think differently

nova energy

24 November 2014

Gas Industry Company Limited
PO Box 10 646
Wellington 6143

(By email)

Dear Sirs

Re: Maui Pipeline Operating Code (MPOC) Change Request

Thank you for the opportunity to provide feedback on MDL's proposed change request.

Nova supports moves to improve the efficiency of the gas transmission market and recognises that there are some benefits to the MDL proposal. It is of course incumbent on GIC to ensure that the proposed changes represent the best solution for the New Zealand market in the context of a limited number of participants and scale of operations.

In this respect, Nova understands that the cost-benefit analysis to be conducted by Covec is important to the GIC decision on whether to approve the proposed change. The draft 'Outline of a cost benefit analysis' refers to adopting 'the industry/nation-wide perspectives indicated in the Gas Act 1992'. It is important in this context that the overall best result is achieved for the market.

Any Code change must ultimately benefit consumers through improvements in the pipeline operations, rather than be a redistribution of shippers' costs, if it is to provide an overall net benefit to the market.

The GIC has indicated that the reference point for the Cost benefit analysis is to be the MPOC as is currently stands. That reference point ignores the benefits of the back-to-back balancing (B2B) arrangements that have already been ratified by the GIC and can be implemented by MDL. In effect, if the cost-benefit analysis is completed as proposed, the Daily Cash-out (DCO) proposal may potentially be justified entirely on the net benefits accruing from the changes incumbent in the B2B proposal. The cost-benefit analysis should be assessed in terms of the current market inclusive of the B2B changes to the MPOC.

There is also significant uncertainty on how the DCO will work in practise vis-a-vis the EMS Tradepoint gas market.

One of the frustrations for some parties has been their inability to participate in the provision of balancing services to MDL through the BGX. The reason that those parties are unable to supply balancing services to MDL is that they are unable to meet the criteria in the underlying balancing gas contract that performance of the service can be observed directly via scheduled quantities. This has directly or indirectly led to dissatisfaction with the balancing costs as they believe that those costs are not reflective of the market prices for gas.

Ultimately, it should be incumbent on MDL to structure its charges in such a way that they reflect the true cost of balancing gas requirements. As a result, we suggest the MPOC should be linked directly back to the principles of the Gas Act 1992 and encapsulated in rules consistent with that. Given that, it is important that the preferred trading platform remains under a competitive pressure to meet the market's needs.

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The cost-benefit analysis is not the appropriate tool for assessing the potential interaction between the Tradepoint market and DCO. Nova believes that DCO should only be implemented once there is a gas trading market operating with sufficient liquidity to ensure that all balancing trades can be completed on-market without an undue impact on market prices. It is not adequate that MDL should have discretion over how and when the traded prices are to apply.

The proposal, as presented, does not place enough onus on MDL to best manage line-pack, or reduce costs for consumers. In particular, Nova firmly believes that in the absence of additional obligations on MDL to manage line-pack then there will be no material improvement in line-pack conditions for producers, and as such the notional benefits should be ignored for the purposes of this analysis. This is further exacerbated by the potential for reduced incentives for primary balancing by nominations under the proposed code changes.

We have appended further specific comments on parts of the proposal to this letter. Please feel free to contact me if you wish to discuss our views further.

Yours sincerely

Paul Baker

Commercial & Regulatory Advisor

Appendix:

Comments on proposed framework for cost/benefit analysis

Section 2.1.3

1) Nova does not believe that the statement that “shippers and welded parties face uncertain consequences from running an imbalance” is correct. If a shipper or welded party has an Accumulated Excess Operational Imbalance (AEOI) then unless they take action and reduce it to zero, then a cash-out will occur regardless of MDL’s balancing actions. The only costs that are dependent on whether or not MDL buys or sells balancing gas on a day are those related to peaking charges and the incentives pool scheme. Even those costs are predictable and can be managed as MDL publishes line-pack conditions and when it buys or sells balancing gas on a day.

2) With respect to the commentary around line pack being used to provide swing, Nova believes that most swing is actually provided by producers in the normal course of business. Seasonal and weekday/weekend consumption profiles are provided for through increases and reductions in gas field production and Contact’s Ahuroa gas storage facility. An analysis of daily production/demand in the aggregate will show this. If line pack provides “swing’ it is primarily related to diurnal (day/night) consumption profiles and short term transitions in demand/production steps. It should be noted that the MPOC provides only for daily nominations with an ad-hoc operational profile process for hourly profiles when welded parties are expected to exceed peaking tolerance provisions. The decision to use daily nominations as the lowest common denominator instead of hourly was made at the outset of Maui pipeline open access trading on the basis that line pack was able to provide for day/night swing requirements. This was supported by analysis at the time of development of the open access terms. Implicit in that analysis was the agreement that the costs of operating an hourly nomination system as opposed to a daily system would outweigh the benefits.

3) While we accept that producers may potentially be affected under high line pack scenarios, there are very few references to this issue compared to the issue of cost recovery and allocation which appears to be the main issue MDL is seeking to resolve.

A significant weakness in the proposal is that there are no changes to the provisions relating to MDL’s obligations with respect to line pack management. In effect, while daily cash-outs may occur – there is no guarantee that line pack management outcomes will be improved and nothing that requires MDL to give effect to its discretion to actually improve line-pack.

In this sense, it would be wrong for Covec to treat improved line-pack as providing a benefit as it cannot be shown that there will be an improvement or benefit. There is in fact, a risk of line-pack management deteriorating rather than improving. Nova believes that if the charges to users of balancing, are cost reflective, that may potentially drive pipeline users (shippers and welded parties) to utilise that market and create imbalance in order to buy and sell gas. As such this may inadvertently undermine the incentives for improvement in primary gas balancing.

Section 2.2

4) With respect to the comments regarding perverse incentives from parties who cause imbalance being able to avoid balancing costs by correcting their position during the day,

we do not believe that this is an accurate summary of how the MPOC provisions work. Under the current status quo, there is an ability of welded parties to avoid cash-out costs and peaking charges. This is because they can resolve their imbalance the following day. Under the B2B arrangements (that have not been implemented by MDL), the ability to avoid costs in this way is reduced. This is because the offending party likely to incur peaking charges if they attempt to rectify a material imbalance within a day. For example, if a producer has a material short-fall in production during a day, then to correct the position by the end of the same day, it is highly likely that they would breach the peaking limits and enable MDL to recover balancing costs via peaking charges and/or the incentives pool (and vice versa). The ability to avoid balancing costs under B2B arrangements is therefore significantly limited compared to the status quo.

5) As raised above, the B2B provisions include an automatic peaking charge being incurred by welded parties if they breach peaking limits on the same day as line pack minimum or maximum thresholds are breached. This occurs regardless of whether or not balancing gas is bought or sold.

6) For these reasons Nova believes that the implementation of the B2B arrangements would largely resolve the issue of socialisation of balancing costs and the incentives improved around primary balancing.

Section 2.3

7) The summary of the proposed cash-out prices under the daily cash-out regime as being at marginal prices is not correct.

The proposed cash-out price calculations are subject to a default rule should there be no trading activity or the volume of trading is lower than a volume to be specified by MDL on the Trading Platform. MDL has discretion to create and modify and decide what the minimum trading volume. This level of discretion creates significant uncertainty regarding cash-out pricing for shippers, and hence risk.

Such risks are very difficult to quantify in terms of a cost-benefit analysis.