

9 May 2017

Electricity Authority
Via email: submissions@ea.govt.nz

Consultation Paper Financial Transmission Rights development

Mercury welcomes the opportunity to comment on the proposed developments to Financial Transmission Rights.

Mercury is of the view that it is important to ensure appropriate development of the FTR market occurs. Mercury is an active participant and supports improvements to the existing market on the basis that an overall benefit occurs. Mercury believes enhancements should be of a targeted nature and that sufficient technological expertise and budgetary allowance is available to implement appropriate changes in a targeted manner. Developing the market further when this is likely to result in further complexity and limited benefit to participants or the end consumers could be considered development for the sake of development and be contrary to efficient change and market processes.

Mercury also refers to the guiding principles from the Government Policy Statement on FTR's published in 2002 where some of the key objectives of the FTR market were:

- Realistic long term risk management mechanisms must be made available to end users and to competing retailers.
- Economic efficiency is a critical goal that should be pursued in a robust but realistic fashion. The concept of economic efficiency includes the integrity of nodal price signals for price-sensitive generation, consumption and investment decisions.
- FTR design and allocation should give priority to ensuring consumers have access to competitive markets, particularly in regions subject to transmission constraints, but otherwise have due regard to preserving continuity with established price relativities and commercial arrangements.
- Pragmatic solutions must be developed which are implementable and enduring.

Mercury acknowledges that the market has developed greatly since the policy statement but is of the view that the principles remain the same.

Mercury is concerned that existing enhancements which are supported by the broader participant group have taken an extended period to implement even though the accelerated change process was requested. Subsequent development suggestions appear to overlap the process that was undertaken during the recent consultation on proposals for additional FTR hubs. Mercury would encourage the Authority to focus on delivering industry requested changes in a timely manner before assessing further changes which, while potentially beneficial, be seen as a cause for delaying any change if the Authority chooses to consolidate enhancements for delivery in future work programs.



Mercury is of the view there is a disconnection between the questions participants have been asked to respond to, and the requirement to comment on the high level development options. For the avoidance of doubt, Mercury supports increasing the FTR hub locations by one (Whakamaru), allowing parties to privately fund FTR's as this has the potential to increase liquidity, more training and education in the market and the introduction of a bulletin board.

Other suggested developments are in our view not warranted at this stage of market maturity.

We generally support the work the Authority is doing in reviewing obligations and market development however would suggest that a more focused approach will deliver beneficial changes within shorter timeframes. We also reiterate the need to revisit the principles behind the purposes of developing the FTR regime which should encourage competition and efficiency for the benefit of the consumer which is in line with the Electricity Authority's overarching objectives.

Please contact me on 09 308 8276 with any questions on the above.

Yours sincerely

A handwritten signature in black ink, appearing to read 'AR', written in a cursive style.

Andrew Robertson
Regulatory Adviser



Appendix A Format for submissions

Submitter: Mercury

Question	Comment
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>Mercury believes further enhancements would benefit the market; however they should be of a limited and targeted nature to ensure the timely facilitation of beneficial changes.</p> <p>Specifically, Mercury does not support initiatives that would significantly increase the number of contract types available (e.g. day/week FTR contracts). We believe additional products would do little to improve the ability of participants to hedge their basis risk while substantially increasing the workload and administrative costs for those associated with the market.</p>
Q2. Are there other issues with the current arrangements for FTRs that we have not identified?	<p>Mercury encourages the Authority to complete the previous consultation on adding a new node and ensure changes are made in the short term to allow the market to benefit from them.</p> <p>Mercury would suggest the Authority consider removing hubs which are underutilised within defined periods of time.</p>
Q3. Are there any other ways to develop the FTR market that we have not identified? If so, please describe them.	Refer Q2.



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?

Mercury supports a small number of the changes outlined in the consultation. Mercury would prefer to see a narrower targeted approach to enhancing the market rather than broad brush.

For the avoidance of doubt, Mercury supports increasing the locations by one (Whakamaru), allowing parties to privately fund FTR's as this has the potential to increase liquidity, more training and education in the market and the introduction of a bulletin board. The full list and our support against each initiative is outlined below:

1. Increase the number of locations where participants can use FTRs to manage price risks
Only support the addition of Whakamaru.
2. Help participants to better understand the FTR market and how they can benefit from it.
Supported.
3. Auction FTR contracts more regularly.
Not supported–no significant benefit.
4. Introduce FTR contracts that cover only those locational price risks that arise during certain critical times of the day and week.
Not supported-limited benefit, adds undesirable complexity.
5. Introduce FTR contracts that cover a calendar quarter, on top of the current month-long contracts.
Not supported–limited benefit, adds undesirable complexity.
6. Introduce FTRs that allow parties to cover-off their price risks further in advance.
Not supported–limited benefit, adds undesirable complexity.
7. Split FTRs into two tranches. One tranche would provide certainty that the purchaser will receive the full payment due under the contracts. The other would feature cheaper contracts but they would come with a risk that they might not be paid in full all the time.
Not supported–no significant benefit, scaling risk is easily modelled and hedged.
8. Improve the transparency around the operation of the FTR market and its participants.
Supported
9. Allow parties that are based in Australia to directly participate in the New Zealand FTR market.
Not supported.-Detrimental to achieving market objectives
10. Allow parties to privately fund FTRs and sell them through the existing FTR auctions.
Supported but unsure how this will work practicably.
11. Develop a new financial derivative of an FTR that would be traded on an exchange,
Not supported–limited benefit, adds undesirable complexity.
12. Support developing a platform that parties could use to trade FTRs over the counter,
Not supported – this could be useful but we note that this service is already provided by OMF



<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?</p>	<p>No. Mercury is of the view that policy direction should be provided by MBIE.</p>
<p>Q6. What are your views on the merits of extending direct participation in the FTR market to parties based in Australia?</p>	<p>Mercury is of the opinion, that the ability of parties based in Australia to participate in the NZ FTR market will not help NZ based end users and competing retailers hedge their basis risk (those most exposed to the basis risk). It would, in fact, make it harder and more expensive to do so.</p> <p>Mercury is also concerned that overseas participation could be detrimental to existing participants and specifically those that need to hedge location risk. The price could be driven up due to increased participation (by those outside the existing NZ market) with new players effectively “taking a punt”.</p> <p>Mercury is concerned that while this may open up the market to a small degree, any benefit will be gained by offshore participants rather than locally based business servicing consumers. The consultation paper provides no evidence illustrating how offshore participation would benefit the market and meet the key objectives of the FTR market. Mercury would like to further understand the benefits or otherwise that Authority believes this proposal will deliver from a NZ Inc perspective.</p>
<p>Q7. What are your views on the merits and practicality of allowing parties other than the FTR manager to originate FTRs?</p>	<p>In principle, we do not have an issue with parties other than the FTR manager originating FTRs.</p> <p>This initiative has the potential to increase liquidity in the market which would assist in participant’s ability to hedge basis risk.</p> <p>However, we do not have a view as to the practicality of this initiative at this time due to a lack of information as to how this will work in practicable terms</p>
<p>Q8. What are your views on the merits and practicality of developing an FTR derivative product?</p>	<p>Mercury is of the view that the FTR market is complex as it stands. Mercury would not support the development of a derivative product without further maturity of the market coupled with a greater education and understanding amongst participants of its dynamics.</p>



<p>Q9. What are your views on the merits of developing a bulletin board?</p>	<p>Mercury supports this development as it will provide more transparency and further understanding of the market.</p>
<p>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?</p>	<p>Mercury supports further education to allow parties to originate products.</p>
<p>Q11. Are there other approaches to overcoming the inherent limitations in the supply of FTRs that the Authority has not identified?</p>	<p>Mercury has observed that scaling of the market has not previously occurred. This indicates that the current capacity calculation is overly conservative.</p>
<p>Q12. What are your views on how these developments would complement each other? To what extent might they be dependent on each other?</p>	<p>Mercury is of the view that the changes should be assessed on individual merits, not as a suite of changes and or products. This would enable efficient implementation of changes. Mercury's experience has been that where multiple enhancements are attempted to be initiated, it results in extensive delays to improving the regime.</p>

