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Mr Ian Dempster
Gas Industry Co Ltd.
1 Willis St.
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Wellington

Dear Ian

RE: SUBMISSION ON WHOLESALE GAS MARKET DESIGN

1. Thank you for the opportunity to comment on the above consultation paper regarding gas wholesale market design concepts. Vector offers some general comments and answers to those questions of particular relevance to its business. Vector will continue to contribute to the industry's market development process.

Overview: The Need For A Gas Market

2. Vector notes that there are currently primary and secondary wholesale gas markets operating in New Zealand. Therefore this development is not critical to the operation of the industry. Nevertheless there is scope for a simple standardised market for balancing participants' gas positions at the margin, as long as the additional cost is justified the additional flexibility it provides.
3. A degree of certainty will always be required to manage future risk, so it is reasonable to expect that all major long-term gas supply contracts will be negotiated by direct bilateral contracts. Therefore, any market is likely to focus on buyers and sellers resolving short-term gas surpluses and shortfalls. The success of the market will be measured by its effectiveness in resolving these short-term surpluses and shortfalls.
4. The majority of surpluses and shortfalls are likely to arise from parties having inflexible gas supplies. If flexible gas supply contracts still exist then it is likely that this flexibility will be shared around the industry. This can be done by direct

bilateral contracts, where a party with access to a flexible gas supply helps balance one that does not.

5. If significant supply flexibility exists, it is likely that the parties with supply flexibility will offer to trade gas at a market premium to those that do not have it. Since the two groups would not change (those with flexibility and those without) it would make sense for the two parties to minimise effort and risk by entering into an ongoing direct bilateral agreement for one to balance the other.
6. However, if little flexibility exists in the market a trading platform could become very useful. Mismatch and potential balancing gas costs are the current mechanism for industry to balance supply and demand. However, this is a reactive operational process that aims to resolve shortfalls/excesses of gas in a short period of time. A gas-trading platform may provide a more proactive way for parties to avoid mismatch, as well as potentially allowing the pipeline owner to quickly identify a suitable supplier, and a market price for balancing gas on a day.
7. Analysis of the wholesale market design cannot be done without consideration of upstream supply contracts, risk allocation, supply flexibility and downstream supply contracts.
8. To identify a trading mechanism suitable for the New Zealand gas market we need to consider the size and frequency of potential trades. Trading out of mismatch is likely to be the primary purpose of this gas market, with opportunity cost trading such as a thermal power generator turning on/off likely to be a valuable but less frequent second.
9. Because mismatch is determined by downstream reconciliation many parties do not know their mismatch positions until part way through the following month. This would be a logical time for the majority of trades to occur. Because of New Zealand's small number of industry participants and an expected low frequency of monthly trades Vector Transmission would support a simple, transparent trading mechanism. From the proposed options, Vector Transmission would expect a platform bilateral to best meet these requirements. However this raises questions that are dealt with in our answer to question 27 below.

Answers To Specific Questions

Q.14: 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?

10. Vector does not agree the discussion paper's conclusion that a party-specific limit is sufficient when a defaulting seller does not meet their supply obligations. Vector believes it is inappropriate for mismatch to be the safety mechanism in this situation (as proposed in the discussion paper). Mismatch may work in some instances but if the seller is not a shipper on the Vector transmission network then they could not be placed in a mismatch position. If this were the case, it would mean that only shippers who hold transmission services agreements (supply contracts) with Vector would be allowed to sell gas under this regime – which potentially limits the number of suppliers and shippers able to trade.

Q.18 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?

11. Vector transmission agrees that Rotowaro is a logical location for gas trading to occur. Rotowaro has the largest gas flow across any welded point as well as a significant number of gas shippers on either side.

12. The welded point at Frankley Road is not the most appropriate location for gas trading in Taranaki. Rather the Kapuni end of the Frankley Road pipeline is a more practical choice.

13. Currently there is very limited shipper demand for gas to contractually or physically flow either way across the Frankley Road welded point with the Maui pipeline, for several reasons:

- There are sufficient gas entitlements in the southern pipelines (south of Frankley Road) to meet the majority of shippers southern demand loads. Therefore there is little reason to have additional gas traded and sent south of Frankley Road;
- There are very few shippers requiring transport north into the Maui pipeline from Frankley Road, as this is often not the most cost effective transmission route to northern demand locations such as Pokuru and Rotowaro.

14. Vector suggests that a notional Kapuni hub on the Vector transmission system is a more logical place for gas trading. Most southern fields (i.e. Kapuni, Rimu, Kupe, TAW and potentially Cardiff) inject gas near Kapuni; southern gas can therefore be sold without incurring transmission costs to Frankley Road. Furthermore, gas traded at Kapuni has the added flexibility of being able to flow north via either the Vector pipeline system or the Maui pipeline, and south on the Vector pipeline. These flows would provide transmission alternatives for traded gas.

15. Forcing south system gas entitlements to be traded at Frankley Road may force buyers and sellers to transport gas on a less cost effective route to reach the intended market. Using a Kapuni hub would allow producers to access the market without being a shipper on either transmission system.

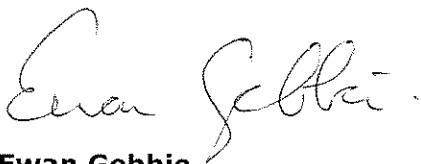
Q.27 Do submitters agree that issues with gas allocation can be resolved separately from the establishment of a trading mechanism? If not, why not?

16. Vector believes that the integration of gas trading into current market reconciliation mechanisms has not been sufficiently explored, and is uncomfortable with the development of any gas trading mechanism without first understanding how the mechanism intends to integrate with the current reconciliation process.
17. Gas transfer agreements are the current mechanism for trading gas at various welded points. Installing a platform bilateral trading market would provide an alternate short-term trading service, but running the two processes in parallel creates difficulties as presumably one process will determine the gas available to calculate the other. The issues this raises need further consideration:
- If these two processes need to be run back to back, which one needs to occur first?
 - How will defaults in gas trading impact on gas transfer agreements or potentially vice-versa?

Concluding Remarks

18. Vector believes that many of these issues need further discussion and would welcome the opportunity to work with the GIC further on this matter. Vector is happy to provide further information as required, please contact me in the first instance.

Kind regards



Ewan Gebbie
Industry Policy Manager