Contact

24 November 2014

Mr Ian Wilson
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Emailed: Ian.Wilson@gasndustry.co.nz

Dear Ian

Daily Cash Out Change Request and Cost Benefit Analysis

Contact welcomes the opportunity to provide feed-back on the recent change request on daily cash-outs lodged by MDL (***CR***) and the Outline of a Cost Benefit Analysis (***CBA***) issued by Covec.

Contact made a substantial submission to MDL on the CR in September as part of MDL's consultation process (***Submission***). Contact attaches that submission for the GIC's review as very little has changed since that consultation and our views remain the same.

The GIC has invited parties to submit on the following points:

1. Agreement or otherwise on the GIC's initial view that the CBA should compare the CR to the current MPOC in force. Including details about why either version of the MPOC should be used and the reasoning behind using that version of the MPOC ; and
2. Views on MDL's Change Request; and
3. Views on the Gas Industry Co's preliminary cost-benefit work. Including itemised and quantified perceived costs and benefits (with supporting evidence) that the submitter expects to incur if the MBB Change Request were implemented.

CBA basis
Contact agrees that the basis for the CBA should be to compare the CR against the current operation of the MPOC on the basis that MDL is unlikely to implement the previously approved B2B CR should the CR fail.

MDL's Change Request
Contact is concerned that the CR will lead to shippers incurring additional costs without additional benefits.

As Contact noted in its previous Submission, the current balancing costs (~$670k including full year costs) that have been quantified are not significant, provide equal benefit to all shippers and are well within an acceptable amount to be socialised. The total volume of put and call gas traded, including daily linepack management gas, only represents 0.5% of total volume flowed (excluding gas flowed to Methanex). This volume is less than acceptable UFG volumes.

It is expected that under the CR there will be an increase in cash-outs such that the balancing costs will increase. There is no evidence to suggest that balancing costs will reduce under the new arrangements. This is based on the fact that currently there are larger imbalance tolerances than there will be under the new regime and therefore there are less breaches of the AEOI to cash out. In addition shippers are incentivised to take action to correct their position within the one and a half days available to them to avoid cash-outs occurring. With no available time to self balance under the new regime this will likely result in more cash-out costs.

There have been suggestions that the cost of balancing extends further than just cash-out costs. We have not been provided with those costs. However, if we refer to MDL's disclosure documents fuel gas for the Mokau compressors (used to control and balance the system) has an estimated value of $1.325m for 2014 increasing to $1.5m in 2015. These costs when compared to gas flowed on the Maui pipeline (excluding Methanex) are not significant and as the compressors are of benefit to all users it is appropriate to socialise these costs. Further the cost of repairs and maintenance and of eventual replacement are disclosed as $262k this financial year, $80k in 2015 and $850k in 2017. These costs should be included in the determination of MDL's pipeline asset valuations and the resulting allowable income.

Until there is some clarity from MDL around the treatment of the compressor costs in respect of the Commerce Commission regulations then Contact has assumed these as being passed through or are recoverable costs in MDL's revenue calculation and price setting methodology.

Other such hidden balancing costs include storing gas on the pipeline and over pressure costs. As these have not been evidenced, Contact has no means of determining if they are real or if they are justified that new regime will address the costs in the most efficient way.

Cost Benefit Analysis
The GIC has asked for Contact's view of the CBA and additional costs benefits associated with the CR.

Contact agrees with the points raised in the CBA outline under 3.1 Status Quo. However those issues may be addressed with other mechanisms of greater merit than through a switch to daily balancing. We would encourage the GIC to invest more work on options that provide the best outcomes to users. This is particularly so for high pressure and park and loan services.

While it is difficult to quantify additional costs to Contact under the CR until we know what information changes will occur, it is likely Contact will require IT changes which are estimated to start at $100k. It is also envisaged that additional time will need to be spent on managing Contact's gas nominations and gas position. We expect this could be in the order of $50k-$100k/annum. These costs do not include the expected additional cash-out/balancing costs. No analysis has been done by Contact on estimating these however we understand that Vector has put together some initial calculations.

Recommendations
Contact believes participants would benefit from further analysis done of the wider issues associated with balancing, including a clear conclusion on the causes and costs. This would enable a work programme to be developed to address any resulting issues. As the wider industry has already begun this work, we would like to see the GIC support this by rejecting the CR on the basis that the solution is not better for the industry than the status quo.

Please contact me should you wish to discuss or clarify any of the points raised in this letter.

Yours sincerely

Sharon Wray
Manager, Fuels Trading