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Dear Ian

MPOC CHANGE REQUEST OCTOBER 2014 SUBMISSION ON DRAFT RECOMMENDATION

Transpower New Zealand Limited, trading as emsTradepoint ("**emsTradepoint**") welcomes the opportunity to provide a submission to the Gas Industry Company ("**GIC**") on its Draft Recommendation on 10 October 2014 MPOC Change Request (Market-based Balancing) ("**MBB CR**").

emsTradepoint supports the Draft Recommendation and the accompanying Cost-Benefit Analysis ("**CBA**") that are in favour of the MBB CR. The arguments in both are consistent with emsTradepoint's views outlined previously in the initial and cross-submission rounds.

This submission does not repeat our views already expressed previously, but rather addresses points that were raised in the workshop held in Wellington 10 March 2015, including:

- (a) the effect of the MBB CR on competition, specifically whether it is a barrier to entry for smaller retailers;
- (b) whether trading fees should explicitly be included as a cost in the CBA; and
- (c) request for feedback on the consideration of unquantified benefits and costs in the CBA.

Lastly, we provide some commentary on recent market activity.

1. MBB CR AS A BARRIER TO ENTRY

It was put forward during the 10 March workshop that the MBB CR may give rise to a barrier to entry for new retailers.

emsTradepoint does not agree that the MBB CR is a barrier to entry for new retailers. As noted by the GIC¹, new entrant retailers may in fact benefit from the increased certainty that an automatic daily cash-out model with reference to a liquid market price provides.

Moreover, comparing against the status quo, the CBA assumes that costs expended by pipeline users to improve their position management are assumed to be profitable investments². The logical extension of this is that any increased costs incurred by new entrant retailers would serve to similarly improve their profitability.

¹ Page 61, s.5.4, GIC Draft Recommendation

² Page 17, Table 1, s.3.1.4, Covec CBA

In any case, the CBA correctly points out that cash-out costs are “...*transfers between parties [that] net to zero*”³ and therefore are not considered a cost and, by extension, a barrier to entry.

2. CONSIDERATION OF TRADING FEES AS A COST IN THE CBA

A second challenge during the 10 March workshop was that the calculated benefit within the CBA from the collapse in spreads between balancing gas purchased on the Balancing Gas Exchange (“**BGX**”) and emsTradepoint should have accounted for the trading (or ‘brokerage’) fee. This would have the effect of reducing the size of the annual benefit.

As stated in its cross-submission⁴, emsTradepoint views this as incorrect since the trading fee is representative of the transaction cost of purchasing or selling balancing gas. Whether incurred via;

- (a) the direct cost of trading fees; or
- (b) resources expended in negotiation and administration of bilateral contracts; or
- (c) developing, administering and hosting the BGX;

these costs exist under both the MBB CR *and* the counterfactual, and should therefore either be mutually excluded or included in the CBA calculations.

It has not been argued by any submitter that the proposed trading fees would be disproportionate to these counterfactual transaction costs - a reasonable indicator that their exclusion from the CBA calculation is justified.

3. FEEDBACK ON UNQUANTIFIED COSTS AND BENEFITS IN THE CBA

emsTradepoint supports the approach and conclusions of the CBA published with the Draft Recommendation. With regards to unquantified costs and benefits, two points can be made to strengthen the finding in favour of the MBB CR.

Allocative efficiency benefits

The CBA excludes the cost of cash-outs when quantifying net costs and benefits since they are transfers between parties and net to zero from an industry perspective. emsTradepoint agrees with this approach, and in fact advocated the same view in its cross-submission. At the same time, however, the substantial allocative efficiency benefits should not be disregarded.

The reduction in the cross-industry subsidy currently in place significantly improves the allocation of the cost of flexibility, directing this cost towards users who make use of the service. Although the CBA does incorporate this benefit under the broader consideration of more accurate price signalling, the reduction in socialisation of costs observed at an individual level is an important benefit in its own right.

Relative size of unquantified benefits

Secondly, the relative size of the unquantified benefits to quantified costs should be noted as potentially rendering these costs insignificant. For example, increased production values due to reduced provision of swing, as well as the value of increased reserves, whilst un-quantified, are likely several magnitudes greater than the ~\$150,000 of quantified cost.

³ Page 17, Table 1, s.3.1.1, Covec CBA

⁴ Page 4, emsTradepoint Cross-Submission, 12 January 2015

Similarly, while these costs are transferred within industry, the indicative reduction in costs on those parties who currently subsidise pipeline flexibility via tariff are also likely to outweigh the industry-wide costs identified in the CBA.

4. OTHER COMMENTS

Update on market liquidity

Although emsTradepoint has expressed confidence in the liquidity of the market in its previous cross-submission⁵, it is appropriate to provide additional evidence for this in light of a recent uptick in market activity. emsTradepoint also understands that the matter was raised in the 11 March workshop held in Auckland.

Figure 1 shows the notable increase in order volume that has been observed on the market since February 2015. This has been reflected in a significant increase in traded volumes in March, figure 2.

Figure 1: Market Liquidity March 2014 – March 2015

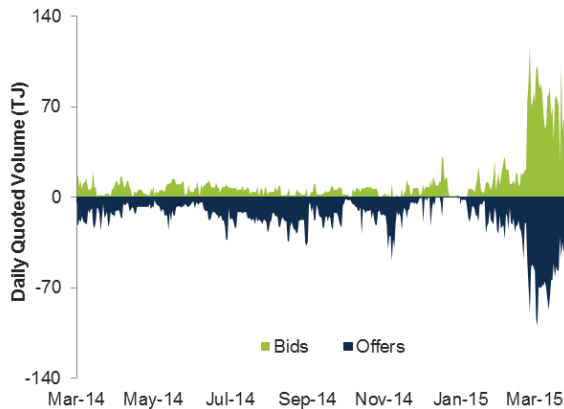
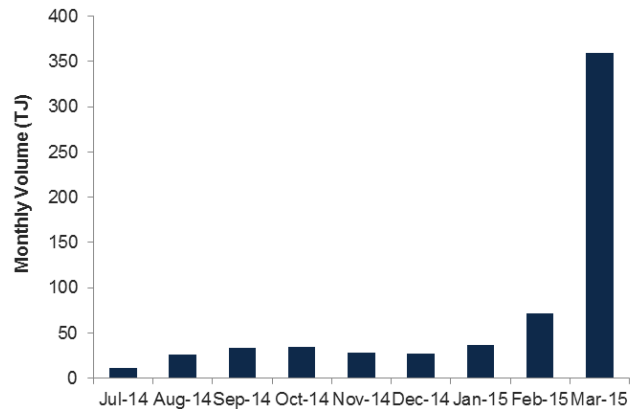


Figure 2: Traded Volumes, FY15 YtD



Such volumes provide strong signs that the market is capable of providing sufficient liquidity for industry to hedge both price and volume risk through the market, allowing the MBB CR model to operate efficiently.

Summary

emsTradepoint supports the GIC’s Draft Recommendation on the MBB CR and supplementary CBA, and look forward to a Final Recommendation in favour of the MBB CR.

If you would like to discuss any of these matters further, please contact me on (04) 590 6856.

Yours sincerely



Kristina Raba
emsTradepoint

⁵ Page 9, emsTradepoint Cross-Submission, 12 January 2015