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Dear Ian

Transmission Balancing Options

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Electricity Commission on the consultation paper "Transmission Balancing Options Paper" dated December 2008.

Genesis Energy remains convinced that incremental change is the best strategy for improving transmission pipeline balancing processes, because:

- the gas market is evolving rapidly;
- there are promising incremental improvement options; and
- big changes are risky and unnecessary in such an environment.

The improvements in pipeline balancing already seen in the three months since the consultation paper was released illustrate the points above. For example:

- self-balancing has improved markedly;¹
- the balancing gas market has evolved;² and

¹ Since removal of the "legacy" provisions from MPOC there has been a reduction in the number of ILONs issued and a lower proportion of ILONs resulting in cash-outs.

² The balancing agent has developed a functioning gas put and call market with predominantly on the day offers.

- Maui balancing agent practices have progressed.³

In submissions on the GIC's balancing issues paper, four market participants (Genesis Energy, MDL, Contact Energy, and Mighty River Power) supported incremental improvement to balancing arrangements while only one participant (Vector) explicitly favoured a clean slate approach.

Genesis Energy is confident that the GIC and industry participants can make further improvements reasonably rapidly and without the transition risks and costs of the proposal to "establish a new balancing agent function".

Appendix A provides Genesis Energy's responses to the consultation questions. Additional comments are set out below.

Single Independent Balancing Agent

Genesis Energy agrees with the GIC's conclusion that a single balancing agent across the Maui and Vector pipelines is likely to be the most efficient approach. Genesis Energy also agrees that the balancing agent should be operationally independent of gas producers, shippers and retailers.

However, Genesis Energy considers that existing arrangements are close to this ideal and should be improved incrementally rather than replaced.

If there is a reasonable probability that the benefits identified by the GIC in its consultation paper can be realised without the costs and risks of a clean slate approach, then an incremental approach should be favoured in the first instance. If an incremental approach ultimately fails to deliver benefits, then the option of establishing balancing agent regulations remains open for future implementation.

If you would like to discuss any of these matters further, please contact Ross Parry on 04 495 3348.

Yours sincerely



John A Carnegie
Regulatory Affairs Manager
Genesis Energy

³ The balancing agent has been making claims on the Maui incentive pool for out-of-balance welded points.

Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
<p>Q1: Do you consider that the objectives identified in Section 2 are appropriate for the analysis of balancing options? If not, what other objectives would you propose?</p>	<p>Genesis Energy suggests that the objectives are on the right track, but could be generalised to avoid directing the outcome.</p> <p>The first objective could be re-written as follows:</p> <p><i>Balancing arrangements should enable gas supply at least cost to New Zealand over time.</i></p> <p>This wording:</p> <ul style="list-style-type: none"> • reduces the risk of minimising balancing costs to the extent that the overall cost of gas supply actually increases; • makes it clear that “least cost” is intended to be an inclusive term focussing on overall long-run costs to the economy rather than the cost to an individual or class of individuals; and • doesn’t single out transaction costs to users for special mention (a high transaction cost approach shouldn’t be discounted if it minimises overall costs). <p>The second objective could be re-written as follows:</p> <p><i>Transmission pipeline users should be able to manage their balancing cost risks.</i></p> <p>This objective is more specific than the first, but it captures a design feature that pipeline users and owners agree is important so Genesis Energy supports its inclusion.</p> <p>This wording doesn’t single out “the ability to hedge price risk” for special mention. Hedging is one of a number of ways for users to manage risks; it is a means to an end rather than an end in itself.</p>

QUESTION	COMMENT
<p>Q2: Do you agree that it is necessary to review tolerances as described in Section 3.1?</p>	<p>Genesis Energy agrees that reviewing tolerances would be a useful exercise, and agrees that the efficient allocation and aggregate level of tolerances is likely to change over time as gas balancing and incentives evolve. Changes that could alter the optimal settings for tolerances include:</p> <ul style="list-style-type: none"> • the quality of information available to pipeline users and operators; • the number and timing of intra-day nomination cycles; • physical and commercial availability of flexibility; • the mix of users at the various Welded Points; and • the range of incentives to minimise imbalances and the overall effectiveness of balancing arrangements. <p>Genesis Energy recommends that the review of tolerances should examine ‘running tolerances’ (running operation imbalance limits) as well as ‘daily tolerances’ (daily operational imbalance limits) and ‘peaking tolerances’ (peaking limits) and consider how to make an equitable, principles-based allocation of tolerances.</p> <p>Genesis Energy also considers that the allocation of large tolerances to the Vector welded points inadvertently provides major plant connected to the Vector system with greater flexibility than plant connected directly to the Maui system.</p> <p>Any review of tolerances should also clarify the treatment of the Rotowaro, Pokuru and Pirongia welded points as the existing tolerances set out in Schedule 7 of MPOC can be applied in more than one way</p>

QUESTION	COMMENT
<p>Q3: Do you agree that it is necessary to consider MPOC changes as described in Section 3.2?</p>	<p>Genesis Energy agrees that addressing balancing arrangements in MPOC should be a priority. Rather than making interim changes pending future transfer to a new balancing regime, Genesis Energy recommends that changes should support MPOC providing balancing indefinitely.</p> <p>As such, Genesis Energy suggests that rather than amending the incentives pool, a better approach would be to implement daily cash-outs of excess operational imbalances (positive and negative) with title transfer. This would sharpen pipeline users' incentives to work within tolerances and would mitigate potential interface issues between the incentives pool and the critical contingency regime.</p> <p>MPOC could also be altered to incorporate balancing procedures and processes enabling efficient balancing across pipelines (rather than creating a service provider contract administered by the GIC). Genesis Energy is comfortable that the ring-fencing provisions in MPOC provide sufficient guarantee of 'independence' and cannot see how transfer to a service provider contract would materially improve balancing agent independence.</p> <p>Genesis Energy notes that use of cash-outs successfully prevented recurrence this summer of the over-pressure episodes experienced in recent summers.</p>
<p>Q4: Do you agree that the primary balancing obligation should remain with pipeline users?</p>	<p>Yes.</p> <p>The development of balancing arrangements should aim to provide pipeline users with the information and tools to meet that obligation.</p>

QUESTION	COMMENT
<p>Q5: Do you agree there should be a single independent balancing agent?</p>	<p>Yes, however Genesis Energy considers that current arrangements are, in effect, close to this ideal already:</p> <ul style="list-style-type: none"> • the existing ring-fencing provisions applying to the MDL commercial operator provide, in Genesis Energy's view, a satisfactory level of commercial and operational independence; and • in practice, balancing actions on the Maui pipeline substantively balance both the Maui and Vector systems. <p>Genesis Energy would support changes to both MPOC and the Vector Transmission Code (VTC) that provide for greater transparency of policies and processes, harmonisation and, ultimately, unification of balancing processes across the Maui and Vector transmission systems.</p> <p>Genesis Energy does not agree that it is desirable to replace existing balancing agent arrangements with a new service provider agreement. Such a transition is unnecessary and risky.</p>
<p>Q6: Do you agree with the Section 7.1 preliminary assessment of balancing procurement options?</p>	<p>Since GIC published its consultation paper, the balancing gas market has evolved considerably. In effect, the MDL commercial operator now runs an on-the-day balancing market (daily quantity, weekly price).</p> <p>The current state of the market is unlikely to be the end-point and Genesis Energy expects that it will continue to develop. However, Genesis Energy is wary of the risks of trying to design an ideal gas market in the abstract and then entrenching it via regulations and a balancing agent service provider agreement.</p> <p>The value of current arrangements is the ability for the balancing gas procurement arrangements to adapt to changes in the gas market. It seems extremely unlikely that the gas market will settle</p>

QUESTION	COMMENT
	into a state in the near future where this adaptability won't be valuable.
<p>Q7: Do you agree with the Section 7.2 preliminary assessment of daily allocation options?</p>	<p>Genesis Energy agrees that the third approach (historically based algorithm) is the most promising of those canvassed. This option could readily be enhanced by:</p> <ul style="list-style-type: none"> • using a simple temperature adjustment algorithm; and • applying the algorithm to daily published Vector gas gate volumes net of any TOU data voluntarily submitted by retailers. <p>Mass-market consumption is thermally driven, so a simple temperature adjustment, combined with the ability to submit time of use (TOU) data, would significantly improve accuracy without adding much complexity or cost.</p>
<p>Q8: Do you agree with the Section 7.3 preliminary assessment of the extended nominations options?</p>	<p>Genesis Energy shares the GIC's concerns with this proposal and has additional concerns that:</p> <ul style="list-style-type: none"> • the large station/small station distinction would effectively create two tiers of shippers; • balancing activity would increase as more points came under the ILON and cash out processes; • retailers would lose the value of customer base diversity; • determining an efficient allocation of tolerances would become more difficult; and • balancing processes would be less efficient without the pooling of delivery points on the Vector transmission system at the relevant welded point.

QUESTION	COMMENT
<p>Q9: Do you agree with the hybrid approach proposed?</p>	<p>No.</p> <p>Genesis Energy agrees that there should be an independent expert review of tolerances and that there should be further work on a process to deal with excess daily imbalance positions.</p> <p>Genesis Energy doesn't support further work on the extended nomination option.</p> <p>For the item "establishing an independent balancing agent function", Genesis Energy would substitute "VTC and MPOC changes to improve balancing arrangements across the Maui and Vector transmission systems".</p> <p>Genesis Energy agrees with the need for MPOC changes, but disagrees with the substance of those changes as proposed by GIC. MDL's submission on the balancing issues paper provides a more promising starting point for developing MPOC change proposals.</p>
<p>Q10: Do you agree with the proposed work programme?</p>	<p>No. Refer Q9.</p>