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Mr I Wilson
Acting Chief Executive
Gas Industry Company Limited
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Dear Ian

Retail Competition and Transmission Capacity Statement of Proposal

Introduction

1. Mighty River Power welcomes the opportunity to comment on the Gas Industry Company's (GIC) Statement of Proposal on Retail Competition and Transmission Capacity dated 12 November. No part of this submission is confidential and Mighty River Power is happy for it to be publicly released.

Comments

2. Mighty River Power is not involved in the large commercial or industrial sectors of the gas market which will be directly impacted by the introduction of the Rules proposed by the GIC. Therefore, we do not consider ourselves biased by the possible financial implications resulting from any Rules implementation

3. Mighty River Power's view is that the GIC is only addressing the symptoms of the problems surrounding capacity constraints on the North pipeline rather than addressing and resolving the root cause of this problem. The proposed Rules do not fully address the concerns of those few customers who may be impacted by this issue and will create problems for retailers and Vector transmission that the GIC has not recognised.

4. A fundamental flaw in the proposed Rules is the GIC's assumption that retailers *"require sufficient capacity to cover their peak demand of its end users*". As has been discussed at many of the meetings on this subject not all retailers manage their capacity reservations in this manner. Rather retailers manage aggregate gas demand using a portfolio approach. Only the highest peaks of the aggregate sum of individual loads needs to be

considered when reserving capacity. Not all peaks of each individual gas purchaser occur at the same time of the year, for example, dairy load is counter-cyclical with retail load. A retailer with predominantly retail customers may need very little incremental capacity to supply a dairy load. If the capacity of a dairy load customer (or any customer whose load is not perfectly peak correlated with the retailer's portfolio) is transferred with the customer, then the incumbent retailer will be left with insufficient capacity to meet the load requirements of the remaining customers in its portfolio. This will cause the retailer to incur excess capacity reservation overrun charges which will ultimately be passed onto their tariff customers. Further, this will incentivise retailers to seek customers who have peak loads uncorrelated with its current portfolio of customers. The GIC has not considered the potentially significant cost implications and economic inefficiency of this consequence.

5. When assessing retailers' capacity reservation portfolios it must be borne in mind that the weather during the winter period can have a significant impact on the accuracy of a retailer's reservations. A mild winter can create the impression that a retailer has over booked capacity whilst a cold winter can have the reverse impact and result in excessive capacity reservation overruns. The potential impact of the GIC's proposal combined with a cold winter could increase a retailer's overrun charges significantly.

6. The proposed Rules basically confer rights and benefits of access to capacity to Large End Users without any of the obligations or responsibilities associated with capacity rights within the Vector Transmission Code (VTC). In particular the liabilities for unauthorised overruns are significant, up to $10 million for a single event and $30 million for a series of events. Mighty River Powers position on these matters is that if end use customers wish to have capacity rights, and there is no reason why customers cannot have these rights, then they should access these by signing the VTC.

7. From a retailer's perspective the Rules would create a number of problems. Firstly as stated above retailers do not aggregate the capacity demands of each individual customer these are optimised on a portfolio of customers basis. Some retailers may mange their overrun risks by reserving their predicted peak demand of their portfolio at each delivery point. Other retailers, like Mighty River Power, however seek to optimise their overrun risks by estimating a %ile of highest daily demand at each transmission delivery point.

8. Regardless of the methodology that retailers currently use to calculate their capacity requirements, from 1 October next year the Rules will, in our opinion, result in retailers with Large End Users calculating the value of the capacity they would be forced to relinquish if their large end use customers changed retailers. The retailers will then aggregate these and add that total figure to their optimised capacity reservations for their remaining customers. Mighty River Power is of the view that the net result will be that for the 2011-2012 capacity reservation year the total capacity requested by retailers on the current "constrained" pipeline will increase significantly over capacity currently held by retailers on that same pipeline.

9. Mighty River Powers view of this problem is that it is essentially the allocation of available capacity on the North pipeline. This view is based on the following:-

   - To the best of our knowledge there have been no interruptions of firm capacity on the North pipeline
   - There has been no new significant load growth on the North pipeline
   - There is sufficient capacity in the North pipeline for organic growth until at least 2015

10. The GIC has indicated that the Grandfathering rights within the VTC are to a large extent creating the constraint problem on the North pipeline. In our opinion the GIC should be proposing a review of the VTC with a view to introducing a new arrangement for the annual allocation of capacity. This would include addressing their concerns with the current Grandfathering arrangements

11. Our view is that the current request process should continue as it is within the VTC at the moment. Where capacity requests exceed the available capacity retailers will then have to supply a justification for their requests and Vector (or some independent third party) will be required to assess and allocate the available capacity.

12. We appreciate that the above has an impact on retailers' contractual rights and that it includes a role that Vector may be reluctant to undertake. The GIC is however proposing Rules that also impact on retailers' contractual rights and also require Vector to undertake a similar role in determining capacity allocations.

13. If you would like to discuss any of our above comments directly with Mighty River Power, then please do not hesitate to me on 06 348 7926 or jim.raybould@mightyriver.co.nz .

Yours sincerely

Jim Raybould
Gas Manager

Retail Competition and Transmission Capacity: Statement of Proposal- format for submissions

Company name: Mighty River Power

To assist the Gas Industry Co in consider stakeholders' responses, below is a suggested format for submissions. The questions are the same as those contained in the body of the document. Respondents are also free to include other material in their responses.

QUESTION	COMMENT
Q1 Do you agree with our description of the retail competition problem?	Whilst Mighty River Power agrees that this issues could have a potential impact on the competitive nature of the gas market we remain to be convinced that the impact is significant and nor that it requires the implementation of the proposed set of Rules. The GIC's Statement of Proposal tends to support this view as it has identified that switching of large end users on the North pipeline is in line with the transmission system as a whole and has only identified one customer who was unable to select the lowest tender. This customer still made a significant saving on his current gas supply by switching to a new retailer. In addition it appears that the GIC has concluded that the only reason that retailers are not tendering for certain customers is due to the lack of availability of capacity despite being advised that there are a number of reasons why a retailer may decide not to tender for a gas supply.
Q2 Do you agree with the economic analysis?	No the analysis is simply far too theoretical and is being applied in a "market" which is not a perfect competitive market.
Q3 Do you agree with the proposed regulatory objective?	Yes
Q4 Do you consider that the evaluation criteria are appropriate for evaluating the options?	We note that the GIC has not considered the economic inefficiencies that would occur if the Rules were introduced and the capacity compulsorily transferred did not meet all of the winning retailers' requirements to supply the end user and/or caused the losing retailer to incur increased overrun charges. In our opinion this is an important factor that needs to be considered given the proposed Rules is the GIC's preferred option.

QUESTION	COMMENT
Q5 Do you have any comments on the evaluation of options?	Yes. The proposed options are all designed to address the current situation with regards to the availability of capacity on the North pipeline. All of the options are based on the premise that the current demand on the pipeline exceeds the capacity on it, yet there have been no curtailments of reserved capacity on the North pipeline. In our opinion the options are seeking address the symptoms of the current problem on the North pipeline and not to address the root cause of the problem.
Q6 Do you agree that Gas Industry Co has, through the evaluation of options, correctly identified the 'Capacity Follows End User' as the preferred option?	No, the "Capacity Follows End User" proposal will create as many problems as it proposes to resolve, see our covering letter.
Q7 Do you have any comments on the details of the proposal?	Yes please see our covering letter
Q8 Do you agree with the next steps?	No we believe that the GIC should address these matters as described in our covering letter.