



Transmission Balancing Second Options Paper

Submissions close 17 August 2009

Greymouth Gas New Zealand Limited (Greymouth Gas) is pleased to make a submission on the Transmission Balancing Second Options Paper published by the Gas Industry Company in July 2009.

1. Do you consider that the objective identified in Section 2 is appropriate? If not, what other objective(s) would you propose?

Greymouth Gas considers that the GIC is on the right track but that there are a few issues with the objective:

The first issue is the word 'provide'...

- 'To provide' suggests that the object/narrator of the sentence is going to apply the verb, meaning basically that the GIC is going to do the plan. Given the collaborative nature that the GIC engages in, we suggest that more appropriate wording would be 'To facilitate the provision of...'

The second issue is the word 'arrangement'...

- The wording suggests that the GIC's objective is to just provide a plan – it makes no reference about enacting that plan, which is the obvious intention. We suggest that more appropriate wording would be 'To facilitate the provision and operation of...'

The third issue is a missing word, 'effective'...

- It is no good having an efficient plan that only works 50% of the time or having one that poorly manages the pipeline line pack. We suggest that more appropriate wording would be 'To facilitate the provision and operation of an efficient, effective...'

The fourth issue is about socialisation of costs...

- Stemming from the GIC's June 2006 Transmission Access Review, one of the six core reasons for starting this project was that there was poor targeting of costs to causers. It would be tragic to get a new system that doesn't address one of the roots of the problem.

We therefore consider that the objective should make reference to minimising the socialisation of costs and/or maximising the pass through of costs to causers. We suggest the following be adopted as the objective, or words to this effect:

"To facilitate the provision and operation of an efficient, effective single balancing arrangement for managing pipeline imbalance that results in no socialisation of costs"

This needs to be addressed because failing to do so would:

- Provide the wrong steer to whomever develops the Balancing Policy,
- Likely result in expensive capital and operational costs without an equal (or greater) increase in productivity

2. Do you agree that the scope of the proposed regulatory options for this paper identified in section 2.2 is reasonable? Are there any items that should be considered in the scope that GIC has not identified? Alternatively, are there any items in the scope that GIC has included that should not be included?

Greymouth Gas considers the GIC's thinking to be very thorough and we agree with the items that are outside the scope of the proposed regulatory options. Balancing is a significant issue and a targeted approach will likely generate short-term momentum.

We also agree with the items that are inside the scope of the proposed regulatory options and we have a number of comments:

- i) A link between the balancing framework and the use of curtailment should be addressed; however, the roles and responsibilities of the Balancing Agent and the TSOs need to be clearly defined.
- ii) No market is perfect so a disputes process is a positive in-scope item. The specific wording of this will be paramount because a User's successful dispute may have cost implications on other Users.
- iii) The ongoing funding of the Balancing Agent (including operating costs and trading losses) should be included in the scope because currently they are socialised. Later in our submission we propose a simple approach that will allocate these costs to causers and create a non-levy-based, self-funding model with no trading losses.
- iv) The Incentives Pool is not listed as inside or outside the scope. We note from Appendix D of the intention to remove this as a balancing tool and we support this approach.

3. Do you consider that the evaluation criteria set out in section 3 are appropriate for evaluation options for pipeline balancing arrangements? If not, why?

Yes.

4. Do you consider that the GIC has correctly identified the need to consider the alternative options based on our conclusions from the consultation process outlined in section 4?

Yes.

5. Do you agree that the contracts based option identified in section 5 is reasonably practicable? If not, why?

Greymouth Gas notes that this option provides a helping hand to the industry to encourage contract-based arrangements, rather than allowing those arrangements to develop on an ad-hoc basis.

The theory suggests that a contracts-based option is reasonably practicable because it is the most simple. However, it may be difficult to achieve because of the different incentives at play. At no stage so far during 2009 have all the Shippers and all the TSOs sat in a room and discussed balancing.

Unless all parties were forced to develop contract-based arrangements within a certain timeframe, we think it is quite likely that initiatives will stagnate, delay or embrace certain circular characteristics.

The question must therefore be whether the GIC thinks that they can get all parties to engage in productive discussion within the timeframe outlined in Figure 2 on page 38 of the paper.

By nature of including this in the paper, the GIC thinks they can (or can try), ergo it is reasonably practicable.

However, we suggest that the GIC should be more concerned whether this option is reasonably efficient and reasonably effective. And that depends on how quickly it can be achieved and how good the GIC wants the end-result to be.

6. Do you agree that the prescriptive regulation option A identified in section 6 is reasonably practicable? If not, why?

Yes.

7. Do you consider that the outline of the prescriptive regulations in Appendix B is appropriate? If not, why?

Greymouth Gas considers that the outline is generally appropriate, except we do disagree with some points, seek clarification on one or two and point out problems with others. In addition to those discussed in the answer to question 10, these are:

4.d Prudential Requirements

We seek clarification on the circumstances in which the Balancing Agent can call upon the prudential requirements. Further, we note that we already provide prudential requirement to TSOs, so if a User meets those requirements, then they effectively have been deemed fit to trade. Thus the prudential requirements in this paper should not be greater than those in the VTC or MPOC.

9. Management of Line pack

We support this, but question whether it should be the Balancing Agent who uses the curtailment provisions, rather than TSOs.

10.iii Procurement of Balancing Gas

We seek clarification on what is meant by the Balancing Agent being able to verify performance on accepted offers. This clause should not punish Users if it is not the fault of that User as to why the Balancing Agent cannot verify performance, e.g. if TSOs fail to provide information to show the receipt of nominated gas by a User.

12 Curtailment & Damages

It is important to have clearly defined roles, e.g. will TSOs still provide OFO notices or Potential OFO notices, or will this become a function of the Balancing Agent? We anticipate that current arrangement would continue such as Operational Flow Orders will be given by TSOs or the Contingency Operator.

We submit that having a liquidated damages regime (separate to any in the Critical Contingency regulations) would be making a simple process overly complex. During normal pipeline operations, the issue of damages is arguably more closely aligned to discussions on Reserved Capacity.

13. Performance Audit

We submit that an audit should also look at cost socialisation and whether the post-regulation balancing environment is cheaper and more effective than the pre-regulation environment, particularly when taking into account the massive cost that the industry would now fund. I.e. has it generated the desired savings and are costs more or less socialised than before?

15. Funding

We support any trading gas losses to be allocated to the GIC, however, we think it bad practice for the GIC to then recover these losses through fees.

This effectively provides the GIC with an easy out if the regulations prove ineffective. We strongly suggest that the GIC be incentivised to ensure that the proposed recommendation submitted to the Minister for approval results in an effective arrangement with no/minimal cost socialisation.

8. Do you agree that the prescriptive regulation option B identified in section 7 is reasonably practicable? If not, why?

Yes.

9. Do you agree that the participative regulation option identified in section 8 is reasonably practicable? If not, why?

Yes.

10. Do you consider that the outline of the participative regulations in Appendix C is appropriate? If not, why?

Greymouth Gas considers that the outline is generally appropriate, except we do disagree with some points, seek clarification on one or two and point out problems with others. In addition to those discussed in the answer to question 7, these are:

Timeframe

One of the most attractive parts of this option is the fast timeframe and we submit that this must generally be adhered to (or be accomplished faster than the Prescriptive Options) for it to still stand as the preferred option. However, we do have two concerns:

- Other options include a preliminary recommendation to the Minister, an industry consultation period, then a final recommendation to the Minister. This option jumps straight to the final recommendation – can this timeframe be achieved?
- Balancing Policy is approved after the regulations are gazetted which may create a loophole whereby the Balancing Agent has powers but cannot take any actions – what is the risk?

To facilitate this option running smoothly, we suggest the TSOs be given a non-negotiable deadline for development of Balancing Policy and that the GIC has a fast-tracked but robust industry-consultative approach for review. We note the flow chart in Figure 8 and, in general, we support this process.

Document Ownership

The Balancing Policy sits outside of the regulations meaning a party must own the policy for it to be effective. Even though TSOs would write the Balancing Policy, the nature of the consultative approach, the GIC fall-back option, and the GIC-approval of change requests all point to the GIC as being the owner of the Balancing Policy. We support this approach.

3.a: Definition of Balance

The definition of balance means a shipper has to maintain matching quantities of receipts and deliveries of gas. We submit that this is both too tight and that the wording is too vague.

Firstly, receipts and deliveries will practically never exactly match. This is because of the inability to change receipts more than four times during a day, the associated time-lag, the imperfect information from not knowing exactly what customers are going to take, the physical limitations of reading residential customer's deliveries on an hourly basis, and so on.

However, the VTC and the MPOC largely have it right when they add in a time reference and an obligation to track towards zero over time. The definition in clause 8.1 of the VTC is quite good and, summarised, it says that shippers shall use all reasonable endeavours to ensure that daily Mismatch is zero and that Running Mismatch tends towards zero, recognising that at times the former may not hold true so that the latter can.

The same comments apply to injected Welded Points and TSOs – exact matching is impossible. We submit that the VTC's wording (by way of an example) is a much more appropriate interpretation of the concept of 'balance'.

4.a: Obligation to Balance

Similar to the above, the use of reasonable endeavours to maintain matching quantities of receipts and deliveries has connotations of a daily concept only. It should refer to daily and cumulative concepts as discussed above.

4.b.i: If a User Fails to Balance (1)

Notwithstanding that all users may fail to balance unless the above clauses are improved, there are shortcomings with liabilities in this section.

We seek clarification of what kind of adjustment the Balancing Agent will do to shippers'/Welded Points' gas entitlement. The wording is vague and could suggest that deliveries will be scaled to receipts, or receipts will be scaled to deliveries. We suggest that what is meant is that if one fails to balance properly, they may be cashed-out.

4.b.ii: If a User Fails to Balance (2)

We also seek clarification on a User's liability to pay/receive funds from Balancing Gas actions.

From the wording it seems that one will be liable simply if receipts and deliveries do not match. This is in direct contradiction to 7.b which says that Balancing Policy must give Users a tolerance before allocation of Balancing Gas title and costs. We seek clarification on this point.

Further, current practice is that a User is only deemed to contribute to a cash-out if they directly influence that cash-out (e.g. if Balancing Gas is purchased because of a shortfall in line pack, only those Users who have a negative cumulative position in excess of a tolerance will be penalised).

The wording in this clause suggests that even if a User has a positive cumulative position in excess of tolerance, and using the above example re a shortfall in line pack, Users would still be liable for allocation of Balancing Gas and title (because they are in imbalance, irrespective that they helped, not contributed to the problem). This is a major policy shift to what happens at the moment.

Not only would it unfairly punish those who have not caused the problem, but it would incentivise those Users to remain within tolerance, thus providing less of an off-set to the problem (e.g. a high positive running imbalance would reduce to within tolerance meaning that overall line pack decreases and the original problem becomes worse).

We seek clarification of the intention here.

5.h: TSOs to Indemnify Balancing Agent

It is interesting to note the proposal that the TSOs must indemnify the Balancing Agent for any amounts that cannot be recovered from Users.

The key word here is 'recover', which strongly implies that costs must first be allocated to Users before seeking to recover those costs. This process will likely

improve with a single balancing arrangement and a good dispute process. If TSOs have to indemnify the Balancing Agent then it is likely that these costs will be socialised in future transmission charges.

This clause would punish end use businesses and customers and does not lend itself to minimising the socialisation of costs. It may also prove problematic for TSOs who might be bound by regulated price increases.

7.b: Users Having a Tolerance

The new Balancing Framework means a User will have just one relationship with the Balancing Agent, with no pass-through arrangement as at present.

Let's say that tolerances at Welded Points will not change (is it out of scope of the paper). In the case of a supplier's injection station, they will be able to freely operate their running imbalance within the +/- tolerance level without being penalised during any cash-out process.

But what happens at the Maui-Vector Welded Points? Currently Vector, as Welded Party, has the tolerance which creates AEOI if it is breached. At a basic level, this is sometimes cashed-out and passed on to Shippers. If you assume that Users in aggregate will still have a tolerance, one could surmise that this arrangement will continue.

However, if you assume that Users individually will be given a tolerance, this means that each Shipper has its own tolerance within which to operate, at each Vector Welded Point. We make no comment on the merits of this but it does change things slightly.

We are unsure what the intention is here and we seek clarification.

7.c.i: Allocation asap

Balancing Policy dictates that Balancing Gas title and cost must be allocated as soon as practical after committing to the Balancing Action. However, we see disconnect between this desire and what is possible in practice.

It is out of scope of the proposed regulatory options to explore day-after-gas-flow or the D+1 allocation model. For the Balancing Agent to allocate Balancing Gas title and cost, they must know deliveries. For shippers, deliveries are only finalised at month-end after going through M-co's process.

Therefore the allocation of Balancing Gas title and cost to shippers will not occur very close to when the Balancing Action happened and will probably reflect what happens at the moment.

We think it likely that the Balancing Agent will need adequate working capital facilities to cover this potential lag in cash-flow.

7.c.ii: Allocations

As discussed in our comments on 4.b.ii, we seek clarification on how Users will be cashed-out, i.e. whether any gas greater than tolerance will be cash-out, or only gas greater than tolerance if it's in the right direction and causes the problem.

Further, the Balancing Policy must provide scope for the TSOs to also be shippers when transporting their own gas for things like compressor fuel.

10.a: Status of Balancing Agent

The relationship between the Balancing Agent and TSOs will be paramount. We suggest the Balancing Agent and/or TSOs be incentivised to warn when line pack is too low or too high, so Users have the ability to self-correct the problem first.

11: Management of Line pack

We have a number of general comments:

- Clear rules should stipulate when the Balancing Agent should act
- The actual selling/buying of line pack may have no impact on the level of line pack if the purchaser/seller only buys/sells gas from their running imbalance position
- Will line pack be pipeline-specific and as such, will the balancing zones be redefined?
- What will happen with minor points, such as Opunake?

11.j: TSOs Adjusting User's gas entitlement

On the Vector Transmission system, we seek clarification as to whether Vector will continue to provide shippers with their BPP positions or if this will become a function of the Balancing Agent. The wording suggests that Vector will continue to do this.

The wording also says that TSOs must immediately adjust the Users' gas entitlement. But it doesn't specify the *effective day* of the adjustment and this could be interpreted one of three ways:

- a) That TSOs put through cash-out changes to shippers' BPP positions, back-dated to the effective day of the cash-out (as happens at the moment), or
- b) They put it through on the effective day that they are able to calculate shippers' quantities (after month end), or
- c) They put it through as a future adjustment, pro-rated across a period

The second and third options would allow shippers time to self-correct, rather than currently flying blind. It is a good opportunity to address this and make the process fairer.

11.k & n: Unallocated Balancing Gas

Gap

Under current arrangements, a significant portion of funds are not able to be allocated to causers, leaving, initially, MDL with a shortfall in funds resulting from operating the balancing function. We consider this gap to have been a major factor in developing these new arrangements.

This gap may begin to close, but we consider it unlikely to close completely. The reasons for this are operating a tolerance system (as noted by the GIC in 11.n), but also back-to-back cash-outs.

When considering back-to-back cash-outs, one must also consider what is outside the scope of this paper, namely the transmission service nomination cycle and investigating the potential to improve balancing. This means we will continue to have 4 Intra Day nomination cycles, with Mismatch and Running Mismatch positions deemed to be on a daily basis.

The Balancing Agent must purchase gas during a nomination cycle, and must accept offers as late as is reasonably practical (11.b.ii). Therefore the last cycle to purchase/sell gas on a day is the ID4 cycle, which closes at 5pm, with changes to nominations at 7pm. It is likely that the Balancing Agent will issue notice of procurement of the gas or that shippers will closely monitor the line pack trigger points, meaning shippers will then be able to act at least as quickly as the Balancing Agent and in any case, in time for the ID4 cycle, thus limiting User exposure, incentivising self-correction, but maximising Balancing Agent exposure.

Injector Welded Points will also have until midnight to adjust flows giving them a bigger advantage.

All this increases the risk that the Balancing Agent will be stuck with liability for which shippers have simultaneously corrected for. Thus we think it is likely that less than 100% of the allocations will be able to be passed on to causers and some sort of shortfall in funds gap will continue. This situation is exacerbated if the Balancing Agent buys/sells gas in the ID3 cycle or earlier.

Wording

Allocations should be based on the AEOI as near as possible to the time when the balancing action was committed to. The wording suggests that the closest time could be in the future (as at the moment), but also in the past. We have clarified with the GIC and 'as near as possible' only is only forward-looking, so the wording should reflect this.

Legalities

Despite the nomination cycles being out-of-scope of this paper, the intention of the GIC looks like it is to operate a 24-hour operation (which indeed must be the case when managing real-time line pack).

Aside from the double-up in costs if MDL is not the Balancing Agent (as MDL must already track their line pack), one must consider how such a 24-hour operation will work during the nomination cycles.

If, as one would surmise, the nomination cycles are not going to change, then what happens if there are differing interpretations of the time in which a balancing gas transaction was entered into? E.g. if the Balancing Agent needs gas at 2pm, they must source it through the ID4 cycle which closes at 5pm and nomination title transfer occurs at 7pm. What time is the balancing action committed?

In this example it makes no difference to Users because the time 'as near as possible' is still midnight later that night. Where it might be more contentious is during the P, CP or ID1 cycles.

Let's also consider that something changes and title can transfer at any time of the day, i.e. there are no nomination cycles and any nomination changes are instantaneous and go through a 2 hour approval process effective from the minute when a change is submitted. Such a situation would increase the ability of the Balancing Agent to more quickly source Balancing Gas. However, it would also allow Users right up until midnight to correct their nominations such that their AEOI would not contribute to the balancing action. This might increase the risk of the Balancing Agent being stuck with gas it cannot allocate.

Unallocated Gas

There will likely be some quantity of unallocated gas which will then need to be allocated to the Balancing Agent (11.k). Would the Balancing Agent then be considered a shipper on the TSOs' pipelines (as they would carry a Running Mismatch position)? We seek clarification here.

This slightly contradicts 11.n which says that any gains or losses that are not allocated to Users, are allocated to the TSOs. However, there cannot be any allocation to TSOs because 11.k already allocates the difference to the Balancing Agent itself.

We surmise two things from this; firstly, that the Balancing Agent will operate at a loss, as MDL and Vector arguably do currently. This is because they will have bought gas which they cannot fully recover (they have gas but owe money). Gas is typically purchased at a premium, say \$12. If they look to sell the unallocated gas to recover the money, what are the chances they can get \$12 for it? It's quite unlikely when the current offers for purchase of put Balancing Gas is about \$3. The Balancing Agent will therefore be subject to direct loss and this is perhaps why TSOs have been pushing for change.

If the Balancing Agent is not allowed to make a profit from sales, i.e. the cash-out price is the clearing price plus transmission fees, then the Balancing Agent's only source of funding will be operating levies. Therefore if there is any unallocated gas, they will make a loss and this will erode equity (or be socialised in fees and tariffs).

We suggest that the Balancing Agent be allowed to add a variable fully-disclosed margin onto the cash-out price which will allow it to recover its losses. Let's consider an example: 100GJ bought at \$10, plus \$1 transmission fees/GJ, plus 10 days of overheads of, say \$0.1/GJ/day, giving cost recovery that needs to be \$1,200. If there is only 50GJ of AEOI to cash-out then:

- Current policy would mean the Balancing Agent only recovers $50 \times 11 = \$550$, meaning \$650 and 50GJ of unallocated gas. Say this is sold later for \$3/GJ, then the Balancing Agent has made a loss of \$500.
- If the price was set by 'needed cost recovery'/GJ's available, then the Balancing Agent would cash out Users' 50GJ at $1,200/50$, which is \$24/GJ. This results in no loss, direct allocation of costs to causers, no socialisation of costs, and no operating levy.

This example also incentivises Users not to breach. There would need to be some sort of wash-up arrangement to ensure that the Balancing Agent did not profit from the recovery of overhead costs during the long-term. Recovery of overhead costs would largely replace the operating levy.

What we do not want to see happen is the Balancing Agent (via the GIC or otherwise) approach Users for more money in the form of an increased levy to cover an eroding equity position. Not only does this socialise costs, but it will also signal that the project has failed as the original short-fall in funds gap will not have closed sufficiently. The problem simply would have moved from MDL to Users.

Secondly, maybe we need to consider that the intention is actually to pass through the costs to TSOs who would indemnify the Balancing Agent. If this is the case, then the losers are the end-use customers. This would perhaps be the greatest socialisation of costs there could be and in direct contrast to the GIC's original objective.

We submit that unless some of the clauses are tested and tightened, there is a chance that the industry will end up with a very efficient single balancing arrangement that is not very effective.

13.a: Disputes

Greymouth Gas supports this approach as it would provide a fair solution of last resort.

14.d.i & vi: Balancing Policy

The terms of Users providing Balancing Gas will have a direct impact on price and liquidity. Policies affecting Users will greatly affect the market, such as only purchasing gas from a supplier or stating that a User must make a physical adjustment to take into account a purchase/sale.

We also question why there should be a cap on the price at which the Balancing Agent will accept offers for Balancing Gas. Let Users decide at what price they are willing to avoid the contingency process. Further, the arrangements should not penalise those who can provide gas during times of shortage; they should be rewarded for having this competitive advantage.

Let the market decide and this will help facilitate our sustainable funding suggestion.

15. Funding

This is an essential part of the model given that Users will be paying.

We note that everything up until the recommendation to the Minister is covered by GIC funding. We also note 15.a but believe it remiss not to elaborate on such a key piece of information.

We understand that under this model, the TSOs will appoint a Balancing Agent (with GIC appointment a back-stop option). It is unclear who will do the invoicing and collect fees.

It doesn't make sense for Users to pay development and ongoing Balancing Agent costs direct to a TSO (unless they were the Balancing Agent). Why should they get use of the cash flow and interest? It also brings the TSOs into the loop, possibly creating a pass-through dispute situation just like the one Vector is currently pushing back against. We think it sensible to be invoiced directly by the Balancing Agent and have the Balancing Agent set the charges.

The basis of the charges is just as important. If operating costs are pro-rated based on the number of ICPs, then those with a few, large customers benefit and mass market retailers are penalised. Similarly, if you divide equally amongst, say, ten users, then those who don't use the pipeline as much are penalised.

Users have an equal opportunity to manage their exposure relative to their use of the pipelines, therefore we believe the second-best option is for Users to pay based on the proportion that they use the pipeline, e.g. based on deliveries (or receipts). The TSOs must also pay when they act as pipeline users (e.g. compressor fuel purchases).

We consider that the best approach might involve wrapping operational costs (and trading losses) into the cash-out price that is passed on to Users who caused the Balancing Action.

We disagree with 15.b that says that any net amount from trading Balancing Gas is fed back into ongoing costs. We submit that profits be added back into ongoing costs, but not losses as this would socialise the cost of developing an ineffective model.

Maybe the GIC should indemnify any trading Balancing Gas losses that the Balancing Agent makes? After all, it would be a direct result of the policy that it recommended for approval.

We suggest that the directors of the Balancing Agent be empowered to ensure that trading losses are minimised or eliminated. To a large extent this loop cannot be closed unless the directors' tools are provided for in the regulations.

We suggest that ongoing costs (and trading losses) be added as a margin onto the cash-out amounts as this would better reflect a user-pays system, and in theory would not result in trading losses.

11. Do you agree with the GIC's approach to evaluating the options identified as reasonably practicable in section 9? If not, why?

No.

Greymouth Gas considers the approach is not as strong as it could be because there are no weightings to any category and still there are no cold hard numbers.

We submit that a basic NPV analysis is undertaken that compares all options with the status quo, from the perspective of overall costs/benefits and the socialisation of costs.

12. Do you consider the GIC's assessment of the options presented is fair and reasonable? If not, why?

No.

Generating the overall ratings is, by nature, a qualitative process done by humans. Some parts are more important than others and we believe the lack of a weighting system is a flaw in the process.

An example of the lack of weightings is with adaptability. It doesn't overly matter how adaptable the system is, rather that it is adaptable, ergo it should have a low weighting.

Some of the ratings also appear to have been skewed, for example the Participative Option is given an adaptability rating of 4, whereas the others have 1. However, once up and running, the three main options will all be as adaptable as each other, i.e. all changes will need to go through a formal process, ultimately culminating in GIC sign off. One could even consider adaptability to be irrelevant (because all systems are adaptable somehow), or at a minimum, the three main options should all have the same overall rating for adaptability.

Another example of skewed assessment of the options is in the Balance section, in which the Participative Option is given a rating of 5, as compared to 3 for the Prescriptive Options. The only difference between these three options is who drives the consultation process (TSOs and GIC respectively). The point is that all options have a consultation process that develops a balancing policy with the interests of all stakeholders. Again, the analysis is skewed, albeit slightly, in favour of the GIC's preferred option.

There is also no analysis of what is considered to be a low IT cost. This should be done as part of this process, so we seek confirmation that the GIC has scoped these costs, and if not, that these costs will be funded by the GIC irrespective of when the costs will be incurred.

Overall it looks like the answers have been skewed slightly so as to justify the GIC's preferred option. This isn't wrong because they are trying to have influence, but did they get the right answer?

13. Do you agree that the GIC has, through the evaluation of options, correctly identified the participative regulation option as its preferred option? If not, why?

To answer this question, one must consider the big picture and the best way of doing so is to ascertain if we think the Participative Option should be the preferred option. We can then compare this with the GIC's analysis and answer the question in reverse.

Contract Based Option

Ignoring the practical difficulties, we see too much risk that duplicative or more highly socialised mechanisms, such as the Incentives Pool, will bed-down into a contract based solution. It also takes two years longer than the Participative Option.

For this reason, whilst incremental approach is the best option in theory (as evidenced by submitter's responses to the first paper), it is perhaps not the best option when one considers the significant leverage that TSOs have over the current balancing processes.

Therefore we have to weigh the risk of continuing with the partly-socialised Incentives Pool arrangement, with the cost and timeframe of setting up a new Balancing Agent.

Accordingly, we think this option should not be considered, but only as long as our funding and policy concerns with the other options are addressed.

Cost

By excluding effectiveness and socialised cost minimisation from the objective of this whole process, the GIC is illustrating that it just wants the regulations to be running. Ergo, there is limited consideration of whether it will improve cost recovery and minimise the socialisation of costs.

We see a real danger that the industry pays for, say, a \$2m Balancing Agent, with \$x of operating costs and that, aside from developing the single balancing policy, no real improvements are made to cost recovery, productivity or minimising the socialisation of costs.

A single Balancing Agent would achieve the GIC's stated objective of implementing an efficient single balancing arrangement, but it would:

- Come at a net cost to the industry (GIC has not proved it has greater NPV than the status quo),
- Not result in 100% cost recovery (due to the imperfect back-to-back regime and the removal of the Incentives Pool), and
- Result in the same or increased cost socialisation (because operating costs and trading losses are rolled back into GIC/TSO tariffs, which is new from Users' perspectives)

Implementation of a single balancing policy is not dependent on a new Balancing Agent, thus this cannot be a factor when summarising the situation. Therefore if we run with Prescriptive Option A or the Participative Option, we submit that the

industry will essentially have to pay for the current arrangement to be conducted by a new Balancing Agent at great cost.

Sure, there will be some improvements, such as removal of the Incentives Pool, improving the dispute process, streamlining relationships and back-to-back cash-outs triggered by line pack limits. But this can be achieved via regulation.

If a new Balancing Agent is also appointed as part of this process then we want to see:

- the system improved,
- a positive return on capital invested

Balancing Agent

We need to be pragmatic and consider the drivers of the GIC and the TSOs. Given the options in the paper and the incentives of the different parties, it is highly likely that a single Balancing Agent will be required to implement the single balancing policy.

We submit that in the interests of keeping costs down, the Balancing Agent should be MDL as they currently do most of the process.

If this can be regulated for, then we lean towards favouring Prescriptive Option A. But would MDL be bound to accept a directive to become the Balancing Agent? And would the GIC even appoint MDL as the Balancing Agent? Then there's the question of whether MDL wants to be the Balancing Agent.

Balancing Policy

Greymouth Gas considers it likely that a Balancing Agent will be appointed to implement the single balancing policy. We think it is absolutely critical to address shortfalls in the drafted policy and incentivise the correct parties so as to minimise or eliminate the socialisation of costs.

Development costs aside, the appointment of a Balancing Agent is a lot more appealing if ongoing costs and losses from trading are fed-back into the cash-out recovery mechanism and are truly paid for by causers.

Prescriptive Options

Option A is superior to Option B because the funding is sorted by GIC, as opposed to the TSOs. Also the latter option implies that Vector will not be completely removed from the loop and we see this as messy.

So is Prescriptive Option A better than the Participative Option?

The Best Option

The question is: what is relevant?

- Who drives – given that anything decided by the industry would have to be approved by the GIC, any industry initiatives will largely approach the GIC's scope in section 2 of the paper. Not relevant...

- Costs – it will take longer to develop the participative option, but we don't see this as added cost, because those involved will likely still be working for their employers regardless of what they're working on. Not relevant...
- Regulations – it doesn't matter whether the Balancing Policy sits inside or outside the regulations, as long all risks and strategy is adequately addressed. Not relevant...
- Timing – the Participative Option is superior by half a year, which will result in removing the Incentives Pool sooner. Relevant...

We believe the GIC has correctly identified the Participative Option as the preferred option. But we strongly submit that the objective needs to be re-worked such that, regardless of who writes the Balancing Policy, the balancing framework is effective, costs are not socialised and the industry gets value for money.

If this does not happen, then the project should stop right now.

14. Do you agree with the next steps identified in section 11? If not, why?

Yes.

15. Optional Questions 1-5...

No comment.