30 March 2015

Ian Wilson
Gas Industry Company Ltd

WELLINGTON 6140

Dear Ian,

Re: Draft Recommendation on 10 October 2014 MPOC Change Request

1. This is a submission by the Major Gas Users Group (MGUG) on GIC's Draft
    Recommendation dated 25 February 2015 on Maui Development Limited's MPOC
    Change Request dated 10 October 2014 to introduce Market Based Balancing (MBB).
    MGUG comprises:

    a. Ballance Agri-Nutrients Ltd
    b. Carter Holt Harvey Ltd
    c. Fonterra Co-operative Group
    d. New Zealand Steel Ltd
    e. Refining NZ

2. Individual members may be impacted in different ways by the MBB proposal and may
    choose to provide feedback and comment reflecting their own views and particular
    circumstances. Nothing in this submission is confidential.

3. In our view the change contemplated by MBB is significant. The uncertainty surrounding
    it is also significant. The proposal will have both financial and practical impacts on end
    users which are difficult to fully comprehend. This is partly due to the inherent
    uncertainty but also because it is only one element of a balancing regime. For these
    reasons we strongly recommend that GIC allows for a cross submission process as part
    of issuing its final recommendation.

4. GIC may see the MPOC CR as a starting point to achieving primary balancing. B2B could
    also have been seen as a starting point, perhaps as more pragmatic when there is some
    uncertainty around costs (e.g. more transaction costs because of cash outs) and risks
    (e.g. misalignment that might promote instability of the pipeline through perverse
    incentives, adequacy of tools to manage imbalance, how individual shippers respond to
    the change).

5. As we have stated before MGUG is supportive of principles that promote primary
    balancing to keep transmission costs down. We accept that the proposal moves
    responsibility in the direction of primary balancing but we struggle with the practical

uncertainties inherent in it, particularly when the value attributed by the cost benefit analysis is relatively small. From a major user perspective change is being made without benefit of good problem definition, an unsatisfactory outcome of the code change approach and co-regulatory model.

Cost Benefit Analysis

6. When the Maui proposal was first issued we noted (MGUG submission of 24 November 2014) that a big part of the challenge for end users was understanding how MBB and the associated transaction costs would impact their day to day operation. It has been difficult to get clarity from retailers because they too appear to be struggling to understand the impact on their businesses and how that would flow through to end users.

7. In the face of this continuing uncertainty the outcome of the CBA becomes critical. Stakeholders need to be confident that the CBA is a good measure of the proposal and that all the elements of the CBA have been properly understood and weighed up.

8. Vector (submission of 24 November 2014, para 3) noted the impact of higher costs. The workshop discussions following release of the draft proposal indicated differing views amongst stakeholders. As GIC itself say the volume of Cash-Out transactions will increase dramatically [page 38].

9. The CBA is premised on two effects, namely
    a. The impact of fuel gas usage in relation to the amount of extra primary balancing that will occur (the more primary balancing the cost of balancing action goes down)
    b. Reduced cost of balancing actions.

10. The CBA raises some questions/issues regarding costs:
    a. User investment – Covec excludes extra costs incurred by users for the purpose of managing their own physical positions; whatever they are Covec says they would expect them to be value enhancing. However investment may be required simply to manage the impact of changing from the status quo (they are a necessary cost). Hence we do not think it is valid for all user investment to be disregarded in this manner.
    b. If costs are higher will shippers look to pass on costs of any investment they make?   What impact does that have for any potential new entrants?
    c. Adjustment factor – the CBA discusses this but in the end concludes that combined with cash out prices under MBB is more efficient than the status quo. Hence the validity or otherwise (including the discretion available to MDL) is not discussed.

11. It seems likely that the question of cost will continue to be hotly contested. If certainty of outcome is questionable we believe it would be good regulatory practice for GIC to undertake appropriate ex poste analysis to determine whether the proposal has worked as premised. The two CBA elements adopted by Covec look to be acceptable and reasonable metrics and there may be others. This would seem to be an appropriate response where the code change process only allows GIC the ability to consider whether it is an improvement on the status quo.

Practical Effects

12. We believe GIC's examination in reaching a final recommendation should also extend to the following practical considerations versus the status quo:

    a. The impact of a Maui nomination regime on Vector connected sites (e.g. any compliance costs) that currently have limited nomination requirements.
    b. How transaction costs might alter if consumers are given the means to manage imbalance through e.g. the shifting of nomination day cycle times
    c. The impact of MBB on end users with interruptible contracts – will they be subject to cash out? What if interruptible customers are curtailed after the final nomination time?
    d. How would arrangements operate to ensure that any balancing action taken by a User accrues to the User? This raises questions like "To which party do arbitrage opportunities between GSA gas price and imbalance gas prices accrue; retailer, shipper, or end user?"
    e. Does MBB exacerbate or reduce pressure excursions as shippers/ retailers/ end users attempt to arbitrage between GSAs and balancing market or react to increased sensitivity to being cashed out?

Yours sincerely

Hale & Twomey/Arete Consulting Ltd
For the Major Gas Users Group