17 December 2009 MPOC Change Request

Submission on GIC Draft Recommendation

4 June 2010

A. Introduction

MDL welcomes the opportunity to comment on the GIC's Draft Recommendation, (Draft Recommendation), concerning the 17 December 2009 MPOC Change Request, (Change Request).

MDL appreciates the effort that the GIC has gone to in its analysis of a long and detailed document and ultimately agrees with the GIC's recommendation that the Change Request should be supported.

However, MDL does have comments on some of the points raised in the Draft Recommendation and has set these out below in the order of the sections in which they are found in the Draft Recommendation. References to section numbers are references to the section numbers in the Draft Recommendation.

B. Proposed Balancing Changes (Section 5)

B.1. Codification of MDL's System Operating Procedures

An apparent area of disagreement between MDL, the GIC (and some other industry participants), relates to the processes for developing and changing System Operating Procedures, (SOPs), as they relate to the Maui Pipeline.

There are currently three separate SOPs in effect which deal with (1) balancing, (2) curtailment and (3) the procedures to be followed if demand exceeds available pipeline capacity. Further SOPs may be added to this list in the future – for example, a separate SOP may be needed to cover the operation of the Trading Hub.

MDL notes that the apparent area of disagreement in relation to the SOPs does not appear to be the content of the current SOPs themselves, but the perception that MDL can unilaterally change the SOPs "at its discretion" without being accountable to anyone for the effect such changes might have. MDL notes that these arguments have often gone further to the point where largely hypothetical claims that excessive costs could be incurred if MDL was of a mind to make changes to the SOPs.

To some extent we can understand how the concerns lead to calls for the SOPs change procedure to be either made part of the MPOC, and subject to the change request procedures under the MPOC or to be subject to a separate set of procedures which govern their modification and content. However it also needs to be understood that the SOPs and in particular, the balancing SOPs, govern matters that are critical to the operation of the Maui pipeline, including its ability to transmit gas and its operational safety. These are matters for which MDL accepts direct responsibility in the current version of the MPOC and in the Change Request. Consequently, MDL believes that it must have discretion to alter its SOPs at short notice in response to any changes in operational and safety requirements, without having to go through a drawn out modification process and in that regard it must have a final say on the procedures adopted. However, we note that in the Change Request itself, MDL has accepted that it should be subject to an obligation to consult with the industry in relation to SOP changes before they come into effect.

MDL disagrees with the proposition that it has an unlimited discretion to set SOPs in any way it wants. MDL is bound to comply with a number of contractual obligations set out in the MPOC which have the effect of limiting MDL's discretion in setting SOPs. Examples include the requirement to maintain Maui Pipeline pressure within the Target Taranaki Pressure range in accordance with section 2.19 and the requirement to provide posted flexibility for Peaking Limits and Contingency Volume in accordance with section 18.1 (b). In complying with these and other obligations set out in the MPOC, MDL is required to act as a Reasonable and Prudent Operator at all times. Adherence to this standard requires MDL to act in accordance with "good gas transmission operating practice as determined by reference to proper and prudent practices recognised internationally". MDL also seeks to act consistently with the Gas Act and Government Policy Statement efficiency objectives in order to reduce balancing costs as much as possible. MDL considers that its compliance with these requirements and principles does not leave room to adjust SOPs in a way that is inimical to the industry.

B.2. Use of SOPs

The recommendation notes that the GIC is

> *"concerned the treatment of operational gas leaves scope for inefficient or poorly executed operating instructions, which may reduce any productive efficiency gains. For example, the proposal does not explain (or set principles for) how the Balancing Operator determines when and how much gas to buy and sell gas for pipeline operations, distinct from Balancing Gas. These matters are determined in an SOP and according to MDL in accordance with operational balancing agreement principles (see Appendix B).*
>
> *Similarly, the thresholds for balancing actions are set in an SOP, at MDL's discretion".*

The limits on MDL's discretion in the setting and operation of SOPs are noted in the preceding section. MDL notes that the balancing SOPs issued to the System Operator set out the actions the System Operator should take in relation to balancing the Maui Pipeline and the degree of discretion that is permissible in acting in accordance with the SOPs. These SOPs have been developed consistently with the obligations which MDL is required to perform under the MPOC which, as previously noted, impose significant limits on the level of discretion that is available to MDL. The current balancing gas SOPs are publicly available on the OATIS web-site and detail the circumstances in which balancing gas may be bought and/or sold and the thresholds that are to be applied in relation to the relevant sale and purchase transactions. Although there is a difference of opinion as to how SOPs should be issued and amended, MDL considers it is not the case that the current SOPs may lead to inefficient or poorly executed balancing transactions.

B.3. Peaking

In the Change Request, the Incentives Pool mechanism is designed to collect charges for Peaking and Excess Daily Imbalances in circumstances limited to:

- days on which a call balancing gas transaction has occurred, and;
- there is insufficient negative Running Operational Imbalance (ROI) at the end of the day across all Welded Points to allow all the costs of the call balancing gas transaction to be allocated in full to Welded Parties through the back to back cash-out mechanism.

The retention of Incentives Pool mechanism is primarily to cover the possibility of balancing costs that are not recovered under the back-to-back cash-out mechanism but also arose from MDL's intention to keep the required MPOC changes simple and incremental. At the same time MDL strongly believes that the incentive to manage hourly and daily imbalance needs to be retained so as to reduce the likelihood of socialised balancing costs.

MDL notes that the complete removal of the Incentives Pool mechanism and its replacement by new double-sided provisions dealing with peaking and transfer of title would require further MPOC changes. These would have to encompass a revised mechanism for Welded Party to Welded Party claims if it is still required. MDL has indicated that it is open to consideration of these changes.

B.4. Removal of TP Welded Party Balancing Gas

MDL does not consider the GIC's analysis of the removal of the TP Welded Party Balancing Gas mechanism to be accurate. The proposed amendment will not in fact close off an option that Vector has to manage its own pipeline imbalance. While the Change Request removes Vector's right to make "post intra-day" nominations for "Balancing Gas", Vector still has the ability to nominate gas for balancing purposes by using the standard intra-day nomination facility. MDL currently uses the intra-day nomination facility, as distinct from a "post intra-day" facility, in meeting its own balancing gas requirements for the Maui Pipeline.

B.5. Removal of TSO Imbalance

The Draft Recommendation suggests that confusion may arise in relation to balancing gas purchased for the purpose of correcting users' operational imbalances and gas purchased to manage TSO imbalance to line pack (adjusted for total user ROI) within a specified band around the Target Linepack. With respect, MDL considers the concerns raised in the Draft Submission are overstated.

MDL notes that the two types of transaction are currently handled separately under the Balancing SOPs without any apparent confusion. TSO imbalances are calculated at midnight each day and if any action is required to adjust the TSO imbalance, the TSO Imbalance transaction will usually take place at the intra-day 3 nomination cycle. The main exception to this practice is if the adjustment would be likely to force linepack over either the upper or lower band limit. In these cases no adjustment is made that day. This exception benefits pipeline users as it reduces the amount of balancing gas that otherwise might be needed to compensate for operational imbalance.

The financial information posted on the Balancing Gas Exchange (BGX) distinguishes between gas purchased or sold to maintain TSO imbalance and balancing gas purchased or sold to manage operational imbalances at Welded Points. The operation of the procedure is clear and transparent and will become an MPOC requirement once the Change Request is implemented.

Some concern was expressed in the Draft Recommendation about the handling of compressor fuel gas. Under the current SOP, compressor fuel gas is nominated and handled separately from TSO imbalance. TSO imbalance as currently calculated by MDL does include UFG however, and changes occurring in the Target Linepack as overall gas transmission demand rises and falls also affect it. The current TSO imbalance measurement is also affected by gas purchased or sold due to cash-outs following the issue of ILONs. However, ILONs will no longer be issued and this factor will go with the introduction of the back- to- back balancing under the Change Request.

B.6. Mismatch Cash-out

We note that there has been some discussion as to whether the provisions for cash-out of Mismatch are needed and whether they can be deleted from the MPOC. The criteria for MDL putting Shippers into Mismatch are set out in the current curtailment SOPs posted on OATIS. MDL considers that it is necessary to change the Mismatch cash-out mechanism to an end of day cash-out in order be consistent with the back-to- back cash-out mechanism proposed under section 12. MDL notes that it has been suggested that the Shipper Mismatch provisions should be removed from the MPOC entirely. MDL has not yet carried out a detailed investigation as to whether such a change is justifiable but is open to discussing options with Shippers and Welded Parties.

B.7. Upper and Lower Price Limits on Balancing Gas

The Change Request contains no provisions requiring MDL to set upper and lower limits for the purchase of balancing gas. MDL makes the following points:

- Upper and Lower price limits <u>are</u> necessary if the Balancing Operator has no discretion about purchasing or selling gas if the linepack threshold limits are exceeded. Otherwise the pipeline users might be exposed to very high balancing gas costs resulting from opportunistic pricing.
- There are circumstances when linepack is outside the threshold when purchase of balancing gas at any price serves little purpose. These include circumstances when it is known that linepack balance will return within threshold limits without further intervention, or circumstances where a large portion of the supply has been lost and balancing gas (and in particular highly–priced balancing gas) will provide no significant amelioration of the situation. In MDL's view these circumstances are best left to the judgement of the pipeline operators at the time.
- The balancing actions by MDL are published on the BGX and the more extreme cases are analysed in Incident Reports for all users to see.

With the ability to exercise a judicious discretion, MDL has not considered it necessary to publish upper and lower limits for balancing gas sales and purchases. Instead it evaluates the benefits arising from specific transactions at the time.

B.8. Make neither a Profit nor a Loss

The Change Request removes statements of the no profit/loss principle from the MPOC because they are considered unnecessary and because they do not match the consequences of the back to back balancing system. The reasons are as follows:

- Back to back balancing and the supplementary/residual operation of the Incentives Pool regime have been set up in the Change Request in a way which removes any ability for MDL to charge for a greater quantity of balancing gas than has been delivered at the weighted average price on the day.
- Although MDL does not expect it to happen often, it is possible that gas may be taken from, or added to pipeline linepack in cases where there is insufficient ROI to allow the full quantity of balancing gas used to be allocated to users. However since MDL is required to keep pipeline linepack, less accumulated imbalance by users, within defined limits it may have to buy or sell gas (TSO imbalance) as a result. The price at which it may do so will not necessarily be the same as the relevant cost per GJ of the balancing gas that was earlier added or subtracted from the linepack.
- This process could lead to MDL (effectively all the Shippers) unavoidably making a profit or a loss on gas added to linepack in this way. Under the current tariff arrangements these eventualities will be taken into account when the tariffs are adjusted.

MDL believes that these new arrangements provide adequate protection for pipeline users.

B.9. Pay Now, Dispute Later

These provisions are consistent with the agreement reached during the MoU process last year. MDL believes that effective balancing gas purchase agreements require reliable and effective payment provisions so that those supplying the service know that they will get paid for it in a timely fashion. This principle also has to apply to payments due to MDL as it cannot be expected to fund balancing charges in a situation where payment has been held up because of disputes. The costs of doing so are ultimately borne by Maui Pipeline users. It is MDL's experience that many disputes affecting balancing payments take a long time to resolve and where payment can be held up indefinitely there is little incentive to reach a settlement.

MDL is also prepared to support measures to ensure effective and rapid settlement of disputes.

C. Non-balancing Changes

C.1. Indemnification

In the current version of the MPOC there are provisions requiring MDL to indemnify a TP Welded Party for loss in respect of gas delivered to a TP Welded Point in the situation where:

- The Shipper, and any other party to which it sells or transfers gas does not have a valid and binding gas transfer agreement; or
- The Shipper takes delivery of gas for onward transport at the TP Welded Point and does not have a valid and binding TSA with the Welded Party at the TP Welded Point; or
- The Shipper sells or transfers gas at a TP Welded Point and does not have a valid and binding TSA with the Welded Party at the TP Welded Point.

MDL does not believe that it (effectively the Maui Shippers) should be required to provide indemnification in circumstances where agreements to which it is not a party may or may not have been made, or may have been suspended or terminated. It believes that the responsibility for ensuring these agreements are in place rests with the shippers and the Welded Party at those TP Welded Points concerned.

MDL also does not believe that this change has any particular relevance to the question of compatibility between the Vector and the Maui Operating Codes. It deals simply with the question of whether MDL should provide an indemnity for consequences arising from a Shipper's failure to become a party to a gas transfer agreement or a Transmission Services Agreement with another party.

Related, these provisions inevitably have a direct link with the MPOC balancing related obligations; it is appropriate at this time to ensure the parties that have responsibilities for imbalances have the onus *inter se* (as opposed to MDL) to take steps to more accurately address their transactions/arrangements which, as implemented, may be seen as contributing to the causes and costs of MPOC imbalances.

C.2. Order of Curtailment

This change deals with the priority to be given to AQ nominations in the event of a curtailment. MDL does not anticipate any OATIS related costs as a result because it will simply mean there will be no longer be any contracts in OATIS that are set up in a way which gives priority to nominations that are made outside of the standard nomination cycle times.

D. Evaluation of Balancing Changes

D.1. Productive Efficiency (Section 7.1)

MDL agrees with the overall conclusion of this section but there are some aspects of the argument that merit some further discussion:

- MDL can determine whether an imbalance is operational or not. The measure of non-operational imbalance (or TSO imbalance) is calculated on a daily basis. Adjustments to TSO imbalance are made by reference to a band of 5 TJ either side of the Target Linepack. Any attempt to achieve greater precision will result in the TSO buying and selling gas to chase random fluctuations in the TSO imbalance measurement, due to inherent errors in its measurement MDL has discussed the need to take account of these errors in its earlier submissions.
- If there is a need for an adjustment to the TSO imbalance in the same direction and on the same day as a balancing action, then the quantity of the TSO imbalance will be known(as it is calculated at midnight). That TSO imbalance can be subtracted from the total quantity of gas purchased or sold on the day before any allocation of balancing gas is made to pipeline users. MDL notes that if the TSO imbalance is in the opposite direction to the operational imbalance, then no TSO adjustment will be made.
- MDL has been operating this procedure for some months now. The results in terms of the TSO imbalance adjustments needed are available on the BGX web-site.
- MDL does not consider that this procedure is unfair to pipeline users and further considers that it represents a reasonable compromise that allows for measurement uncertainties and day-to-day operational reality.

D.2. Allocative Efficiency

MDL has analysed the process of making corrections for metering errors and is of the view that procedures which provide for the making of retrospective adjustments are problematic and should be avoided as much as possible. The following points highlight the difficulties that are involved in this type of process:

- Starting at the point at which the correction commences, the consequences of each subsequent balancing action would have to be analysed sequentially as follows:
    - ROI values at the time of the balancing action would have to be corrected for the consequence of the metering error.
    - The allocation of balancing gas to the pipeline users would have to be recalculated.
    - The effect on title transfers would have to be calculated.
    - This would result in a revised set of ROI values after the balancing action, which would be carried through day by day to the next balancing action, when a further adjustment for the metering error would be made and the process repeated until the point at which the calculations were being made was reached.

- Once these calculations have been completed, a "cash-out" type of adjustment would have to be scheduled, after an appropriate period of notice. This adjustment should be neutral in its overall effects but should:
  - Adjust ROIs for all affected users.
  - Adjust title tracking.
  - Result in the issue of the invoices and credit notices related to the changes in balancing gas allocations.

This type of process will likely affect all balancing actions for all parties after the initial adjustment. This is because the ROI adjustments that will be required as a result of the early adjustments will affect the results of later adjustments.

It will also likely create further difficulties at TP Welded Points as corrections for any balancing charges allocated to them will in turn have to be reallocated among the users of those points.

It is also relevant that while MDL/the MPOC requires accurate metering, responsibility for maintaining accuracy is assigned to the owners of the meters.

Metering adjustments have been a source of disputes in the past. In running a system based on real-time meter readings it is important that pipeline users are able to determine their positions easily. It is also important that if any imbalance charges are levied, they are determined from the information that was available to users at the time.

In this section MDL also notes the concern expressed about the costs of Mismatch created by the release of contingency volume. This is not a circumstance that occurs often – in fact it has not occurred in the past two years. MDL considers the concerns about MDL's determination of the Mismatch Prices are misplaced because MDL is required to set Mismatch Prices which reflect the Balancing Operator's costs of accessing and disposing of gas. (section 11.7 of the Change Request).

D.3. User Risks

MDL notes the comments in the Draft Recommendation concerning the inability to hedge positions and there being limits on balancing gas prices under the Change Request. MDL has addressed the reasons why there are no limits on the balancing gas prices in B7 above. MDL has also stated in earlier submissions that the utility of hedging on the BGX can be overstated. The BGX is a physical market and in practical terms will always only be open to parties who can supply balancing gas on the terms it requires. This means that smaller users without access to gas supplies or the ability to finely tune their own gas off take cannot use the BGX to hedge.

The larger pipeline users who can offer balancing gas into the market will still be able to protect themselves from balancing charges by offering balancing gas, although the use of weighted average pricing will mean that their hedging may not result in a perfect offset. However in MDL's experience the preference of these companies to date has been for the more favourable balancing charges resulting from weighted average pricing, rather than the higher prices that may result from marginal pricing (although the latter can be more perfectly hedged).

The question of budgeting for balancing costs, as distinct from collecting the costs through Tariff 3 is rather more complex than set out in the Draft Recommendation. MDL's budget for balancing gas has to be set in advance of the year that those funds are applied to. Since additional money is unlikely to be available or difficult to obtain once the year has started, balancing gas budgets have to take some account of the worst case outcomes that may occur during the year. This can lead to over collection through the normal tariff mechanism. The proposed monthly Tariff 3 billing process is designed to eliminate any under or over-collection by matching the amount billed to users as closely to the actual expenditure as possible. It will also provide a useful gauge as to whether the current system of balancing is working appropriately in terms of allocating balancing gas costs to causers.

E. Costs

E.1. Agreement Cost

MDL disagrees with the score of -1 allocated to agreement costs. These costs appear to relate principally to costs associated with consulting on the SOPs and associated changes. Given that the GIC's preference seems to be for an even more extensive process in relation to the SOPs, it is difficult to see how that preferred approach would be any less expensive.

E.2. Implementation Cost

MDL notes that it does not anticipate OATIS costs associated with the changes in nomination curtailment priority. MDL does not think the score of -2 allocated is justified given that implementation costs will be minimal. Given that the TP Welded Party has never sought to utilise the post intra-day facility to make Balancing Gas nominations to balance its pipelines since the introduction of the Open Access arrangements on the Maui Pipeline and the fact that the ability to make retrospective adjustments to Scheduled Quantities interferes with the efficient operation of a back-to-back cash-out balancing regime, the benefits of the changes far outweigh the costs. Further, to address the GIC's concerns, MDL believes that there are straight-forward solutions available to facilitate the TP Welded Party's access to balancing gas without the needing to utilise the problematic and inefficient retrospective mechanism.

F. Governance

F.1. Transparency and Non-discrimination

Separation of balancing and operational gas is a matter of concern in this area. MDL covers this procedure in Section D.1 above and also notes that the results will be transparent as they will be published. Nevertheless it appears that some further explanation of the separation of balancing and operational gas should be included in the SOP when it is next revised.

F.2. Enforcement

MDL is currently owed a considerable sum in relation to unpaid ILON cash-out and Incentives Pool charges. MDL has not been paid due to a number of disputes downstream of a TP Welded Point. The particular TP Welded Party claims that it is not required to pay MDL until the TP Welded Party receives payment from its customers. While MDL disagrees with the TP Welded Party's position in relation to payment obligations, it also has no control in relation to the progress and resolution of the related disputes. Therefore, MDL believes that orderly and rapid processes for resolution of disputes are needed if the balancing system is to work effectively. MDL believes strongly that further work in developing an improved system for resolving disputes is needed.

G. Conclusion

MDL agrees with the GIC's conclusion that the Change Request should be supported.