



# Note on capacity meeting and additional Gas Industry Co work

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The Capacity Working Group met on Wednesday 15 September 2010. This note outlines some of the key discussion points. Gas Industry Co has continued to refine the options discussed at the meeting and has included its work in this note.

You may find it useful to review the presentations from the meeting. The presentations can be found here: <http://www.gasindustry.co.nz/work-programme/transmission-pipeline-capacity?tab=1849>

## **Purpose of workshop and objective of the capacity project**

The objective of the workshop was to discuss the competition issue and to identify possible solutions. We identified six options for resolving the issue and meeting the objective of the capacity project. The group considered the best formulation of the objective was:

*To ensure that, in the short term, end users who are able to be supplied by existing pipeline capacity are not prevented from having an effective choice of supplier. The solution should not compromise achieving the Gas Act objectives in the longer term.*

## **Options**

Gas Industry Co presented three broad short-term options for resolving the competition issue:

- new capacity;
- transfer capacity;
- 'common' carriage.

Four variations on new capacity have been identified. Each option and variation is outlined below. Gas Industry Co has expanded the description of each of these options since the workshop.

### **Option 1: New capacity**

#### **Option 1a: Issue unlimited capacity with entry barrier (regulatory)**

**Main idea:** *Vector issues unlimited capacity. If a pipeline becomes constrained, an 'entry barrier' applies to limit demand for new capacity.*

- Vector issues capacity on pipelines. If a pipeline becomes constrained, Vector notifies the industry body.
- The industry body assesses the information and declares whether or not the pipeline in question is constrained. If the pipeline is constrained, an entry barrier applies to that pipeline.

- The class of end users subject to the entry barrier are specified in regulation. Users could be specified by demand (for example, all users with a demand greater than 50GJ/day), or by allocation group (for example, allocation groups 1 and 2).
- New end users are allowed to enter into this class only at Vector's discretion. Shippers are obliged to offer supply only to end users in this class. Vector or another party are responsible for monitoring this obligation through switching registry reports (that is, to verify no new ICPs had been added without Vector's approval).
- Increased load from existing customers in the class is similarly subject to Vector's approval. The reference base load would be historical usage.
- If a customer takes more than its reference base load, charges apply. Delivered quantities are obtained from the Allocation Agent, and Vector or another party calculates and settles the penalty charges for excess deliveries.
- All new load is admitted at Vector's discretion, subject to established principles (for example, first come, first served).
- Grandfathering rights would be unnecessary because Vector may issue unlimited capacity.
- If Vector considers a pipeline is no longer constrained, it notifies the industry body. The industry body assesses the situation and determines whether or not to declare the pipeline no longer constrained.

### **Option 1b: Vector contracts with power stations (non-regulatory)**

**Main idea:** *Vector agrees interruptible contracts with power stations. The contracts allow Vector to require power stations to reduce their output to manage congestion.*

- Vector contracts with power stations to have interruptible service.
- When interrupted, power stations are compensated at the electricity spot price at the time of the interruption.
- Vector issues new capacity as it becomes available. The cost of the interruptible contract (compensation for interrupted power stations) is recovered from new capacity (capacity reservation fees). The cost of the contract needs to be treated as a regulatory pass through; that is, Vector does not receive any revenue from the new contracts.
- The option cannot be regulatory, because Gas Industry Co has no power to force participants to enter into contracts.

### **Option 1c: New service (regulatory)**

**Main idea:** *Vector offers new capacity service to shippers. This new service is in addition to existing capacity products. If curtailment occurs, curtailed shippers make claims through a claims pool funded by revenue from holders of new capacity contracts.*

- Vector provides a new service.
- A claims pool similar to the Maui Pipeline Incentives Pool compensates existing users who are curtailed.
- Shippers with new contracts are charged a high tariff to fund the claims pool.
- Shippers with new contracts could (if they wished) contract with power stations to either avoid congestion occurring, or to buy reserved capacity on the day curtailment is going to occur.
- Secondary trading of power station capacity is needed.
- The service is similar to reserved capacity but with a different tariff and an obligation to pay additional amounts (to the claims pool) if interruptions occur.

### **Option 1d: Annual authorised overrun (regulatory)**

**Main idea:** *Vector offers a new capacity product replacing the existing authorised overrun service. The product is purchased annually at a price higher than reserved capacity.*

- Vector offers a new capacity product, 'annual authorised overrun', which replaces existing authorised overrun and is priced at a premium.
- The price includes a reservation fee, utilisation charge, and the base price (loosely based on the marginal cost of expansion (MCE)).
- The industry body sets the price.
- The product is bought annually and is not tradeable or transferable.

### **Option 2: Transfer capacity (regulatory)**

**Main idea:** *When an end user switches, the capacity used to serve that end user transfers from the old retailer to the new retailer.*

- When a large customer switches to a new retailer, the amount of capacity it requires is transferred from the old retailer to the new retailer.
- Large end users are classified based on demand or allocation group.
- The capacity transferred is based on historical customer demand at the pipeline's peak. The Allocation Agent could provide information to Vector. Vector calculates the amount to transfer based on a set of principles. The amount would need to be adjusted slightly to allow for overrun and to remove volatility. Where the end user was connected to a distribution network, the amount would also be adjusted to account for unaccounted for gas (UFG).
- Shippers are required to notify Vector when a large customer is tendering.
- Timeframes for transferring the capacity would need to fit the tendering process.

- Retailers may appeal to Vector if they did not agree with the amount of capacity transferred (whether they are losing or gaining capacity).
- Capacity is priced at capacity reservation fee (CRF) or 'market price' for capacity.
- Capacity is transferred when the outcome of the tender is known.
- If the new retailer does not need all of the capacity to be transferred (because it has sufficient in its portfolio), the capacity reverts to Vector rather than staying with the old retailer. Vector may then issue the capacity through its queuing process.
- The option applies only on a constrained pipeline.

### **Option 3: Common carriage (regulatory)**

**Main idea:** *Users have no contractual entitlements to capacity. Capacity is available for all shippers to share.*

- A tariff is calculated at each delivery point based on average business day demand across winter period.
- The existing capacity reservation fee is scaled as needed to preserve Vector's current revenue.
- The option could apply to all pipelines.
- Invoices are based on forecast demand, but washed-up to actual demand at the end of the year.
- An entry barrier applies on constrained pipeline (as described in option 1a).

### **Evaluation objectives**

The Capacity Working Group considered a set of evaluation objectives. These objectives will be used by Gas Industry Co to evaluate the above options. The objectives are that the solution:

- achieves the regulatory objective on competition;
- reduces retail gas prices:
  - if prices are higher than the 'competitive level'; or
  - if competitive prices are considered too high for a short period (due to investment issues), creating instability and dynamic inefficiency;
- (if a regulatory solution) seeks to avoid unnecessarily interfering with property rights;
- is quick to implement;
- minimises price/revenue shocks;
  - allows retailers to offer multi-year contracts; and

- gives the right price signals for gas use and pipeline investment
- minimises curtailment;
  - users expect and rely on firm service
  - curtailment is necessarily inefficient: it rations practically rather than economically

### **Action items**

The 'action items' from the meeting are as follows.

- Gas Industry Co will gather statistics on the size of the problem.
- Gas Industry Co to find out how many TOU customers are on the North Pipeline.
- Vector has been asked to declare it has considered all possible changes it could make to alleviate the problem.
- Vector has also been asked to notify how many shippers did not get their full requested amount of reserved capacity for the new gas year.