07 July 2010

Christine Southey,
Chief Executive
Gas Industry Company Ltd
Level 8, the Todd Building,
95 Customhouse Quay,
PO Box 10 646,
Wellington 6143.

Dear Ms Southey,

RE: Submission on the Options for Vector Transmission Capacity – May 2010

Please find attached our submission regarding the above paper. We are available to be heard on this submission if required. As an end user we are rather limited in our understanding of the intricacies of the gas industry. However, we are very concerned regarding the current constraints applied to the Northern Pipeline by Vector and the resultant market distortions and costs imposed on end users.

Submission

QUESTION	COMMENT
Q1 Do you agree the objectives identified in section 5 are appropriate criteria for evaluating transmission capacity options?	Generally we agree with the Capacity objectives (5.1), however we are not convinced that the method of addressing these capacity issues should be limited to addressing capacity shortages through pricing. Why not simply increase capacity and apply that cost across all users of the Northern transmission line over the life of the investment. We have some issues with 5.2 as this reflects an ideological economic model where increased costs reflect value, which unfortunately does not account for the ability of an individual industry to sustain increases. Furthermore under the current situation where Carriers own the historic capacity and are unwilling to relinquish that capacity when an end user changes supplier there cannot be an efficient model as hoarding will occur.

Q2 Do you agree with the evaluation of the current capacity arrangements?	No, under the current model the real or perceived capacity constraint has become a significant barrier to operating an efficient market and the carriers are able to hoard historic capacity and use it to drive up prices to end users. Under the current system the barriers to competitiveness posed by the 'historic' access to capacity mean Efficient Pricing, Allocation, Competition, Transparency, and Price Stability are all very poor to the end user and new entrants to the retail market.
Q3 Do you agree with the evaluation of the contract carriage option?	No – if the contract carriage option is rated as very poor for competition, investment and allocation how can the price within the market be rated as moderate?
Q4 Do you agree with the evaluation of the common carriage option?	Yes – as long as fees for transmission are competitive across the whole network. Although as an end user rather than a carrier we do not fully appreciate all the issues surrounding this proposed methodology. However, we do not understand how pricing can be rated as moderate if transition costs are high.
Q5 Do you agree with the evaluation of the current hybrid option?	No, unless the market is transparent the competitiveness of that market must be adversely affected. As an end user rather than a carrier we do not fully appreciate all the issues surrounding this proposed methodology, but would question how the hybrid model would improve the situation where capacity is constrained, surely everyone would enter into long-term contracts, disadvantaging new entrants and affecting potential expansion of existing end users.
Q6 Do you agree with the evaluation of the MDL carriage option?	Yes – again reiterating that as an end user rather than a carrier we do not fully appreciate all the issues surrounding this proposed methodology.
Q7 Do you agree with the evaluation of the incremental change option?	No – there will not be a competitive market unless carriers are required to transfer capacity with the end user, or unless the end users own that capacity.
Q8 Are there other options you think should be considered and evaluated?	We believe the capacity should reside with the end user (or the incumbent carrier must be required to transfer capacity at the end of an existing end user contract), especially with medium to large users, this will eliminate the anti-competitiveness of hoarding capacity, it would also reduce the barriers to entry for new retailers/carriers.
Q9 Do you agree that only the hybrid and incremental change options should be considered further?	No - we believe the only models that should be considered are those that result in a competitive market for gas. Anything that artificially impedes the competitive market needs to be excluded. From the options presented a mix of the Hybrid and the Incremental change options seem to be the better options, but only if they include mandated capacity transfer if the end user changes retailers/carriers. However, we reiterate that we believe addressing the capacity issue is the best outcome, rather than finding models to attempt to mitigate this capacity constraint (real or perceived).

Q10 Do you agree with the proposed next steps?	Not unless they include the option of increasing capacity to match future demand. Otherwise we are constraining development for industries that require the use of the Northern transmission Line. We are of the firm belief that the capacity should reside with the end user, or at the very least retailers/carriers should be required to transfer capacity to the new retailer/supplier upon the end user selecting a new retailer/supplier. We also believe a long-term solution is required rather than developing a system to mitigate the short-comings associated with the current capacity constraint.

Additional Submission Information:

In addition to the above views we would submit that the current model being implemented by Vector has resulted in significant anti-competitive behaviours within the industry and has resulted in end users paying significantly inflated prices as the retailers/carriers hoard capacity and then use that capacity to inflate prices to existing users.

Our group of companies has recently tendered out our gas requirements, we are an Auckland based manufacturing organisation that operates from a single site and we currently use approximately 130,000 GJ per annum at an MDQ level of 545 GJ/day. We sent the tender document to 7 companies, received responses from 6 (5 of which were subject to gaining capacity). When approached about transferring capacity the incumbent supplier sent the attached statement, which clearly reflects their views on capacity transfer.

"(Supplier name excluded) would like to communicate in no uncertain terms that if it is unsuccessful in securing the energy supply for the period 1 July 2010 to 30 June 2012 we will not be relinquishing the transmission capacity as we have other uses for it."

Under the current restrictions imposed by Vector our greatest concerns as an end user of Natural Gas are:

1. No-one seems to know what the current available capacity actually is and how or when we will be able to increase that capacity.

2. It is possible that an incumbent supplier may have 'better uses' for the capacity and as such may not offer supply at the end of an existing contract and due to the fact that carriers are not willing to transfer capacity we may end up not having gas offered. Therefore, the end user should 'own' the capacity for their gas requirements.

3. Prices are wildly distorted due to the uncompetitive market associated with the grandfathering of capacity. In our most recent tender the gas price offered by our

incumbent supplier was more than 30% higher than the most competitive offer. We could not take the most competitive offer as they did not have available capacity and the incumbent would not transfer that capacity.

4. Outside of the gas industry player's no-one seems to be aware of these capacity constraints and investment within industry is occurring assuming gas is readily available. Our company replaced 2 coal boilers with gas boiler 18 months ago – under the assumption that there were no capacity issues.

As an end user of natural gas, all we ask for is a consistent and competitive market that is free from distortions that impose economic rents on the end user, as well as supplying a consistent product. Ultimately any uncompetitive distortions within the market are reflected through additional costs to the end user.

Copy to: *Ian Wilson, Gas Industry Company*