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Dear Ian

Review of Vector Capacity Arrangements

Introduction

1. Thank you for the opportunity to comment on the Gas Industry Company's (GIC) research paper "Review of Vector Capacity Arrangements which we found both interesting and informative. No part of our comments is confidential and we are happy for them to be publicly released.

Mighty River Power's views

2. Mighty River Power (MRP) believes that the GIC has captured the main issues with regards to the current Vector transmission arrangements. The following are our comments and observations on the report which are given in no particular order of importance.

3. One area of particular interest to us is the conclusion that based on the Marginal Cost of Expansion (MCE) is that the current Capacity Reservation Charges appear to be set higher and Transmission Throughput Fees are lower than they should be to achieve economic efficiency. We would be interested to know if the GIC has a view as to what the likely reductions and increases on these fees would be if they were adjusted to meet the MCE criteria. We would also be interested to know if the GIC reviewed the pricing arrangements for all of the transmission delivery points including those which are deemed to have capped Capacity Reservation Charges.

4. We agree with your analysis and conclusions of the impact of other potential solutions to the Short Term capacity issues including cheaper Short Term Capacity and more

Interruptible Capacity for mainstream customers who will at any given time only purchase their gas from a single gas retailer. We have never encountered any difficulties in obtaining additional capacity during the year to accommodate any increases in customer numbers and therefore increased load where we have had the exclusive right to supply gas to these types of customers.

5. We have however encountered difficulties in tendering for the supply of gas to a customer who was able to purchase gas from multiple retailers and was seeking a short term or peak load supply of gas. Unfortunately the lack of short term capacity made the supply of gas to the customer uneconomical. We are therefore of the opinion that in order to create a competitive market for these specific types of customers it is essential to have access to some form of Short Term Capacity or Interruptible Capacity services. The absence of this some form of short term capacity arrangement will in our opinion almost always result in less competitive pressure on gas prices for short term loads.

6. The main problem with changes in capacity during the year is in our opinion, a result of losing rather than gaining load at a transmission delivery point. We note with interest that whilst a number of possible solutions to this issue are discussed one of the simplest, the requirement by Vector to purchase back the lost capacity does not appear to have been considered. In our opinion Vector should apply the same rules to the purchase of surplus capacity as they do to the sale of additional capacity. In other words if the Shipper can demonstrate that it has lost a specific load at a transmission delivery point then Vector should reduce the Shipper's capacity reservation at that delivery point accordingly. We do not believe that the present arrangement that requires another Shipper to purchase an equal volume of capacity at that delivery point to be practical and would be surprised if a retailer has ever successfully sold back this type of capacity.

7. We believe a Secondary Trading Market for surplus capacity would be beneficial but are not currently convinced that there is sufficient demand for secondary capacity to justify a formal Secondary Trading Market mechanism. It is however possible that some form of informal mechanism may be cost effective.

8. MRP would support the paper's suggestion of the introduction of Non-Gas-Year Capacity aligned to specific customers whose retail contracts did not align with the gas contract year of 1 October. Where Vector is unable to offer a contract price for these customers then the published Capacity Reservation Charges would apply.

9. Whilst we can appreciate that there may be some concerns over Vector's vertical integration MRP does not believe that there is any evidence that Vector has sought to favour its own affiliates at the expense of others. In our opinion the real potential abuse of the system would be for Vector's retail business, On Gas, to pass on any reduction or elimination of capacity reservation overrun charges to its customers. Such a move would potentially give On Gas a competitive advantage in the retail market. However given that the gas market where capacity reservation charges apply to individual customers is so small it is unlikely that this practice would remain undetected by On Gas's competitors. The impact of such a policy when discovered would be counterproductive to Vector's interests and the damage to Vector's reputation probably beyond repair.

10. We would be interested to see how much money would be returned to retailers under the proposal to pay back surplus Capacity Reservation Overrun Charges. Until such times as there is an indication of what the value of such repayments would be you cannot really determine if such a scheme would be cost effective or have any real value. It is however an interesting concept which should be explored further.

11. The Common Carriage alternative to the existing arrangements appears to resolve a number of concerns regarding the current Contract Carriage regime. Certainly it eliminates the problems with increases and decreases in loads that a retailer may experience during a contract year. It also eliminates the competitive advantages that retailers enjoy through customer diversity and/or supplying a large number of customers at a particular transmission delivery point.

12. Common Carriage is attractive given the current lack of any significant constraints on the existing transmission system. However MRP would not support any move to a Common Carriage regime unless it included some form of firm capacity which we would require to ensure that the operation of our Southdown Power Station would not be adversely affected by constraints that may develop in the future.

13. Rate shock is a potential concern that we have with regards to any change to a Common Carriage regime. We appreciate that the research paper did not go as far as suggesting a possible Common Carriage tariff for the Vector pipelines but a fuller appraisal of the potential benefits of such a change cannot be made without a pricing comparison. We would anticipate that as with all such changes that there is the potential for there to be winners and losers. It would therefore be important that any price changes created by the

introduction of a Common Carriage regime did not result in large increases in costs for end use customers.

Concluding remarks

14. 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
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cc: Duncan Jared
Josh Butterfield