

## **PRODUCT RULING - BR Prd 12/06**

This is a product ruling made under s 91F of the Tax Administration Act 1994.

### **Name of the Person who applied for the Ruling**

This Ruling has been applied for by the Electricity Authority.

### **Taxation Laws**

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of ss 3(1)(kaa), 11A(1)(k), 11A(2), 14(1B)(a), and the definitions of "consideration", "supplier" and "taxable supply" in s 2(1).

All references to the Electricity Industry Participation Code 2010 (Code) are to the Code as at the date of this Ruling.

### **The Arrangement to which this Ruling applies**

The Arrangement is the issue of a financial transmission right (Option FTR) created under subpart 6 of Part 13 of the Code. The Option FTR is issued as a financial hedge against the volatility in the price of the transmission of electricity across the national grid caused by losses and constraints on the physical grid.

Option FTRs will provide the purchaser (Participant) with a cap on the FTR reference price (the sum of certain differences in the final prices for electricity between two designated points on the national grid over a specified period) in return for a premium that will be determined at auction. If the FTR reference price exceeds the strike price on settlement day, the Participant or the FTR holder (as that term is defined at para 14) will receive the difference between the FTR reference price and the strike price from the market operation service provider contracted as the Clearing Manager under the Code (Clearing Manager).

Further details of the Arrangement are set out in the paragraphs below.

## Locational price risk

1. Sources of electricity generation are often hundreds of kilometres away from electricity consumers. The transmission system used to transport electricity over long distances is subject to:
  - loss of energy (which means more electricity must be generated than is consumed);
  - congestion (where a shortage in the transmission capacity to supply the demand leads to more expensive sources of generation being used to supply electricity demanded); and
  - risk of failure of critical elements (which means generation or demand reduction must be on standby to cover such an event, referred to as “instantaneous reserves”).
2. These factors can result in large unpredictable price differences across the electricity grid, resulting in “locational price risk”.
3. Electricity retailers buy electricity on the wholesale market at points of connection on the grid where their customers are located. Generators sell electricity to the market at the location where they generate electricity. As most generators are also retailers, they sell electricity to the wholesale market at different locations from where they buy it.
4. Wholesale market prices are volatile and can rise quickly and sharply if certain events occur, such as when transmission cables or power stations are taken out of service (either for faults or maintenance). This can result in large and volatile differences in wholesale market prices across New Zealand, such as between the North and South Islands, or between locations within each island.
5. An example of this problem occurs during “dry winters” when low rainfall constrains electricity generation from hydro dams, most of which (and the largest) are in the South Island, such as occurred in 2008. Minimising the use of hydro generation in the South Island requires large volumes of electricity to be “imported” from the North Island, which occurs over the high voltage direct current (HVDC) link between Wellington (Haywards) and Benmore. When the desired volume exceeds the southward capacity of the HVDC link, wholesale market prices in the South Island rise above North Island prices.
6. The lack of a secure and low-cost mechanism to manage locational price risk makes electricity retailers unwilling to enter new areas and compete for customers in regions where they do not have generation. This has resulted in some areas having relatively weak retail competition and, possibly, higher retail prices than they would otherwise have.
7. Before the introduction of FTRs, generator–retailers minimised their locational price risks by seeking retail customers in regions near to their generation assets. Retailers could also arrange hedge contracts with generators or other market participants. However, they were still likely to be exposed to some locational price risk. Retailers could also seek to arrange a basis swap (swap their locational risk position) with another party, but they may have continued to be exposed to locational price risk

if the other party was subject to weak competitive pressure and could alter the price and undermine the benefit of the swap. Sufficient basis swaps may not have been available because local generation in a region often accounts for only a portion of the load served—the rest is served from power imported over the transmission network.

8. Locational price risk was a matter that the Electricity Authority was required to address under s 42 of the Electricity Industry Act 2010 which relevantly provides:

**42 Specific new matters to be in Code**

- (1) Before the date that is 1 year after this section comes into force [1 November 2011], the Authority must either—
  - (a) have amended the Code so that it includes all the matters described in subsection (2) (the new matters); or
  - (b) to the extent that the Code does not include all the new matters, have delivered to the Minister a report described in subsection (3).
- (2) The new matters are as follows:  
...
  - (c) mechanisms to help wholesale market participants manage price risks caused by constraints on the national grid:

9. In late 2011, the Code was amended to address locational price risk by enabling qualifying participants to purchase FTRs. FTRs are a form of hedge contract for wholesale market participants to cover price risks between two points on the national grid. They are intended to operate as a hedge against the volatile price differences between the half-hourly spot prices of electricity in the North and South Islands that arise and to hedge Participants against additional costs they may incur in the use of the national grid because of physical constraints and energy losses. FTRs will allow electricity traders to manage locational price risk arising from variations in wholesale spot prices between two price points (hubs) on the wholesale electricity market, such as Benmore and Otahuhu. FTRs will provide cover for the full price difference between the two hubs (except where insufficient funding is available to settle the FTRs, in which case a pro-rata scaling of the payment will apply).
10. FTRs allow generators to fix the price at which they can deliver electricity to a particular point and allow consumers to remove the risk of price escalations between the point of generation and the point of consumption. To clarify, FTRs hedge against price risk due to transmission effects rather than energy price. By analogy to an industry producing physical goods, FTRs allow the producer or consumer to fix the cost of delivery, and thus the return or cost to them, regardless of actual cartage costs.
11. In contrast to standard hedge contracts that are funded by the parties issuing them, FTRs are centrally funded from surplus money accruing in the wholesale electricity market (often called “loss and constraint rentals”). These surpluses arise because prices in the wholesale market reflect the marginal cost of electricity at each point along the national grid. The surplus money in the wholesale market is expected to be broadly sufficient to fund FTRs. However, funding for an FTR is not guaranteed and occasionally because of extreme events the price difference between Otahuhu and Benmore may not be fully covered by the FTR.

12. Ownership of an Option FTR does not entitle the Participant or FTR Holder to any rights for physical delivery of electricity or power.

### **Relevant documents**

13. The following documents are relevant to the Arrangement:
- The Electricity Industry Participation Code 2010; and
  - The FTR Allocation Plan, issued (from time to time) by the FTR Manager under cl 13.238 of the Code and approved by the Electricity Authority under subpart 6 of Part 13 of the Code.

### **Parties to the Arrangement**

14. The parties to the Arrangement are the:
- Electricity Authority;
  - Clearing Manager;
  - FTR Manager;
  - Participant; and
  - FTR Holder (the person registered as the holder of the FTR on the FTR register maintained by the FTR Manager, in the event that the FTR has been assigned in accordance with cl 13.248 of the Code).
15. The Electricity Authority is an independent Crown entity responsible for the efficient operation and regulation of the New Zealand electricity market. The Electricity Authority must pursue the statutory objective set out in s 15 of the Electricity Industry Act 2010 to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.
16. Energy Clearing House is the current Clearing Manager. Energy Clearing House is a company incorporated under the Companies Act 1993, resident in New Zealand for GST purposes and a "registered person" as that term is defined in s 2(1).
17. Energy Market Services (EMS), a division of Transpower New Zealand Limited (Transpower), is the current FTR Manager. EMS is the market operation service provider contracted as FTR Manager under the Code.
18. The Electricity Authority appoints the Clearing Manager and the FTR Manager under Part 3 of the Code as market operation service providers. Under cl 3.4 of the Code, the remuneration of a market operation service provider is as agreed between the Electricity Authority and the service provider. Clause 3.4 of the Code provides:

#### **3.4 Terms of market operation service provider agreements**

- (1) The remuneration of a market operation service provider is as agreed between the Authority and the market operation service provider.
- (2) The Authority and the market operation service provider may agree on any other terms and conditions, not inconsistent with the functions, rights, powers, and obligations of that market operation service provider under this Code (except parts 6 and 9) and Part 2 and Subpart 1 of Part 4 of the Act.

## Option financial transmission rights

19. Option FTRs ("one way" FTRs), will provide the Participant with a cap on the FTR reference price in return for payment of a premium. If the FTR reference price on settlement day exceeds the strike price, the Participant (or the FTR Holder, if the Participant has assigned the FTR in accordance with the Code) will receive the difference between the FTR reference price and the strike price.
20. The reference price for FTRs will be the sum of certain differences in final prices for electricity between the relevant hubs over the relevant contract period. For example assuming that the relevant hubs are the nodes at Benmore and Otahuhu:
  - If the final price at both Benmore and Otahuhu is \$60 per megawatt hour (MWh) for every trading period in the contract period, then the FTR reference price will be zero; but
  - If the final price at Benmore is \$40/MWh and the final price at Otahuhu is \$100/MWh for every trading period in the contract period, then the FTR reference price will be \$60/MWh multiplied by the number of trading periods in the contract period. Conversely, if the final price at Benmore is \$100/MWh and the final price at Otahuhu is \$40/MWh for every trading period in the contract period, then the FTR reference price will be zero (as the differences in final prices are all negative \$60/MWh).
21. As of the date of this Ruling, Option FTRs will be for multiples of 0.1 MW, and will be issued in respect of a particular billing period (calendar month) or part of a billing period. FTRs may be made available up to two years or more ahead of the billing period to which they relate.
22. Option FTRs will require the Clearing Manager in accordance with cl 13.246 of the Code (see para 34), and in respect of the Option FTR contract, to pay the Participant or FTR Holder where the FTR reference price (the sum of certain differences between the final prices for electricity at the two hubs specified in the Option FTR contract—for example, Otahuhu and Benmore—over the specified contract period) is greater than the strike price. No corresponding obligation to make payment arises for the Participant or FTR Holder under the Option FTRs (that is, where the FTR reference price is less than the strike price on a specified date in the future (Settlement Day)). The FTR reference price will be calculated in accordance with the formula set out in the contract. Settlement Day is the 20<sup>th</sup> day of the calendar month following the end of the contract period.
23. Option FTRs will be auctioned. On the date of entering into the Option FTR contract, Participants will agree to pay the premium determined by the auction.
24. The premium will not be payable at the time of the auction; instead, it will be payable at the time payment is required for the billing period in which settlement occurs, and will be included in the invoice issued by the Clearing Manager for the relevant Option FTR (and for any other services that may have been acquired from, or supplied to, the Clearing Manager – such as electricity or ancillary services). If any payment is due to the

Participant or FTR Holder from the Clearing Manager, the premium will be deducted from this amount.

25. Option FTRs will initially be split into two sub-types:
- North Island to South Island, where the Participant or FTR Holder will receive the difference if the price at the relevant South Island hub exceeds the price at the relevant North Island hub (providing hedge protection for, by way of example, North Island generators retailing electricity in the South Island); and
  - South Island to North Island, where the Participant or FTR Holder receives the difference if the price at the relevant North Island hub exceeds the price at the relevant South Island hub (providing hedge protection for, by way of example, South Island generators retailing electricity in the North Island).

*Terms and conditions of an Option financial transmission right*

26. All Option FTRs will be on standard terms and conditions. The standard terms and conditions will provide:
- the type of FTR (option or obligation);
  - the contract period and contract unit;
  - the relevant hubs or “grid reference points”;
  - the formula for calculating the FTR pay-out and total settlement amount;
  - settlement terms; and
  - market disruption and termination events.

**Financial transmission right auctions**

27. FTRs will be allocated to Participants by way of an auction that the FTR Manager will conduct.
28. It is currently anticipated that the following would be an appropriate list of Participants. However, entities not listed may be permitted to be Participants in future:
- a person whose principal business is purchasing or selling electricity;
  - a person who uses in excess of 10 GWh per year of electricity;
  - Her Majesty the Queen in right of New Zealand;
  - A Crown entity named in the Crown Entities Act 2004 that is permitted to enter into a derivative transaction in accordance with subpart 3 of Part 4 of the Crown Entities Act 2004;
  - a State enterprise named in the First Schedule or Second Schedule to the State-Owned Enterprises Act 1986;

- a member of the trade association known as the Major Electricity Users Group;
- a registered bank as defined in the Reserve Bank of New Zealand Act 1989;
- a person whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money;
- a person who is authorised to carry on the business of dealing in futures contracts under the Securities Markets Act 1988;
- a person authorised in another jurisdiction by the competent authority of that jurisdiction to deal in futures contracts; and
- a person that is a related body corporate of any of the persons listed above.

#### *FTR Manager*

29. The FTR Manager will be responsible for:
- preparing and publishing the FTR allocation plan (which the Electricity Authority must approve);
  - collecting relevant information from the grid owner, system operator and Clearing Manager;
  - determining the number of FTRs to be offered in each auction;
  - designing and operating the auction process; and
  - operating the FTR register.
30. The FTR Manager will prepare an FTR allocation plan, which will determine the number and nature of FTRs to be offered for auction in respect of a particular FTR period. Schedule 13.5 of the Code sets out the requirements for the FTR allocation plan and provides:

#### **Schedule 13.5**

##### **Requirements for FTR allocation plan**

##### **1 Purpose**

The purpose of this Schedule is to set out the requirements for the **FTR allocation plan** prepared by the **FTR manager** under subpart 6 of Part 13.

##### **2 Requirements for design of FTRs**

- (1) **FTRs** must be allocated by auction.
- (2) At a minimum, the FTRs allocated under the **FTR allocation plan** must be **FTRs** between a hub in the South Island and a **hub** in the North Island that would provide a reasonable match with the trading points for exchange-traded futures products or the equivalent **electricity** futures products, and which would enable the volumes of **FTRs** available to reflect inter-island grid capacity.

- (3) The **FTR manager** must offer **option FTRs** and **obligation FTRs**.
- (4) The **FTRs** offered must include **FTRs** for which the **FTR period** is 1 month.
- (5) Subclause (4) does not prevent the **FTR manager** from offering **FTRs** relating to a shorter **FTR period** in addition to **FTRs** for which the **FTR period** is 1 month.

### 3 Requirements for FTR auction design

- (1) The number and nature of the **FTRs** allocated under the **FTR allocation plan** and available for auction must be—
  - (a) supported by a reasonable estimate of the capacity of the **grid** for the relevant period; and
  - (b) set so as to achieve a reasonable balance between the following:
    - (i) ensuring that there is revenue available that is sufficient to settle the **FTRs**;
    - (ii) ensuring that sufficient **FTRs** are available so that **participants** who wish to purchase **FTRs** are able to obtain them.
- (2) The **FTR auction** must be designed to—
  - (a) maximise the value of trade in the auction as determined by the bids made in the auction; and
  - (b) maximise competition in the auction; and
  - (c) minimise costs of participation in the auction.
- (3) The **FTR allocation plan** must include **FTR auction** rules.
- (4) The initial **FTR allocation plan** must specify a plan that seeks to—
  - (a) ensure that, no later than 1 year after the first **FTR auction**, **FTRs** are available in each **FTR auction** relating to an initial month and to at least each of the 11 months following the initial month; and
  - (b) ensure that the availability of **FTRs** is progressively increased so that, no later than 3 years after the first **FTR auction**, **FTRs** are available in each **FTR auction** relating to an initial month and to at least the 23 months following the initial month.

### 4 Requirements for FTR grid design

The **FTR grid** must—

- (a) be based on each **grid owner's** forecast of the configuration and capacity of its **grid** for the **FTR period**; and
- (b) make allowance for relevant planned and unplanned outages in accordance with reasonable transmission operating practice.

31. Clause 13.242 of the Code states that the FTR Manager must create and allocate FTRs. Clause 13.242 provides:

**13.242 FTR manager must create and allocate FTRs**

- (1) The FTR manager must create and allocate FTRs in accordance with the FTR allocation plan approved under clause 13.240.
- (2) Every FTR must relate to -
  - (a) a minimum quantity of **electricity** (in **MW**) of 0.1 **MW**; and
  - (b) an amount of **electricity** (in **MW**) that is a multiple of 0.1 **MW**.

*Clearing Manager*

32. The Clearing Manager will be responsible for:

- ensuring persons wishing to take part in an FTR auction satisfy the prudential security requirements set out in the Code;
- collecting and allocating FTR auction revenue, and dealing with all receipts and payments in respect of FTRs, in accordance with Part 14 of the Code;
- monitoring the prudential position of Participants and FTR Holders and ensuring Participants and FTR Holders maintain acceptable security;
- managing the FTR account, including making and receiving final payments to and from the FTR account on the maturity of FTRs;
- making recommendations to the Electricity Authority in relation to market disruption events; and
- dealing with events of default.

33. Clause 13.245 of the Code states that the Clearing Manager must collect and allocate auction revenue. Clause 13.245 provides:

**13.245 Clearing manager must collect and allocate auction revenue**

The clearing manager must collect the FTR auction revenue and allocate it in accordance with Part 14.

34. Clause 13.246 of the Code states that the Clearing manager must deal with all receipts and payments in respect of FTRs. Clause 13.246 provides:

**13.246 Clearing manager must deal with FTR receipts and payments**

The clearing manager must deal with all receipts and payments in respect of FTRs in accordance with Part 14.

35. Clause 13.252 of the Code states that the FTR Manager must provide the following information to the Clearing Manager in relation to each successful bidder in an FTR auction. Clause 13.252 provides:

**13.252 Information to be provided to clearing manager**

- (1) The FTR manager must provide the following information to the clearing manager in relation to each successful bidder in an FTR auction:
- (a) the details of each FTR allocated under an FTR auction, including—
    - (i) the period to which the FTR applies; and
    - (ii) whether the FTR is an option FTR or an obligation FTR; and
    - (iii) the formula under which the amount payable or to be paid is to be calculated for the settlement of the FTR:
  - (b) the price at which each FTR has been allocated.
- (2) The FTR manager must provide the information specified in subclause (1) to the clearing manager as soon as practicable and no later than 1 week after each FTR auction.
36. Nothing in the Code states that the Clearing Manager is acting as agent for any other person when the Clearing Manager makes or receives payments in respect of an Option FTR.

*Auction process*

37. The FTR allocation plan outlines the FTR auction process which is broadly as set out below:
- The FTR Manager will first announce an FTR auction. A party wishing to participate in the FTR auction (Participant) will apply to the FTR Manager to do so. The FTR Manager will notify the Clearing Manager that the party wishes to participate in the FTR auction.
  - The FTR Manager will then determine the security that the Participant will need to provide, in accordance with the Clearing Manager's prudential security assessment methodology. This methodology will be based on the Code's current security requirements, which require a Participant to maintain an acceptable credit rating in accordance with cl 14.6 of the Code, or to provide to the Clearing Manager, and maintain, acceptable security in accordance with cl 14.5 of the Code. Acceptable forms of security include cash deposits, unconditional guarantees or letters of credit, security bonds, hedge settlement agreements or any similar securities.
  - Based on information received from the Clearing Manager, the FTR Manager will determine a limit for the Participant in an FTR auction that specifies the maximum liability that the Participant can incur in respect of its bids in the auction.
  - The FTR Manager will establish an "account" for the Participant in the FTR register and record the Participant's auction trading limit.

The FTR Manager will then determine the quantity, type and price of FTRs that will be awarded to different Participants given the available supply of FTRs.

- As in the electricity market, most FTR markets use uniform fixed pricing rather than pay-as-bid pricing. This means that the price all bidders pay for each FTR type and period will be the price at which the market clears (where supply equals demand). Given the shape of demand curves, which are downward sloping, this is likely to mean all Participants will pay the price bid by the marginal (lowest price) winning bidder.

#### *Clearing and settlement*

38. Although the detail of the FTR clearing and settlement design is still being determined, it is expected that the following process will apply:
- Once the auction has been completed, the FTR Manager will record the quantity of FTRs that Participants have purchased into Participants' accounts in the FTR register, and advise bidders of the results of the auction and make the results available on the FTR Manager's website. The FTR Manager will also inform the Clearing Manager of the successful bidders, the details of each FTR allocated, and the price at which each FTR has been allocated.
  - The FTR Manager will subsequently monitor the prudential position of Participants or FTR Holders according to the methodology for determining the minimum level of security developed according to the requirements of the Code. This may involve using the latest clearing prices in FTR auctions and futures market prices as indicators of the expected value of FTRs before the FTR period. If necessary, it may also mean requiring Participants or FTR Holders to adjust their security position in the event of adverse movements in the expected FTR value. Conversely, if price movements are favourable, the Clearing Manager can reduce the level of security that a Participant or FTR Holder is required to hold.
  - At the completion of the FTR contract period, the Clearing Manager will calculate FTR pay-outs and payments required. The Clearing Manager will publish this information on a per megawatt (MW) basis (but not on an individual portfolio basis—portfolio information will only be provided to the Participant or FTR Holder).
  - The Clearing Manager will then issue invoices to Participants or FTR Holders. As with the wholesale electricity market, payment will be required by the 20th of the month following the FTR period.
  - The Clearing Manager will deposit revenue received in relation to FTRs in the FTR account.
  - The FTR Manager will be responsible for calculating the portion of the loss and constraint excess the Clearing Manager must pay into the FTR account each month (in accordance with sch 14.6 of the Code).
  - Any residual loss and constraint excess in the FTR account (that is, an amount remaining in the FTR account that relates to the relevant billing period and is not required to settle FTRs for that billing period) will be treated as loss and constraint excess, and will be paid to the grid owner for allocation to its transmission customers (as is the current position).

- Following settlement, the FTR Manager will record in the FTR register that the FTRs have been settled.

*Invoices and payments*

39. The Code requires invoices to be issued two business days after the Clearing Manager receives reconciliation information for the prior billing period (cls 14.36 and 14.44 of the Code).

40. Clause 14.36 of the Code provides:

*Invoices to and payments by payers*

**14.36 Issue of invoices**

- (1) 2 business days after the clearing manager receives reconciliation information in respect of the prior billing period from the reconciliation manager in accordance with clause 28(c) of Schedule 15.4, the clearing manager must issue to each purchaser an invoice in respect of the trading period of the billing period to which the reconciliation information applies.
- (2) At the same time as the clearing manager issues invoices under subclause (1), the clearing manager must issue an invoice to each person to whom ancillary service costs have been allocated.
- (3) At the same time as the clearing manager issues invoices under subclause (1) or, if publication of final prices is delayed under clause 13.184 for any trading period in the billing period, 2 business days after the relevant final prices are published, the clearing manager must issue an invoice in respect of the settlement of any amount owing under an FTR and any FTR payment due in respect of an FTR.

41. Clause 14.44 of the Code provides:

*Payments to and from payees*

**14.44 Issue of invoices to payees**

Payee invoices must be issued as follows:

- (a) concurrently with issuing invoices to payers, the clearing manager must issue pro forma invoices to each payee. Each such pro forma invoice must detail the amount that the clearing manager must pay in respect of a billing period upon receiving payment from the payers, subject to clause 14.47 and clause 14.47A and the issue of an actual GST invoice for the amount payable to that payee. Payees must not issue GST invoices for supplies of electricity or ancillary services or ancillary service administrative costs to the clearing manager:
- (b) if the clearing manager issues a pro forma invoice to a payee and the total sum of the items specified in that pro forma invoice is such that the payee is obliged to pay the clearing manager, the payee is deemed to have been issued with an invoice, and the payee is deemed to be, in relation to that invoice, a payer. Clauses 14.36 to 14.54 apply to the payee as if it were a payer for the purposes of issue and payment of the invoice.

42. Clause 14.47A of the Code states that the Clearing Manager must calculate the total amount payable in respect of FTRs and must pay that amount in accordance with the terms of the FTR. Clause 14.47A relevantly provides:

**14.47A Payments in respect of FTRs**

- (1) The clearing manager must calculate the total amount payable by the clearing manager in respect of FTRs in respect of the current billing period.
- (2) The clearing manager must publish the amount payable by a person or to a person per MW in respect of FTRs in respect of the current billing period.
- (3) The clearing manager must pay any amount payable in respect of FTRs in respect of the current billing period from the FTR account, in accordance with the terms of the FTR.
- (4) If the total amount required to be paid by the clearing manager in respect of FTRs in respect of the billing period exceeds the amount of all funds in the FTR account available for the settlement of FTRs in the relevant billing period, the clearing manager must amend each amount payable to a person in respect of each FTR for that billing period so that the amount payable is calculated according to the following formula:  
...
- (5) Subclause (4) does not apply to an FTR in respect of which the holder of the FTR is required to pay an amount to the clearing manager.

**Secondary market**

43. It is expected that over time a secondary market will develop for FTRs. The Code provides that FTRs may be sold or assigned to other persons, providing the purchaser satisfies the requirements that the Code specifies for Participants in the FTR market. That is, the purchaser would need to apply to the FTR Manager for registration of the FTR assignment, and provide the Clearing Manager with the necessary prudential security before the FTR Manager would be able to register the assignment of the FTR on the FTR register (at which time the purchaser would be an "FTR Holder"). The requirements for prudential security and assignment of FTRs are set out in cls 14.3 to 14.6 and 13.248 to 13.250 of the Code respectively.
44. Persons who acquire an FTR (or part of an FTR, for example, 0.5 MW of a 1.0 MW FTR) by way of assignment cannot do so otherwise than in accordance with cl 13.248 of the Code. Clauses 13.248(5) and (6) of the Code provide:

**13.248 Assignment of FTRs**

...

- (5) An assignment of an **FTR** or part of an **FTR** is not effective unless it is registered on the **FTR register** by the **FTR manager**.
  - (6) The **FTR manager** must not register an assignment that is expressed to have effect after the end of the **billing period** to which the **FTR** relates.
45. Once an assignee has been registered as the holder of the FTR on the FTR register the assignee replaces the Participant as the counterparty to the FTR.

46. If the FTR has been assigned under cl 13.248 of the Code and the notification of assignment discloses the price at which the FTR has been assigned, cl 13.249 will apply and the assignee will become liable for the price disclosed when it becomes due on settlement. If the price disclosed in the notification is less than the FTR acquisition cost, the assignor will be liable to pay the difference to the Clearing Manager. If the price disclosed in the notification is more than the FTR acquisition cost, the assignor will be entitled to be paid the difference by the Clearing Manager. Clause 13.249 of the Code relevantly provides:

**13.249 Liability for FTR payments when FTR assigned and price disclosed**

- (1) This clause applies if—
- (a) an **FTR** is assigned under clause 13.248; and
  - (b) the notification of assignment discloses the price at which the **FTR** has been assigned.
- (2) The **FTR manager** must provide a copy of the notification of assignment to the **clearing manager**.
- (3) The assignee becomes liable for the price disclosed under subclause (1)(b) when it becomes due on settlement of the **FTR**.
- (4) If the price disclosed in the notification is less than the **FTR payment** in respect of the **FTR** that would, if the assignment had not taken place, become due on settlement of the **FTR**, the assignor becomes liable to pay to the **clearing manager** an amount equal to the difference between the **FTR payment** and the price at which the **FTR** has been assigned.
- ...
- (7) If the price disclosed in the notification is more than the **FTR payment** in respect of the **FTR** that would, if the assignment had not taken place, become due on settlement of the **FTR**, the assignor becomes entitled to be paid by the **clearing manager** on settlement of the **FTR** an amount equal to the difference between the **FTR payment** and the price at which the **FTR** has been assigned.

**Loss and constraint excess**

47. FTRs will be underpinned, and payments made by the Clearing Manager to Participants or FTR Holders under the FTRs will be funded, by FTR auction revenue and the “loss and constraint excess”.
48. The loss and constraint excess is, broadly, the difference between the aggregate amount the Clearing Manager receives from purchasers of electricity in a billing period (calendar month) and the aggregate amount the Clearing Manager pays to generators of electricity.
49. Historically the Clearing Manager allocated this loss and constraint excess to the owner of the national grid, which means it was not available to fund an instrument to protect purchasers from the high price under the constraint or generators from the low price. With the introduction of FTRs, the Clearing Manager will retain part of the loss and constraint excess for each billing period and use it to settle FTRs for the corresponding billing period.
50. Under cl 14.73 of the Code, the FTR Manager is required to determine the amount of loss and constraint excess that the Clearing Manager must retain and pay to the FTR account on the 20th day of each month following a billing period.

51. Where the amount retained for a billing period is greater than the amount required to settle the relevant FTRs, the balance will be paid to the grid owner.
52. Where the total amount required to be paid to Participants or FTR Holders in respect of FTRs for a billing period exceeds the amount of all funds in the FTR account (which is managed by the Clearing Manager), payments under the FTRs will be prorated and Participants or FTR Holders will receive a scaled amount.

### **Condition stipulated by the Commissioner**

This Ruling is made subject to the following condition:

- a) Option FTRs are entered into on arm's length terms.

### **How the Taxation Laws apply to the Arrangement**

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows:

- The supply of an Option FTR is a supply of financial services under s 3(1)(kaa).
- The supply of an Option FTR (being the provision of a financial service as defined in s 3(1)(kaa)) by the Clearing Manager to a Participant or FTR Holder who is not "resident" in New Zealand (as defined in s 2(1)) and who is outside New Zealand at the time the services are performed is subject to GST at the rate of 0% under ss 11A(1)(k) and 14(1B)(a), provided that s 11A(2) does not apply.
- The premium paid by a Participant or FTR Holder to the Clearing Manager to acquire an Option FTR is "consideration" (as defined in s 2(1)) for the supply of the Option FTR.
- Amounts paid by the Clearing Manager to a Participant or FTR Holder in performance of the Clearing Manager's obligations in respect of an Option FTR are not an adjustment to the "consideration" (as defined in s 2(1)) paid by the Participant or FTR Holder to the Clearing Manager for the supply of the Option FTR.
- Amounts paid by the Clearing Manager to a Participant or FTR Holder in performance of the Clearing Manager's obligations in respect of an Option FTR are not "consideration" (as defined in s 2(1)) for any "taxable supply" (as defined in s 2(1)) made by the Participant or FTR Holder to the Clearing Manager.
- Amounts paid by a Participant or FTR Holder (in the event that the Option FTR has previously been assigned) to the Clearing Manager in performance of the Participant's or FTR Holder's (as appropriate) obligations in respect of an Option FTR that has been assigned to another FTR Holder are not "consideration" (as defined in s 2(1)) for any "taxable supply" (as defined in s 2(1)) made by the Clearing Manager.

- Amounts paid by a Participant to an FTR Holder, or by an FTR Holder to a Participant or FTR Holder (in the event that the FTR has previously been assigned) in consideration for the assignment of an Option FTR are not "consideration" (as defined in s 2(1)) for any "taxable supply" (as defined in s 2(1)) made by the Participant or FTR Holder (as appropriate).

**The period or income year for which this Ruling applies**

This Ruling will apply for the period beginning on 18<sup>th</sup> October 2012 and ending on 18<sup>th</sup> October 2015.

This Ruling is signed by me on the 18<sup>th</sup> day of October 2012.

**Fiona Heiford**  
Manager (Taxpayer Rulings)