

Submissions
Electricity Authority
PO Box 10041
Wellington 6143

28 September 2020

Removing requirement for FTR manager to calculate the amount of LCE to be applied to FTRs

Dear Sir/Madam,

Thank you for the opportunity to make a submission on the Authority's proposal to revoke schedule 14.3 of the Code. We have been active participants in the FTR market since its inception and look forward to its continued evolution and development.

The FTR market is likely to play a more central role in risk management in the coming years as the TPM places more emphasis on nodal price separation to achieve investment signalling and if large consumers exit the market, changing the balance of energy supply and demand and fundamentally altering energy flows on the grid. As this occurs it is important that the industry continues to strive for efficiency and best practice in the FTR market alongside energy markets.

Whilst on the surface, the proposal makes sense, our view is that it is premised on what has been a systematic under-issuance of FTRs by the FTR manager which has resulted in FTR scaling far below the targets specified in the FTR Allocation plan (and by proxy, the Code).

The main argument put forward by the Authority is essentially that because the entirety of the LCE is so infrequently used to settle FTRs, there is little point in incurring the cost of calculating it. Whilst the logical conclusion is correct, unfortunately the fact that LCE is so infrequently used raises questions around FTR issuance, the Authority's compliance monitoring functions, and whether consumers may be missing out on LCE payments because FTR participants have been paying non-firm prices, for what have effectively been firm products. This may in turn be impacting the economics of large electricity consumers, which in turn creates uncertainty and volatility in forward markets for energy.

The current FTR Allocation Plan¹ states that "*The FTR Manager will evolve the FTR policy on the FTR Grid such that, in its reasonable opinion at that time, it is expected that the primary objective will be achieved, with consideration given to also achieving the secondary objective:*

- *The primary objective is for Revenue Inadequacy² to occur one month in twelve*
- *The secondary objective is for the annual average scaling factor to be 98%*

Given this, and the requirements under 13.242 of the Code for the FTR manager to create and allocate FTRs in accordance with the Allocation Plan, it is reasonable to assume that FTR participants bid for FTRs with the expectation that the objectives around scaling will (an average at least) be met. We'd expect that the prices bid for FTRs under this expectation will be less than if the objective was no scaling, or the much more limited scaling than has been observed.

¹ And, to the best of our knowledge, all previous allocation plans

² Emphasis added

As the Authority notes in the consultation paper, there have only been two months where revenue inadequacy has occurred, out of a total of 86. This is only 28% of the number of events stated as the objective in the Allocation Plan. Furthermore, the average scaling factor has been 99.76% as opposed to the secondary objective of 98%, indeed there has not yet been a single 12 month period where the average scaling factor has been as low as the target.

The degree to which this issue has impacted total FTR revenue is unclear due to the fact that both price and quantity of FTRs would be different if the objective were being met³. However, it stands to reason that there has been a wealth transfer from recipients of LCE and residual FTR revenue to FTR participants as a result of FTRs being *firmer than what it says on the tin*.

So, whilst “The Authority considers it is inefficient to pay the FTR manager to determine how much LCE should be available for settlement of the FTR market when the FTR market is regularly being allocated approximately 90% of LCE, and allocating the full 100 per cent would very rarely affect the settlement outcome.”, our view is that this proposal should only be progressed if modelling shows that the premise would hold under much more frequent scaling to the extent that the objectives in the FTR Allocation Plan were being met.

Furthermore, prior to implementation of a Code change based on the premise that the calculation is of low importance due to the lack of scaling, we’d expect that the Authority would first conduct the appropriate compliance monitoring and/or review of the frequency of scaling.

If, following those activities, it was still found that the calculation was of little importance relative to the cost (ie there was still no meaningful wealth transfer from consumers to FTR participants), then we would support the proposed Code amendment.

Yours faithfully,



Stuart Innes,
Director

³ Analysis of the price elasticity of demand for FTRs is not currently possible as there is no publicly available information on historic bid curves.