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Mr Ian Dempster
Gas Industry Co
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Dear Ian

SUBMISSION ON GAS WHOLESALE MARKET DESIGN – SEPTEMBER 2006 DISCUSSION PAPER

Vector greatly appreciates the opportunity to comment on the above discussion paper, and thanks the Gas Industry Co (GIC) for the extension of time provided.

In brief, Vector supports the development of a matching platform for short term gas trades.

Vector believes that short term gas trading will become increasingly important in the daily functioning of the New Zealand gas market. Vector, in its current role of gas transfer agent has seen an increase in the level of short term gas trading. These trades are becoming an increasingly important tool for the industry to fulfil gas obligations efficiently.

Currently, parties can trade gas for a short term at any Welded Point that has a Gas Transfer Agent. This is facilitated via a Gas Transfer Agreement, which determines the rules, locations and duration of the trade. Hence a mechanism for trading already exists and is being employed.

The GIC report has acknowledged that the development of a gas market cannot be done in isolation to the current industry codes and reconciliation processes that exist in the New Zealand market. However increased focus needs to be placed on determining how the standard contractual rules will be incorporated with the existing codes, rules and roles. In particular:

- The MPOC
- The Gas Transfer Code and Gas Transfer Agent role.
- The integration with reconciliation applications such as OATIS.

It is not entirely clear from discussions to date how the proposed trading process is intended to sit alongside the current Open Access and reconciliation framework, and any developments would benefit strongly from the consideration of these relevant processes in its own design.

While Vector supports the development of a matching platform developed collaboratively by the industry and GIC as a first step in the evolution of short term gas trading in New Zealand, the following issues are raised with a view to improving the development of such a platform.

Contingent Liability Issues

While Vector is aware that the favoured "matching platform" will not reconcile trades, the obligation and methodology for completing a trade (once posted) have not been discussed. If a party posts a trade there must be some mechanism that forces them to fulfil their promise to buy or sell. If there are no specific rules or obligations backing up a trading platform then the platform may not provide the degree of certainty that many parties need to make 'on the spot' commercial decisions. Hence Vector is unsure that a punitive "liability provision" is sufficient assurance, as it cannot guarantee a trader a source of gas – only a pathway to reclaim damages against the defaulter. An integrated reconciliation mechanism could be investigated to force any trading party to provide sufficient gas on the day. This may remove / reduce the possibility of defaulted trades occurring and avoid lengthy disputes.

Questionable Transaction Benefits

Vector notes that while the number of trades is increasing, the number of potential participants in a wholesale market is still relatively few. Hence search costs for a buyer / seller to find a respective partner are still relatively low. As a result any trading platform is unlikely to significantly reduce search and transactional costs. However, the ability to make all trades transparent to industry should assure better price efficiency (especially among more infrequent traders). Hence Vector would suggest that a significant proportion of a platform's value will be in its transparency. A simple "matching platform" should be sufficient to allow this.

Concluding Remarks

Vector is happy to provide further information as required, and would welcome the opportunity to work with the GIC further on this matter. Please contact me in the first instance.

Kind regards

Ewan Gebbie
Group Regulatory Manager Operations

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?	Vector agrees that a wholesale market will provide better market efficiency and align with regulatory objectives
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?	Applying qualitative and quantitative assessment criteria to a relatively small market with limited players, adds a high subjectivity to the exercise. Vector would suggest that while the methodology seems valid the results should be viewed with caution.
Q3: Are there other time horizons that should be considered for the trading of gas? If so, what are those time horizons?	The time horizon of one year is too long. Vector has observed that most gas trades usually range from a few weeks to a few months. In the future weekend / weekday trading is possible. Vector would suggest short term trading is anything under 3-6 months, with an upper bound limit of 6 months.
Q4: Are there any other reasonably practicable alternatives for longer term trading of gas that should be considered and if so, what are they?	No
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?	No comment
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
Q7: Are there any other options that should be considered for short term gas trading, and if so, what are the options?	No
Q8: Are you satisfied with the qualitative assessment of short term trading options? If not, what aspects would you change and why?	To a degree – please refer to Q2

Questions	Comments
Q9: Do you agree that the standard contract should allow for both types of approaches? If not, what would you prefer and why?	Yes. A standard contract needs to not only cover both the determination of volumes and terms of trade but also needs to specify how it intends to integrate with existing reconciliation processes. An example would be – does a trade occur before or after the gas transfer process? How is change of ownership tracked and communicated to the transmission provider? Can the same volume of gas be traded more than once on the same day?
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?	If the contract term is longer than 6 months then a price adjustment mechanism should be included. Most major contracts are moving to 1/4'ly ppi movements. There may also be a need for an additional clause to take into account a change in other taxes/levies etc such as a GIC levy during the contract term. However, contracting parties will always be free to add any additional clauses they feel are necessary for their particular transaction.
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 – but Vector is unsure that the original intentions of s.41 are valid in today's environment. Vector has noted that short term trading in the market is already occurring without s.41 approval hence it seems the wording in the Act needs clarification.
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?	Yes. Liability for gas specifications is captured in other contractual arrangements (such as ICAs) and is being discussed in other GIC workstreams.
Q14: Do you agree that the standard contract should not provide for any priority rights? If not, what alternative would you prefer and why?	Priority rights are important but they don't need to be contained in the standard contract – it can be captured in the Gas Transfer Agreement.

Questions	Comments
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?	Need to be reasonably specific as to the obligations of parties. Not only for their own transmission arrangements but also obligations to enter Gas Transfer Agreements etc and any other allocation/reconciliation arrangements that need to be made.
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?	Liability provisions won't be sufficient. There needs to be significant disincentives to defaulting on a trade. Alternatively, an integrated reconciliation mechanism that forces a trade to occur should be investigated (see comments in cover letter).
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?	FM provisions should be allowed for but there needs to be clarification over when FM can be invoked. If the FM provisions are too weak they will undermine the certainty of the trading process. Excluding FM will only work for very short trades, maybe less than 1 week otherwise exposure is too high.
Q18: Do you agree with the proposed dispute resolution provisions for the standard contract? If not, what alternative would you prefer and why?	Yes. While a disputes process may be inevitable, both the contractual provisions and resolution process itself should remain as streamlined as possible.
Q19: Do you agree that the standard contract should provide a standard assignment provision? If not, what alternative would you prefer and why?	Yes, consent not to be unreasonably withheld.
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?	Yes although with limited players in the gas market selective criteria applied to the white list should be overly onerous or specific. Even the blacklisted participants may become attracting to white listed players given the appropriate price incentive.
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?	Yes
Q24: Do you consider the indicative cost ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	It's often hard to determine the exact cost of an IT platform if the exact design and scope is not entirely known. However the functionality is relatively simplistic so the medium to high case scenario would seem reasonable. Vector is keen to know how the GIC intends to fund the platform and allocate costs. Will this be funded out of levies? How is the ongoing cost to be paid for, per trade? Per GJ ?
Q25: Do you consider the indicative benefit ranges for the matching platform to be reasonable? If not, what amendments would you propose and why?	7.33, states that "it is impossible to verify whether this present value estimate is accurate". Vector would agree as there are far too many variables to provide any quantitative certainty.
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 costs are kept to a minimum Vector would see the platform as beneficial.
Q27: Do you consider the indicative cost ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	Please refer to Q24 & 25

Questions	Comments
Q28: Do you consider the indicative benefit ranges for the trading platform to be reasonable? If not, what amendments would you propose and why?	Please refer to Q24 & 25
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
Q30: Do you consider the quantitative assessment methodology to be reasonable? If not, what amendments would you propose and why?	Yes, please refer to Q25