MIGHTY RIVER POWER

20 April 2011

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Dear Steve

Retail Competition and Transmission Capacity Workshops

Introduction

1. Mighty River Power welcomes the opportunity to provide feedback on the workshops on Retail Competition and Transmission Capacity Investment held on 14 April 2011. No part of this feedback is confidential and Mighty River Power is happy for it to be publicly released.

General Comments

2. We have restricted our comments to the short term issues which are essentially contractual issues relating to the availability and allocation of capacity on Vector's North transmission pipeline. With regards to the long term issue of investment in transmission infrastructure we regret that given the current market arrangements we cannot see any immediate solution to this particular problem.

3. Mighty River Power agrees that the current constraint on the Vector North transmission pipeline has caused a problem with the availability and allocation of capacity. We are not convinced that this is the only reason that there has been a reduction in retail competition perceived or otherwise for large end users. We do however agree that the capacity allocation problem does require to be addressed with a degree of urgency. We are concerned the Gas Industry Company (GIC) and large end users appear to believe that the resolution of this particular problem will automatically lead to an increase in the number of retailers tendering for gas supplies. We do not believe that this problem on its own has caused the apparent reduction in gas supply quotes for large end users.

4. In our opinion changes in wholesale gas contracts have had a more significant impact on the number of tenders that consultants and end users have been receiving.
5. The initial Pohokura gas contracts which were tendered in 2005 not only introduced daily take or pay commitments, they also set this commitment at very high levels which by default significantly increased annual take or pay commitments. This contract structure has resulted in gas retailers on-selling gas at below cost and at prices below which other gas retailers are willing to compete. Under these high daily take or pay contracts selling it made economical sense to sell gas at below cost and therefore make a contribution to the take or pay costs rather than not uplifting the gas and paying all of the take or pay price.
6. Our understanding is that the new gas contracts currently being negotiated have daily take or pay commitments that are significantly lower than the original Pohokura contracts. As gas retailers move onto new contracts and their daily take or pay component is lowered this reduces the need for them to offer gas contracts to end users at below cost. The likely outcome of these changes is that fewer retailers will be prepared to quote for gas contracts at around $6.00/GJ as this no longer makes economical sense.
7. In support of this proposition we would refer you to McDouall Stuart's presentation at the GIC's own Industry Conference in 2009 which showed Contact Energy's average delivered gas price was $7.18/GJ. This figure based on Contact Energy's half year report to December 2010 is now $9.64/GJ. These prices are significantly above the $6.00/GJ average specified in your Submissions Analysis paper. Contact Energy's half year report also confirms that they have sold some gas to large users at loss making prices in order to assist in their management of their take or pay commitments.

Workshop Options

8. Mighty River Power agrees with one of the two options identified at the workshop, an arrangement that allows Non-Code shippers to on-sell a portion of their contracted capacity which may go towards alleviating the short term capacity constraint on Vector's North transmission pipeline.
9. Implementation of this option is of course subject to successful negotiations between Vector Transmission and the gas fired Power Stations on the North pipeline. Whilst we cannot pre-determine the outcome of such negotiations Mighty River Power can advise the GIC that we will be happy to enter into negotiations with Vector Transmission on this option.

10. The above option has the additional benefit that it would address any potential capacity reservation issues for all of the retail market and not just a few large customers.

11. We note that Vector Transmission was quite clear that whilst they would be happy to facilitate the development of a secondary/spot trading market for capacity it did not want to own or operate it. Mighty River Power would consider receiving requests for transmission capacity on a case by case basis provided that any agreement with Vector Transmission would allow for this.

12. Finally Mighty River Power accepts that should the market fail to remedy this issue that the GIC has a right to impose a regulated solution. As part of the discussions at the morning workshop and from the submissions from the November 2010 Statement of Proposal it was clear that our own misgivings with regards to the "capacity follows customers" proposal are shared by most industry participants. We would take this opportunity to confirm that we are still of the opinion that this regulated option is neither a practical nor an efficient solution to this problem.

13. If you would like to discuss any of our above comments directly with Mighty River Power, then please do not hesitate to me on 06 348 7926 or jim.raybould@mightyriver.co.nz .

Yours sincerely

Jim Raybould
Gas Manager