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### **Submission on Market Based Balancing (MBB) Change Request pre-consultation**

Contact Energy welcomes the opportunity to make submissions on MDL's MBB proposal dated 13 August 2014.

#### **Introduction**

Contact recognises some unresolved issues around pipeline management remain, but does not believe all the outstanding issues have been properly identified or defined.

Contact considers it is not possible to form a proper view about the appropriateness of the proposed MBB change request without better understanding all the unresolved pipeline management issues.

Balancing issues are not confined to transmission, and solutions should not be confined to transmission arrangements. The causes and effects of balancing issues occur throughout the industry, including downstream (end users) and upstream (producers).

Contact believes only a collaborative approach by industry as a whole will provide a robust and lasting resolution to pipeline management issues. Significant progress has been made in addressing transmission access issues through a Vector and MDL convened industry working group set up for the purpose.

Contact submits a similar approach, encompassing wider industry stakeholders to represent the various interests affected by balancing, could draw on the momentum and success experienced by that working group to produce a collaborative solution.

Contact acknowledges MDL has immediate balancing concerns caused by high pressure incidents on its pipeline but, as stated above, believes these issues are best addressed through a collaborative industry approach and not the proposed MBB change request.

#### **Alternative approach proposed**

Contact recently canvassed Vector pipeline shippers, most of which are also Maui pipeline shippers, to gauge their interest in forming a small panel, with a focus on interviewing the wider pipeline users, from upstream producers to Vector pipeline end users, on issues relating to balancing. Using this information a larger industry working group would then be set up to analyse the feedback and work through possible solutions. At this early stage, positive feedback has been received and resources have been offered.

Contact believes there is a very real commitment and appetite within the industry to addressing pipeline issues and that, as an industry, we should take the opportunity to harness that rather than adopt a change request that doesn't address all issues and only provides partial solutions.

### **Balancing Issues**

The main problem with the change request and associated slides is the lack of any clear problem definition. Without this definition it is difficult to provide meaningful feedback.

Based on the information provided and Contact's understanding of the issues, the main concerns of MDL are within day balancing requirements that cannot be connected to a cash-out action and reducing its exposure to dispute risk.

### **Level of balancing costs has reduced and is now quite low**

Contact believes there will always be a certain amount of balancing that cannot be attributed to a causer and therefore must be socialised. At the inception of open access on the Maui pipeline the cost of balancing was ~\$5m.

Since then as Maui legacy gas rolled off, shippers have improved their systems and the Maui Pipeline Operating Code (MPOC) has been refined, and this cost has reduced considerably. This is evidenced in the GIC's reports on balancing that show the volume attributed to balancing has dropped substantially over time.

Last year balancing costs were only ~\$344k, which is a very small proportion of the value of gas transported on the system and represents a very small volume of gas in proportion to that flowed on the system.

### **Lack of daily information is an issue**

Without tools such as daily allocations there is no way to identify causers, and because of the lack of daily information as to shipper's downstream gas take all parties taking gas at the Vector Welded Points will be causers of balancing and as such socialisation of those costs is an equitable outcome.

The proposed MBB changes do not address this issue and will impact on shippers with higher retail customer loads more than on others, thereby increasing the cost to those customers.

Allocation of costs to causers is not guaranteed by the MBB change request proposal.

### **Nominations**

Another issue is that nomination cycle times do not help shippers to manage their imbalance positions as there are only two change cycles within normal working hours. The MBB does not address this issue and while it may not be a substantial issue to Contact, as a generator that has 24 hour operations staff, other smaller shippers (and potential new entrants) would find this an additional expense that would have to be passed on to customers.

### **Cash-out formula**

Under the proposal the cash-out price will be determined by the highest (or lowest depending on put or call gas required) market price on the day concerned. This is not reflective of the actual cost incurred if a small quantity of gas is traded at a high price relative to the total quantity traded. In addition, a percentage adjustment is also added and cash-outs are not related to actual balancing actions. These factors have the potential (and in Contact's view are highly likely) to increase the frequency and cost of balancing and as a result increase costs passed on to customers.

Also, if cash-outs are made independent of balancing actions, and without depending on AEOI at other welded points, more cash-outs will occur even though the pipeline as a whole is within acceptable linepack and pressure limits. This further indicates additional costs will be incurred that will have to be passed on to customers.

### **Overpressure is a major concern**

The high pressure issue, which has the ability to shut in gas production, is not acceptable but Contact is not convinced the MBB proposal will address it. It seems evident that producers do not have the flexibility to match daily demand. This, together with the increasing dominance of Take or Pay contract terms and increased gas supply in the market, means overpressure is likely to continue to be an issue going forward. This problem requires additional thought and the MBB proposal does not sufficiently address it.

### **Other actions and costs not quantified**

We have been told there are other balancing actions and costs that are not apparent to shippers. However, no detail of these has been presented by MDL so it is not possible to ascertain if they are material or how the costs could be mitigated. The proposal cannot be approved based on unquantified issues or concerns

MDL has listed a number of bigger picture outcomes from the proposed MBB. None of these outcomes come with evidence either, and are purely subjective.

### **Benchmarking to EU Regulation not appropriate**

MDL has based the proposal against the European Commission Regulation (EU). This was designed after many years of consultation among interested parties. Contact acknowledges that some time has passed since the inception of open access in New Zealand, but a large part of that has been waiting on B2B to come into effect and the sudden change to MBB has not been adequately considered and is not ready to be adopted by the industry in New Zealand.

The EU regime was designed for a considerably different market and was essentially to accommodate improved access and trading across borders, which is not the issue at stake in NZ. However, of greater significance for present purposes is that MDL states it has not replicated the EU regulation *in its entirety* into the MBB proposal but has chosen only those aspects that it thinks reflect the New Zealand market. The problem with this is that MDL has not replicated the tools that assist balancing and trading for the shipper. Therefore, it is a one-sided proposal that clearly favours pipeline owner interests over shippers'.

### **Dispute risks**

MDL considers the new proposal will decrease dispute risk. Contact considers the main risk of dispute to MDL is with regard to using the BGX for sourcing balancing gas when there is another gas market now available. This market is open to all participants and has shown better prices than are offered by BGX (which is a closed market and now provides the ability to arbitrage too). If MDL was to open the BGX to all parties or instead use the emsTradepoint gas market for sourcing balancing gas this issue would be resolved. All other risks regarding dispute would remain under the new proposal.

### **Daily delivery and daily allocation go together**

MDL also states that “Market-based balancing goes hand in hand with a daily cash-out regime. A liquid daily market requires a daily delivery incentive.” Contact would extend this to include the fact that a daily cash-out regime with a daily delivery incentive *goes hand in hand with daily allocation mechanisms*.

However before even venturing to this conclusion the individual issues and problems need to be defined to ascertain whether the MBB is the right solution for New Zealand’s gas market.

### **Recommendation**

The proposal received from MDL is far from providing a complete balancing solution. Implementing the proposed change request now would, in our view be, at best, a quick fix to address some immediate issues for MDL but it is likely to have a larger cost implication for other industry participants that will be passed on to customers. Contact hasn’t yet considered the implications regarding the Vector Transmission Code (VTC) and any amendments to that or Vector’s systems as a consequence of the MBB.

Accordingly, Contact recommends further industry consultation is carried out to investigate the issues. Contact believes there would be benefit in looking at, among other things:

- nomination cycle changes;
- an improved IT system (OATIS is nearing end of life);
- double sided incentives to address over pressure (including the same level of tolerance at receipt Welded Points as delivery Welded Points);
- investigate tools that assist shippers to manage their gas position;
- investigate products that would assist balancing such as a transparent borrow and loan facility on the pipeline for which a service fee would apply;
- ability for shippers to trade imbalances between Welded Points and then limit cash-outs to AEOI on the pipeline as a whole.
- consequential VTC impacts

(This list shows the extent of work to be done before implementing a daily cash-out system.)

### **GPS Objectives**

Any solution must also meet the GPS objectives including: to be fair, encourage competition and place downward pressure on prices (or at least do not increase prices). Contact considers that the MDL MBB falls short of these objectives.

Contact encourages further industry discussion on balancing as set out in the introduction.

No part of this submission is confidential and therefore Contact is happy to make this submission publically available.

Regards

A handwritten signature in blue ink, appearing to read 'Sharon Wray', with a long horizontal flourish extending to the right.

**Sharon Wray**  
**Fuels and Gas Transmission Manager**

