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By email: wholesaleconsultation@ea.govt.nz

Review of the application of loss and constraint excess (LCE) to the settlement of Financial Transmission Rights (FTR)

Meridian supports the Electricity Authority looking at the allocation of LCE to FTR settlement and agrees that the current Schedule 14.3 calculation becomes disproportionately burdensome as further hubs are added. Ultimately Meridian believes the addition of further FTR hubs to be a positive thing for the market and so supports work which helps new hubs be added.

However, we are concerned that it may be relatively difficult for the industry, and in particular those participants who will be most affected by the Authority's preferred option, to assess the impacts of the proposal based on the Authority's consultation paper.

LCE arises because wholesale purchasers of electricity are paying more for that electricity than it cost the market to provide. Idealised allocation of that LCE would provide it back to transmission customers and wholesale consumers according to the extent to which they have faced higher costs as a result of congestion. The fact that LCE is made available for settlement of the FTR market reflects the reality that many transmission customers and wholesale consumers can use FTRs to manage their locational pricing and congestion risks. However, whilst more hubs have and will continue to successively increase its coverage, the FTR grid does not account for all LCE, and some transmission customers / consumers cannot adequately address their particular locational and congestion risks with FTRs. This is fundamentally why Schedule 14.3 exists in the first place. By excluding LCE associated with such participants from the FTR rentals, the Code ensures that FTR participants are not benefiting from (i.e. by getting the first bite at) what are essentially overpayments by those participants who cannot use the FTR market to manage their congestion risk.

In proposing to remove the Schedule 14.3 calculation entirely, Meridian considers it would be useful for the Authority to provide stakeholders with a clear explanation of why the calculation was initially thought to be important so that they can judge and comment on the extent to which that rationale is still relevant. More information on the operation of the current process would also be useful as affected participants do not have much insight into the way the current Schedule 14.3 calculation is conducted by the FTR Manager. Examples of details that might assist stakeholders in understanding the possible costs of the proposal:

- What is generally included or excluded from the normal grid configuration assumption under clause 4 of the Schedule?
- How concentrated would the effects of the proposal be on, for example, direct connect transmission customers? The Authority calculates at paragraph 5.21 that the proposal would have reduced payments to transmission customers by around \$7.2 million over ~7 years. This is only 0.67% on average, but Meridian anticipates that the effects would be concentrated on specific transmission customers.
- What is currently preventing the FTR Manager from using Grid Owner data in the way explored in alternative (b)?

Even if FTR coverage accounted for all LCE, the proposal would still represent a significant shift in the way congestion risks are managed for some direct connect customers. While some may previously have relied entirely on passive allocation of LCE, they will now need to consider the benefits of engaging with the FTR market.

The Authority states at paragraph 5.23 that it has not considered the impacts on transmission customers as part of the costs of the proposal “because the cost is financial, not economic”, but it may be difficult for stakeholders to constructively engage with or test this conclusion based on the information provided. Further, where allocating LCE to transmission customers rather than the FTR market is more economically efficient (e.g. because for example relevant customers cannot obtain appropriate FTRs, or it is disproportionately burdensome for them to have to buy FTRs), then Meridian considers that there is an economic cost to allocating that LCE to the FTR market. Because it is difficult to compare the efficiencies of these allocations without a more detailed understanding of the way FTR rentals are presently being calculated, economic costs may be being missed.

We are also less certain than the Authority that recent outcomes demonstrate a structural normalisation of the FTR market. FTR outcomes are inherently linked to underlying wholesale market conditions, which can vary over multi-year cycles. The fact that FTR holders have recently experienced periods where FTR products are “out of the money” does

not necessarily indicate that the underlying concerns regarding the profitability of the FTR market which were identified in the Authority's earlier reviews of the FTR market have permanently dissipated. Whilst this is a separate issue from the question of whether to allocate all LCE to settlement of FTRs, any undue profitability of the FTR market represents an avenue for the allocation of LCE in a way which may not be efficient or in the interests of the end consumers of electricity, and increasing the portion of LCE susceptible to this brings increases in the severity of the risk that FTR outcomes become problematic if market conditions change.

On a related issue, we encourage the Authority to review the interaction between FTR settlements and the LCE washup processes. In particular, there may be merit in ensuring that washup amounts are resolved prior to FTR settlement. This would reduce the likelihood that washup creates unpredictable cash-flow impacts for market participants where they are required to pay further amounts as washup for the prior month where the LCE has already been entirely depleted by FTR settlement. While such impacts may be manageable for larger participants, they may be more material for smaller generators or emerging market participants, including smaller renewable generation projects, and directly connected industrial customers, which may have less access to capital and may be more reliant on the FTR market in the absence of an allocation of LCE in future.

Closing remarks

Meridian supports the direction of the proposal and agrees that the Schedule 14.3 calculation is unlikely fit for purpose, particularly as the FTR market matures and additional hubs are introduced. However, we consider the Authority should more fully assess the distributional consequences of simply removing Schedule 14.3 entirely. There may be benefit to giving more consideration to alternative (b) or other solutions which maintain a calculation of FTR Rentals in some form.

Nothing in this submission is commercially sensitive.

Nāku noa, nā



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Specific questions

	Question	Meridian response
1	Do you agree that Authority should ensure the Code arrangements enable the FTR hub network to develop?	Yes. We consider the further development of the FTR market and addition of further hubs will drive more efficient management of LPR for relevant participants.
2	Do you support the allocation of all available LCE to the settlement of the FTR market? Why/why not?	It is not currently clear to Meridian that the calculation of FTR rentals should be done away with entirely. See covering letter to this submission.
3	Do you agree with the objectives of the proposed amendment? If not, why not?	Yes, however we believe that, given the proposal will on average allocate more LCE to the achievement of its aims (and brings with it risk of allocating more than currently anticipated), it should demonstrate that it represents a reasonably efficient use of that LCE.
4	Do you agree the proposed amendment is preferable to the other options? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory objective in section 15 of the Electricity Industry Act 2010.	It is not currently clear to Meridian that the distributional impacts of the proposal are sufficiently negligible that it should be preferred over alternative (b).
5	Do you agree with the costs identified by the Authority? Are there additional costs we have not considered?	Meridian considers that one potential "cost" of the proposal is the increased potential for inefficient transfers of value away from transmission customers. The Authority has pointed to recent FTR market outcomes appearing to demonstrate a normalisation of profitability. However, future market conditions could materially change (and there is in any event reason to believe current FTR non-profitability is reflective of prevailing wholesale conditions). The proposed amendment therefore increases the degree to which payment of LCE to transmission customers depends on the ongoing effectiveness / efficiency of the FTR market. In general, we note the Authority's view that the impact on transmission customers is financial rather than economic, but consider that if some allocations of value are more efficient for the market / end consumer, then that allocation is an economically relevant issue.
6	Do you agree with the benefits identified by the Authority? Are there additional benefits we have not considered?	Yes.
7	Do you agree the benefits of the proposed amendment outweigh its costs?	Yes, but we note that the value of the benefit (\$127,000 NPV over ten years) is not especially high relative to the volume of wealth transfer that could occur under the proposal (\$7.2 million over ~7 years based

		on previous experience, with larger or smaller amounts possible based on the evolution of the market). If those wealth transfers are inefficient, then the costs have the potential to outweigh the benefits.
8	Do you agree the proposed amendment would give effect to the Authority's statutory objective and the matters listed in section 32(1) of the Act?	Yes.
9	Do you have any comments on the drafting of the proposed amendment?	No.