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MPOC Change Request (MBB) 10 October 2014

Trustpower thanks Gas Industry Co (GIC) and Maui Development Limited (MDL) for the opportunity to submit on the Maui Pipeline Operating Code (MPOC) amendment. Trustpower recognises the significant time that MDL has spent attempting to overcome some of the inefficiencies in the current Balancing regime. We accept that the issues that MDL is attempting to correct are real, and warrant attention, however disagree that the current change is an improvement over the status quo, as there will be significant inefficiencies imposed upon downstream gas users which appear to not have been considered. The proposals seem to be focussed on improving inefficiencies for large upstream participants, at the expense of downstream parties, most of which are small with limited ability to manage imbalances.

There is often reference to the international best practise, particularly around the EU rules. In our experience the EU market is significantly different to the New Zealand Gas market. The EU has a larger number of participants, and several means of providing flexibility for gas offtake which can be traded easily and efficiently on the intraday gas market. New Zealand has only recently introduced a gas market, which includes an on the day market, but there is frequently no bids or offers posted. Over the last 13 months the volume executed on the On the Day market has accounted for only 2.6%[1] of all volume, whilst in Europe significant volume trades in the On the Day market. Until participants can have sufficient confidence that there is sufficient liquidity in the On the Day market for them to manage their imbalances and discover an efficient market price, this proposal needs to be deferred. The current proposal appears to force participants to manage balancing on an exchange that currently does not offer sufficient liquidity, whilst taking away the flexibility needed to manage imbalance.

We are of the opinion that Balancing will remain an issue in New Zealand until such a point that there is either a significant change in the nature of offtake contracts, or an increase in storage flexibility which this proposal appears to restrict. The gas market is dominated by offtake arrangements which are typically inflexible, with field production capabilities dictating supply, and limited ability for demand side to request variation. Parties with no means of storage are often

[1] For the period 24 October 2013 until 19 November 2014

forced into imbalance as there is currently no credible means to manage imbalance as parties often have a similar imbalance position. For example over low demand periods most parties are typically over supplied, and unwilling to procure gas, meaning there is no means to manage imbalance. As highlighted in the Covec report[2] the Maui Pipeline currently acts as a park and loan facility though the balancing market due the high level of spare capacity. Whilst there are some obvious inefficiencies, particularly how the park and loan facility is priced (indirectly through the incentive pool charges), the point remains that the Pipeline still offers the most economic means for participants to manage their imbalance position. Before balancing becomes more onerous on participants there need to be a clear means to allow participants to manage imbalance. This could be through a market mechanism, which requires high liquidity, or through the pricing of a Park and Loan facility on the pipeline.

Trustpower understands the direction that the proposed amendments are taking; however believe that the industry needs greater certainty that there will be volume on the market, as this has been limited to date. We also need confidence that MDL will use the market in preference to the BGX. This has not happened to date, with many cash outs allowing selected BGX participants a significant arbitrage across the platforms. Further to this the proposal ensures that the price is the most extreme price discovered from BGX transactions and the VWAP of the Market Trading platform. This provides little comfort that prices will be an accurate reflection of imbalance costs as participants will be cashed out at the most extreme price countering their position, not the actual cost to the pipeline operator. Our understanding was that the Pipeline Operator exercised discretion when deciding whether to procure balancing services to ensure that the illiquid balancing market did not send a distortionary price signal. This proposal removes any such protection to the industry, further increasing the costs faced by participants for balancing services. In our view all balancing should be executed through the Market Trading platform, to ensure that all participants have some control over the price of imbalance they will face. Once these concerns are addressed, then participants can have confidence that the imbalance price will be a fair and reflective cost of imbalance.

This change cannot be considered in isolation and it will further stress imperfections in the allocation process. Currently the market penalises participants for imbalance with a cash settlement based off initial submissions or estimates, but with no wash up as better balance information is gathered in subsequent submissions. Participants are returned gas that was incorrectly allocated, but there is no return for the financial penalty incurred. This provides a distortion in the market, and inefficiencies in the way gas is allocated across participants, particularly participants with non-telemetry data. To provide the certainty required in any market, there needs to be clarity around price and volume, and efficient allocation of penalties, including the wash up of penalties incorrectly allocated by the initial reconciliation cycle.

Before this proposal is implemented Trustpower believes there is still more work to be undertaken to ensure that participants have sufficient information and means to manage their position to the same granularity as balancing will be undertaken. Since Trustpower has entered the gas market in 2013, we have invested significant time and effort to manage our imbalances to ensure that we have as minimal impact to the pipeline balance. It appears that there has been limited consideration to the costs that this will impose on the downstream gas industry, and their customers. Whilst it is believable that solving balancing issues may reduce the cost of supplying gas from a field, the burden has been shifted to the participants with the least ability to manage imbalance. Shippers with limited flexibility and inelastic demand will be at the mercy of the market with no means to manage moderate deviations, increasing costs to their customers.

Trustpower supports efficient economic changes to market rules, however we struggle to see the benefits the current proposal will have to downstream participants, and believe more work needs to be taken that encompasses both up and downstream gas market players, to ensure that risks are correctly allocated to the participants with the best means to manage them. Failure to do this will impose significant costs to the industry, and ultimately end users.

This proposal currently represents a significant change to the operation of the New Zealand Gas market, increasing the risk to downstream participants and new entrant retailers, and participants need to be given significant lead time before any change is introduced. For a change of this magnitude at least 6 months would assist in keeping costs to a minimum, and allow participants to prepare for the increased risk.

For any questions relating to the material in this submission, please contact me on 07 572 9888.

Regards,

CRAIG SCHUBAUER

WHOLESALE MARKET MANAGER