Retail Competition and Transmission Capacity: Statement of Proposal

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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?	No Section 3 of the Statement of Proposal does not provide an adequate description of the "retail competition problem". The focus of the problem definition and supporting evidence is restricted to consideration of existing end users. There is no mention of or examination of the impact of transmission capacity constraints on new end users or on suppliers (new or existing). This is a fundamental weakness in the problem definition. There is no denial that a problem exists as suggested in the paper but it appears that the GIC is determined to address symptoms rather than address the route cause which is a shortage of physical capacity. In addressing symptoms, we believe that this will lead to unintended consequences and inefficient allocation of capacity. The definition of the problem needs to address the issue of new end users acquiring capacity. This supports the economic principle of scarce resources being allocated to the highest value uses regardless of the use being an existing use or a new use. Without consideration of new users, possible solutions are likely to conflict with the objectives of the Gas Act and the Government Policy Statement for the gas industry.

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Q2 Do you agree with the economic analysis?	No. **Section 4.2 The competitive model of the gas market** The statement that that the price of posted terms capacity is fixed is incorrectly represented in the paper. Posted terms capacity charges for retailers, who act as aggregators of capacity, are only fixed for a 12 month period. Retailers have no restrictions on how they reprice that posted terms capacity to end users or other aggregators of capacity and there are no restrictions on who they trade it to or what value they place on such trades. This is not the case for supplementary transmission agreements such as those entered into by Contact and Mighty River Power which contain restrictions on the ability to transfer or trade that capacity. As these supplementary transmission agreements account for up to 65% of Northern pipeline capacity, the affect is significant and constrains the ability of parties to trade in a away that ensures that capacity is able to flow to those that value it the highest. The evidence provided in section 3 of the report supports the proposition that competition is occurring and that users are able to obtain capacity from retailers although they may be required to pay a price that is indicative of a higher transmission capacity price rather than a higher wholesale gas price as suggested. Contrary to the analysis within Section 4.2, In Novas experience, pipeline capacity has a value that is equal to or greater than the posted terms price and that end users (new or existing) are able to procure transmission capacity either separately or as a bundled part of delivered supply. For customers that have countercyclical demand profiles, the price of capacity is generally lower than the posted price. **Section 4.3 The Franchise model of the gas market** With respect to the low liquidity of the secondary capacity trading market described in Section 4.3 we believe that it is primarily due to: - the fact that a significant proportion of capacity (65-70%) is tied up in contracts where trading of that capacity is prohibited; - the parties with non tradable capacity also happen to be users that are in the best position to make capacity available to other higher value uses; - the remaining 30% of posted terms capacity is allocated to users who in general have coincident peak demand with little diversity between retailers that may give rise to secondary trading of firm capacity; - capacity of prices have historically been insufficient to created incentives for users and aggregators to

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	consider interruptible service level agreements; - the recent emergence of the constraint and failure of the industry to remove impediments to the barriers to trading of capacity between retailers/aggregators; - regulatory uncertainty The issue of retailers “dropping” customers is a commercial decision and the risk of lower prices as opposed to higher prices or adverse publicity is a matter for each retailer to manage. It is also the decision of the consumer on how active they are in seeking our competitive bids. In one recent case, a customer complained to the GIC about not having access to competing offers because they elected to not request bids from two major suppliers! The conclusions drawn that retailers are in effect only able to supply their existing customers is incorrect and there is no supporting evidence of that with existing customers switching between retailers and the ability of new consumers to receive supply if they can agree commercial terms with a retailer. The role of retailers as aggregators in ensuring that capacity is allocated to the highest value use and also that new commercial arrangements (such as interruptible supply) are developed in response to consumer demand is not considered by the consultation document and if it is, the importance of that role is underestimated. It is incorrect to use The Franchise model as a representation of the current position as it assumes that: - each franchisee effectively has a monopoly over its customers, - there is no competitive tension and that the franchisee is free to price at the maximum level the customer can afford to pay without threat of switching to another supplier - a franchisee must supply a consumer. The reality is different as has been shown in section 3 of the report and consumers can switch, have switched and as far as Nova is aware it has no obligations to supply a customer if it elects not to regardless of price or that there are any restrictions on retailers offering supply to new consumers or increasing supply to existing consumers. We note that the paper concludes in section 4.5 that the status quo mechanisms for allocation of capacity rights does not appear to have any impact on competition in the retail services market or the wholesale market. This is relevant when it comes to what the affects are on those markets when it comes to assessing

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	alternative mechanism for allocation of capacity.
Q3 Do you agree with the proposed regulatory objective?	No. Nova believes that the regulatory objective should ensure that industry arrangements support the efficient allocation of scarce resources (in this case Northern pipeline capacity) to the highest value use. The favoured tool for ensuring efficient allocation is the use of competitive market mechanisms in ensuring that resources are appropriately priced. With respect to objectives regarding pricing and investment there is a strong crossover with the Commerce Commission in this area. We note that one potential solution that the GIC has not addressed is incremental investment in additional capacity given its powers under Section 43F 2(d) of the Gas act that enable the GIC to regulate for the purpose of “requiring expansions, upgrades, or service quality improvements to gas transmission pipelines including specifying how these will be paid for”.
Q4 Do you consider that the evaluation criteria are appropriate for evaluating the options?	Nova has a number of concerns regarding the evaluation criteria. No mention is made of efficiency although that could be bundled with competition. If the most important issues of competition and efficiency are weighted equally with secondary considerations such as consistency, timeliness and price affects, then the evaluation may result in potentially expedient outcomes that do not meet the overall regulatory test of efficiency. Nova believes that the curtailment criteria should be refined and labelled “forced curtailment”. This reflects that if there are arrangements that contemplate curtailment on a voluntarily basis as a part of a commercial bargain then that is a positive development compared to forced and arbitrary curtailments of consumer demand.
Q5 Do you have any comments on the evaluation of options?	**9.1 Evaluation Summary** Nova disagrees with some aspects of the evaluation including: 1) Capacity End User – competition should be rated as “xx”.

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	This is because if capacity transfers from an existing retailer on a switch how can a new user ever acquire (through competitive bidding for available capacity) firm capacity. A retailer who loses a customer is unable to retain capacity to sell to a customer who places a higher value on the capacity than the incumbent; 2) Tradable PS capacity – competition should be rated as "✓✓". Allowing parties with long term capacity rights to trade that capacity to others in competition with other participants will create more competitive tension, improve incentives for innovation and increase the diversity of users exposed to incentives to consider demand shaving/shifting. It is potentially quick and easy to implement with minimum amendment to existing contracts in a way that is neutral to Vector revenue wise and a benefit to the power station capacity holders (MRP and Contact). 3) Capacity follows end user – shock, consistency and curtailment should be rated as a "xx" due to the fact that when capacity is transferred to another retailer, insufficient capacity may be transferred meaning that the switching retailer and customer is exposed to potential overrun charges and possible curtailment. If this is not the case then the remaining customers of the retailer at the affected gate may instead be left with insufficient capacity due to loss of diversity and to much capacity being transferred with the switching customer resulting in risk of overrun charges and curtailment for those remaining customers. New users are of course curtailed all of the time or can only be supplied on interruptible terms. In addition, as capacity automatically transfer at the CRF price, existing end users do not see any price signals that capacity is scarce and face little incentive to become more efficient or consider different usage profiles and alternative fuels. Our comments have focussed primarily on the option proposed in the consultation paper and Nova preferred solution which is to reduce barriers to capacity trading.\ **9.2 Priority of objectives** We disagree with the assessment that existing contractual rights is not important. Erosion of property rights created through contract creates regulatory uncertainty for end users and suppliers and undermines investment decisions they may seek to make. This is especially important for those parties that are considering: - investment in new plant requiring gas supply;

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	- development of new retail products designed to offer retail solutions to capacity constraint issues; - investment in gas storage or alternative fuels for consumers; - investment in new capacity
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" option is flawed for the following reasons: - it effectively denies access to gas transmission capacity for new users and in particular those that have a higher value use for capacity than an existing user; - It creates disincentives for retailers who act in the market in an aggregator role from pursuing innovation in the area of peak demand shaving/shifting; - It prevents price signals from reaching consumers who then have no incentive to modify usage patterns, consider alternative fuels, etc. - The suppression of price signal also weakens the incentive for investment in new capacity These also have the flow on effect to suppliers in constraining supply and reducing incentives to invest in oil and gas exploration and development as suppliers cannot get their gas to market, especially when there is off peak capacity available to be utilised given the right incentives for consumers.
Q7 Do you have any comments on the details of the proposal?	Nova believes that the proposal, if implemented, will lead to inefficient allocation of capacity and will not pass any normal regulatory cost/benefit test. The role of retailers as aggregators of capacity is important in ensuring that capacity is allocated to the highest value use and that new users can access capacity on an equal playing field with existing users. Current transmission arrangements are based on aggregation of individual customer loads and diversification of peak demand across many consumers. The proposed capacity follows end user proposal is fundamentally incompatible with gate level transmission bookings and will result in: - disputes over what an individual customers contribution to a retailers demand portfolio actually is; - winners and losers when too much/too little capacity is transferred - exclusion of new users who value capacity higher than existing users

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Q8 Do you agree with the next steps?	Clearly not. Nova does not believe that the proposed solution will pass the normal net public benefit test for regulation and that there are other alternative solutions available that would and that may not even require regulatory action.