Appendix A: Recommended Format for Submissions

To assist the Gas Industry Co in the orderly and efficient consideration of stakeholders' responses, a suggested format for submissions has been prepared. This is drawn from the questions posed throughout the body of this consultation document.

Respondents are also free to include other material in their responses.

Submission from: PHI Developments Limited, Calgary, Alberta, CANADA (403) 283-0584, phidev@shaw.ca Jamie Fisher, President

Questions	Comments
Q1: Do you agree with regulatory objective for the component of the Wholesale Market work stream? If not, what objective should the Gas Industry Co be considering?	Yes. There appears to be competing objectives as laid out in The Gas Act. In a market, producers will always want higher prices (facilitation of ongoing gas supply) and consumers will always want lower prices (sustained downward pressure). A better objective, as implied by the desire to encourage transactional efficiency, may be the creation of a market structure where prices for gas reflect fair value that can be used as a reference for investment decisions.
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?	Not entirely. Markets reflect, by their very nature, the interaction of individuals seeking to maximize gain. Although economic models and charts (a quantitative framework) are effective conceptual tools, there are inherent risks in using them as a proxy for future human behaviour. It is suggested that a review be made of the existence and evolution of similar markets to determine appropriate market structures.

Questions	Comments
Q3: Are there other time horizons that should be considered for the trading of gas? If so, what are those time horizons?	Yes. An alternative way to define short term trading is all transactions that flow for a period of one month or less, and they can be agreed to within a day of the actual start date. An alternative way to define long term trading is all transactions that flow for longer than one month, and they too can be agreed to within a day of the actual start date.
Q4: Are there any other reasonably practicable alternatives for longer term trading of gas that should be considered and if so, what are they?	Yes. It is common for buyers to secure gas for a specific term and allow the price paid during that term to float with short term prices (daily prices at an agreed upon point usually referred to as the "index"). With this arrangement, buyers agree to pay "market" prices for gas they take title to, and preserve the ability to lock-in future prices if they are able to agree on a value with the seller.
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?	Not entirely. Given the limited number of market participants, some consideration may need to be given to the ability to exercise market power (i.e.; conduct transactions in a manner that could be considered inefficient).
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?	Not entirely. Transactional efficiency can be encouraged in the long term market by addressing issues such as: the need for standard contracts, the development and reporting of index prices, and capacity release bulletin boards.
Q7: Are there any other options that should be considered for short term gas trading, and if so, what are the options?	It is common in short term markets to use brokers (i.e.; indirect bilateral) to provide anonymity and liquidity. The use of brokers also attracts speculators that can play a very important role in any efficient market.

Questions	Comments
Q8: Are you satisfied with the qualitative assessment of short term trading options? If not, what aspects would you change and why?	Not entirely. Given the limited number of market participants, some consideration may need to be given to the ability to exercise market power. Also, the short term market must have adequate liquidity in order for it to be transactionally efficient, and qualitative assessments likely need to allow for this.
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?	Yes.
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?	No. A standard contract should require the seller to warrant that they have title to the gas that they are selling. If the seller does not hold title to a sufficient volume of gas once their contractual obligation commences, then the seller is obligated to buy the necessary volumes from someone else. This is a core contractual concept that allows speculators to participate in the market (i.e.; people can sell gas they don't have if they think they can buy it for less money later).
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.

Questions	Comments
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?	No. A product that has a broad range of specifications is, by definition, no longer a commodity. In order for price discovery to have any meaning at all, pricing must refer to a product that has known and unchanging characteristics. Seller should be responsible for delivering gas to buyer as per a specific set of requirements. It is the responsibility of the seller, then, to have contractual arrangements in place that ensure pipeline deliveries meet a predetermined set of specifications.
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?	No. Fundamentally, the standard contract should be a title transfer document only. Prices agreed to under the contract reflect change in ownership, and are an accurate measure for the fair value of the gas. Transport obligations/rights should be described in separate transportation agreements.
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?	Generally, yes. It may be simpler to define the direct loss as the replacement cost for the gas.
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?	Generally, yes. It may make sense to broaden the Force Majeure clause beyond the simple definition that balancing has been suspended.

Questions	Comments
Q18: Do you agree with the proposed dispute resolution provisions for the standard contract? If not, what alternative would you prefer and why?	No. The standard contract is a legal document that, in all likelihood, will realize incremental changes as the gas market itself evolves. Many potential counterparties will not want to forfeit their legal right to have disputes settled in a Court of law. It is desirable to have a standard contract that does not restrict market liquidity by excluding potential counterparties.
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?	Yes.

Questions	Comments
Q22: Do you agree that the preferred approach to prudential management is the white-list? If not, what alternative would you prefer and why?	No. A matching platform that facilitates transactional efficiency is one where bids and offers reflect only the inherent commodity value of the gas. To achieve this end, specifications for the gas must be consistent, and prices must not include any risk premium related to the ability of a counterparty to perform. Minimum prudential standards are required to ensure transactional efficiency of a matching platform. If the minimum prudential standards greatly restrict the number of counterparties able to use the matching platform, then another market structure (brokers, for example) should be considered.
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?	No. An efficient market is characterised by transparent prices and narrow bid-offer spreads. Increasing market liquidity is one of the most effective ways to increase market efficiency. Market liquidity can be increased by encouraging all transactions to take place at the same location. Transportation requirements can, and should, be negotiated separately.
Q24: Do you consider the indicative cost ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	Not able to comment.
Q25: Do you consider the indicative benefit ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	As stated in 7.33, “it is impossible to verify whether this present value estimate is accurate”. Rather than justifying the creation of a platform by estimating “improvement in pricing accuracy”, it is suggested that consideration focus on qualitative benefits.

Questions	Comments
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?	If a majority of potential industry participants agree to fund the matching platform, then it would be reasonable to proceed with development. It is should be understood, however, that the platform may not able be able to achieve the same level of liquidity as other market structures (i.e.; a broker market).
Q27: Do you consider the indicative cost ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	Experience has shown that it is common to underestimate the scope and cost of gas related information and trading systems.
Q28: Do you consider the indicative benefit ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	No. Benefit analysis should not rely on concepts as esoteric as "price inaccuracy". Instead of investing funds in a theoretical end state, put sufficient rules and tools in place and let the market evolve naturally.
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?	Yes.

Questions	Comments
Q30: Do you consider the quantitative assessment methodology to be reasonable? If not, what amendments would you propose and why?	No. Consistent with the objective of increasing transactional efficiency, it may make more sense to focus on qualitative benefits (for example, increased liquidity). From a qualitative point of view, it is not clear how the conclusion was reached in 10.10 that benefits could be constrained. All major gas producers and users need mid and back office functions to support their operating activities.

PREAMBLE:

New Zealand has an exciting opportunity to encourage the continued evolution of the wholesale gas market. Emphasis on a collaborative process coupled with the recognition that the market will evolve through time reflect the sound approach that is being taken to identify future steps that should be taken. Wholesale market evolution in New Zealand will be influenced by the specific production, transportation, and usage parameters that are found in the country. However, there are general traits that are characteristic of most natural gas markets, and it may be beneficial to consider these traits whilst reviewing the options describing to how to proceed.

MARKET TRAITS:

1) Liquidity

Markets with low volumes (less than 1.0 PJ of daily flow) and a limited number of participants tend to be illiquid. This is especially true during upset conditions thus amplifying potential financial impacts or ramifications.

2) Price Discovery

Illiquid markets tend to have wide bid-offer spreads, and this usually results in a limited number of transactions. A limited number of transactions also tend to increase the desire for confidentiality thus reducing price transparency.

3) Transactional Efficiency

A market with poor price discovery is incapable of providing the consistent and reliable price signals needed to make investment decisions.

OPINION/SUGGESTIONS:

1) Market Participants have Competing Interests

Gas producers want higher prices. Gas consumers want lower prices. By definition, the two main groups of market participants have interests that are diametrically opposed to each other. If one group can use the market tools or systems available to realize benefit, then they will do so. A transactionally efficient market is one where no market participant has the ability to unduly influence prices.

2) Encourage Liquidity through Short Term Market

The single most important characteristic of any market is liquidity. Narrow bid-offer spreads resulting from liquid markets reduce execution costs thus encouraging high transaction frequency which is the key element of price transparency. Wide bid-offer spreads for longer term markets that are illiquid can result in a situation where weeks go by without a transaction being agreed to. The smaller volumes inherent in short term transactions (especially day ahead trades) reduce the potential exposure that can result from agreeing to a fixed price. When considering the appropriate market structure, then, particular emphasis should be given to ensuring that a liquid and dynamic short term market is allowed to evolve.

3) Encourage Entry of Speculators

Speculators increase market liquidity. It is common in commodity markets for speculators to account for more than 80% of all transactions. Consideration should be given to prohibiting or restricting the activities of speculators that do not have the financial resources to maintain financial liquidity during a broad range of market conditions.

4) Consider Deferring Development of the Matching Platform

Brokers can play an invaluable role in creating liquidity in a market that has a limited number of counterparties. In addition to providing anonymity, brokers are able to negotiate small adjustments in price to reflect non-standard variance such as credit risk, operational need, and special rights or provisions. Many major markets that trade electronically today began as broker markets.

5) Use a Liquid Short Term Market to Support the Long Term Market

A liquid short term market supports development of the long term market in two ways. First, price discovery provided by current gas values provide information that can be used during negotiations as to what future gas values will be. And second, liquid short term markets support the evolution of indexes which can be used as the price component of long term transactions (i.e. a counterparty can agree to buy gas at a location for one year where the price is equal to the daily index for that location).

6) Expect the Unexpected

Markets evolve through time. Many of the changes that take place in markets are a response to market events or upsets. Market events can be very wrenching and damaging, and may include: sustained interruption or reduction of gas supply, counterparty bankruptcy, and criminal or illegal behaviour. The policies and procedures of the market overseer need to be robust enough to make quick, and sometimes drastic, changes when upsets occur.