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Dear Ian

Submission on Concept Design for Wholesale Gas Market

INTRODUCTION

1. Thank you for the opportunity to comment on the Gas Industry Company's (GIC's) consultation paper "*Concept Design for Wholesale Gas Market*", March 2006.
2. Mighty River Power's general comments are provided in the following section. Responses to each of the specific questions are provided as an Appendix to this letter.

MIGHTY RIVER POWER'S VIEWS

3. Mighty River Power considers that the GIC's consultation paper is well written, and of a high quality. It develops and analyses the options well. The GIC is clearly considering all of the options with an open-mind.
4. We also agree with the GIC that it would be premature to undertake a quantitative Cost Benefit Analysis at this stage in the process. We agree that it is appropriate to undertake an initial screening of the options – and that "*the comprehensive qualitative evaluation contained in this paper is adequate for the purpose of eliminating a number of options*". We do note that we consider a quantitative Cost Benefit Analysis will form an important step in the policy development, not only for deciding whether there should be new wholesale market arrangements, but also for determining the detail of those arrangements.
5. We consider that the objective and evaluation criteria that the GIC has used are reasonable. As a minor point we note that there may be one-off costs associated with establishment of new market arrangements, and that these costs may not be reflected in the criteria (notably "Administrative and compliance costs").
6. We also agree with the GIC's narrowing of the options, with the elimination of the gross pool and clearing house options.

CONCLUDING REMARKS

7. In summary, Mighty River Power is confident that the GIC is heading on the right track with its concept design for the wholesale gas market.
8. If you would like to discuss this matter directly with Mighty River Power, please do not hesitate to contact either me (on 09 308 8213 or neil.williams@mightyriver.co.nz) or Rob Allen (on 09 308 8259 or robert.allen@mightyriver.co.nz).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Neil Williams', with a stylized, cursive script.

Neil Williams
General Manager – External Affairs

APPENDIX: RESPONSES TO THE GIC'S QUESTIONS

Q1	Do submitters agree with the objective defined for this work stream? If not, how and why would you change it?	Yes
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?	Set up costs are not given sufficient consideration. New Zealand's natural gas market is very small and costs should be at the forefront of the mind especially given the high chance of low liquidity in any trading environment.
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?	<p>There has been a step change in prices as discussed, but there has also been a step change in contract terms from very flexible to very rigid take-or-pay. Gas users will face additional charges as a result.</p> <p>Contrary to the comment "Little uncommitted gas is expected to be offered to the market", open access has brought with it the ability to sell "spot" gas on short term contracts and a reasonable quantity has been transacted as a result.</p>
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.	Yes

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?	In general, tenders have been used for new long term contracts of large quantities and negotiations are used for small quantities or renewing existing contracts. This is because of the additional time and resource required in a tender process.
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?	Yes, especially if posted prices come with standard terms. There is far more contractual risk involved in entering a long term contract and probably without exception every party will have a different risk tolerance.
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.	Yes
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?	One important market characteristic, which was not mentioned, is the level of known natural gas reserves. The limited natural gas reserves increases the market power of producers. This reduces the efficiency of any pool type market.
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.	Yes
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?	Yes as long as the contract has specific terms that allocate the cost of default to the defaulting party and the maximum potential cost of default is included in the calculation of the trading limit.
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.	A pure volume measure. If a party sells non-specification gas and incurs a charge, this charge should not be offset by the same party buying a quantity of gas. A party could default on a buy and a sell contract at the same time and should independently face the consequences of both.

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?	Yes
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.	Yes
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?	Yes
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?	Standardising the disputes process is important. Defining force majeure and the remedies in these situations including procedures for re-nominating (and mismatch allocation) is important.
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?	Yes

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.	Due to the limited number of gas producers in New Zealand there is general understanding among wholesale industry participants of what a reasonable sale price for gas is. In actuality it may be the case that industry participants will gain more information on market price from direct trading than from a potentially illiquid net pool or platform bilateral market. Therefore the efficiency score in table 4 may be closer than illustrated.
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?	Yes
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.	Yes
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?	Yes
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.	

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 as long as traded volumes can not be retrospectively adjusted.
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?	Providing two hubs, Rotowaro and Frankley Road will allow the vast majority of gas entering the system to be traded
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?	As mentioned earlier, the benefit of a platform bilateral market over a net pool market seems to be understated.