



# MAJOR ELECTRICITY USERS' GROUP

28 April 2006

Mr Ian Dempster  
Gas Industry Company  
By email to [info@gasindustry.co.nz](mailto:info@gasindustry.co.nz)

Dear Ian

## **Submission on concept design for Wholesale Gas Market**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Gas Industry Company (GIC) consultation paper *"Concept Design for Wholesale Gas Market,"* released 17 March 2006.
2. A significant number of MEUG members including those whose membership is via Business New Zealand or the Wood Processors Association use reticulated natural gas at some stage of their production processes or in the co-generation of heat and power on their process sites. The ability or capacity to either buy or sell quantities of gas has considerable appeal subject to a number of criteria:
  - a) transmission should not act as a barrier where (for example):
    - i) if a sale, the ability to sell is inhibited by capacity rights or contractual conditions which impose ongoing uncertainty and costs on the vendor; and
    - ii) if a purchase, the ability to obtain delivery of such gas at lowest cost is undermined because the purchaser is exposed to "ongoing" delivery costs beyond the "spot transaction."
  - b) the trading platform or mechanism must be simple, voluntary, and involve low transaction and compliance costs;
  - c) there must be a high level of transparency and appropriate levels of pricing disclosure to enable buyers and sellers to be informed about market prices;
  - d) all barriers to entry should be eliminated and prudential requirements kept to a minimum;
  - e) the underlying objective of the trading mechanism is designed on a "fit for purpose basis" and tied to achieving "tradable gas at least cost/price;" and
  - f) the market must guarantee pro-competitive outcomes.
3. MEUG members support market solutions that ensure effective and efficient outcomes and which deliver benefits to end users. To achieve this requires robust and rigorous debate involving all stakeholders. They are strongly opposed to so called market solutions which simply entrench supply side market power. Therefore any form of wholesale gas market will be evaluated against the criteria set out above.

4. It is not clear to MEUG members that in the context of the principles outlined above adequate emphasis have been allocated to the issue of carriage. The transmission of gas has proved problematical in the past and currently a number of industrial gas users are experiencing problems with contractual terms imposed by the supply side. For a wholesale gas market to be supported by industrial users the questions associated with carriage and the bundling or unbundling of gas and transmission services will need to be dealt with. They are not issues which can be dealt with in sequence as how carriage is resolved will impact on the view of users on whether a wholesale gas market will be of any use to them or not.
5. Responses to the 29 questions in the consultation paper are attached. Nothing in this submission is confidential.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Terrence Currie', with a large, stylized initial 'T' and 'C'.

Terrence Currie  
Chair

## Appendix

	Question	Comment
Q1	Do submitters agree with the objective defined for this work stream? If not, how and why would you change?	Agree with the general thrust of objective but believe it could be improved and a better outcome achieved by amending "for the trading of gas" to "for the trading and carriage of gas". Resolving the issue of bundled or unbundled transmission services is critical to the success of any wholesale gas market.
Q2	Taking into account the conceptual nature of the options at this stage, do submitters agree that these criteria reflect the key measures of suitability of a trading mechanism in the New Zealand wholesale gas market? If not, what criteria would allow a better evaluation of proposed mechanisms?	The evaluation criteria appear to be broadly appropriate. However it may be necessary to add additional criteria to deal with the design of the market being "fit for purpose" having regard to the opinion of some sections of the industry that for the foreseeable future the market will deal with "overs and unders" or balancing, mismatches, outages or plant maintenance activities. Also the criteria proposed do not place adequate emphasis on low price outcomes as price and "efficiency" in economic terms do not necessarily coincide.
Q3	Do submitters agree with the characterisation of existing long-term contracts outlined in this section, or are there additional important contract features that should be considered?	It is understood that current contracts which major users are committed to prevent or inhibit their ability to "on sell" or "participate in a wholesale gas market" by virtue of the bundling together of gas and transmission. It will be critical to resolve the issue of bundled or unbundled contracts and large industrials will be looking for long term contracts which do not impose onerous conditions on them.
Q4	Do submitters agree that there is both a theoretical and practical need for long-term contracts in the wholesale gas market? If not, why not?	Yes.
Q5	Do submitters agree that auctions, negotiations and posted prices represent the range of contracting mechanisms available for long-term contracting in the New Zealand wholesale gas market? If not, what other options should be considered? Please provide a brief outline of the suggested mechanism.	Until the issues of bundled and unbundled gas and transmission services are resolved and the options for dealing with "overs and unders" have been further developed including the potential use of a simple electronic platform for transactions it is difficult for major users to finalise which option is preferable.
Q6	Do submitters agree that the key features of each of the mechanisms are captured in this section? If not, what features have been excluded and what impact would they have on the evaluation of the options below?	See above
Q7	Do submitters agree that posted prices should not be considered further? If not, what features of posted prices have not been considered that lead you to this conclusion?	See above
Q8	Do submitters agree with the evaluation of the options outlined above? If not, why not? Please explain what your argument would mean for the conclusions.	There is general support for the descriptions outlined in Table 1. The evaluation does highlight the difficulties associated with providing transparency and adequate price information. There does not appear to be any benefit to industrial consumers from mandating the type of mechanism or the form of auction.

Q9	Do submitters agree that there is prima facie no net benefit to be had from formalising or mandating the form of auction by which long-term contracts are established? If not, what benefits of formalisation or mandating, or costs of the existing auction form have not been accounted for?	Yes
Q10	Do submitters agree that the mechanisms listed above cover the range of options for short-term trading mechanisms in the wholesale gas market? If not, what other mechanisms are available?	Yes
Q11	Do submitters agree that the analysis above accurately reflects the applicability of anonymous/known counterparty and compulsory/voluntary participation to the mechanisms identified? If not, what relevant factors were not identified?	Yes
Q12	Do submitters agree with this outline of the key effects of the characteristics of the gas market on mechanisms for short-term trading? If not, what other factors should be considered and how do they affect the viability of the options?	Yes
Q13	Do submitters agree that both the clearing house and gross pool options are not likely to be practical mechanisms for short-term trading in the New Zealand wholesale gas market and should not be considered further? If not, please explain your reasoning.	We strongly agree that the clearing house and gross pool options are unlikely to be practicable. We also believe they would be high cost options.
Q14	Do submitters agree that a party-specific limit on the net trading position of participants is sufficient to manage the risk of default? If not, are there other risk management mechanisms that would allow anonymous trading?	The issue of prudential arrangements needs careful assessment as it can prove to be a significant barrier to participation in any market arrangements.
Q15	Would submitters prefer a net sell position based on an ability to pay for an underlying quantity of mismatch gas or a pure volume measure? Please explain your preference.	Major users tend to favour "net sell" arrangements.
Q16	Do submitters agree with the assessments of the relative advantages of trading at a hub and trading at all welded points outlined above? If not, what other factors should be considered, and how does your argument affect the conclusion?	This issue is in part tied to successfully resolving the issue of carriage, ie dealing with the bundled versus unbundled transmission issue. The question of welded points and trading at a hub is important but the cost implications are not clear.
Q17	Do submitters consider that the other options identified represent the range of potential solutions and that the assessment of them is accurate? If not, please elaborate.	See above
Q18	Do submitters agree that Frankley Road and Rotowaro should be specified as hubs? If not, where do you consider a hub should be and why is it more advantageous than Frankley Road and Rotowaro?	See above.

Q19	Do submitters agree with the characterisation of disputes processes, information disclosure and contract standardisation outlined above? Are there any other factors that should be considered?	Yes
Q20	Do submitters agree that the characterisation of the contract terms and features of direct bilateral trading outlined above is appropriate? If not, what additional, or different terms should be considered and why?	There is little support for this option. However the characterisation is supported
Q21	Do submitters agree with the assessment of the direct bilateral trading mechanism? If not please explain the nature of your argument and what it would mean for the relative score in Table 4.	See above
Q22	Do submitters agree that the characterisation of the contract terms and features of platform bilateral trading outlined above is appropriate? If not, what additional, or different terms should be considered and why?	See above
Q23	Do submitters agree with the assessment of the platform bilateral trading mechanism? If not please explain the nature of your argument and what it would mean for the relative score in Table 4.	There is tentative support for this option subject to the development of a low cost user friendly system.
Q24	Do submitters agree that the characterisation of the contract terms and features of net pool trading outlined above is appropriate? If not, what additional, or different terms should be considered and why?	A voluntary net pool would probably end up being ranked as second preference. The characterisation appears appropriate.
Q25	Do submitters agree with the assessment of the net pool trading mechanism? If not please explain the nature of your argument and what it would mean for the relative score in Table 4?	See above
Q26	Do submitters wish agree that both these options require further consideration? If not, why not?	Yes
Q27	Do submitters agree that issues with gas allocation can be resolved separately from the establishment of a trading mechanism? If not, why not?	Yes, but subject to caveat that carriage must also be resolved.
Q28	Do submitters agree that these issues should be considered further but need not delay the development of the wholesale market? If not, what factors have not been considered that lead you to this conclusion?	The development of a wholesale market cannot precede the resolution of transmission issues
Q29	Do submitters believe that the summary of the suitability of the mechanisms above accurately reflects the relative strengths and drawbacks of each of the options as considered? If not, which factors not considered would alter the relative merits of the options?	Yes...in general terms.