



Gas Industry Company
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Attention: Ian Wilson

24 November 2014

Dear Ian,

Submission in response to MPOC Change Request (MBB) 10 October 2014

OMV Exploration & Production

OMV welcomes the opportunity to provide a submission on the MPOC Change Request (MBB) received by the Gas Industry Company (GIC) on 10 October 2014, and to provide comment on the report "Daily Cash-Outs on Maui Pipeline, Outline of a Cost-Benefit Analysis" prepared by Covec for the GIC (Covec CBA).

In summary, OMV supports the proposed MBB change request as proposed by MDL for the following reasons:

- The status quo arrangements provide unpriced flexibility over a 72 hour period which is not enjoyed equally by all users, and the costs of which do not fall to the parties who enjoy the benefits.
- The balancing period is being shortened to 24 hours, in alignment with the current balancing obligations of the MPOC.
- The financial incentives at the end of the balancing period are being moderated significantly through the use of an efficient and competitive market for pricing, rather than the BGX.
- The proposed MBB arrangements better support the GIC's objectives under the Gas Act 1992 and the Government Policy Statement on Gas 2008.

For the purpose of this submission, OMV will ignore the back-to-back (B2B) code as MDL have indicated that the appropriate analysis for the MBB proposal is against the status quo code.

Balancing Remains a Problem

Although a problem definition is not a requirement of the GIC process for reviewing proposed code changes there have been submissions by industry parties that balancing is no longer an issue and this change request is therefore unnecessary.

This argument is usually based on the GIC graph which shows that the amount of balancing gas transacted has fallen significantly since 2008/2009.

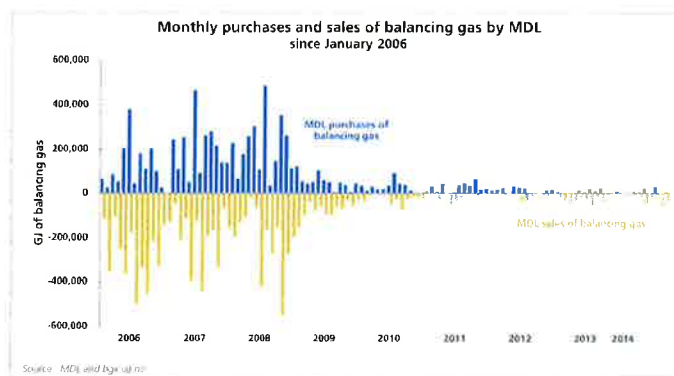
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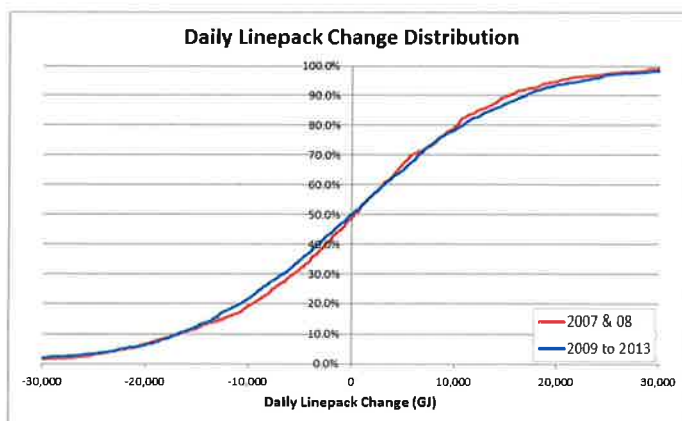


This graph only shows a small part of the balancing story, that is the amount of gas bought and sold by MDL for "pipeline management". In other words the gas which is bought and sold for managing:

- "unaccounted for gas" (UFG),
- adjusting the flowing linepack to support nominations,
- managing the residual title gained or passed through cash-out transactions, and
- in rare circumstances, attempting to mitigate pipeline instability risks.

The reduction seen in 2008/2009 reflects the introduction of costs. Despite MDL being able to pass these costs through under Schedule 10 of the MPOC and more recently under Part 4 regulation, MDL has sought to minimise the costs which are being carried between years.

Notwithstanding that the amount of pipeline management gas being transacted has reduced, the balancing performance of pipeline users has not changed. This can be seen by plotting the distribution of daily net operational imbalance across all users both before and after the 2008/2009 "improvement". The graph below, based on daily changes in linepack, demonstrates that there has been no improvement in balancing performance; in fact performance has arguably degraded marginally over that time.

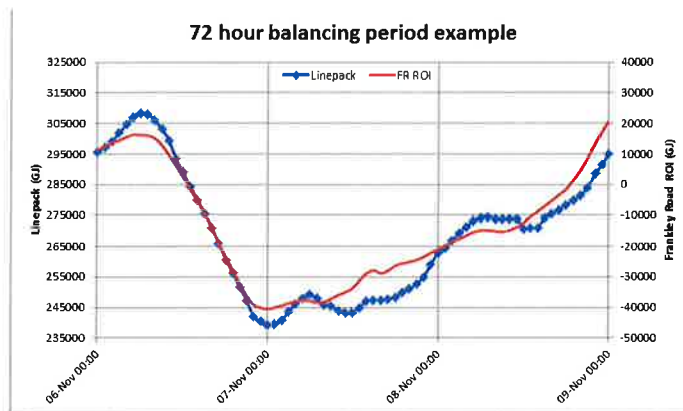


Another major issue with the current arrangements is the unpriced 72 hour "borrow and loan facility". The costs of providing this service are socialised to all users via tariff. While socialising the costs of a service enjoyed

equitably by all users may be efficient, under the status quo arrangements this is not the case.

An example of the use of this 72 hour flexibility is shown in the next graph, which plots linepack and Frankley Road operational imbalance over the period 6 to 8 November 2014. It should be noted that the low linepack was of sufficient concern that the System Operator purchased call balancing gas at the lowest point on this graph, and then had to sell put balancing gas at the end of this period.

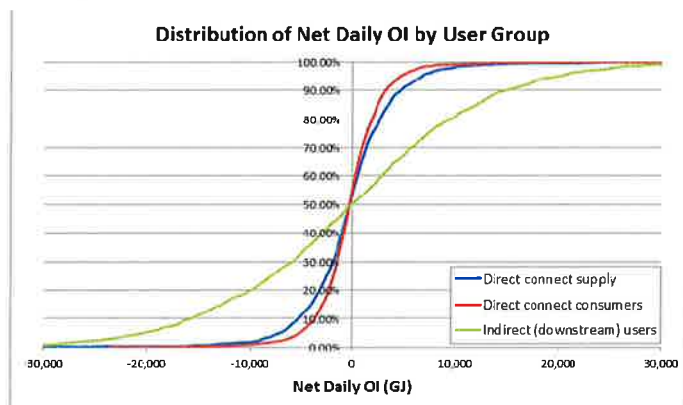
As the Frankley Road operational imbalance recovered within the ILON period the cost of this cycling of balancing gas will be socialised.



That the benefits of this 72 hour flexibility aren't being enjoyed equally by all users is most clearly demonstrated by comparing the operational imbalance data between three groups of users:

- direct connect suppliers
- direct connect consumers
- indirect (downstream) consumers

The following graph, based on daily metered and scheduled quantities between 2010 and 2014, shows the distribution of balancing performance for each of the user groups outlined above.



Under the current code the directly connected suppliers, in aggregate, have approximately 15,000 GJ of positive and negative tolerance and the directly connected consumers have in excess of 10,000 GJ of positive and negative tolerance. In each case these users remain within that daily tolerance almost 100% of the time.

In contrast, the downstream users which have approximately 15,000 GJ of positive and negative tolerances remain within these limits less than 80% of the time.

Balancing Cost Framework

OMV submits that in carrying out a cost-benefit analysis of the MBB proposal, there needs to be a distinction between costs which are a direct part of the balancing regime and costs which may (or may not) arise as an indirect result of system performance or user incentives.

More particularly the discussion which follows focusses on the indirect (downstream) users as these users have argued that they face the most cost and difficulty in adjusting to the MBB proposal. In contrast the directly connected consumers and suppliers demonstrate that they are already largely able to operate within the proposed MBB framework.

Costs directly relevant to balancing

To ground the discussion which follows the mechanisms for passing costs through to users need to be outlined. There are three main areas where costs arise for users under both the status quo and MBB codes:

- *Direct costs.* These are the costs and revenues of cash outs at welded points. These fall directly to the directly connected parties (e.g. producers, Methanex, Huntly Power Station) and flow indirectly to Vector shippers through the pass-through mechanisms of the Vector Transmission Code (VTC).
- *Indirect pipeline management costs.* These are the net costs or revenues for accessing balancing gas, managing UFG and managing the residual title gained or passed through cash out transactions. Under the Default Price Path determinations under Part 4 of the Commerce Act, these costs or revenues are socialised across all users of the pipeline system. The downstream users currently withdraw approximately 30% of the gas which flows into the Maui pipeline.
- *Direct incentives costs.* These are the costs imposed on users for peaking and excess daily imbalances.

Direct costs - status quo

Actual cash out data over the period 2012 to 2014 shows that on average the downstream users have incurred 60-70 TJ of positive and negative cash outs per year. The spread between the positive and negative cash out prices has averaged \$7.50 over this same period, leading to an annual cost to the downstream users of approximately \$500k.

Direct costs - MBB proposal

Based on statements from downstream users that information scarcity is the main driver for the daily imbalances seen at the Vector interconnection points, the historic daily imbalance data can be used for analysis of the costs of MBB, however it should be noted that the historic data includes the corrections which users make within the 72 hour balancing period. As these ex-post corrections would no longer be necessary under the MBB proposal it should be reasonably expected that future daily imbalance data will be less volatile.

Based on the above assumption, the volume of cash-outs will increase significantly under the MBB proposal, potentially up to 1.5 PJ of positive and negative cash outs per annum.

The cost of this to downstream users will again be a function of the spread between positive and negative cash out prices, however this spread will be determined by the spot market for "standard products" rather than the BGX. Although there is no historical data which can shed light on what this might be, it is assumed that the spread will be a reflection of the percentage adjustments MDL applies to the average market price. This assumption is based on the logic that market participants, acting rationally, would prefer to transact gas at prices no worse than they would be exposed to through inaction and cash out.

The net cost to downstream users, based on a gas price of \$6/GJ, would therefore be:

- +/- 2% = \$360k p.a.
- +/- 5% = \$900k p.a.
- +/- 10% = \$1,800k p.a.

Direct costs – direct connected suppliers and consumers

The directly connected suppliers and consumers are likely to be neutral in this regard as they have demonstrated that they are able to operate within the MBB daily framework.

Indirect costs - status quo

Over recent years the amount of gas which has been transacted through the BGX has averaged 70 TJ of call gas and 270 TJ of put gas, at a net cost to the entire industry of ~\$130k p.a. As downstream users currently represent around 30% of gas outflows from the Maui pipeline, the net cost to downstream users is \$40k p.a.

Indirect costs - MBB proposal

Based on the cash-out volume noted above, and the net position actually transacted through the BGX over recent years it is assumed that MDL will purchase 1.5 PJ of gas p.a. and sell 1.7 PJ p.a.

Once again assuming MDL is able to transact gas at the margins of the spread based on their own percentage adjustments, this provides the following net costs and benefits to industry. Also shown is the proportion of these costs and benefits expected to flow to the downstream users, based on the 30% net proportion noted above:

- +/- 2% = \$250k benefit
- +/- 5% = \$70k benefit
- +/- 10% = \$220k cost

Indirect costs – direct connected suppliers and consumers

Because the directly connected parties remain within their daily obligations any indirect cost, or reduction in indirect benefit, under the status quo arrangements should be considered a cross-subsidy for the benefit of the downstream users.

Under the MBB arrangements this subsidy is removed and the costs or benefits of socialised indirect costs will fall to the directly connected parties, predominantly Methanex and Genesis:

- +/- 2% = \$570k benefit
- +/- 5% = \$170k benefit
- +/- 10% = \$500k cost

Incentives Payments - status quo and MBB

OMV has not taken the time to analyse the costs of peaking and excess daily imbalance. From the 2013 annual report of the Incentives Pool Trustee the income recovered from industry was less than \$100k.

Under the MBB, excess daily imbalance will be irrelevant and the costs of peaking are expected to drop significantly due to the peaking charges being priced on the spread between positive and negative cash out prices which is expected to be very small as discussed above.

Net Impact on Downstream Users

From the analysis outlined above it is clear that there is a "breakeven" point for the costs which flow to the downstream users between the status quo code and the MBB proposal.

This analysis by necessity treats all Vector shippers equally as there is no publicly available information on the breakdown of shipper throughput by Vector welded point or the imbalances by users created on the Vector system. If this data would prove useful for further analysis we would invite Vector to publish their users daily mismatch positions by Welded Point as this would aid understanding of the issues.

Comments on Issues and Costs Indirectly related to balancing

Costs related to information

The Covec CBA canvasses whether downstream users will incur costs (whether capital or operating costs) related to improving their systems for the purpose of improving primary balancing performance.

From the analysis outlined above it is apparent there is likely to be a breakeven point for the MDL adjustment which would mean there was no additional costs flowing downstream.

However as it is likely that the costs will not flow proportionately to all downstream shippers/users some companies may face increased costs at the margin and therefore may decide to upgrade their resourcing or systems. As this decision would be taken to upgrade system to meet daily delivery obligations which already exist under the MPOC, to the extent that these investments haven't been taken to date is a further signal of the benefit which users have enjoyed through the unpriced flexibility which has been offered by the pipeline. For this reason OMV questions whether these costs should be taken into account.

Upstream costs related to high pressure

OMV is not an operator of gas fields directly connected to the transmission system. It is understood that high pressure creates costs for some operations. To the extent that these pressures are in excess of the range MDL is contractually required to provide (the Taranaki Target Pressure or

TTP) and these are due to users “parking” gas in the pipeline then these costs should be taken into account.

The MBB proposal better supports the GIC's objectives under the Gas Act 1992 and the Government Policy Statement 2008

Finally OMV makes the following observations in relation to the MBB proposal and how it supports the GIC's objectives under the GPS:

- All users will be able to make use of the spot market for the purpose of price and volume risk management, leading to a more competitive market based outcome than under the status quo where the BGX is used
- Barriers to competition in providing spare capacity for system balancing and maintaining security of supply are eliminated
- Incentives for investment in high frequency storage or other forms of flexibility are created or enhanced
- Depending on the level of adjustment set by MDL delivered gas costs may be subject to downward pressure, however the MBB proposal will create a new level of competitiveness between shippers who can compete on the basis of the efficiency of their internal systems, again helping to maintain downward pressure on delivered gas costs
- Risks relating to system stability and security of supply will be reduced as the system operator will be able to take more direct action rather than second-guessing the intentions of users
- The full costs of flexibility will start to emerge and be correctly costed

If you have any questions in relation to OMV's submission, please contact Nick McDougall.

Yours sincerely,



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