



3 November 2006

Ian Dempster
Gas Industry Co
Level 9, State Insurance Tower
1 Willis Street
P O Box 10-646
Wellington

Dear Ian

I attach Contact's submission on the Gas Industry Discussion Paper "Wholesale Market Design", September 2006. Thank you for inviting submissions.

Contact largely agrees with the conclusions set out in the Discussion Paper. In particular, Contact continues to support the GIC developing and offering a standard contract for short-term trades. Because the risks associated with trades of less than one week are significantly different from those associated with short term trades of duration of more than one week but not in excess of one year it would be useful for the GIC to propose standard terms to address those two separate requirements. We suggest in order to allow the GIC to offer standard contracts attuned to gas market participants needs it may be helpful for it to invite comment on the terms of the proposed contracts.

We consider that it is premature to make definitive conclusions in relation to the quantitative analysis set out in the Discussion Paper given the very preliminary nature of that work. We agree that it is inappropriate to spend significant resources on developing a more functional platform until the costs and benefits can be assessed more reliably and market needs are better understood.

Yours sincerely

Alex Love

Contact Energy Limited Submission on the Gas Industry Company Limited Discussion Paper "Wholesale Market Design", September 2006

Contact person: Alex Love

Questions	Comments
Q1: Do you agree with regulatory objective for the component of the Wholesale Market work stream? If not, what objective should the Gas Industry Co be considering?	Contact agrees with the regulatory objective set out in the discussion paper "Wholesale Market Design" dated September 2006 (the "Discussion Paper").
Q2: Do you agree with the general approach to assessing the different options using both quantitative and qualitative criteria? If not, what alternative approach, that also complies with the Gas Act, would you suggest?	Contact agrees with the use of quantitative and qualitative criteria to assess the options.

Questions	Comments
<p>Q3: Are there other time horizons that should be considered for the trading of gas? If so, what are those time horizons?</p>	<p>Contact considers that the risks related to a trade under a contract with a term of a day to a week are substantially different to the risks related to a trade with a term of a month or more. Many provisions normally found in a gas trade contract such as those to address assignment, termination, confidentiality, dispute resolution are not required in very short-term arrangements and many other provisions can be significantly simplified. It may therefore be worth considering the effect on contract provisions of time horizons of up to a week and in excess of a week but less than a year.</p> <p>A number of parties have recently developed trading relationships governed by a set of enduring master terms that apply to on going individual trades that are of very short duration, usually no greater than one week and sometimes as short as a day. Either of the parties can withdraw from such a relationship by not accepting individual trading opportunities but are fully committed for the duration of each individual trade. It seems that master terms could be agreed by a number of parties who wished to be involved in bilateral trades. This approach of short-term trades incorporating master terms greatly minimises risks for both contracting parties and significantly avoids the need to address issues that are only likely to arise in a longer time relationship such as assignment and credit worthiness. This appears consistent with the structure of the Short Term Trading Contract set out in Appendix F of the Discussion Paper although the detail of that contract appears unnecessarily complex if it is used in that way.</p>
<p>Q4: Are there any other reasonably practicable alternatives for longer term trading of gas that should be considered and if so, what are they?</p>	<p>The listed options adequately cover the possibilities.</p>
<p>Q5: Are you satisfied with this evaluation of options for longer term trading of gas, and if not, what aspects would you alter and why?</p>	<p>In relation to "Formalised auction/tender", "Posted Prices" and "Formalised negotiation" in the row headed "Costs and prices subject to downward pressure" we would change "standardised" to "customised". Apart from this change we are satisfied with the analysis.</p>
<p>Q6: Do you agree that there is no case for formalising arrangements for longer term trading of gas to improve transactional efficiency? If not, what alternative do you prefer and why?</p>	<p>Contact agrees that there is no case for formalising longer term trading of gas to improve transactional efficiency.</p>
<p>Q7: Are there any other options that should be considered for short term gas trading, and if so, what are the options?</p>	<p>Contact is not aware of other options.</p>
<p>Q8: Are you satisfied with the qualitative assessment of short term trading options? If not, what aspects would you change and why?</p>	<p>Contact is satisfied with the qualitative assessment.</p>

Questions	Comments
<p>Q9: Do you agree that the standard contract should allow for both types of approaches? If not, what would you prefer and why?</p>	<p>Both approaches should be addressed.</p> <p>From Contact's experience and considering contracts of up to one year's duration there are essentially two types of contracts:</p> <ul style="list-style-type: none"> • fully featured contracts that contain rights to sell and purchase a fixed volume of gas within a fixed period with some daily take flexibility; and • much simpler contracts usually comprising master terms with renewal of the agreement on usually a weekly but sometimes daily basis providing for the sale and purchase of a fixed quantity of gas on each day of the term of the renewed contract. <p>In designing a standard contract it may be worthwhile for the GIC to distinguish between these two types of arrangements and to accordingly design separate standard agreements to meet the separate requirements.</p>
<p>Q10: Do you agree that the standard contract should not provide for price adjustments for taxes and government charges? If not, what changes would you prefer and why?</p>	<p>The purpose of price adjustments and provisions covering changes in taxes and government charges are to remove risk for buyer and seller. These provisions are appropriate in contracts with duration of say greater than a month. Such provisions are unnecessary in contracts with duration of less than a month where it should be possible to foresee any changes in taxes and government charges.</p>
<p>Q11: Are you satisfied with the proposed approach for addressing s.41 of the Crown Minerals Act in the standard contract? If not, what alternative would you prefer and why?</p>	<p>The application of section 41 of the Crown Minerals Act clearly requires clarification as it leaves the status of many contracts uncertain while the contract is operational. That problem arises because of the time required to gain approvals. Contact supports the action the GIC is taking to attempt to resolve the issue.</p> <p>It is difficult to see why the issues that section 41 attempts to address need to be addressed in contracts that are agreed in an open competitive market.</p>
<p>Q12: Do you agree that the standard contract should not provide for any conditions precedent? If not, what alternative would you prefer and why?</p>	<p>Contact agrees that the standard contracts should not provide for conditions precedent. Such conditions are usually specific to a particular contract and should only be necessary when the contract is executed significantly prior to delivery of gas under the contract and physical projects must be completed or third party approvals gained before gas can be delivered or taken. It seems unnecessary to provide for such uncertainties in a short duration contract.</p>

Questions	Comments
<p>Q13: Do you agree that the standard contract should not make seller liable for gas specification? If not, what alternative would you prefer and why?</p>	<p>Gas quality should be addressed through open access arrangements as it is under both the MPOC and Vector arrangements although not satisfactorily under Vector arrangements. It is pointless the buyer seeking to make the seller responsible for gas quality under a bilateral trade since under open access arrangements the buyer is fully exposed to the quality of gas injected by all parties into the relevant open access system. The buyer requires protection from all gas injections and that can only be provided under the open access arrangements.</p>
<p>Q14: Do you agree that the standard contract should not provide for any priority rights? If not, what alternative would you prefer and why?</p>	<p>Priorities are likely to be specific to a particular trade. Contact agrees that there should be no generic priority provisions in the standard contract.</p>
<p>Q15: Do you agree that the standard contract should set out a broad description of the transport obligations/rights on buyer and seller? If not, what alternative would you prefer and why?</p>	<p>Contact considers that transportation in a gas trade contract should be restricted to establishing responsibility for arranging transportation and dealing with the consequences of failure to make those transportation arrangements. It is only possible for a trade to occur at a defined delivery point and for the seller to warrant transfer of title at that point if the seller delivers the relevant quantity of gas to the delivery point. The buyer will only be able to make use of the same quantity of gas to which title is transferred if it transports that quantity of gas away from the delivery point. Therefore the seller should be liable for the consequences of its failure to deliver to the delivery point and buyer should be liable for its failure to transport from the delivery point. We note that the MPOC makes it very clear how gas is delivered and title is transferred at Maui receipt points and delivery points. That is through establishment of an Approved Nomination. Hence for a trade made at a MPOC receipt or delivery point it only seems necessary to establish liability for failing to make an Approved Nomination consistent with the agreed traded quantity. The MPOC addresses failure to deliver or to take in accordance with an Approved Nomination.</p> <p>The Vector arrangements are substantially less satisfactory because of Vector's requirement that transportation capacity must be purchased on an annual basis. That may preclude short-term trades involving transport on Vector pipelines. However, putting that aside and assuming one of the parties holds sufficient capacity, it is only necessary to address the consequences of the seller's failure to deliver the correct quantity to the delivery point and the buyer's failure to take the correct quantity from the delivery point. That would be established through payments made for mismatch.</p> <p>The standard agreement may need to include a provision to cover situations when the seller was unable to deliver the gas to the delivery point or the buyer was unable to take the gas at the delivery point for reasons outside their control. A standard force majeure/maintenance clause would cover this.</p>

Questions	Comments
<p>Q16: Do you agree that the standard contract should have liability provisions that exclude indirect losses, and that direct losses (in equivalent \$/GJ terms) would be capped at the pipeline mismatch/imbalance price? If not, what alternative would you prefer and why?</p>	<p>Contact agrees with this approach. In fact a trade effected at a Maui receipt point or delivery point does not require liability provisions apart from provisions to address the situation when either the seller or the buyer fails to establish an Approved Nomination that allows transfer of title to the agreed traded volume. If the seller fails to take action to establish the correct Approved Nomination then buyer is kept whole if it draws on balancing gas and is compensated by the seller for the difference in cost between balancing gas and the price of the traded gas. If the buyer fails to take action to establish the correct Approved Nomination then seller is kept whole to the extent that buyer compensates seller for the difference between the price for put balancing gas and the sales price of gas under the trade. The Vector mismatch arrangements should work in the same manner.</p>
<p>Q17: Do you agree that the standard contract should have FM provisions based on the principle that for very short term trades FM cannot be invoked unless balancing has been suspended – i.e. curtailment is occurring? If not, what alternative would you prefer and why?</p>	<p>Contact believes the standard contract could include force majeure provisions that grant relief to the buyer from the obligation to take and pay for gas for reasons that are beyond its control and that grant relief to the seller if it is unable to deliver gas for reasons outside its control. We think this may be necessary in longer-term arrangements and for contracts of significant size. Excluding a standard provision granting force majeure relief from the standard contract is likely to increase risk associated with a trade over the longer term under the standard contract and may therefore limit the usefulness of the standard contract. Conversely there may be situations where certainty of performance may be appropriate and buyers and sellers may be willing to price the risk.</p> <p>Inclusion of a force majeure is less necessary if the parties are able to adjust the agreed traded quantity in the event an unforeseen event arises that hinders the gas trade. The intraday notification provisions of the MPOC go some way to achieving that but this need to be reflected in the standard terms. Effectively provisions allowing adjustment of the agreed traded are force majeure provisions in another guise.</p> <p>We note that under the MPOC a welded party is able to seek force majeure relief through amendment of Approved Nominations whereas a shipper cannot seek that relief. It seems more likely that a seller will be a welded party rather than a shipper and that a buyer will be a shipper rather than a welded party. Exclusion of a force majeure from the standard terms would mean the buyer and seller would often have asymmetric protection from risk under the standard terms. That is unreasonable.</p>

Questions	Comments
Q18: Do you agree with the proposed dispute resolution provisions for the standard contract? If not, what alternative would you prefer and why?	<p>Contact believes the best method for resolving well-defined technical disputes such as those related to invoices is through resolution by a technical expert. Compared with other options such a process is low cost and produces a timely outcome. Where the dispute is more complex and involves contract interpretation Contact believes the courts provide the best resolution process. In a short-term contract disputes requiring resolution by the courts should be a remote possibility. At this stage, the expertise and the effectiveness of the proposed Ruling's Panel is unclear. Contact is also reluctant to commit to pay fixed charges that may be necessary to establish and maintain the Panel without a clear understanding of the benefits that may accrue.</p>
Q19: Do you agree that the standard contract should provide a standard assignment provision? If not, what alternative would you prefer and why?	<p>Contact agrees that a contract with a term of more than say one month should include a simple assignment provision.</p> <p>We consider that an assignment provision is unnecessary in a shorter-term arrangement.</p>
Q20: Do you agree that the Gas Industry Co should make the standard contract available for use (once the feedback from this discussion paper has been considered and incorporated)? If not, what alternative path forward would you prefer and why?	<p>Contact agrees that it would be helpful for the GIC to make available a contract that could be used for short-term gas trades.</p> <p>It may also be helpful for the GIC to seek comments on its proposed standard contract before the standard contract is offered by the GIC. The more the standard contract is attuned to the needs of gas market participants the more likely it will be used.</p>
Q21: Do you agree that a platform should extend the compliance regime being developed by the Gas Industry Co in order to keep costs to a minimum? If not, what alternative would you prefer and why?	<p>The form of compliance regime that the GIC is developing is unclear. Until that is clear it is difficult to determine whether use of the proposed compliance regime to manage the proposed platform is appropriate. Contact, nevertheless, supports an approach that minimises costs. Indeed Contact considers it inappropriate to proceed to develop a platform until it is clear what costs will be incurred in that development and until it is also clear how those costs will be recovered.</p> <p>We also question whether it is necessary to have a compliance regime associated with a matching platform because, we assume that no rights or obligations would be created until the bilateral contract was executed. It seems that a matching platform could be as simple as a standard email sent to parties interested in trades and advising fundamentals such as price, quantity and term.</p>

Questions	Comments
<p>Q22: Do you agree that the preferred approach to prudential management is the white-list? If not, what alternative would you prefer and why?</p>	<p>Balancing the need to ensure trades do not involve unacceptable financial risk whilst ensuring trades are not unnecessarily restricted is difficult particularly when the financial exposures across trades could vary widely.</p> <p>Contact agrees that the white-list appears the preferred approach but the approach should be carefully designed to avoid any unnecessary limit on trades.</p>
<p>Q23: Do you agree that the platform should allow participants to nominate their preferred location for making offers or bids (provided this does not add undue cost to a platform development)? If not, what alternative would you prefer and why?</p>	<p>Contact agrees that trading is much simpler at Maui receipt points and delivery points. In order to simplify the standard contracts it may be preferable to limit trading to those points. This would increase the reason for Vector to introduce a similar regime to the MPOC. There is an opportunity to achieve that through the consultation that Vector has agreed will take place in 2007. We note that Vector's requirement that pipeline capacity should be purchased annually limits the ability to effect short term trades at Vector pipeline delivery points. Contact acknowledges that restricting trading to Maui receipt points and delivery points may at least initially limit the usefulness of the platform.</p>
<p>Q24: Do you consider the indicative cost ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?</p>	<p>We are uncertain whether these estimates are reasonable. This is largely because the design specification of the matching platform is undeveloped.</p> <p>The source and justification for the cost estimates set out in Appendix H are not identified so that it is difficult to judge whether or not these are informed estimates. Based on Contact's experience of the cost of other internal and external customised IT developments the costs of IT projects can vary widely depending on the level of functionality and specialisation of the development.</p> <p>At one end of the spectrum of functionality, it should be possible to construct a matching platform that involves little more than designing a standard email to send to a list of market participants who have indicated interest in gas trade. That would involve virtually no costs. Another option would be to develop a website to publish trade opportunities. We believe the cost of that would also be negligible.</p> <p>We are aware of examples of matching platforms that have been developed at low cost and have satisfactory functionality. An example of that is Energyhedge which was developed relatively cheaply and possibly could be built on to meet the requirements of a gas market.</p> <p>Contact suggests the CIG should consider, at least initially, developing one of these very low cost options.</p>

Questions	Comments
<p>Q25: Do you consider the indicative benefit ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?</p>	<p>In light of the footnote concerning the proposed Australian bulletin board, the lack of any factual information supporting the calculations of benefits in Appendix H and that Appendix L indicates that there are only nine active short term traders whose trades usually have a duration of between 1 to 6 months we are uncertain whether the quantified benefits set out in Appendix H are reasonable.</p> <p>In attempting to calculate the benefits of a matching platform the following matters require further consideration:</p> <ul style="list-style-type: none"> • generally longer duration trades will be more customised for specific circumstances making a standard contract less useful for such trades; • the market is currently in a transition from long term stable contracts with a high level of flexibility to shorter term inflexible contracts and that growing inflexibility may generate more short term trades; • until the market starts to experience the impact of inflexibility it is very difficult to assess the likely volume of trades; • because of the lack of participants and because users' requirements are dominated by one market, the electricity market, opportunities for trade will inevitably be very limited; • we do not understand why the benefits of a matching platform should be substantially lower than the benefits of a trading platform. That conclusion seems based on the assumption that near real time trades cannot be effected using a matching platform. That assumption appears questionable.

Questions	Comments
<p>Q26: Do you support the conclusion that it would be reasonable to proceed with development of a matching platform, provided it can be progressed at modest cost? If not, what path forward would you propose and why?</p>	<p>As indicated, Contact is uncertain about the reliability of the assessed costs and benefits of a matching platform set out in the Discussion Paper. This partly arises because of the lack of attribution of those estimates. Contact supports the GIC's proposal to better assess those costs and benefits before deciding whether to proceed with expending resources on developing a platform. Contact supports the initial development of a platform at low cost. As indicated above we think that appears possible.</p> <p>The GIC should exercise caution in developing a platform on a shoestring if that is likely to cause the project to fail. That could cause the market to discredit development of a trading platform. We don't think that should happen if initially the matching platform was made extremely simple, transparent and low cost with users having a clear understanding of its limitations.</p> <p>Therefore Contact considers a preferred approach is:</p> <ul style="list-style-type: none"> • to develop an agreed standard contract, • to offer an extremely simple matching platform such as a website; • to proceed to develop a more highly specified platform when the take up of the standard contract has been reasonably assessed, the limitations of the simple arrangements are understood, the benefits of a more highly specified platform can be determined and the impact of more inflexible contracts is clearer. <p>That approach would allow proper assessment of the costs and benefits and better specification of the platform required to meet market participants needs. It would also provide adequate opportunity for Vector and users of its pipelines to resolve the form of the regime it will implement from 1 October 2007 and so enable implementation of a platform better designed to meet market needs.</p>
<p>Q27: Do you consider the indicative cost ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?</p>	<p>It is difficult to assess whether the cost ranges are reasonable given the lack of specification of the trading platform and the lack of detail and justification for the estimates in Appendix I.</p> <p>If OATIS already incorporates the ability to function as a trading platform then the costs, may be over stated. We note, however, that the reduction in costs, attributed to a reduced number of trades, may not be realised as we imagine it probably costs about the same to build a trading platform for 10 participants as for 50 participants.</p>

Questions	Comments
<p>Q28: Do you consider the indicative benefit ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?</p>	<p>It is difficult to assess whether the estimated cost benefits are real. It is not easy to understand why the difference in benefit between a matching platform and a trading platform should be so large. But this difference seems primarily because of the assumption that a matching platform cannot allow near real time trading whereas a trading platform is able to provide that. We question that assumption. Assuming a suitable ex ante standard agreement is in place there seems to be no reason why a matching platform could not allow near real time trading.</p> <p>We also note that as yet there is uncertainty about how contingencies are managed and rights and obligations in such circumstances. Until that is resolved it is difficult to assess how participants in gas markets will manage their exposures during such events and to assess the value associated with near real time trades.</p>
<p>Q29: Do you support the conclusion that it would be risky to proceed with development of a trading platform due to uncertainty over net benefits, but that it would be worthwhile to seek to narrow the uncertainties, and in particular to examine the costs and benefits of making the pipeline imbalance pricing mechanisms more responsive and dynamic? If not, what conclusion would you draw and why?</p>	<p>We agree that the unreliability of the estimates of costs and the benefits mean that it would be inappropriate to progress the development of a trading platform at this time. Contact believes further work on developing a trading platform should not be progressed until:</p> <ul style="list-style-type: none"> • the impact of the full balancing regime of the MPOC is understood; • the regime applying on Vector pipelines is settled; • the uptake of the proposed standard contract has been assessed; • contingency arrangements are in place; • the level of participation in trading market becomes clearer; and • the use of a simple matching platform has been assessed.

Questions	Comments
<p>Q30: Do you consider the quantitative assessment methodology to be reasonable? If not, what amendments would you propose and why?</p>	<p>The context of this question is not clear because it does not seem to have been included in the body of the Discussion Paper.</p> <p>However, as indicated above Contact is uncertain that the quantitative analysis is correct because of:</p> <ul style="list-style-type: none"> • the lack of specification of both the matching platform and the trading platform; • the lack of consideration of simple low cost matching platform; • the lack of analytical detail; • the lack of attribution of the cost estimates; and • Contact's experience of the costs associated with customised IT projects. <p>Contact is also doubtful of the benefits identified in the quantitative analysis because of:</p> <ul style="list-style-type: none"> • the lack of analytical detail; • the comments related to the proposal to implement a trading bulletin board in some Australian states; and • the wide difference in the assessed benefits of a matching platform and a trading platform. <p>Because of the above doubts it is difficult to agree that the quantitative analysis provides sound grounds to progress either the matching platform or the trading platform. As indicated we think an appropriate approach is to complete and publish the standard contract, to test the market place uptake of that and to proceed with development of a very simple low cost matching platform. That will enable better specification and implementation of a more highly specified platform once the cost and benefits show that is appropriate.</p>