



11 Chews Lane  
PO Box 10568  
The Terrace  
Wellington 6143  
New Zealand

Genesis Energy Limited

Fax: 04 495 6363

24 November 2014

Steve Bielby  
Gas Industry Company  
Level 8, The Todd Building  
95 Customhouse Quay  
WELLINGTON

By email: submitted via company website

Dear Steve

## Submission on MPOC change request October 2014 (market-based balancing)

---

Genesis Energy Limited welcomes the opportunity to provide a submission to the Gas Industry Company ("the GIC") on the Maui Development Limited ("MDL") Maui Pipeline Operating Code ("MPOC") change request regarding market-based balancing dated 17 October 2014.

Given the substantial increase in costs to both Genesis Energy and the end consumer, Genesis Energy does not support MDL's proposed changes to market-based balancing. From our analysis the proposed changes are very likely to result in a three fold increase in balancing costs for customers and gas users in general. In addition there is no evidence that the proposed market-based balancing will provide any improvement in pipeline pressure. In our view, this is at odds with the GIC's objective of efficient pipeline operation. We strongly recommend the GIC declines MDL's MPOC change request and support an industry approach for a durable solution.

### **Market-based balancing will create excessive costs**

Our assessment is that the proposed regime will introduce significant costs to the industry. The changes are likely to result in a marked increase in balancing costs – potentially by up to three times the current balancing costs for customers

and gas users in general. We expect similar costs will be faced by other shippers. In our view, these costs heavily outweigh any perceived benefits.

A well-functioning and liquid market for balancing gas, coupled with increased volumes, may close the price spread and reduce the cost impact. But if MDL were to use a well-functioning spot market it will also, in our view, further reduce the scale of the problem and remove any requirement for the change. We also note MDL is already obligated by clause 11.10<sup>1</sup> to use such a market (such as emsTradepoint) for balancing. However, MDL has refused to follow this requirement.

### **Current nomination cycles and information availability remain as obstacles to achieve more accurate nominations**

We acknowledge that other jurisdictions have adopted similar regimes to the proposed market-based balancing. However, the important distinction is that these jurisdictions (Europe) also implemented tools enabling end users to mitigate the additional costs of balancing. These tools include daily allocation of shipper's mismatch positions that allow end users and retailers the ability to manage their exposure to gas balancing costs.

Similar tools are not available in the New Zealand gas market. The current nomination cycles and information availability remain obstacles to achieving more accurate nominations. Currently, the last nomination cycle on the Maui pipeline is due at 5pm daily (4pm under Vector nominations), and balancing actions relating to cash outs will need to be conducted prior to this time in order for buyers and sellers of balancing gas to deliver or take gas from the pipeline. Minimising the exposure to costs under the proposed regime also requires accurate forecasts of gas use for the remainder of the day. Thus, even with real time metering, end users may still be caught by balancing actions.

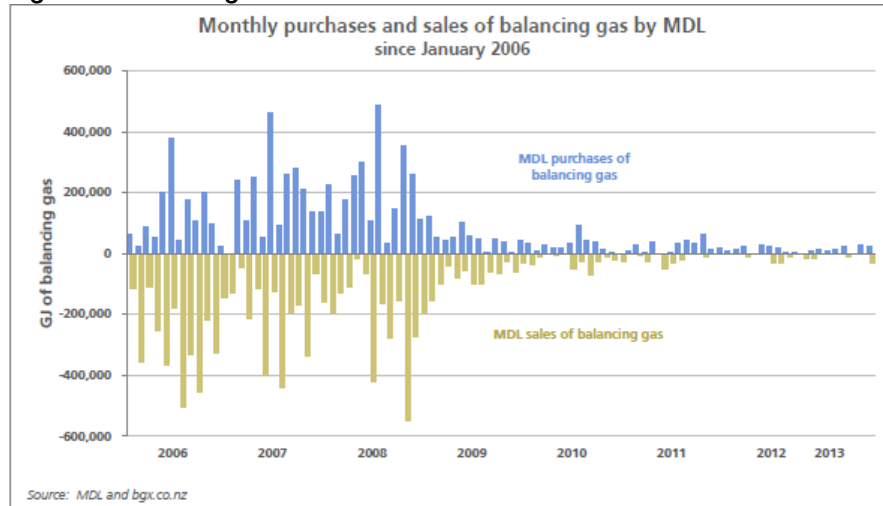
---

<sup>1</sup> MPOC version dated 22 July 2013, clause 11.10 "The Negative Mismatch Price and the Positive Mismatch Price shall be published on the MDL IX in accordance with section 4. These prices will reflect the Balancing Agent's costs in accessing and disposing of Gas. If a liquid Gas market develops, these prices will reflect the buy and sell spot prices in that market. MDL undertakes that, as the operator of the Maui Pipeline, it shall not seek to make a profit or loss from its activities in relation to the sale and/or purchase of Gas used to balance the Maui Pipeline, or settle Mismatches and Running Operational Imbalances."

## Solutions must be proportional to the problem<sup>2</sup>

Figure 1 shows that the quantity of balancing gas has dropped dramatically since 2009. This illustrates the size of the balancing problem for the market has reduced significantly since it was first raised in 2006.

**Figure 1: Balancing Gas Purchase and Sales**



Source: The New Zealand Gas Story – 2<sup>nd</sup> Edition April 2014<sup>3</sup>

Genesis Energy considers it is best practice for any regulatory solution to be proportional to the corresponding market problem or need. Given the continual decline of balancing requirements over time, we suggest there is no justification for the costs imposed by implementing the daily cash out regime as there is little underlying need. We also note that this change will have costly impacts on shippers, despite the fact that a shipper has never caused the high pressure on Maui pipeline which potentially leads to critical contingency events.

### Potential conflict of interest

In our view, it cannot be assumed that a change that is in the interests of MDL will also improve efficient pipeline operation.

MDL is vertically integrated with the Maui field and Maui Pipeline. This common ownership means there is a very real risk that the development of MPOC rules will favour the Maui Field, rather than the New Zealand gas market overall. This risk is especially prevalent as the Maui field approaches end of life. MDL may

<sup>2</sup>This was raised in Genesis Energy submission to MDL on “Feedback on market based balancing change request” dated 19 September 2014.

<sup>3</sup><http://gasindustry.co.nz/dmsdocument/4127>

have a strong commercial incentive to reduce the overall Maui pipeline gas pressure to prolong gas and liquids revenue from the Maui field. Given the price of gas is circa 10 times the cost of gas transmission on the Maui pipeline, the incentive on MDL may focus on ways to improve Maui's profitability rather than improving the operational efficiency on the Maui pipeline and balancing issues.

With this potential for conflicts, the role of the GIC as the independent decision maker on MPOC change requests is critically important. For the market to be confident of this function, we need to be sure that the GIC is not bound to accept MPOC change requests and that their discretion is unfettered.

**Recommendation: decline the MDL MPOC code change**

On the basis of the points outlined above, Genesis Energy strongly recommends that GIC decline MDL's current MPOC change request.

We suggest that MDL's and the GIC's efforts should be redirected at finding a durable industry solution to this concern. An industry group has started to consider gas pipeline balancing issues and appears to be making good progress. As a result of its first meeting on 15 November 2014, the group has already outlined a number of action points including conducting interviews to determine, amongst other things, the problem definition.

If you would like to discuss any of these matters further, please contact me on 04 495 6357, or Duncan Jared, Fuel Portfolio Manager, on 09 951 9145.

Yours sincerely



Daisy Shen  
Regulatory Advisor