think differently

nova energy

4 June 2010

Ian Wilson
Senior Advisor
Gas Industry Company
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Dear Ian,

Nova Gas Submission regarding MPOC 17 December 2009 Change Request Draft Recommendation

Nova has reviewed the May 2010 draft decision regarding the proposed MPOC change request made by MDL in December 2010.

In general we agree with the assessment of the GIC that on balance the proposed changes represent a net improvement on the current contractual arrangements.

MPOC Changes and Section 29

Nova is disappointed that the change request submitted by MDL included some amendments that were not necessary and that do not contribute to improved balancing provisions and instead seek to simply shift risk to another party. The bundling of such changes with others that create an overall improvement has meant that under the current change control regime (section 29 of the MPOC) those changes are likely to be approved regardless of the merit of those changes.

Nova believes that such outcomes are not supported by industry and that changes should be made to section 29 governing MPOC changes so that the GIC, following consultation, may fully or partially approve rule change proposals. Such a change will prevent negative elements of rules changes from being approved if bundled with other more positive proposals.

Evaluation of Balancing Changes

1) Productive Efficiency

Nova agrees with the comments and assessment by the GIC. The allocation of residual balancing costs through incentives pool debits could be improved by the transfer of title to gas associated with the allocation of costs.

2) Allocative Efficiency

Nova agrees with the comments regarding allocative efficiency. It is hoped that this rule change will be followed by further refinements addressing some of the issues around delineation between UFG and compressor fuel management and operational imbalance management. Similarly, we believe the treatment of metering corrections needs further

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investigation and that the mismatch mechanism provided for in MPOC could be removed as for all intents and purposes it is defunct and has never been used as initially intended. MDL once did employ forced mismatch which resulted in several disputes that were later settled and it is unlikely that forced mismatch will be used in that way again.

3) Dynamic Efficiency

We note that the GIC has not included dynamic efficiency in the assessment. Nova believes that this rule change is an important step for the industry to take in avoiding the imposition of a regulated solution that would reduce dynamic efficiency in the long term.

Contractual arrangements will be able to be modified over time at a lower cost and in a more timely manner than under a regulatory framework. This should be recognised in the assessment of the change proposal and we would score the change proposal as having a + 2 affect in this regard.

4) Security

Nova believes that the reduction of socialisation of balancing costs will improve incentives for pipeline users and welded parties to manage imbalance and that an indirect outcome of this will be an improvement of security of supply. We would score the change proposal as having a +1 affect for security.

5) User Risks

Nova does not agree with the assessment of the GIC with respect to user risks. Currently shippers are exposed to balancing costs even though no balancing gas has been bought or sold. Shippers are also exposed to incentive pool debits that are linked to uncapped electricity prices. The proposed rule changes reduces this risk and ensures that parties who do contribute to balancing requirements are allocated the costs associated with managing imbalance.

We believe that removing cross subsidies through socialisation will improve participants incentives to manage operational imbalance, participate in the balancing procurement process and is more likely to see reduced volatility in price as well as reduced volumes of balancing gas.

We also disagree with the concern expressed by the GIC that uncapped balancing prices are a negative aspect of the change process. Pipeline users are already exposed to uncapped prices through the incentives pool regime and applying caps to balancing charges may only reduce incentives for balancing gas providers to make available capacity potentially resulting in premature curtailment of demand under the critical contingency regulations.

Although Nova would prefer marginal pricing of balancing gas we recognise that there are some difficulties with adopting such an approach due to daily allocation and the procurement of balancing gas several times through the course of a day. We also believe that there will be little difference between average and marginal pricing as balancing gas providers adjust their pricing behaviour to take this into account. Under “paid as bid” pricing, providers are mostly to adopt pricing strategies that seek to bid at close to what the expected the marginal price will be and therefore the average price will be approximate to the marginal price (in theory at least).

On this basis we disagree with the assessment that the average cashout price will reduce participant's ability to effectively hedge.

Nova believes that the "no notice cashout" label is a misnomer with respect to the proposed regime as participants have access to pipeline information in real time and the balancing gas website in order to assess risk and exposure to imbalance charges so that they can mitigate those risks either through adjustments to supply nominations or their gas offtake. As such, pipeline users are continually on notice of potential for cashouts.

With respect to those pipeline users who participate in the downstream retail market and who face uncertainty about the level of their consumers demand, this risk is faced by all participants in that market and those participants should manage that risk through the means available to them including (but not limited to):

- improved demand forecasting;
- improved access to metered consumption data (ie monthly meter reads as opposed to bimonthly);
- supplying additional gas or reduced levels of gas when aggregate demand is higher/lower;
- hedging through participation in the hedge market.

These means of managing risk are commercial decisions available to all participants.

If a participant elects not to manage its risk by employing the various tools available to them then they should bear the consequences and not expect cross subsidies from other participants or consumers.

Nova believes that appropriate allocation of risks will result in improved incentives for participants to manage their commercial affairs accordingly and will result in a more efficient and robust gas supply for consumers and as such Nova would score the change request as +2.

6) Costs

No comment

7) Governance

Nova agrees that some additional transparency around gas bought or sold for the purposes of managing UFG and compressor fuel requirements as opposed to operational imbalance management would be useful.

Evaluation of non balancing changes

1) Liability when valid agreements are not in place

Nova does not believe this Section 2.15 of the MPOC is a major issue.

If a Maui pipeline shipper transmits gas to a Vector welded point who does not have in place the required transmission arrangements for the Vector transmission system then that shipper is not likely to be able to onsell that gas to anyone else as title tracking of gas on the Vector pipelines is effectively performed through the Balancing and Peaking Pool and Gas Transfer Agreements. Any party shipping gas to a Vector welded point in effect would be abandoning gas in the Maui or Vector pipeline if they did not have in place the appropriate commercial arrangements.

While we do not agree that the change was necessary with respect to balancing, in effect it will have little impact on MDL or Vector.

2) Curtailment priority

Nova agrees with the GIC that any costs associated with the introduction of AQ should be passed through to AQ users only. We also note the apparent divergence of views regarding efficiency with respect to transmission capacity pricing. MDL appears to continue to pursue introduction of the AQ regime when supply of transmission capacity north of Mokau is tightening and when a similar regime on the Vector system is proving to be problematic in a constrained capacity situation. It may be that MDL should pause to consider the appropriateness of the AQ regime in light of the recent GIC's transmission capacity options paper.[1]

3) Welded Party flow to nominations

Nova agrees with the assessment of the changes regarding sole consequence of imbalance is a reduction in uncertainty and would prefer that provision to be reinstated at the next available opportunity.

We note that the consultation paper contained a specific request for comment from participants regarding user risks and we hope that comments made above are sufficient in that regard. If there are any other issues that you would like to discuss then please let us know.

Yours sincerely

Charles Teichert
Nova Gas Ltd

[1] GIC consultation paper: Options for Vector Transmission Capacity May 2010