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12 February 2010

Attention: Ian Wilson

Gas Industry Company Ltd
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WELLINGTON

Dear Ian

Draft Gas Governance (Balancing) Rules (Updated @ 15 December 2009) (*draft rules*)
Some Issues – 12 February 2010

Maui Development Limited (*MDL*) refers to its letter to Gas Industry Company of 2 February 2010 in which, among other things, MDL drew attention to the serious concerns which it has about Gas Industry Company's proposed process and timeframe for consultation and submission in connection with the draft rules. In that letter MDL also recorded that it would participate in the Gas Industry Company scoping discussions of draft rules.

This paper is intended to record some issues which appear to be material in connection with the draft rules. Some of these issues were discussed at the various workshops held by the Gas Industry Company last week. The paper is by no means comprehensive: further matters will certainly come to light.

MDL understands that Gas Industry Company is currently considering a number of amendments to the draft rules as a result of feedback received on them at the workshops. In MDL's view the workshops illustrated that the draft rules, as they stand, have serious problems of conceptualisation and drafting and are not capable of being implemented in their present form. If, after consideration, Gas Industry Company decides to continue this process then the draft rules need significant revision and new rounds of consultation. In the expectation that the draft rules will be significantly revised, MDL has decided to make its detailed comments in the next draft once MDL has had the opportunity thoroughly to review the new draft, and to discuss it with Gas Industry Company and other industry participants. MDL will give those comments to Gas Industry Company, and to other industry participants, when they are complete

MDL is firmly of the view that no regulatory intervention is necessary or appropriate in respect of residual balancing. Nonetheless, as always, MDL's efforts in considering and commenting on the draft rules are directed to ensuring that any regulatory intervention concerning the balancing of the Maui Pipeline, or the transmission system generally, is sensible, implementable and, once implemented, workable.

Separating the Wheat from the Chaff

Background

In MDL's view the workshops last week emphasised what has been clear for some considerable time, namely:

(a) that the industry does not consider that the draft rules do, or can, deal with the key issues which actually relate to the balancing of the Maui Pipeline and/or of the Vector transmission system;

(b) that the industry does not consider there is any need for regulatory intervention (participative or otherwise) in respect of residual balancing as a single issue;

(c) that the industry does not believe that such regulatory intervention can be justified on a cost benefit analysis, or is justified by the cost-benefit analysis (such as they are) provided to date.

The workshops were remarkable for the disparity between the issues which the industry believes ought to be addressed (and in respect of which some regulatory intervention might be justified) and those actually addressed by the draft rules. As a result, much of the discussion at the workshops was, strictly, "beside the point". In MDL's view, this is not the industry's fault. In MDL's respectful view it would be unwise for Gas Industry Company either:

(a) to continue to pursue work streams in which the industry has little interest; or

(b) to seek to adapt the current residual balancing work stream, or the draft rules, to deal with issues beyond their respective scope.

Points of Concern

Two key issues which, in MDL's view, do need to be addressed in order to progress the industry's "reform agenda" are:

1. The lack of a means of identifying, downstream of a TP Welded Point, the imbalance attributable to a particular potentially liable user. This implies that each of the following elements is required:

    (i) a nomination, profile or other periodic (say, daily) gas scheduling system applicable to all potentially liable users;

    (ii) a metering or other measurement or allocation methodology which is accurate and the results of which are virtually immediately available; and

    (iii) the availability to potentially liable users of information derived from these inputs in or near real time.

2. Lack of access to the information required for balancing and, to some extent, to balancing tools. This is, materially, a consequence of 1 above.

The Role of a TSO

There is an apparent desire, on Vector Transmission's part:

(a) not actively to balance gas flows within its own transmission system as against "demand follow"; but

(b) to eliminate or reduce its obligations as an interconnected party at a TP Welded Point while, at the same time, not organising, managing or taking responsibility for the behaviour of its customers on its own transmission system.

In MDL's view the proper role and function of a transmission system owner needs to be settled upon: currently this is a major cause of confusion and delay in dealing with the *Points of Concern* noted above and with many other issues.

If regulation is required on a particular transmission system then so it be.

Legacy Contracts on the Vector Transmission System/Regulation to Abrogate Contracts

These legacy contracts have not been disclosed but appear to be a significant obstacle to achieving industry objectives on the Vector transmission system. In MDL's view, there are real risks that parties to these contracts will:

(a) on the one hand, seek to preserve existing rights while designing a residual balancing scheme which reduces or eliminates their exposure to the imbalances which result; and

(b) on the other, use regulatory means to abrogate the legacy contracts for private benefit.

Vector Transmission is clear that it requires regulation to abrogate these legacy arrangements. Vector Transmission's candour in this respect is of some assistance. Unfortunately, though, the terms and effects of these legacy contracts have not been disclosed. This makes it impossible for others in the industry, or for Gas Industry Company, to form a view as to whether public (as against merely private) benefits would arise from doing so. In MDL's view, Gas Industry Company must be vigilant to ensure that neither the draft rules nor a Balancing Plan will have an unintended, and unanalysed, effect in this regard.

Scope of the Draft Rules

The scope of the draft rules is, despite the purpose statement, strictly limited to residual balancing. In MDL's view, Gas Industry Company must not adapt the current process to deal with issues that are out of scope (albeit that, in MDL's view, far more important issues urgently need to be dealt with). To adapt the current process would be a material distortion and misuse of Gas Industry Company's process to date, and would be contrary to the Gas Act. In MDL's view, Gas Industry Company should be particularly careful to ensure that the scope and ambit of the Balancing Plan is limited to what is required for residual balancing.

Succinctly, in MDL's view the draft rules, and the residual balancing process, should be abandoned, with improvements to the balancing regime being left to code-based development. Rather, Gas Industry Company should identify and locate the key issues which have to be addressed, see above, and deal with those.

Some Material Issues Arising Out of the Draft Rules

1. Potential Damage to Balancing Market

- The balancing market, which has been principally developed by MDL, is relatively illiquid. It is possible that opening the market to suppliers off the Maui Pipeline will improve liquidity but a number of factors (apart from the draft rules), including the lack of relevant information on the Vector transmission system in real time (for example as to imbalances on that system, and the performance of balancing obligations) and that the number of balancing actions is relatively low, will affect the development of that market.

- The nascent balancing market will potentially be damaged by the draft rules by:

  - the "pay-when-paid" condition (R18.1.3) which passes the credit risk of unknown user principals to balancing service providers. While R18.1.3 is optional, practically the design of the draft rules makes it virtually certain that the condition will be included in the relevant terms and conditions since, otherwise, the balancing agent will have to assume credit risk and, thus, will itself have to be creditworthy;

  - the likelihood that balancing service providers will set the price of call balancing gas at, or at close to, the relevant cap because of the "pay-when-paid" condition – which will result in something of a "false" market;

  - the definition of the "clearing price" and the possibility that balancing service providers will be paid, or will pay, different gas prices depending upon the incidence of transmission charges – leading to price uncertainty;

  - limiting the balancing market to a spot market and, then, to a market where delivery of the balancing service is required as quickly "as is reasonably practicable" after the creation of a balancing transaction. The balancing period is not described in the draft rules but, at least in principle, balancing transactions should be entered into having regard not only to pipeline conditions, but also the length (or remaining length) of the balancing period;

  - the capping (at both higher and lower bounds) of the prices payable for balancing gas:

    – limits range of prices possible in the balancing market, and thus may exclude potential balancing service providers;

    – confuses the upper and lower balancing thresholds with the relative thresholds for critical contingencies. By definition, in a critical contingency "real" contingency prices will be determined and there is no need for the pre-estimates;

    – requires the balancing agent to estimate prices where those estimates will not be credible and will, in fact, be no better than guesses. This will distort the market;

- is inconsistent with "causer-pays" since the costs, whatever they maybe, will be the actual costs. What justification is there for deviating from policy?

- is effective only to create cross-subsidy since those actual costs are likely to be incurred anyway (but socialised) - because R15.3 will apply and, if reasonable and prudent in the circumstances, the balancing will have to be undertaken by the transmission system owners anyway in order to comply with their codes;

- suggests that Gas Industry Company does not believe that the prices in the balancing market will be credible.

- R17 provides for the balancing agent to go outside the balancing market, but:

  (i) the circumstances in which that can occur are ambiguous in that, among other things, the balancing market could not, on its own, ever meet the purpose of the draft rules as provided by R17.1;

  (ii) despite the heading, there are no rules for balancing transactions undertaken outside the balancing gas market: not even that (for example) the terms and conditions are published, or that transactions are competitive;

  (iii) there is no "appeal", which means that the balancing market may practically be placed "off limits" to the balancing agent as and when Gas Industry Company so wishes.

- As explained elsewhere in this paper, the transmission system owners will need always to "stand ready" to balance their respective transmission systems irrespective of any residual balancing undertaken by the balancing agent. Transmission system owners also need access to a balancing market or markets for this purpose. The damage which is likely to be done to the balancing market by the draft rules will result in the creation of a two-tier market: one, which can be accessed by the balancing agent, and (in theory, but not in practice) by the transmission system owners; and a second, which can be accessed only by the transmission system owners. The result is likely to be illiquidity, limitations on the kinds of balancing services available through balancing markets, and balancing costs which are higher than is necessary.

2. A Muddle of Agents

- The balancing agent:

  - is practically, and probably legally, the agent of the transmission system owners by virtue of appointment under R28.1.1(a) and R29.1;

  - is practically, and possibly legally, the agent of Gas Industry Company by virtue of:

    - being approved as such under R32 and R28.1.1(e) and Schedule, A;

    - being subject to dismissal under R39.1.2;

- is practically, and probably legally, the agent of Gas Industry Company by virtue of appointment under R42.

- is the agent of each user in connection with the "Management of linepack" under R15.4.

- An agent is a fiduciary and:

  - must not have conflicts or mixed loyalties: in fact they will abound under the draft rules;

  - must strictly observe and perform the terms of its appointment;

  - must not profit from the appointment, except if and to the extent the principal has given informed consent. The users will never give such consent. The transmission system owners will not give such consent where the balancing agent is appointed by Gas Industry Company. Note: in each case the agent is appointed by contract not the draft rules.

- Third parties will be reluctant to take on the position absent stringent terms and conditions and assurance:

  - for the reasons noted in the previous bullet points;

  - because, if appointed by the transmission system owners, the balancing agent is subject to dismissal without cause by Gas Industry Company.

- Principals commonly have two sets of liabilities in respect of a transaction undertaken within the scope of its authority by an agent:

  - to the agent, by way of indemnity;

  - to the counterparty to the contract.

  In this case the indemnity of the user principal to the balancing agent, at least as to money, appears to be limited by R15.5 but:

  – the user principal's liability to the balancing agent in respect of other aspects of a balancing transaction is not limited;

  – the user principal's liability to the counterparty to the balancing transaction (ie the balancing service provider) is not limited except by the terms of the transaction itself. The user principal does not set those terms.

- User principals will be liable for certain balancing agent operations:

  - despite the balancing agent having been appointed either by the transmission system owners or by Gas Industry Company;

  - despite the terms and conditions of those appointments having been determined by the appointers not by the user principals;

- despite the user principals having no means to exercise management or control of the balancing agent in any relevant part;

- despite the balancing agent being required to exercise its functions independently – R14.

- If the balancing agent is appointed by the transmission system owners then it is likely (R29.1.2) that the transmission system operators will have to indemnify the balancing agent including, apparently, against costs which would otherwise have been payable by the user principals: see paragraphs (a) and (b). As a result:

  - liabilities will be duplicated (possibly on a several basis so that they will have to be valued and costed by each liable party);

  - transmission system owners may be liable for the defaults of users who are not their customers (and with whom they have no relevant contract or prudential assurance) or for defaults which occur on a transmission system other than their own;

  - transmission system owners will bear the costs associated with the balancing agent's operations without being in a position to manage and control the balancing agent in respect of those operations.

- Whilst conceptually the transmission system owners may require a balancing agent itself to be credible and creditworthy, the transmission system owners cannot do so in circumstances where the balancing agent is appointed by Gas Industry Company. Nonetheless, in both cases, the actions of the balancing agent could result in significant liability for transmission service owners or, presumably, the industry by virtue of the Gas Industry Company indemnity. It is unsatisfactory that liable parties have, apparently, no means of redress against a balancing agent for poor performance of its role.

- The audit procedure set out in Part 4 is of little value to the industry unless it is coupled with remedies against the balancing agent, including termination.

- It is not at all clear that there is any need for the balancing agent to be an agent at all – see 3 *Balancing Operator* below.

- Transmission system owners will have to "stand ready" to balance at any time because:

  - they will (in MDL's case) and may (in Vector Transmission's case) have an obligation, as a reasonable and prudent operator, to provide a contracted service to customers;

  - the balancing agent may fail to perform its residual balancing obligations;

  - the balancing agent may be unable to obtain balancing services from the balancing market – see R15.3.1;

  - the balancing agent may be precluded from selling or purchasing balancing services by virtue of the price caps – R16.6;

- a code may impose an obligation on a transmission system owner to provide a quantity of gas for pipeline management or other services; an example is the provision of the contingency volume under MPOC;

- a transmission system owner is, anyway, obliged to endeavour to balance – R6.1.

This implies:

- the transmission system owner will itself carry out the stand ready balancing function, or appoint somebody else to do it;

- codes will continue to contain balancing provisions.

It is highly likely that the result will be inefficient. It would be unwise, perhaps unworkable, for transmission system owners to appoint either more than one balancing agent or one person to carry out two different balancing functions.

3. Balancing Operator

- For reasons of the kind described at 2 *Muddle of Agents* above, a person appointed to exercise the balancing functions contemplated by the draft rules need not be, and should not be, an agent.

- The balancing agent created by the draft rules should act as a principal as regards all users and all counterparties. This implies:

  - that the appointed person is technically and commercially capable and appropriate and is financially creditworthy;

  - that the appointed person is liable (up to some material but sensible limit) for the consequences of its own behaviour, including by way of indemnification of a transmission system owner who is liable to a customer for a failure to provide a service caused, or contributed to, by the balancing agent;

  - that the appointed person, and all users, need to establish and maintain prudential assurance to support their respective obligations.

- The appointment of a person to perform residual balancing functions under the draft rules also requires a careful delineation and attribution of roles and responsibilities, as between the balancing agent and respective transmission system owners, in respect of the performance or delivery of transmission services. In particular:

  - transmission system owners' respective responsibilities and liabilities will, notwithstanding residual balancing under the draft rules and the appointment of the balancing agent, be defined with respect to, and confined to, their own transmission system for obvious reasons, including that their own "stand ready" balancing function can only be performed on their own transmission systems;

- transmission system owners and users on the relevant transmission system will need to find a fair means of distributing responsibility and liability for the performance and delivery of transmission services;

- in principle at least, users will need to have a direct right against the balancing agent.

These requirements follow necessarily from the scheme established by the draft rules. They are likely to:

- wastefully create additional costs which will have to be recovered from users;

- unnecessarily create co-ordination risks which may impact upon security of supply;

- have the effects on the balancing market noted at 1 above;

- add complication to the open access transmission regime generally and, possibly, adversely affect investment dependent upon that regime.

4. Confusion of Purpose

The purpose of the draft rules is set out in R3.

- The statement in R3 is ambiguous and, potentially, at such a high level as to be of limited use as a purpose statement anyway. For example:

  - use of the term "unified" suggests that more than one element has to be considered whereas, in fact, each balancing zone is managed separately some directly, some indirectly;

  - there is only one balancing plan, so it cannot be "unified";

  - there is only one balancing agent, and apparently only one relevant function.

- The use of the term "efficient" is also ambiguous:

  - what kind of efficiency is provided for?

  - does the efficiency test extend to, say, the Gas Industry Company's activities?

  - what is the "arrangement" under review?

    - is it the arrangement that is required to be efficient;

    - is that arrangement required to have efficient outcomes; if so, why not say so?

- The draft rules do not, on any basis, manage "imbalance in the transmission system" (imbalance is any deviation from matched flows):

  - the draft rules provide for the management of imbalance above or below specified thresholds - this has been called residual balancing;

- the draft rules provide for the management of residual imbalance within balancing zones not the transmission system.

- The purpose statement is "over-extended"/poorly utilised in the draft rules. For example:

  - how can the balancing market meet the purpose of these rules? see R17.2;

  - the terms of appointment of a balancing agent are required to be "not inconsistent with these rules" – is this a reference to R3 or not? If it is not, why have a different test?

  - the contents of a draft balancing plan are required by R30.1.2 to be consistent with the purpose of the draft rules "including by containing processes and procedures that support a unified regime for balancing the whole transmission system". The quoted phrase is neither the purpose as stated in R3 nor what is provided for by the draft rules;

  - the balancing agent maybe dismissed or "failing to carry out its functions in accordance with these rules". Is this a reference, or does it include a reference, to R3? If not (or not only) why have a different test? What rules are contemplated by R39.1.3? What if the balancing agent is carrying out its functions in accordance with the terms and conditions of its appointment and the balancing plan?

- The function of the balancing agent is described in R13.1.1 as being to "manage the linepack of the transmission system" whereas the draft rules merely provide for the balancing agent to carry on residual balancing actions. Other balancing is plainly left to transmission system owners. The stated primary function is inconsistent with the purpose of the rules.

- Moreover, R13.1.1 will create confusion as to who is responsible for providing gas transmission services. R13.1.1 will prevail over any inconsistent provisions of transmission codes or contracts.

- MDL doubts the value of any purpose statement being included in the draft rules. Rather, MDL believes that each relevant decision, behaviour or activity in the draft rules should be:

  - tested against, or justified by reference to, a set of principles, objectives or requirements that are designed for the particular purpose;

  - subject to consultation where material;

  - where material, based upon, and given for, publicly stated reasons; and

  - subject to an appropriate form of overview, review or "appeal".

5. Balance and Imbalance

- R6.1 is, potentially, of critical importance (and, as a behavioural requirement, is supported by MDL) but is possibly "toothless" because:

- it is only a “reasonable endeavours” obligation;
- there are no consequences for imbalance except if and when a balancing action occurs;
- there are strong commercial incentives on users to exploit imbalance (possibly even when a balancing action occurs) because all or a portion of the imbalance gas, and of the flexibility imbalance provides, is free; and
- when balancing services are not available (R15.3.1) or cannot be accessed because of the price caps (R16.6) there are no remedies for imbalance at all, unless provided for in a code – in which case the cost is likely to be borne differently from what is prescribed by the draft rules.

- How can a shipper or a trader “ensure” that quantities or flows of gas match?
- Given that it is the “allocated” gas that must match, how can a shipper or trader seek to perform its obligation during a balancing period if allocations are made only at the end of, or after the end of that period?
- How can a transmission system operator meet its obligations when:
  - it does not know the balances allocated to other users until after the end of a balancing period;
  - it is responsible and liable for the balancing agent’s inaccuracies and/or decision to go “close to” but not to a threshold;
  - it must allow for UFG which can only be quantified at the end of a period;
  - it may, unexpectedly, be called upon if the balancing agent is unable to obtain balancing services (R15.3.1) or is unable to access the balancing market because of the price caps (R16.6).
- In MDL’s view, a transmission system owner should only be required to balance within a specified or determinable quantity of the relevant target, and then over a specified or determinable period.
- How can a transmission system owner calculate the amount of linepack “owned by it” where a balancing zone crosses two transmission systems?
- The draft rules are confused about allocation, the effect of allocation as regards the costs of particular balancing actions, the attribution of those costs to particular imbalances, and the balancing period. It is not possible on the one hand to say that the draft rules will respect and adopt the balancing periods determined in the balancing plan and, on the other (in paragraph E (a) (i) and E (b) (ii) (A) of the Schedule to the draft rules) that imbalances must be determined, and costs attributed, at the time the balancing actions occur.

- MDL notes if paragraph E of the schedule to the draft rules is to be given effect, then transmission system owners will be required to create, give effect to and operate an allocation system which determines imbalance at any moment and instantaneously, as against the end of the day as is currently the case for most purposes. This would be very expensive both initially and to operate

- MDL also notes the longer the balancing period:

  - the more random the attribution of balancing costs to those who actually contributed to the balancing action;

  - the more likely that balancing costs will be unallocated;

  - the greater the impact of averaging on balancing costs;

  - the more complex the balancing agent's job in allocating balancing costs becomes.

  If the intention of the draft rules is that potential users be incentivised to balance, the effect of all these factors is to dampen that incentive.

- Similar issues arise with imbalance.

6. Title

MDL wishes to understand how, conceptually, title is dealt with under the draft rules. Questions include:

- Given that, under the Primary Allocation Agreement, shippers (and, MDL presumes, traders) will have title to the quantity of their Approved Nominations how can title to gas comprised in a balancing action pass to or from them so effectively as to vary the Approved Nomination after the event?

- The transfer of title to gas acquired in a balancing action to an interconnected party would eliminate only part of that interconnected party's Operational Imbalance. How will an interconnected party give title to its shipper customer to the balance of that Operational Imbalance if the Operational Imbalance is not reduced to zero?

- The draft rules require adjustments to allocations made under the codes. What adjustments are contemplated:

  - in respect of a shipper or trader, given that each of them was allocated its Approved Nomination;

  - to interconnected party, given that it's "allocation" is by reference to its Operational Imbalance at a particular Welded Point. This is not so much an allocation but rather the quantification of an imbalance.

- R19.4 provides for title to pass at the time of a balancing action. The discontinuity between the passing of title and payment evident in this rule is logical given that the balancing service provider may not be paid at all, or in full, for the gas which it provides.

- How will title to gas be tracked given that it will pass during a balancing period rather than, for example, by specific allocation at the end of that period?

- Given R19.4, why is a transmission system owner's imbalance calculated having regard to whether or not balancing gas which is allocated to it has been paid for – see, for example, imbalance (vi) (C)?

7. Loss of Participative Option

Gas Industry Company has, according to the documents which it has produced, selected the participative option over others because of the additional value that the participative option adds to the regulatory method.

- Despite this R41.1.3 revokes the participative option if the industry body appoints a balancing agent under R42:

  - the circumstances in which Gas Industry Company may dismiss a balancing agent appointed by transmission system owners are all of poorly specified; non-transparent; and un-appealable; and a case of the industry body acting as prosecutor, judge and jury. In MDL's view the participative option should not be lost in those circumstances;

  - conceptually, MDL does not accept that the participative option should ever be lost (even were the circumstances in which that occurred were regularised). If the participative option has the value attributed to it by Gas Industry Company then the industry should always retain the right to resort to it going forward that is to say, displace the Gas Industry Companies' balancing agent and balancing plan. Otherwise what curb is there upon the regulator?

  - MDL has already pointed out that, given Gas Industry Company's requirement that transmission system owners agree a balancing plan and that one of the transmission system owners prefers a fully regulated outcome for its own commercial reasons, the benefits attached to the participative option by Gas Industry Company are likely initially at least to be illusory. However, that may not always be so.

8. Power of the Regulator

- As mentioned above, Gas Industry Company has attributed significant benefits to the participative option. MDL is concerned that the participative option can be revoked and lost without cause shown; non-transparently; and without appeal

- The draft rules exclude users and empower the Gas Industry Company in many other situations that are obviously, or potentially, of considerable importance. These include:

  - closing and reopening the balancing market; R17

  - approving a balancing plan; R32.1

  - approving amendments to a balancing plan; R36.1

  - dismissing a balancing agent; R39.1.3

- determining the identity and terms and conditions of a substitute balancing agent; R42 and 43;
- approving Gas Industry Company's own balancing plan; R45
- approving its own amendments to its own balancing plan; R48;
- determining the costs included in fees charged to the industry; Subpart three.

- Sometimes Gas Industry Company is required to give reasons for its decision. However, those decisions are not required to be made (or requisite opinions formed) transparently or by reference to any objective list of criteria; they are not appealable or subject to third party overview; they can be made in circumstances where Gas Industry Company is clearly conflicted; and, almost always, they will have material or potentially material downstream effects.

- In MDL's view allowing a regulatory body power to this extent and kind is inconsistent with good regulatory policy.

9. Differences Between Transmission Codes

- R30.1.4 requires the balancing plan to be consistent with transmission codes except to the extent necessary to comply with the draft rules. There are significant conceptual and operational differences between the two current codes. MDL notes:
  - wholesale changes will need to be made to one or both of them, and there are no guidelines or rules as to how this should be done;
  - the rules themselves are unclear in certain respects (as other parts of this paper show);
  - the process will be time-consuming, and expensive;
  - Gas Industry Company is not in a position to require amendments to the codes should it make an approved balancing plan.

- Despite the differences in the codes transmission system operators are required, for example, to provide assistance or resources in various ways – see R8.1, 8.2, 9, 10 and 11. In MDL's view, these obligations tend to go far beyond what, practically, is possible given, among other things, that:
  - the balancing agent is required to act independently – R14;
  - there is no obligation on the balancing agent to cooperate with the transmission system owner;
  - a transmission system owner may be required itself to balance under its own code;
  - a transmission system owner simply cannot know the position and/or requirements of any particular user at any time, let alone a user on another transmission system;

- certain services (for example, information and balancing tools) simply are not available to parties connected to the Vector transmission system for reasons that are exclusively the concern of, and in the control of, the owner and users of that system; and

- no compelling justification has yet been given for users in one balancing zone to be entitled to access balancing tools available in another, reliance upon *force majeure* being a good example.

10. Transmission System Owners' Indemnity for Development and Ongoing Fees

- The balancing agent will undertake balancing actions for, and for the benefit of, users, rather than transmission system owners as such. The costs associated with doing so (including development and ongoing fees) should be recovered from users as a group, or on a causer-pays basis, as is appropriate.

- Transmission system owners, as such, are excluded from the balancing regime provided for by the draft rules and should not be required to pay for it. There is no certainty that those costs can be recovered by transmission system owners whether under their contracts with their customers (which are limited to the customers of their particular transmission systems) or under separate regulatory processes and decisions.

- Transmission system owners should not be required to indemnify any party where it is not in a position to control and manage that party's behaviour. Moreover, the party indemnified must owe obligations to the indemnifier to conduct its activities efficiently and accurately, and should be liable (or not indemnified) where that is not the case.

11. Interplay Between Transmission System Owner and Balancing Agent

- The rules create a tiered system where:

  - the transmission system owners manage and balance linepack by reference to the target;

  - the balancing agent manages residual balancing;

  - the transmission system owner is, practically, required to balance or curtail when either the balancing agent cannot obtain balancing services for its residual balancing function or those balancing services are available at prices which exceed the relevant maximum or minimum.

  This combination will require effective management as between the transmission system owners and the balancing agent, and will inevitably duplicate costs since both parties will need to maintain the resources required for the tiers of activity.

- Transmission system owners may be in imbalance:

  - because of random daily UFG fluctuations, which can only be determined at the end of a balancing period;

  - because of errors and inaccuracies of, and decisions made by, the balancing agent – see further below;

- ➢ because the balancing agent cannot or fails to residually balance – see further below;

- ➢ for unallocated quantities – R19.3;

- ➢ because of other users' imbalances, which will only be determined at the end of the relevant balancing period.

As a result, transmission system owners:

- – will not be in a position to manage their own imbalances before they are determined;

- – thus, will not be able to use balancing tools available to other users

- – thus, will not be in a position to control the costs which they incur in respect of balancing actions;

- – cannot themselves buy and sell gas which result from balancing actions: this, for some reason, being left to the balancing agent, R23.

- In addition, the indemnity described in R29.1.2 would, on the face of it, make the transmission service operator responsible (as some type of surety) for other users' balancing charges and for the settlement of balancing transactions even though:

  - ➢ the transmission system owners do not manage or control those liabilities;

  - ➢ the users and counterparties may have no, or not relevant, contractual relationship with the transmission system owners;

  - ➢ the transactions concerned may occur on another transmission pipeline.

- The transmission system owner's risks in respect of imbalance are greater because the transmission system owner (not the balancing agent) is responsible for any imbalances that arise because:

  - ➢ the amount of gas purchased by the balancing agent under R15.1.1 is greater or lesser than the amount required to return the linepack to a threshold;

  - ➢ the balancing agent may anyway elect only to go "close to" the threshold;

  - ➢ by virtue of R15.3 (and, by implication, R16.6) the transmission system owner's imbalance would include the quantities of gas which the balancing agent is unable to acquire for residual balancing purposes.

Conclusion

If it is of any assistance, representatives of MDL would be willing to meet with you to discuss the concerns that MDL has raised in this letter.

Yours sincerely

Murray Jackson
Maui Development Limited