



meridian

9 May 2017

Submissions  
Electricity Authority  
Level 7 ASB Bank Tower  
2 Hunter Street  
Wellington

**By email: [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)**

### **Issues and Options Paper – Financial Transmission Rights development**

Please find attached Meridian's submission.

In relation to all the developments proposed by the Authority Meridian's view is they potentially offer benefits. They should however be considered in the context of an FTR market, and wider hedge market that are currently both functioning very well. It may be possible to make further enhancements but these will come at some cost. In particular it seems that a number of the proposed developments will increase the complexity of an FTR market that is already relatively complex. This may discourage rather than enhance participation.

Meridian submits that individually and collectively any enhancements ultimately pursued by the Authority or its service providers (the FTR manager and clearing manager) should be the subject of rigorous cost benefit analysis to determine if the additional benefits they bring to the relevant markets outweigh the costs. Unless they do, further enhancements will not deliver any substantial progress in furthering the Authority's statutory objective.

Please contact me if you have any questions.

Yours faithfully

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## Appendix – responses to consultation questions

Question	Meridian comment
<p>Q1. Do you agree that further enhancing the FTR market could support the issues identified by the Authority, and provide benefits to the wider hedge market?</p>	<p>Yes in principle. However in Meridian's view both the wider hedge market and the FTR market are already working very well. The FTR market for example is fully subscribed in the sense that the full volume of FTRs offered are purchased. Further proposed enhancements to the FTR market need to be subjected to rigorous cost benefit analysis as the costs of further enhancements may outweigh the benefits.</p>
<p>Q2. Are there other issues with the current arrangements for FTRs that we have not identified?</p>	<p>The FTR market is complex and this complexity may be discouraging and acting as something of a barrier to increased participation.</p> <p>Meridian notes that a number of the developments discussed in the consultation paper seem likely to provide additional benefits to the FTR market but come at a cost of adding additional complexity to what is already a complex product. It may be that the additional complexity counteracts and ultimately reduces the benefits realized from the various developments discussed.</p>
<p>Q3. Are there any other ways to develop the FTR market that we have not identified? If so, please describe them.</p>	<p>No</p>
<p>Q4. What are your views on the relative merits or priority of these twelve potential developments? Could some of them complement or substitute for others?</p>	<p>In relation to the twelve potential developments identified in clause 5.1 of the Authority's paper:</p> <p>(a) Allow for direct overseas participation in FTR trading.</p> <p>Meridian is particularly concerned at the risk identified by the Authority that this will expose the FTR market to other countries' laws and financial regulations. We note that the paper seems to suggest but does not clearly state that legal advice obtained by the Authority indicates that, in the case of Australia, these risks may be manageable for NZ participants. Meridian requests that the Authority make that advice publicly available. Until it is and Meridian and other parties have had the opportunity to review such advice, Meridian's view is that the FTR market should not allow for direct overseas participation. This is particularly the case given Meridian's understanding that overseas participation in the FTR market can already be facilitated indirectly through brokers such as OMF.</p>

	<p>(b) Allow parties other than the FTR manager to originate FTRs.</p> <p>Meridian notes that parties can already originate FTRs via the OTC market but, like the Authority, queries how many willing sellers of FTRs there are likely to be. Further comment on this option is provided below in response to consultation question 7.</p> <p>(c) Develop an FTR-like derivative product.</p> <p>Again Meridian points out this can already be done via the OTC market</p> <p>(d) Support for secondary trading with bulletin board.</p> <p>Meridian sees potential benefit in this development. As far as Meridian is aware there is nothing currently stopping the FTR manager (or any other entity) from developing a bulletin board which could be funded via a transaction fee for each trade completed via the board.</p> <p>(e) Add FTR hubs under the allocation plan process.</p> <p>This 'development' is already in place under current arrangements. Meridian supports it. Meridian has also consistently advocated that the allocation plan needs to include a process for the 'retirement' of FTR hubs that are not useful or which have seen a substantial reduction in their usefulness. As far as we are aware there is currently no means by which this can be done and it seems a significant omission.</p> <p>(f) Support FTR education.</p> <p>In principle Meridian supports efforts by the Authority to achieve greater and more confident participation in the FTR market.</p> <p>(g) Auction all FTR contracts each month.</p> <p>Meridian has no problem with this proposed development but queries whether it will deliver significant additional benefit.</p> <p>(h) Introduce a "peak" or "Super Peak" FTR product</p> <p>Meridian can see some advantages to these products. They would however reduce the sufficiency of the LCE pool</p>
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because funding of a peak or Super Peak product would reduce the LCE available for baseload FTRs. So introduction of peak or Super Peak products would likely impact the availability of baseload FTRs and hence involve a cost benefit trade-off between availability of peak or Super Peak products and the existing FTRs. Given that the OTC market can provide an alternative mechanism for managing peak (or Super Peak) related risks it must be an open question as to whether the benefits of introducing new FTR products aimed at managing the same risks outweigh the costs.

- (i) Introduce a quarterly FTR product or strip product

Meridian has the same comments on this as with the previous development - the impacts on availability of the existing products due to the new products' impact on revenue sufficiency needs to be carefully considered. The cost / benefit analysis related to introduction of such a product therefore needs to be robust.

- (j) Extend FTR price horizon (to 36 months)

Meridian supports this proposed development

- (k) Introduce FTRs with preferential pay outs

Meridian doubts the cost benefit analysis of this option would show significant gains given that 'fully funded' or 'more certainly funded' FTR-like products can already be purchased via the OTC market.

- (l) Improve transparency around FTR market

Meridian supports efforts to achieve greater transparency around the FTR market and believes these could deliver substantial benefits at minimal costs. Meridian would like to see:

- Auction bids published the day after auctions
- Full details of the assumptions made by the FTR manager in running the FTR auctions
- Annual independent third party review of the FTR manager's model

In summary on the relative merits or priority of the twelve potential developments Meridian's view is that priority should be given to developments:

	<p>(f) Support FTR education</p> <p>(j) Extend FTR price horizon (to 36 months)</p> <p>(l) Improve transparency around FTR market</p>
Q5. Do you agree the Authority should provide policy direction on the four developments in Group 1, but that service providers can lead further assessment of the developments in Group 2?	Yes
Q6. What are your views on the merits of extending direct participation in the FTR market to parties based in Australia?	As already noted Meridian doubts the merits of this development as it is not satisfied as to the legal position. Also Australian and other overseas persons can as we understand it already participate indirectly via brokers like OMF. It is not clear what significant additional benefit direct participation will provide.
Q7. What are your views on the merits and practicality of allowing parties other than the FTR manager to originate FTRs?	In terms of the merits Meridian considers this would be positive development. However as already noted Meridian doubts the practicalities of this development. In particular there may be limited parties who are willing to originate FTRs.
Q8. What are your views on the merits and practicality of developing an FTR derivative product?	As already noted Meridian doubts the merits and practicalities of this development.
Q9. What are your views on the merits of developing a bulletin board?	Meridian does not see significant merit in this development.
Q10. Of the two approaches to overcoming the inherent limitations in the supply of FTRs that have been discussed (allowing parties to originate or develop a derivative product), which do you consider preferable and why?	Meridian does not have strong views or preferences but considers it will be easier for parties to originate FTRs than develop derivative products.
Q11. Are there other approaches to overcoming the inherent limitations in the supply of FTRs that the Authority has not identified?	No. More accurately, there are no alternative approaches that seem sensible to us. The Authority may receive submissions urging relaxation of the FTR manager's objective to target FTR revenue inadequacy one month in a year (e.g. by increasing it to two months a year). While this would increase the supply of FTRs it would in our view be counterproductive as it would reduce the effectiveness of FTRs as a means of hedging basis risk. Further the chances of revenue inadequacy would be greatest at precisely those times that holders of FTRs are most relying on them to provide protection against basis risk. For these reasons Meridian does not consider this to be a sensible alternative approach.
Q12. What are your views on how these developments would complement each other? To what extent might they be dependent on each other?	Meridian considers that however the proposed developments are packaged (i.e. whichever of the 12 options are pursued) there is a real question mark over whether the benefits are likely to exceed costs.

