Analysis of Submission on GIC Options Paper

Presentation to Transmission Workshop

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Creative Energy Consulting

Response Areas

- Evaluation method
- Preferred Options
- Current Arrangements
- Incremental Change
- Hybrid Model

Concerns with Evaluation Method

- Include additional objectives:
  - Property rights (Vector) - comes under “transition costs”
  - The National Interest (NZ Refining) – objectives reflect Gas Act
  - Rate shock (MRP) – comes under “transition costs”
  - No entry barriers from Vector dual roles (MEUG) – comes under “competition”
- Objectives should be prioritised and weighted
  - But everybody will have different priorities
  - This will be done implicitly in a cost-benefit analysis
- Objectives are Related (Vector)
  - Don’t necessarily agree
  - But, issue (and response) is similar to the “weighting” issue

Options to be Considered Further

Submitter	No Change	Contract Carriage	Common Carriage	Hybrid	MDL Carriage	Inc Change	Other Option
Carter Holt Harvey				✓		✓	
Contact		✓	✓	✓	✓		
Energy Direct NZ				✓		✓	
Fonterra				✓		✓	
Genesis	✓						
Greymouth						✓	✓
MDL	✓						
MEUG							✓
MRP				✓			
NZ Refining			✓				
Vector							✓
Wilson Hellaby				✓			✓

Other Options

- Greymouth
  - Hybrid + mandated transfer of capacity to new retailer
  - [in fact, Hybrid effectively includes this]
- MEUG
  - Focus on improving transparency
- Vector
  - Several “sub-options” proposed
- Wilson Hellaby
  - Mix of hybrid and inc change, with mandated capacity transfer
  - [in fact, Hybrid effectively includes this]

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No Change

- Genesis
  - No obvious case for GIC intervention
- MDL
  - All access arrangements perform badly when physical capacity scarce
  - Focus should be on increasing physical capacity

Analysis of Current Arrangements

- Assumption of no secondary trading
- Problem is physical capacity, not access arrangement
- Demand is being suppressed
- Major increases in throughput fees
- GIC has know about the constraint since 2006

No Secondary Trading

- Submission:
  - Vector: causing, not caused by, access arrangement issues
  - MEUG: “harsh” to assume 2ndary market will never develop
  - Fonterra: Contract Carriage downgraded by assumption
- Response:
  - Empirical evidence of no secondary trading
  - Also, fundamental reasons to expect this (eg small market)
  - Therefore, considered reasonable assumption
  - Conversely, assuming future development of secondary trading seems heroic

Problem is Physical Capacity

- Submissions:
  - Vector: current regime designed assuming sufficient capacity
  - Genesis: primary issue
  - MDL: all AAs perform badly when physical capacity scarce
- Response:
  - GIC cannot solve physical capacity shortage, only address its consequences
  - It is not clear how and when capacity shortage will be fixed, or whether future shortages will occur
  - Disagree that all AAs perform badly under shortage conditions
  - A key objective of an AA is to allocate capacity: of course, this is trivial if capacity is not scarce
  - The Gas Act does *not* say: “don’t worry about meeting these objectives if capacity happens to be scarce”

Demand is Being Suppressed

- Submissions
  - NZ refining: uncertainty destroys future demand
  - MDL: difficult to determine potential demand
- Response
  - Agree with submissions
  - This primarily is relevant to the case for investment, rather than the design of access arrangements
  - Agree that we need to be careful making statements like “there is currently sufficient capacity to meet demand”
  - But note that, if demand were *not* suppressed, then capacity shortage (for existing customers) would be worse [discussed further later]

Major Increases in Throughput Fees

- Submissions
  - CHH: Vector, MDL prices increased by 49% and 38%, respectively, over 4 years
  - Fonterra: Vector fees increased by 12% pa since 2003
  - Greymouth: Vector approach to throughput fees should be addressed
- Response:
  - GIC has not reviewed throughput fees
  - The issue may be a result of capacity reservation fees being held down, so might be relevant to capacity issue [discussed later]
  - Split between peak and anytime charges is issue under any access regime: not specific to current arrangements

GIC has known since 2006

- Submissions
  - MDL: perceived capacity constraint on Nth Pipeline first identified by GIC in 2006
  - Greymouth: GIC has known about these issues since 2006
- Response
  - Paper stated: “in 2006, GIC identified access to *short-term* capacity as an issue”
  - This does *not* refer to the Nth Pipeline constraint
  - In the January 2009 research paper, there was no discussion or anticipation of shortages of annual capacity: it was all about sub-annual capacity
  - GIC learnt about the capacity shortage at the same time as shippers (mid-2009)

Inc Change: customer-assigned transfer

- Submissions:
  - MRP: may take too much capacity away from old retailer, leaving them exposed to overrun
  - Contact: likely to be of net detriment
  - EDNZ: retailers may end up with negative capacity
  - Greymouth: transfer should be administered by Vector, not through retail contracts
  - MDL: can be done through system of “capacity certificates”
- Response:
  - ST implementation would require that it is done through VTC
  - Agree that determining amount to transfer will be problematic
  - Considered further as ST solution [discussed later]

Concerns over Hybrid

- Contract Service takes over
- Potential Gaming
- Pricing Issues
- Contractual Issues
- Congestion Management

Contract Service Takes Over

- Concern
  - If capacity scarce, contract service firmer than common service
  - Some shippers migrate to contract service
  - Common becomes progressively less firm
  - All shippers migrate to contract service
- Response
  - Agree that this flaw exists in hybrid description
  - Problem is that existing common customers permitted to go onto contract
  - This should be prohibited unless there is sufficient physical capacity that common reliability standard is maintained
  - If capacity scarce, contract customers may need to pay for new physical capacity
  - If demand for contract service exceeds supply, higher prices may be justified

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Potential Gaming

- Concern
  - There are price and quality differences between the two services
  - Shippers may be able to exploit these by switching between services
- Response
  - Contract service entails a long-term commitment
  - Contract customers would not be eligible to switch to common service until end of contract
  - Contracts are site-specific, so no ability to switch customers “beneath the radar”
  - So, do not agree that gaming is a significant concern – although this will depend upon the detail

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Pricing Issues

- Concerns
  - As relative attractiveness of two services changes (eg due to physical capacity changes), relative prices must also change
  - Price variations will cause tariff shock for end users
  - May be price shock on contract renewal
  - Complex to manage dual pricing
- Response
  - Dual pricing already exists
  - Not clear how CC will regulate contract prices
  - Common tariffs likely to be regulated and stable
  - Contract prices likely to be negotiated
  - Contract prices will vary depending upon capacity situation
  - Agree that renewal price shock likely – but inevitable

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Contractual Issues

- Concerns
  - Complex to offer contract customers option to transfer to common
  - Do contract end-users contract directly with Vector?
- Response
  - Contract customers do *not* have option to become common – except at contract expiry
  - Contract end-users, or their agents would contract directly with Vector
  - Concept is that contract end-users buy wholesale gas and then arrange delivery themselves (or through their agents)
  - Thus, contract service only suited to large customers

Congestion Management

- Concern:
  - Since large customers will be curtailed first anyway, what is value of a contract service
- Response:
  - Agree that operationally, congestion management likely to be as now, with largest customers curtailed first
  - But, commercially, Vector are not permitted to curtail contract customers (except in emergency)
  - Thus, Vector must either:
    - Negotiated interruption contract with large customers: eg Power Stations compensated for lost electricity output: or
    - Increase physical capacity to avoid curtailment
    - Financially compensate curtailed contract customers
  - Financial cost of interruption or investment is borne by common customers

Initial Conclusions

- Hybrid Option
  - Hybrid option has broad (but not unanimous support)
  - Some flaws in proposed model have been identified, but these can be rectified
  - GIC considers it appropriate to progress development of this option as medium-term solution
- Incremental Change
  - Urgent changes required to address retail competition issues
  - Focus of “incremental change” should be to address these as quickly and simply as possible
  - Ideally, this “short-term solution” will be a stepping stone to a medium-term hybrid solution

Questions?