3 November 2006

Mighty River Power Limited
Level 19, 1 Queen Street
Auckland 1010
PO Box 90399
Auckland Mail Centre
Auckland 1142

Phone: +64 9 308 8200
Fax: +64 9 308 8209
www.mightyriverpower.co.nz

Ian Dempster
Senior Advisor
Gas Industry Company
Level 9, State Insurance Tower
1 Willis Street, PO Box 10-646
Wellington
New Zealand

Dear Ian

SUBMISSION ON WHOLESALE MARKET DESIGN

Introduction

1. Thank you for the opportunity to comment on the Gas Industry Company's (GIC's) consultation paper *"Wholesale Market Design"* dated September 2006.
2. Mighty River Power's general comments are provided in the following section. Responses to each of the GIC's specific questions are provided as an appendix to this letter.
3. No part of our submission is confidential and we are happy for it to be publicly released.

Mighty River Power's views

4. Mighty River Power congratulates the GIC on a well written, logical and sound consultation paper.
5. We agree with the GIC's approach and conclusions, namely:
    a. The GIC's focus on transactional efficiency of wholesale trading arrangements.
    b. The formalising of arrangements for the trading of gas on longer term contracts is inappropriate because there is no evidence that to do so would increase transactional efficiency.
    c. A simple matching platform to facilitate the development of a secondary market for the trading of excess and shortfall quantities of gas is the preferred option.
    d. A standard contract should be developed that parties can use voluntarily to facilitate short term gas trades.

6. Before going on to answer the specific questions provided by the GIC, we would like to highlight two issues that we consider are the main impediments to a liquid wholesale market:

    a. The first is the lack of a variable pricing structure on the Vector Transmission system. On the Maui pipeline the tariff is based purely on the quantity of gas transported and the distance transported (i.e. $/GJ/km). If no gas is transported, then no cost is incurred. However, on the Vector Transmission system there are in general no standard terms allowing the transmission of gas without paying a substantial capacity fee i.e. paying for transmission regardless of whether gas is transported or not. The outcome is that the cost of selling gas on a short term basis to a party on the Vector Transmission system is prohibitive if that party does not have an existing transmission contract between the Maui pipeline and their plant (and the vast majority of participants do not because the gas supplier/retailer provides transmission). The effective result is that only a retailer with an existing Vector Transmission contract can sell gas to industrial customers on a short term basis.

    b. The second is that there are industrial gas supply contracts with exclusivity clauses prohibiting the purchase of gas from parties other than the current supplier.

7. In Mighty River Power's view these issues are critical and need to be addressed. We suggest the following high level solutions:

    a. The GIC consider means of encouraging Vector Transmission to provide short-term variable contracts for the transportation of gas on its transmission system.

    b. The GIC consider the use of exclusivity clauses in gas supply contracts and whether it has the power to prohibit such clauses. If so, the GIC consider whether it should take steps to prohibit such clauses.

Concluding remarks

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 8202 or john.gilkison@mightyriver.co.nz) or Duncan Jared (on 09 308 3290 or duncan.jared@mightyriver.co.nz).

Yours Sincerely

John Gilkison

Policy Analyst – Strategy Group

APPENDIX: RESPONSES TO THE GIC'S QUESTIONS

Q1	Do you agree with the regulatory objective for the component of the Wholesale Market work stream? If not, what objective should the Gas Industry Co be considering?	Yes.
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?	Yes.
Q3	Are there other time horizons that should be considered for the trading of gas? If so, what are those time horizons?	No. Given the Maui Pipeline Operating Code (MPOC) balances on a daily basis there seems no reason for short term trades to occur more frequently than daily.
Q4	Are there any other reasonably practicable alternatives for longer term trading of gas that should be considered and if so, what are they?	We agree that executing a longer term trade via a trading market would not be practical. However, the GIC could consider a bulletin board where parties can describe their longer term requirements. In all likelihood this would not benefit large scale (power station) contracting because these parties are keenly aware of any large parcels coming to market but industrial sized users may benefit.
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?	In general yes, although the analysis is very subjective. For example, table 7 suggests that voluntary contracting will lead to downward pressure on costs and prices. This outcome is contingent on the buyer and seller having equivalent market power (i.e. in a perfectly competitive market), which is unlikely in the New Zealand gas market given the small number of players who all have differing levels of market share, market power and negotiating tactics.

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?	Yes, subject to the suggestion in Q4.
Q7	Are there any other options that should be considered for short term gas trading, and if so, what are the options?	Yes. Regarding 5.1 Mighty River Power recommends that balancing is not excluded from short term trading. Generally the re-balancing of a pipeline occurs after the day an imbalance occurs. Excluding balancing unnecessarily restricts the value that can be derived from a trading market.
Q8	Are you satisfied with the qualitative assessment of short term trading options? If not, what aspects would you change and why?	Yes. The primary consideration for Mighty River Power is whether the trading mechanism will deliver sensible pricing signals i.e. pricing high enough to encourage or at least not discourage exploration and low enough to encourage/ not discourage electricity generation, industrial and retail use of gas. If this is not the outcome then a voluntary market will probably not be utilised. Platform bilateral and direct bilateral are more likely to achieve this outcome than the alternatives.
Q9	Do you agree that the standard contract should allow for both types of approaches? If not, what would you prefer and why?	Yes
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?	It should not cover changes in taxes or government charges but the contract should state whether it is inclusive or exclusive of the GIC levy (as set at the trade date).

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?	Yes – a blanket exemption is required. The Crown may need to be satisfied that the buyer and seller are not related parties.
Q12	Do you agree that the standard contract should not provide for any conditions precedent? If not, what alternative would you prefer and why?	Yes
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?	Liability for non-specification gas should not be inconsistent with the MPOC. Under the MPOC Injecting Welded Parties and MDL may be liable for non-specification gas.
Q14	Do you agree that the standard contract should not provide for any priority rights? If not, what alternative would you prefer and why?	Yes
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?	The parties should warrant that they have sufficient transmission capacity in their transmission contracts to effect the trade.

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?	We agree that the standard contract should have liability provisions that exclude indirect and consequential losses. However, we believe direct losses should be linked to (not necessarily equal to) the value of the traded gas rather than based on the mismatch/imbalance price for a few reasons. First the traded gas price is always known whereas a mismatch/imbalance price may only be determined after a Welded Party has conducted a tender process for balancing gas. Therefore it may not be clear what the mismatch/imbalance price is at any point in time. Second a party may breach a contract provision without creating a mismatch/imbalance for example by not nominating for and not supplying/taking gas as agreed in a trade. Third, a party who breaches a trade may put themselves in mismatch or imbalance and in this case is likely to already be responsible for and assume the potential liability for their own position. Therefore the mismatch/imbalance price may not be a reasonable estimate or linked to the *other party's* loss.
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?	We would be interested in hearing a pipeline owner's perspective on this. A trading platform should not increase the likelihood of a contingent event occurring because of a lack of FM provisions. It seems that the GIC is suggestion that an event cannot be called an FM event until the point where there is a system wide situation (i.e the damage is already done). It seems more wise to call an FM if it is known that not doing so may result in a system wide event (i.e. before the damage has been done). This is especially the case given short term trades may be up to a year long in the GIC's definition.
Q18	Do you agree with the proposed dispute resolution provisions for the standard contract? If not, what alternative would you prefer and why?	We agree that the Ruling Panel is the preferred option.

Q19	Do you agree that the standard contract should provide a standard assignment provision? If not, what alternative would you prefer and why?	Yes
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?	Yes
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?	It is difficult to answer this question prior to seeing the GIC's compliance regime Regarding 7.1 the seller may be willing to sell part of a gas parcel rather than only the whole parcel. Consideration should be given to allowing this as an option for the seller.
Q22	Do you agree that the preferred approach to prudential management is the white-list? If not, what alternative would you prefer and why?	Generally agree with the white-list approach. However it may also be of benefit to allow parties to disclose their financial details (as in the frosted glass approach). This may benefit a new entrant or a company that does not make public financial reports.
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?	Would not the origin of the gas need to be disclosed? If gas from Maui is sold at Rotowaro and the purchaser is delivering that gas to Frankley Rd the physical gas would not be transported to Rotowaro and then back to Frankley Rd. It makes sense to only pay for transportation between the origin and the delivery point and no further. Note that gas cannot be on-sold at Oaonui because it is currently only a delivery receipt point.
Q24	Do you consider the indicative cost ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	We are cognisant of the many examples of cost "blowouts" in IT costs in the energy industry. We would be pleasantly surprised if the actual cost was within the suggested range.

Q25	Do you consider the indicative benefit ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	The value will greatly depend on the market liquidity, which is difficult to forecast. Given the purported difference between Maui gas prices and Pohokura gas prices, a $0.02/GJ benefit from the platform could well be a significant underestimation.
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?	Yes
Q27	Do you consider the indicative cost ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	
Q28	Do you consider the indicative benefit ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	If we were to guess the difference in economic benefit between a matching platform and a trading platform we would attribute more value to the matching of participants and the potential price discovery that a platform could provide and less value to benefit of being able to trade in real time. In other words the benefit of the matching platform seems understated in the GIC paper and the difference between the benefit of the trading platform and the matching platform seems overstated.

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?	It would be risky to proceed with development of a trading platform at this point. Although the transmission system is balanced on a daily basis under the MPOC, in reality the transmission system is still balanced on pressure (i.e. by increasing and decreasing the flow from Maui in reaction to changes in pipeline pressure). An outcome is that "calls" for balancing gas only occur periodically and are used more for balancing the books than the pipeline. This may or may not continue beyond the conclusion of the legacy Maui gas contract in June 2009. If balancing by pressure will continue, investigating more responsive imbalance pricing mechanisms may be of little value. It is suggested that this is assessed prior to further study.
Q30	Do you consider the quantitative assessment methodology to be reasonable? If not, what amendments would you propose and why?	See Q.28