SFD220 would provide some benefit against the price difference between Haywards and Stratford but Meridian does not see a significant benefit against managing our price risk between Lower North Island and Upper North Island compared to HAY which is already an FTR node. Therefore, we do not see a significant benefit from a SFD220 FTR node.

We see no value to Meridian of an FTR node at EDG. Historically wholesale prices between WKM and EDG are closely matched, any price risk at EDG can be managed using FTRs in and out of WKM.



Please let me know if you have any question regarding this letter.

Yours Sincerely,

Holindu Abhayagunawardena

Transmission Specialist

Email: Holindu.Abhayagunawardena@meridianenergy.co.nz

Hi Ed/Willie,

A high level assessment of the costs to Genesis of adding additional hubs to the FTR Market are outlined below.

Costs

Adding four additional hubs effectively doubles the complexity of the FTR Market. This complexity will necessitate significant upgrade to all in-house tool and models. In addition preparing bids for each auction will be more labour intensive and will require an additional [REDACTED] FTE. At a high level costs are estimated as:

s9(2)(b)(ii)

One off cost: rebuilding in-house models: s9(2)(b)(ii)

On-going costs: [REDACTED] FTR plus maintenance and upgrade of tools: s9(2)(b)(ii) per annum

s9(2)(b)(ii)

Benefits

In our view the FTR Manager and EA are best placed to calculate the benefit to the market as a whole of adding additional hubs. As we cannot anticipate the bidding strategies of other participants it is not possible to estimate the benefit to Genesis in adding the proposed hubs. We would also note that the EA/FTR Manager cost benefit analysis should address the extent to which the additional hubs would help meet the objectives of the FTR market, including in particular, the extent to which the additional hubs would improve FTR market liquidity or exacerbate the lack of liquidity currently experienced by the market and its use by participants in the physical market to manage locational risk.

If you would like to discuss please give me a call.

Have a good weekend,

Pauline

Pauline Martin | Group Manager Electricity & Carbon

Genesis Energy Ltd | Level 6, 155 Fanshawe Street, Auckland CBD 1010

M. s9(2)(a) DDI: s9(2)(a) In-2C-81px-R copy_30 (002) FB-f-Logo__blue_30 (002)

From: Nigel East <Nigel.East@contactenergy.co.nz>
Sent: Friday, 13 November 2020 2:24 PM
To: FTR Manager (EMS) <frmanager@ems.co.nz>
Cc: fmarkets <fmarkets@contactenergy.co.nz>
Subject: RE: FTR | FUG #30 Minutes

Cyber Security Warning – External E-Mail CAUTION: Please ensure you take **EXTRA CARE** when opening any links or attachments.

Hi Ed,

Contact submits the following costs for additional nodes.

		Upfront capital				Operational costs per year		
# of additional Hubs		1	2	3	4	1	2	3
Participant costs								
PARTICIPANT								

s9(2)(b)(ii)

s9(2)(b)(ii)

Please treat the above submission as confidential.

Regards
Nigel

Nigel East | Forward Markets Manager | Generation & Trading

P: +64 4 462 6998 | M: +64 21 1111 705 | E: nigel.east@contactenergy.co.nz



PO Box 10742, Wellington 6143
Level 2, Harbour City Tower
29 Brandon Street
Wellington, New Zealand
contact.co.nz

The FTR Manager
cc The Electricity Authority

16 November 2020

Cost and Benefits of Hub Addition

Dear Sir/Madam,

Thankyou for the opportunity to again highlight some of the costs and benefits that ought to be considered when conducting a CBA on the addition of new hubs in the FTR market. We take this opportunity to build further on the points made in the short submission we made on this topic three years ago (attached for your reference).

Rather than just give an analysis of our own internal costs, we've undertaken to submit our views on the wider costs and benefits of the addition of the proposed FTR hubs and the more granular locational hedging that they will provide.

Marginal participation costs are negligible

The FTR Manager has requested participants provide a summary of their direct costs from the addition of new nodes.

In regards to these direct costs, the marginal cost to us is virtually non-existent. There would be some initial cost in ensuring our visualisation tools display new products. Like most participants, our systems already ingest the vast majority of available market data, and this change would be a simple matter of altering which information is displayed in a small subset of our tools.

We estimate the initial cost of this to be less than \$10k with no ongoing cost. Having said that, by incurring that cost, we would give ourselves the optionality to analyse and trade additional FTR paths (if we were to do so there would be no further system cost, and our expectation, if we decided to trade, would obviously be to benefit from doing so), thus even the initial cost is, in-fact, a net benefit to our organisation (we note that if we didn't think it was, all costs and benefits would be zero rather than negative - we simply wouldn't upgrade).

In summary, there is effectively zero marginal cost to us from the addition of new hubs. We recognise, of course, that not all participants will have the luxury of such low system costs. Indeed this is something that we have had to innovate and invest in to create. We reiterate two points previously submitted that relate to this:

- NZ inc should not be held back by 'lowest common denominator' operational efficiency levels. We again note that any cost benefit analysis that uses the costs of inefficient participants limits competition, innovation, and the benefits of these to the economy by denying those parties that are able to lower cost an opportunity to benefit from this ability. Any party that claims that their relatively higher costs will ultimately be borne by consumers and thus ought to be considered in CBA is effectively claiming that the risk management and retail markets are sufficiently lacking in competition that that party can pass through inefficiencies without fear of losing customers to more efficient competitors. We don't think this is the case.

- We don't believe that parties will participate in trading of additional hubs if it is not of net benefit to them. Thus there is likely no net cost to participants from the addition of new hubs. Some members of the FUG have suggested that they will need to participate in the trading of new FTRs (and incur a net cost) solely in order to ensure that the resultant FTRs are traded at fair value. We provide an explanation, using logic, as to why this isn't the case below.

In any case, when conducting a CBA for a market design change or development, consideration should be given to the costs and benefits of the change to the economy as a whole. We don't believe that a group that consists only of participants is adequately informed or incentivised to be relied upon to make those considerations. Furthermore, our view is that such analysis is beyond the remit (and likely the capability) of the FTR Manager, and as such ought to be conducted by the Authority.

Beneficiaries of a more granular FTR market extend beyond existing FUG members

Whilst we accept that there should be some consideration of participants' costs (subject to the points above about whether there are truly marginal costs), simply canvassing FUG members for their costs and benefits ignores the wider economic value implications of ongoing FTR market development. This value is widely documented¹ and is likely to increase due to significant changes that are occurring in the wider electricity market. For example:

- Transmission Pricing Methodology changes that rely on locational price separation (rather than existing RPCD charges) to act as a price signal for investment and demand response. Any increase in reliance on price separation creates additional value for hedge products to manage the risk of that price separation, including more granular FTR products.
- Recent UTS and Trading Conduct investigations and decisions have further clarified expectations that generators ought to be using risk management methods that don't rely on the use of market power to manage location risk. It is expected that the work of the MDAG on the trader conduct provisions in the Code will also further clarify that historic methods of managing locational price risk are no longer appropriate. Again this will likely lead to further demand for more granular location risk management products (arguably this effect has already been seen following some of the recent lower SI transmission constraints).
- With the announcement of the exit of Tiwai from the market, it is credible that we are going to see radical change in the importance of transmission in supporting a balanced electricity system as South Island load and likely North Island generation are decommissioned. Locational risk management will have a higher economic value as this occurs.

¹ See the Authority's work on the implementation of the FTR market and the previous additions of new hubs.

- Following the Authority's recent decision to procure market making services from commercial providers, there will be a (more) direct reduction in cost of liquidity support mechanisms from greater liquidity and granularity in FTRs. Currently there are a number of *high delta*² FTRs available, particularly in the South Island, which, as well as providing locational price risk management, also provide direct liquidity into the hedge market for energy. Greater access to high delta FTRs gives hedge market participants, and soon commercial market makers, greater ability to find alternatives to electricity futures, ultimately leading to deeper liquidity, more efficient pricing, and lower risk (and therefore cost) to market makers. A more granular FTR market allows those parties to more finely shape their portfolios (with products that have differing delta characteristics), lowering their risk management costs and therefore the cost to the economy of procuring market making services.

Nefarious lobbying ought to be ignored

Our view is that some existing participants recognise the benefit that more granular FTR products provide through more effective risk management, and ultimately lower retail cost to serve, but to realise that benefit a party needs to be willing to invest or innovate towards systems that can cope with the complexity of increasing granularity.

Rather than making that investment themselves, we see parties radically overstating the cost of market changes in order to deny their competitors the opportunity to compete through innovation (in the market for risk management, which ultimately flows through to the retail market) by retaining the status quo - the only genuine cost of the change to that party being an increased risk of reduced market share, which is in fact a net benefit to consumers.

We draw attention to two relatively recent examples of what we consider likely to be nefarious lobbying.

In 2017 in submissions in regards to a proposal to increase the number of FTR hubs it was suggested that "...as the market grows by adding more nodes, and different products there will be a heightened chance that FTRs will be auctioned off below "fair value" as liquidity gets spread across a growing product base. This will erode value which should ultimately be returned to the consumer"³. Comments were made in various FUG meetings which suggested that it was then essential for that party to participate in trading of new FTRs (despite them incurring a net cost to do so), so that they could ensure that fair value was maintained.

This argument is flawed for the following reasons:

- In the FTR auction, 'liquidity' is provided by the capacity of the FTR grid and not by parties originating FTRs, thus liquidity is not analogous to say ASX products where buyers and sellers could be spread too thinly to provide deep liquidity in any given product.

² These FTRs exhibit a very high correlation with underlying base-load energy prices. Already the availability of these products creates liquidity and more efficient pricing in the ASX through the activity of arbitrageurs.

³

<https://www.ftr.co.nz/documents/10179/97733/Trustpower+submission+-+FTR+Allocation+Plan+2017.pdf/74a1a009-481d-b188-c3f3-251a2ec8f02b>

- Adding or removing hubs - unless they are on spurs - does not change the availability of transmission capacity on the FTR grid and this capacity is already fully subscribed in all auctions. An FTR auction solves on a 'system' basis, not on a product by product basis. Adding a product does not suddenly allocate the transmission capacity to that product to the detriment of existing products. Indeed, even if no parties bid on a product today, that product would still have a 'clearing price' which reflects the value that bidders in other products place on the transmission capacity required to deliver that product (effectively the marginal opportunity cost of that product on the FTR grid). The submitter implies that products would be sold cheaply because of a lack of bids... this simply isn't the case. To take the point further, it is possible today to calculate the shadow price of any potential FTR product, and despite it not being available to bid on, this price will still reflect the fair value of that product. Bids would not clear below that fair price even if there were few parties bidding on the new product.
- Whilst we are of the view that the FTR market has enough participants to ensure FTRs will transact at fair value, even if a party felt they needed to bid for FTRs purely in order to ensure this was the case, they could continue to do so following the addition of new hubs without changing their bidding strategy at all. Again, this arises because the FTR grid capacity does not change. Thus, bids on coarse products will dictate the price on more granular products. For example FTRs between HAY and WKM would have simultaneous feasibility with the more granular legs from HAY to BPE to WKM. A party could completely ignore those more granular legs and be safe in the knowledge that their bids were ensuring fair pricing on those products, because they would be bidding on the same transmission capacity (meanwhile, those parties that had the desire and capability to trade in more granular products could do so).
- Notwithstanding the fact that we think it would be irrational for a party to incur a net cost to 'prop up' FTR prices, logic dictates that they could do so without any change in their bidding behaviour (and participation cost) if additional hubs were added.

Our view is that this tenuous argument has been put forward as a means to stop innovative competitors engaging in more efficient risk management practice, as a means to maintain market share in the risk management and ultimately the retail markets.

As another example, in a recent submission in regards to the revocation of schedule 14.3 of the Code, A Meridian Energy made a number of misleading claims about the proliferation of so-called 'speculators'. In their submission they falsely state that

"The value of LCE used to settle FTRs represents the profit made by these speculators over and above FTR purchase costs. In the last four financial years Haast Energy Trading alone has made \$17 million from FTRs net of purchase costs, i.e. funded entirely by LCE that would otherwise have been paid to New Zealand transmission customers and ultimately passed on to New Zealand consumers."⁴

We note the following points in regards to this statement:

- This figure isn't funded entirely by LCE. It is at least partially funded by auction revenue (from FTRs that paid less than they were auctioned for).

4

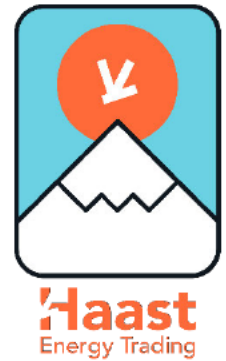
<https://www.ea.govt.nz/assets/dms-assets/27/Meridian-Energy-Limited-Schedule-14.3-Consultation-Submission.pdf>

- The terms ‘speculators’ and ‘profit’ are either intentionally misleading or naive. Most of the parties listed in the submission as speculators would likely refer to themselves as intermediaries. Indeed it is reasonably common knowledge within the industry that Haast Energy Trading is a ‘sister company’ of Electric Kiwi and provides risk management services including, it would seem reasonable to assume, hedge products. In this sense, Haast is likely acting as an intermediary which is directly facilitating increased retail competition for the benefit of consumers (and, notably, to the detriment of incumbent retailers).
- As we’ve noted, FTRs can have significant exposure to underlying energy price risk (in addition to locational price risk). This exposure can be (and is frequently) used by intermediaries to provide hedge products both OTC and through the ASX. When doing so, a gain in the value of the FTR is likely to equate to a commensurate loss on the sold hedge. Ultimately the hedge value ends up with the consumer and only a small margin is retained by the intermediary. Clearly the ‘profits’ that the submission suggests are being made are only one side of the equation, and in fact show the extent to which innovation in energy risk management can facilitate competition from new entrant retailers (Indeed a rudimentary analysis of which FTRs Haast, in particular, have procured will show that they are heavily weighted towards high delta products).
- Either Meridian has deliberately sought to mislead by suggesting this hedge value is being completely re-allocated from consumers and physical participants to speculators, or they are displaying a complete lack of understanding of how the risk management markets are interrelated. Our view is that, facing retail competition as a result of innovation in risk management, they are deliberately trying to stifle the ability of their competitors to take such an approach (to the detriment of consumers).
- We are of the view that similar incentives apply when considering the addition of new hubs in the FTR market in that more granular (albeit complex) risk management solutions are of more benefit to new entrants (to the risk management and retail markets) than they are to the incumbents, and as such we see parties overstate their costs in an effort to stifle innovation and competition.

We encourage the Authority to consider the costs and benefits of additional hubs in the context of the NZ economy, and the long term benefit to consumers, and put adequate scrutiny over the purported marginal costs of additional hubs, both in terms of their magnitude, and whether these are truly costs to the economy in an efficient market (where consumers ought to bear only the costs from the most efficient operators).

Yours faithfully,

Stuart Innes,
Director,
emhTrade Markets Ltd



12 November 2020

To: Edward Oosterbaan, FTR Manager

By email: Edward.Oosterbaan@ems.co.nz, ftrmanager@ems.co.nz

Hub consultation – cost benefit analysis of new Hubs

The following submission is commercially sensitive and should only be made available to the FTR manager and Electricity Authority.

Dear Ed,

Below is a submission from Haast regarding cost benefit analysis for new FTR Hubs:

FTRs **s9(2)(b)(ii)**

Haast Energy Trading is an active participant in the FTR market. We are a sister company of Electric Kiwi, with largely the same shareholding and common Directors. A significant part of Haast's activity in the New Zealand wholesale electricity market **s9(2)(b)(ii)** is in managing wholesale price risk for Electric Kiwi.

Over the last 3 years Electric Kiwi has been the fastest growing retailer in New Zealand. Electric Kiwi's growth has been greater than the combined growth of all other independent retailers in the market over this period. Electric Kiwi has consistently been the price leader in lowering retail prices for New Zealander consumers, for example as of today Electric Kiwi is the price leader in over 80% of plans listed on the independent price comparison site Powerswitch.

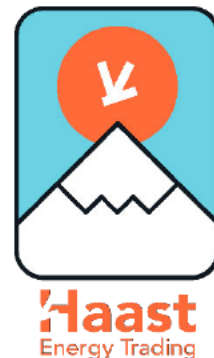
s9(2)(b)(ii)

s9(2)(b)(ii)

s9(2)(b)(ii)

The latest MBIE residential electricity cost data¹ shows real residential unit prices have fallen 3.7% over the last 3 years when Electric Kiwi has been growing strongly and aggressively competing on price. Assuming an average \$1700 bill this is \$63 per customer, or \$125m pa every year for the 2m residential electricity consumers. While a number of factors have contributed to lower retail prices, I believe most informed observers would attribute a meaningful portion to increased competition from independent retailers and in particular to increased competition from Electric Kiwi **s9(2)(b)(ii)**

¹ <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/energy-prices/electricity-cost-and-price-monitoring/>



s9(2)(b)(ii)

Consumers are not well represented among FTR participants

The majority of FTR market participants are vertically integrated gentailers with incumbent retail bases. These participants have an incentive to diminish liquidity in wholesale markets to prevent independent retailers or independent generators from competing with them effectively. The poor performance of the ASX market without regulated arrangements and previous opposition to increasing the size of the FTR market are examples of this strategy in action. The FTR manager and Authority should recognise this when reviewing submissions on the merits for expanding the FTR market and act in the long term interest of Consumers.

For this reason we believe the FTR manager and the Authority should consider over-ruling the NoHub1 selection and inserting the next real Hub in the current round of proposed expansion.

Costs of adding new Hubs

Regardless of the number of new Hubs that are selected to be added, Haast and Electric Kiwi will face no measurable increase in costs to participate in the larger FTR market. We find it very difficult to believe there will be a meaningful cost increase on any participant given all have systems and processes in place to participate in the current market and all are sophisticated wholesale participants. We highlight that some vertically integrated participants may be incentivised to estimate high costs if they think it will result in less additional liquidity being approved and consequently less competition from independent participants.

Conclusion

We encourage the FTR Manager and Authority to add 5 new Hubs and continue to build liquidity in New Zealand's wholesale electricity market. Haast and Electric Kiwi will face no meaningful incremental costs to participate in the larger market s9(2)(b)(ii)

The Authority and FTR manager should consider the interests of unrepresented consumers in this consultation process and continue to grow the FTR market as quickly as possible.

Kind Regards,

Phillip Anderson

Managing Director, Haast Energy Trading

Co-Founder and Director, Electric Kiwi

021460040

phill@haastenergy.com

www.haastenergy.com