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Within-island basis risk: proposed approach

1. Vector welcomes the opportunity to respond to the Electricity Authority's (Authority) consultation paper titled, *Within-island basis risk: proposed approach*, dated 25 June 2013 (the paper). Please see Appendix A for Vector's responses to the Authority's consultation questions.
2. Vector's contact person for this submission is:
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General comments

3. The Authority has proposed a shortlist of four options to help manage the spot price risk that remains within each island, notwithstanding the recent introduction of financial transmission rights (FTRs). The four options consist of two FTR related options (Options 2 and 4) and two hybrid options (Options 1 and 3). The Authority's preferred approach is option 4: multi-point FTR.
4. Vector supports the expansion of the FTR market and to this end, prefers Options 2 and 4. Vector considers that these two FTR options are consistent with a nodal energy market as implemented in New Zealand. FTRs are therefore most likely to best promote the long-term interests of consumers and deliver greatest consumer net benefits. Furthermore, we consider the FTR

options to be a positive and natural step in the development of the FTR market, and will best promote retail competition and industry efficiency.

5. Vector would not support a proposal, in the context of a nodal energy market, to implement LRAs and zonal pricing. Vector considers that no benefits would arise from integrating LRAs with the current FTR market. Vector views the introduction of LRAs as distortionary to the nodal price and we suggest that LRAs be removed from any future considerations.
6. The current energy market is designed around nodal pricing, consideration of zonal pricing is beyond the scope of this consultation and would entertain significant market debate. We do not consider this consultation to be the appropriate avenue for this. If the Authority were to consider switching to zonal pricing, we would expect there to be robust consultation.
7. The consultation paper seems to be confused on the issue of appropriate governance of the FTR market. Vector views that the development of FTR options needs to be undertaken with a clear understanding of the roles and responsibilities of the Authority and the FTR Manager, particularly in regards to Questions 13-18. Vector considers that the primary responsibility for the FTR market (including the development, design, and underlying FTR policies of any FTR options in this consultation) should be left to the FTR Manager and the FTR market participants, while the Authority remains responsible for the development of the Code and service provider agreements.
8. In relation to the Authority's provisional preferences (see page E of the paper), Vector's responses are as follows:
 - Vector considers the use of nodes rather than hubs appropriate in the short-term only – hubs ought to be considered in the future if circumstances change and market participants require it. We would also like to note that we do not consider that an increase of hubs would create added complexity.
 - Vector supports the proposal to offer FTRs between every pair of FTR nodes rather than using a radial system, as this promotes flexibility and choice as to how FTR market participants manage their WIBR.

- Vector also supports the offering of a full selection of option and obligation FTRs in both directions.

Yours sincerely,

A handwritten signature in blue ink that reads "B. Girdwood". The signature is written in a cursive style with a period at the end.

Bruce Girdwood

Manager Regulatory Affairs

Appendix A: Vector's responses to consultation questions

Number	Question	Response
Q1	Do you agree that the Authority has characterised the problem of WIBR correctly? If not, how could the problem be better described?	Vector agrees.
Q2	Do you agree that these four options are an appropriate shortlist? If not, are there other options that should be considered?	Vector agrees, there are no additional options required.
Q3	Do you agree that the four options in Table 2 need not be considered at this stage? If not, which of them should be considered and why and what other options should be considered and why?	In Vector's view, there are only 2 options that should be considered further. These are the 3-Node and Multi-point FTR options ("the two FTR options"). This is because these options are standard market design options that efficiently use rentals to create hedges against WIBR and are consistent with the investment in FTRs already made.
Q4	Do you agree that the two-node hybrid option has been characterised correctly? If not, how could it be better described?	Vector does not agree that this option should be pursued further. We do not consider it based on good market design (see response to Question 8).
Q5	Do you agree that the three-node FTR option has been characterised correctly? If not, how could it be better described?	Vector agrees. However, we consider that this option should be developed and designed by the FTR Manager, in conjunction with market participants.

Q6	Do you agree that the three-node hybrid option has been characterised correctly? If not, how could it be better described?	Vector does not consider this a feasible option. See below, Question 8.
Q7	Do you agree that the multi-node FTR option has been characterised correctly? If not, how could it be better described?	Vector generally agrees. See response to Question 14.
Q8	Do you agree that all four high-level options are feasible? If not, why not.	<p>Vector considers that only two options are feasible – the two FTR options (as noted above).</p> <p>We do not consider that the other options are feasible because they are not based on good market design, are not used in other jurisdictions and are inconsistent with the existing FTR market.</p>
Q9	Do you agree that all four options would avoid distortion to price signals? If not, why not?	In Vector’s view only the two FTR options will enhance price signals, while the other options will have the potential to be distortionary. In particular, the LRAs option.
Q10	Do you agree that the criteria in Table 7 are reasonable and roughly equal in priority? If not, why not? Should other criteria relating to competition, reliability or efficiency be considered?	Vector agrees that the criteria are broadly reasonable and sensible.

Q11	Do you agree that the multi-point FTR would promote the Authority's statutory objective most effectively? If not, why not, and which option do you think would most support the statutory objective?	Vector agrees. The Multi-point FTR option is flexible, provides users with choice and can be expanded as and when market participants require it. e.g. it can be built upon if additional nodes are required in future.
Q12	Do you agree that the multi-point FTR would produce a greater net benefit than any of the other options? If not, why not, and which option do you consider would produce the greatest net benefit?	Vector agrees.
Q13	If the decision is to proceed with the multi-point FTR, which FTR points do you consider should be added at this point, and why?	Vector considers this to be an operational matter, which should be left to the FTR Manager to develop with market participants so that the nodes address the requirements of users.
Q14	Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTR points should generally be nodes rather than hubs? If not, why not?	Vector considers that in the short-term, nodes are sufficient. However, if more nodes are added later hubs should be given serious consideration to ensure ease and convenience of trading. This level of detail should be left to the FTR Manager with input from the relevant market participants and traders.

Q15	Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTRs should be point-to-point rather than radial? If not, why not?	Vector agrees. However, (as stated above in Question 13) we consider that this should be a matter for the FTR Manager to consider in consultation with users.
Q16	Do you agree that, if the decision is to proceed with the multi-point FTR, the new FTR products should include a full selection of options and obligations? If not, why not?	As above, Question 15.
Q17	Do you agree that, if the decision is to proceed with the multi-point FTR, the Authority should proceed according to the roadmap set out in Figure 7? If not, how should the Authority proceed?	Vector agrees. However, we consider that LRAs should not be considered as an option for the future.
Q18	Do you agree that, if the decision is to proceed with the multi-point FTR, the Authority should develop objective criteria for adding and removing FTR nodes in future years? What should be taken into account in developing these criteria?	<p>Vector considers that this is a question of governance and should be left to the FTR Manager to meet the needs of market participants.</p> <p>The Authority should mandate FTRs and leave the development and the details of the market to the FTR Manager.</p>