Short-term Options for Vector Capacity Arrangements

Presentation to Transmission Workshop

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Creative Energy Consulting

Objectives for ST Solution

Capacity Objective	Discussion
Efficient Pricing	Current Arrangements adequate *
Efficient Allocation	Key Issue
Efficient Investment	Not soluble in short-term
Facilitate Competition	Key Issue
Simple and Transparent	Not a burning issue
Price Stability	Current Arrangements adequate *
Firmness	Current Arrangements adequate *
Transition costs	ST solution must be implementable quickly

* The current arrangements are awarded a "moderate" rating

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Competition and Allocation Issues

- Retailers have insufficient "spare" capacity to tender for new, large customers

  - Are the concerns less significant for smaller customers?

- Incumbent becomes a monopoly supplier to its existing customers

- Excessive implied prices for "retail capacity" may create dead-weight losses upstream and downstream

- Loss of competitive discipline in retailing and wholesale gas

- Capacity might be allocated to new customers, leaving existing customers stranded:

  - Although this does not seem to have been a major concern to date

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Possible Solution Areas

- Increase supply of reserved capacity

- Reduce demand for reserved capacity

- Transfer grandfathering rights to large end-users

- Allocate scarce capacity by customer base (ie remove grandfathering)

- Common carriage (remove Reserved Capacity)

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Increase Supply of Reserved Capacity

- No new physical capacity in short-term

- Vector has determined that it is commercially unable to issue more reserved capacity

    - increased supply may cause increased demand and hence more frequent curtailment
    - Liability for curtailment costs falls on Vector and overrunning shippers
    - Vector unwilling to take on more liability by issuing more capacity

- Therefore, in increasing capacity supply:

    - *Either* need alternative mechanism to prevent new customer entry,
    - *Or n*eed to recognise potential increase in curtailment costs and decide where liability for these should lie

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Increase Supply (Continued)

- Firmness concerns can be mitigated in short-term by:

  – Preventing entry of large new customers
  – Recognising that organic growth in smaller customer will be modest in short-term
  – Limiting amount of new capacity issued
  – Issuing new capacity with only limited grandfathering

- Thus, an "increased supply solution" could

  – Allocate new capacity only to shippers winning large customers
  – Match term of capacity to term of new customer contract
  – Prevent large new customer entry through another mechanism

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Reduce Demand

- Obvious approach would be to increase capacity reservation fee (CRF) in affected zones

  - this will impact on existing shippers or customers

- Could offset CRF increase by (say) reduced throughput fee to:

  - Leave cost of utilised capacity unchanged; but
  - Increase cost of unutilised capacity

- Or encourage paid-interruption service

  - So free up additional capacity

- Problems with this approach:

  - Difficult to ensure neutral impact on utilised capacity
  - Don't know how much unutilised capacity there is
  - Don't know how high a price needed to have sufficient capacity rescinded to unfreeze retail market

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End User Capacity Rights

- Each large end-user is assigned an amount of capacity

- When end-user changes retailer, its assigned amount:

  - Is withdrawn from its old retailer
  - And allocated to its new retailer

- Main problem is how to determine capacity amount:

  - Diversity means retailers require differing amounts of capacity to serve an end-user: defined amount could be unfair on old or new retailer
  - Practicality of dealing with large number of customers

- Incumbent retailers may feel it is unfair that their existing rights are being "confiscated"

- Vector sub-option 1.4 is a form of this

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Allocate Capacity

- No grandfathering rights for shippers

- Scarce Capacity is allocated to retailers based on their customer base:

  - *Bottom up*: define a capacity amount for each end-user and then aggregate for each retailer (eg Vector options 1.1, 1.2) [but how to allow for diversity?]; or
  - *Top down*: capacity amount based on aggregate retail demand (eg retailer peak demand)

- Decision points:

  - should new customers be "allocated" capacity?
  - Should shippers still be charged/liable for overrun?
  - How to allocate any spare capacity: eg grandfathering or pro rata

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Allocate Capacity: a simple solution

- Top-down approach: "capacity" allocated based on retailer demand

- Change overrun charging so:

  – Based on maximum overrun at a DP across the year
  – Charged at same price as annual capacity (or a slight premium)
  – Eg book 10GJ, peak demand 12GJ, pay for extra 2GJ capacity as overrun

- Simple because:

  – Easy change to VTC
  – Simple to calculate max overrun
  – No change required to existing capacity issuance, transfer etc

- Issue:

  – How to manage cashflow impacts
  – How to prevent access by large new customers [not automatic]

Common Carriage

- Same as medium-term option in GIC options paper

- Capacity no longer an issue

- Could include a separate mechanism to keep out large new customers

    – So not "common carriage" in this sense

- Vector sub-options 2.1 to 2.3 are variations of this option

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Combinations and Variations

- Under various options can choose whether to:

  – Increase supply and/or price of capacity

  – Prevent or allow new customer entry

  – Charge for overrun: and whether at end-user or retailer level

  – Compensate for curtailment and allocate curtailment liability to Vector, overrun or all demand;

  – Apply different arrangements to "large" and "small" customers and determine where the boundary should be

  – Continue to allow capacity transfer

- Addressing competition issue could reduce incentive to "hoard" and hence also address allocation issue

- All of these options apply only to standard VTC firm annual capacity

  – Not looking to change LT contracts

Objectives for ST Solution

- Address competition and allocation issues

- Quick to design and implement

- Minimise adverse impact on other objectives

- Minimise price shock on shippers and end-users

- Minimise revenue shock on Vector

- Stepping stone to medium-term solution (Hybrid?)

Stepping Stone to Hybrid

- Contract service:

  - End-user holds LT capacity right
  - Similarities with "end user rights" option

- Common Service

  - Capacity allocated to shippers based on customer demand
  - Similarities with "capacity allocation" and "common carriage"

Questions?