

Company Name: Nova Gas Limited,

Contact: Charles Teichert

QUESTION	COMMENT
<p>Q1: Do you consider that the objective identified in section 2 is appropriate? If not, what other objective(s) would you propose?</p>	<p>The objective is appropriate although Nova believes that it is not necessary or desirable to mandate that a balancing arrangement needs be singular.</p> <p>While it is likely that the most efficient arrangement is for one party to coordinate pipeline linepack and balancing, that is only so if that party does so in a way that provides the balancing services required by participants at a cost they are willing to bear. Mandating a single balancing agent creates a monopoly service provider position that reduces incentive to pursue changes to services offered to “customers” and the incentive to reduce costs. Some incentive can be maintained by holding a periodic tender so that some competitive tension is retained but it is only evident at the time the tender is held and not on an ongoing basis.</p> <p>Currently, the existing arrangements have delivered a single balancing provider through MDL although that is not mandated. If balancing costs became excessive or the services offered did not meet the needs of pipeline users then currently there exists the ability for users to seek balancing services in other ways such as under the Vector Transmission arrangements.</p> <p>Retaining the capability for competition, innovation and evolution of balancing gas service provision is a valuable capability that is not easily reproduced under a regulated monopoly situation.</p> <p>We suggest that the objective should be:</p> <p>“To provide efficient balancing arrangements for managing pipeline imbalance”</p>

QUESTION	COMMENT
<p>Q2: Do you agree that the scope of the proposed regulatory options for this paper identified in section 2.2 is reasonable? Are there any items that should be considered in the scope that Gas Industry Co has not identified? Alternatively, are there any items in the scope that Gas Industry Co has included that should not be included?</p>	<p>User obligations to balance</p> <p>Nova prefers that if the obligation to balance is to form a part of a regulatory option then the consequences of imbalance be clearly articulated and limited to:</p> <ul style="list-style-type: none"> a) the costs of balancing as allocated by the pipeline arrangements; b) settlement orders as determined under the independent expert regime that forms a part of the Critical Contingency Arrangements <p>Nova believes that the balancing market has the ability to also perform not only as a physical means of pipeline balancing but also as an “on the day” spot market for gas. Including obligations to balance can only prevent this occurring. Allowing the balancing market to operate in this dual capacity (linepack maintenance plus short term gas balancing for users) in this way will mean that more gas can be bought and sold through that market, assisting in building liquidity, depth of market and also spreading administration costs over higher volumes. It will also create incentives for more participants to become involved adding more competitive tension and reducing the spread between the buy and sell price.</p> <p>If the balancing market is used only when parties are unable to balance then what could result in a market mechanism that has few trades, few participants, little depth such that when significant events do occur, curtailment is more likely to result. This is consistent with what we are currently seeing in the BGX.</p> <p>Curtailments and damages</p> <p>Currently under the existing contractual arrangements, if there is insufficient balancing gas available then before the Critical Contingency Regulations take effect, there is a curtailment and liquidated damages regime that applies.</p> <p>We believe that this is inefficient and confusing and that it is preferable for the Critical Contingency Regulations to take effect should insufficient balancing gas be available making curtailments necessary.</p>

QUESTION	COMMENT
Q3: Do you consider that the evaluation criteria set out in section 3 are appropriate for evaluating options for pipeline balancing arrangements? If not, why?	No comment
Q4: Do you consider that Gas Industry Co has correctly identified the need to consider the alternative options based on our conclusions from the consultation process outlined in section 4?	Yes
Q5: Do you agree that the contracts based option identified in section 5 is reasonably practicable? If not, why?	Yes
Q6: Do you agree that the prescriptive regulation option A identified in section 6 is reasonably practicable? If not, why?	<p>In general, yes although there are some specific components that we believe could be dealt with better such as recovery of costs.</p> <p>The paper proposes that development and ongoing costs associated with a balancing regime should be recovered via a levy from shippers. Given that these costs are currently included in pipeline tariffs, this could mean that incrementally shippers pay twice for balancing services administration unless it could be certain that the shift in responsibility for balancing arrangements was taken into account and transmission tariffs reduced accordingly.</p> <p>Nova prefers that costs of balancing arrangements be recovered from Transmission System Owners who would recover those costs through pipeline tariffs. Note that this also falls under the jurisdiction of the Commerce Commission who monitor and oversee transmission company's pricing and profits as a part of the new thresholds regime being implemented. We recommend some coordination with the Commerce Commission with respect to issues such as this.</p>

QUESTION	COMMENT
<p>Q7: Do consider that the outline of the prescriptive regulations in Appendix B is appropriate? If not, why?</p>	<p>We have reviewed the outline of the prescriptive regulations and note that there are a number of “devil is in the detail” type issues.</p> <p>The main items noted that we believe would require examination:</p> <ol style="list-style-type: none"> 1) 5 e) priority to capacity for balancing gas. Nova believes that priority is not an issue given that pipeline capacity will always be available (unless there are constraints) as the objective is to restore linepack. It is not logical to suggest that pipeline capacity will not physically be available if balancing is necessary. If no capacity was physically available, then balancing would not be necessary in the first place. 2) 10 d ii and 10 e ii marginal clearing prices. Nova believes that this is not necessary given the residual nature of the balancing gas market. A pay on tender price is likely to be feasible and results are not likely to be significantly different from a marginal clearing price and as such the ability for parties to “hedge” their exposure to balancing gas costs is not affected. Parties tendering for the supply of balancing gas will adjust their bid behaviour accordingly. Some discussion on use of marginal pricing was based on experiences in the electricity market although we believe that there are fundamental physical and commercial characteristics (regulated gross pool plus physical requirement to instantaneously match supply/demand) that support marginal pricing do not exist in the gas market. 3) Under section 10, consequences of non performance by the Balancing Agent, Balancing Gas Providers and Users should be articulated. 4) 11 a iii we assume that the mismatch pricing is discovered on an ex post basis? 5) 11 a v re inclusion of overhead allocation in cashout price. We believe that including at least an element of overhead recovery would be efficient as it would reduce the costs recovered via levies or pipeline tariffs. Users who create the need for balancing gas should contribute more to those costs than those who do not and the best way to do that is to recover the costs through balancing gas transactions. 6) 12 Curtailment and damages. Should link to Critical Contingency regs rather than duplicate them. 7) Funding – costs recovered from TSO’s as discussed in Q6.

QUESTION	COMMENT
SeQ8: Do you agree that the prescriptive regulation option B identified in section 7 is reasonably practicable? If not, why?	No. Too many issues with delegated authority for this to work.
Q9: Do you agree that the participative regulation option identified in section 8 is reasonably practicable? If not, why?	Yes.
Q10: Do you consider that the outline of the participative regulations in Appendix C are appropriate? If not, why?	Main issue to get over will be issues of delegated authority under public law. Same issues as highlighted under Appendix B re Prescriptive option.

QUESTION	COMMENT
<p>Q11: Do you agree with Gas Industry Co's approach to evaluating the options identified as reasonably practicable in section 9? If not, why?</p>	<p>Nova's main concern about the evaluation of regulatory options is the lack of any cost/benefit analysis.</p> <p>At a high level, Nova believes that the lowest cost and most effective means of dealing with balancing issues is through improving current contractual arrangements rather than replacing them with regulations and that is an outcome that we believe would be supported if there was a cost/benefit analysis performed.</p> <p>Over the period 1 January – 13 August 2009 82 PJ's of gas has been transported on the Maui pipeline between injection and offtake points. Using a wholesale gas price range of \$6-\$8/GJ, the gas transported has a market value of \$492m-\$656m.</p> <p>Over the same period of time:</p> <ul style="list-style-type: none"> Operational Balancing Gas Put volumes - 0.3PJ Operational Balancing Gas Call volumes - 0.2PJ Secondary Balancing Gas Put volumes – 0.3 PJ Secondary Balancing Gas Call volumes – 0.3 PJ <p>As a percentage of gas transported, total balancing put volumes represent 0.8% and total call volumes represent 0.6%. These such volumes do not suggest that balancing is a significant problem.</p> <p>Assuming a Put price of \$2/GJ and a Call price of \$14/GJ which are based on observations of prices traded on BGX and a wholesale market value for gas of \$7/GJ, the discount/premium associated with gas represents approximately 1% of the total value of gas traded. This is a conservative outcome for the following reasons:</p> <ul style="list-style-type: none"> - balancing gas transactions are higher historically due to the availability of Operational Balancing Gas for free which was used by the System Operator more frequently than necessary (through keeping line pack closer to a target level as opposed to letting it drift within upper and lower limits). - Put gas volumes also include a bias of UFG of approximately 1-2TJ's per day which if removed suggests that Put gas sales have been predominantly due to UFG rather than balancing requirements.

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Q11: continued	<ul style="list-style-type: none"> - the spread between the Call price and Put price appears high and this likely to a function of competitive tension as there are a limited number of parties who can trade on BGX as MDL will only accept trades at certain welded points. The change to the definition of the Payback Point in MPOC may have a significant impact and provide the opportunity for more balancing gas providers to participate in the BGX market. <p>It will be interesting to update this analysis through time.</p> <p>Certainly, contractual balancing gas arrangements can be improved but it appears that a regulatory solution will be the most expensive means of achieving that improvement. Perhaps the recent lack of development is also born out by a lack of motivation by industry participants to improve the status quo via contractual means – ie the benefits of doing so are relatively marginal when compared to other commercial activities.</p> <p>Most industry participants have limited resource and what there is increasingly under pressure in the current economic environment, however in recent times, spurred on by dissatisfaction expressed by Vector Gas Limited and also the regulatory process, participants have been engaged in identifying solutions such as:</p> <ul style="list-style-type: none"> - unbundling of Vector Transmission welded points through the virtual welded point concept; and - improving the cashout process to achieve a back to back allocation of balancing gas costs incurred to causers. <p>It is hoped that process will lead to a series of improvements substantially resolving the issues identified through the GIC consultation process and will see the need for regulation fall away.</p>
Q12: Do you consider Gas Industry Co's assessment of the options presented is fair and reasonable? If not, why?	

QUESTION	COMMENT
<p>Q13: Do you agree that Gas Industry Co has, through the evaluation of options, correctly identified the participative regulation option as its preferred option? If not, why?</p>	<p>In the absence of a contractual solution, then we agree that the participative solution is the most appropriate.</p>
<p>Q14: Do you agree with the next steps identified in section 11? If not, why?</p>	<p>Nova believes that prior to beginning a participative regulated solution, industry should be given the opportunity to commit to a process of making the necessary changes via existing MPOC and/or VTC change processes. If there is not sufficient support within industry for such a process, then the road would seem clear for the proposed participative regulatory solution.</p> <p>Through the consultation process, there has been some crystallisation of what is required to meet the objective of a long term efficient balancing arrangement. Once the regulated path is selected it is difficult to reverse that process later on. If improved contractual arrangements still result in inefficient outcomes then regulation still remains an option for the future.</p> <p>Nova suggests that industry participants be given three months to promulgate changes to existing contracts that deliver improved balancing arrangements.</p>

Optional questions	Comment
<p>Appendix B: Outline of prescriptive regulations</p> <p>OQ1: Gas Industry Co is still considering whether the scope of the regulations for prescriptive regulation options A and B should include provisions for curtailment and damages. They are currently drafted in the outline for prescriptive regulation option A. However, Gas Industry Co seeks submitters' views on whether provisions for curtailment and a damages¹ regime should be included in the regulations or left to industry agreement and codes.</p>	<p>No – see Q2. Appropriate curtailment/damages regime has already been put in place through the Critical Contingency Regulations and there is no need for another set of arrangements.</p>
<p>OQ2: If the scope of the regulations includes damage claims, the quantum of these can be determined through the dispute resolution process (by the Rulings Panel) or predetermined as 'liquidated damages'. Do you consider that the quantum of damages should be liquidated or are better determined by the Rulings Panel at the time of the claim?</p>	
<p>OQ3: In schedule 2, Base Linepack and Thresholds, Gas Industry Co has not yet determined a process for setting and revising this table. Do you have a view as to how this might be best achieved under the regulations?</p>	<p>No although we favour a simple, non complex approach that provides participants with some certainty over what the thresholds are and what actions will be taken as those thresholds are approach and exceeded.</p> <p>Given some of the uncertainties involved in linepack and pressure calculations, there seems to be only very marginal value in providing for a very complex dynamic process for setting thresholds.</p>

¹ Where there is insufficient balancing gas available then the Balancing Agent could curtail users prior to a critical contingency being called, in order to endeavour to prevent a critical contingency. In this situation a well behaved user that is curtailed will want to claim for damages from the causers of the imbalance that lead to curtailment. Therefore curtailment and damage claims go together.

Optional questions	Comment
<p>Appendix C: Outline of participative regulations</p> <p>OQ4: A design issue is how to define flexible linepack available to the Balancing Agent and ensure that this is a fair share of the flexibility available. In proposed regulation 5.f. Gas Industry Co has drafted it to be set as 'wide as practical' with any dispute to go to the dispute resolution process. An alternative would be to establish a special purpose process for establishing the flexible linepack. Do you agree with the current drafting, or would the alternative to create a special purpose process be more appropriate?</p>	<p>Nova believes that in the absence of a formulaic approach for setting linepack thresholds, a specific process should be developed for this purpose.</p>
<p>OQ5: The outline of regulations has been drafted to include tolerances. Do you consider tolerances should be included?</p>	<p>The issue of tolerances is a function of the arrangement proposal by the TSO's and its is difficult to make a judgement regarding tolerances until TSO's have presented their proposed arrangement for comment.</p> <p>Nova believes that tolerances are in effect an allocation of linepack and under current arrangements are effectively tradable. This is an efficient outcome to the extent that there it does not contribute to socialisation of balancing costs.</p>