

14 May 2010

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Dear Ian,

**Cross Submission on Transmission Pipeline Balancing Supplemental Paper to the 2009 Statement of Proposal**

Nova Gas has reviewed the submissions made by other participants and wishes to make the following comments in response to matters raised in their submissions.

**Genesis Energy**

- 1) Genesis submits that the proposed rules would improve existing governance arrangements by creating incentives for more constructive and effective negotiation between the TSO's and provide regulatory oversight and a regulatory backstop for balancing arrangements.

Nova comment: MDL and Vector appear to have significant differences in their views regarding many issues including balancing arrangements. This polarisation is likely to lead to the GIC having to impose a regulatory solution that conflicts with the preferences of either or both MDL and Vector and as such will be fraught with difficulty and risk.

The Gas Industry already maintains oversight over industry arrangements and retains the ability to impose a regulatory solution should it be necessary such as when the benefits or a regulatory solution are greater than the costs.

- 2) Genesis states that "on the basis of the cost-benefit analysis included in the consultation paper it is reasonable to expect that there would be a net benefit from implementing the rules as proposed."

Nova comment: Genesis comment "on the basis of the cost benefit analysis..." indicates a reliance on that analysis in their support of the regulatory proposal despite the significant shortcoming identified by a number of participants including Nova in that analysis, namely the lack of evidence supporting the asserted value of productive efficiency gains.

**Might River Power**

Mighty River Power's submission is inconsistent in that they accept the GIC's proposal to regulate balancing behaviours and at the same time submit that the production efficiency

benefits relied upon within the cost-benefit analysis are overstated and the costs of regulation are understated.

## **Vector**

The submission made by Vector in support of the regulatory proposal is extensive, yet for all of that, it is flawed in a variety of ways including:

- making unsupported assertions;
- using data inappropriately to support its preferred outcome;
- proposing interpretations of contractual clauses that are incorrect;
- advancing particular scenarios that are not likely to occur or are not able to occur;

It is abundantly clear to Nova that that the purpose of Vector's submission is not to critically analyse the proposed regulations or the cost-benefit analysis provided in support but to advance tenuous and flawed arguments that support their preferred outcome.

### **Detailed comments regarding Vector's submission are as follows.**

Paragraph 5:

- The Critical Contingency Regulations set a security standard for the industry.

Paragraph 6:

- System security is governed by the Critical Contingency Regulations;
- Coordinated system operation is excluded from the proposed regulations;
- Since December 2008 when Maui legacy gas provisions of the code were removed and provision was made for MDL to procure balancing gas services from third parties, system security has in fact improved such that outages at major producing gas fields have had little impact on system operation and the ability of consumers to access gas supplies;

Paragraph 9:

- Nova understands that MDL in its cross submission document will provide a table of the curtailments and Operational Flow Orders issued by MDL to Vector welded points in 2009 and 2010. The list shows that curtailments are (except on one instance) in response to unplanned outages at major gas fields. Similar actions are likely to be required under any regulatory regime;
- Operational Flow Orders (OFO) have been generally been issued when there are significant differences between scheduled quantities and actual gas flows that may impact on MDL's ability to supply line function services to other users of its pipeline. In terms of compliance with Operational Flow Orders, in addition to curtailment of gas flows, renominations to reduce Operational Imbalance have been treated as another means of complying with the OFO notice.

Paragraph 10:

- System Security has in fact improved significantly over time with the fragmentation of supply from one large gas field (Maui) to multiple gas fields (Maui, Pohokura, M&M and Kupe);
- The increased diversity of supply means that security of supply has significantly improved and the affects of any outage at a gas field diluted;
- Vector is seeking to draw an inference from operational notices regarding operational imbalance to physical system security which is not correct.

Paragraph 11:

- Many aspects of system operation can be changed at any time by both MDL and Vector and yet Vector does not propose regulation of all aspects of pipeline system operation and has resisted such proposals;
- TSO's have wide discretion over many aspects of pipeline management and yet the regulatory proposal is focused on one very small element that is far less concerning than other aspects of pipeline arrangements such as interconnection and investment in new capacity;

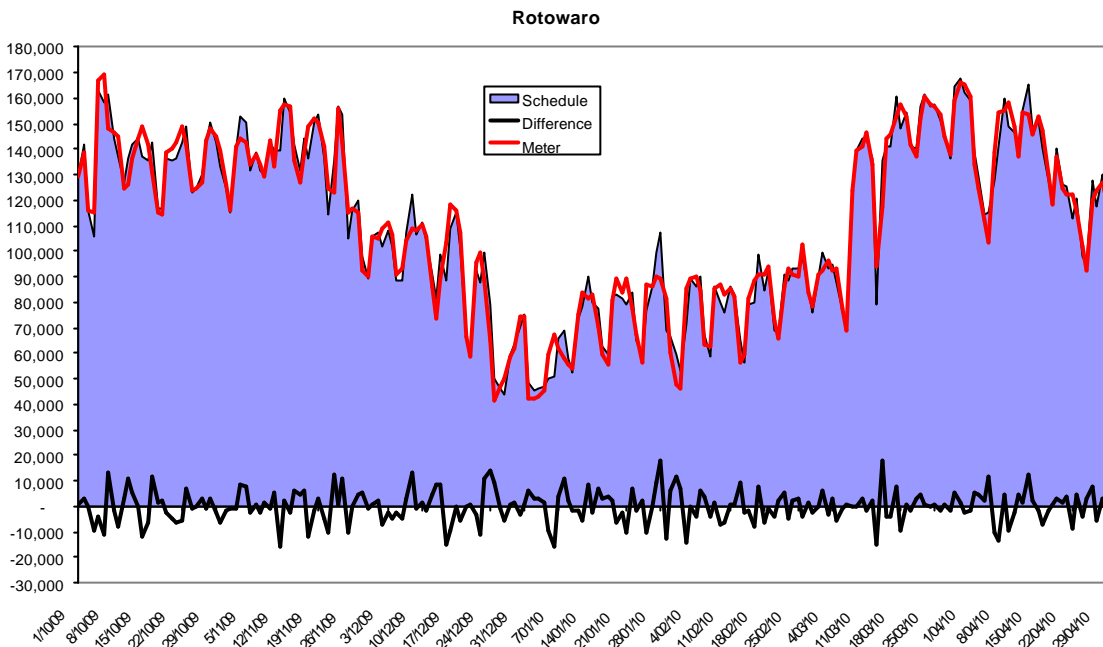
Paragraph 12:

- MDL has not indicated to participants any intention to make such changes. Only Vector has.
- The mode of operation proposed by Vector (and not MDL) is counter to what MDL has said historically regarding use of linepack for the purposes of managing imbalance in an efficient manner;
- Under the proposed new MPOC rules, there will be an obligation on MDL to consult with participants;
- The MPOC may evolve further to provide more certainty where some features may be better placed within the MPOC as opposed Standard Operating procedures;

Paragraph 13:

- Vector makes a broad assertion that there is no link when in fact there is a clear link and correlation between nominations and demand that any proper statistical analysis will show;
- We have performed a rudimentary statistical analysis of the scheduled quantity and metered flow at the Rotowaro welded point over the last several months and the correlation coefficient is very high at 0.98. This shows that there is a significant relationship between scheduled and metered quantity and that there is a significant link between the nominations that represent forecast demand and metered flow. The graph

below clearly shows that there is a strong relationship between scheduled quantity (aggregate nominations) and metered demand.



- Contrary to Vector view Nova believes that, with the right incentives, there is further scope for participants to improve the accuracy of nominations. As the MPOC and VTC evolve to ensure that participants have the incentives to not only nominate accurately but also to ensure that they have adequate commercial arrangements in place with suppliers and consumers to manage force majeure risk, then operational imbalance levels will continue to decline through time without regulatory interference;
- We note that there are aspects of the proposed regulations such as price caps on balancing costs and reduced confidence in receiving payment for balancing gas services that act to reduce incentives for participants to manage their commercial affairs in an appropriate manner.

#### Paragraph 14:

- Vector's focus on imbalance as a nominal number isolated from underlying scheduled quantities and actual metered flow is misleading. This is most evident in Figure 2 under paragraph 15 that uses a monthly aggregate of Operational Imbalance at a welded point when balancing is something that is measured on a daily basis. Monthly balancing ended when Section 3 of the MPOC was removed in December 2008;
- Vector takes a "what if" scenario approach to its analysis of current arrangements and selects one scenario that assists advancing its own preferred outcome. Such an approach ignores the current status quo and is analogous to recommending chemotherapy for someone on the basis that they might one day in the future have cancer;

- Even if in the improbable and unlikely event that balancing arrangements were to be amended as suggested by Vector, the outcome predicted by Vector makes no attempt to account for behaviour modification by participants that is not only limited to nominations activity but extends also to:
  - o hedging through the BGX as clearly if there were so many balancing gas transactions, participants would have a significant incentive to ensure that they hedge themselves;
  - o gas transmission through a competitive pipeline (i.e. for volumes going North on the Vector 8 "line) is used to constrain inefficient behaviour by one pipeline owner;
  - o increased use of transmission swaps;
  - o direct supply and avoidance of open access gas transmission lines

Paragraph 15:

- Competition and efficiency is the key to keeping consumer costs down.

Paragraph 16:

- Self interest is evident in regulatory forums as well as contractual. We note that we have a regulatory framework for the industry in place through the GIC.

Paragraph 17:

- We presume that Vector is referring to Clause 12.7 of the revised MPOC in its assertion that there is a requirement to curtail receipts and deliveries almost every hour. If so then Vectors interpretation is incorrect and self serving in this context.
- Clause 12.7 states:

*"Each Physical Point Welded Party shall use its reasonable endeavours to manage the flow of Gas at each of its Welded Points so that its Running Operational Imbalance at each such Welded Point tends towards zero at all times."*

Clause 12.7 does not, as Vector states, require them to curtail receipts and deliveries on an hourly basis as there is a reasonable endeavours test in what its obligations are. Nova does not believe that "reasonable endeavours" would extend to curtailing potentially innocent shippers on its system if:

- a) it could not identify which shipper was causing mismatch in real time;
- b) there was no impact on the ability of MDL or Vector to provide transmission services for other users as result of the imbalance;
- c) it could pass through costs of imbalance (balancing costs) if there were cashouts;

Generally a "reasonable endeavours" test does not require a party to incur costs or losses. Plainly interrupting gas transmission to customers on an arbitrary basis would result in Vector incurring loss of transmission revenue and put it potentially in breach of its own transmission arrangements and as such the interpretation advanced by Vector is not credible.

Paragraphs 18 and 19:

- Vector's proposed handling of the scenarios depicted in paragraph 18 and 19 rely on a flawed interpretation of clause 12.7 of the new MPOC as noted above;
- In addition, Vector proposes that when it receives an Operational Flow Order that is non shipper specific in nature – ie does not identify any particular pipeline user that may be responsible for operational imbalance that they will select power stations for curtailment ahead of any other gas consumer. Nova believes that such arbitrary action is not provided for under the Vector Transmission Code. Curtailments of that nature are the domain of the existing critical Contingency regulations. We also note that Vector, under Section 2.16 of the VTC, has an obligation not to favour or prejudice any shipper except where that is provided for within the VTC;
- Vector has a **best** endeavours obligation under Section 8.3 of the VTC to manage linepack so it can maintain delivery of gas to its consumers in accordance with their capacity rights. If it was established by Vector that it was a power station that was responsible for operational imbalance, and balancing gas was available and noting also that those balancing costs can be passed onto the causer(s) of imbalance then Vector would not be able to unilaterally interrupt customers on the basis proposed without being in breach of its VTC obligations.

Paragraph 21:

- A security supply policy has already been put in place through the Critical Contingency regulations. If Vector believes that those arrangements are inadequate or the thresholds are insufficient then there is a change process via the GIC for making amendments to those regulations.

Paragraphs 22-29:

- The current contractual arrangements or the proposed amendments to those arrangements provide for curtailments in the manner suggested by Vector without them or MDL being in breach of the contractual obligations under the VTC or MPOC;
- Commercial self interest is equally evident in regulatory forums as much as it is in contractual forums so there is little difference in that regard. It is unrealistic and naive to suggest that participants are altruistic in the regulatory forum and only self interested in the contractual forum;
- The regulatory proposal being considered is very limited in scope and does not provide for the degree of integration between two polarised TSO's that Vector appears to prefer;
- In order to achieve the objectives of system operation integration that Vector desires so much, then a very different regulatory proposal will be required and one that perhaps represents a transition to an Independent System Operator model that has a wider mandate than just residual balancing. Nova believes that such a model is worthy of consideration given that such an arrangement does provide scope for additional efficiency benefits that are not available under the current regulatory proposal or existing contractual arrangements;

- Current contractual arrangements have not, as purported by Vector, led to reduced security of supply although while MDL relied solely on the Maui field for all balancing prior to the December 2008 MPOC amendments, there was undoubtedly a lower level of security of supply than that which exists today;
- As MDL highlighted in their most recent submission, certain aspects of the regulatory proposal such as a cap on balancing prices and the “pay when paid” provisions make it less likely that participants will offer balancing services to the extent that they could or will factor in risk premiums on balancing gas prices due resulting in higher prices and more curtailments.

Paragraphs 31-33:

- Vector does not provide any evidence, empirical or otherwise, supporting the cost benefit analysis;
- The assumed efficiency benefits flowing from regulation were not accepted as being realistic by any participant other than Vector.

Paragraphs 35-36:

- Vector does not take into account the fact that balancing disputes currently occurring in the contractual forum will simply transfer into the regulatory forum where it is our experience that compliance costs are just as high if not higher overall than in the contractual environment;

**Vector’s proposed amendments to the draft regulations:**

- Nova does not agree with the proposed amendments to clauses 6.1, 8.1, 7.1.2, 9.2.1, 11, 45,
- Nova disagrees with Vectors comments as follows:
  - o Part 3 Subpart 1 General Provisions: view that the GIC should appoint the Balancing Operator and recover costs through levies;
  - o 29.2.2: Indemnity from TSO’s to Balancing Operator;
  - o Subpart 4 Funding: Recovery of levies
  - o 55.4: Payment of levies to TSO’s

Please contact me if you have any questions regarding our submission.

Yours sincerely



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