

30 March 2015

Mr Ian Wilson
Gas Industry Company Limited
PO Box 10 646
Wellington 6143
(By email)

Dear Ian

Re: Draft Recommendation on October 2014 MPOC Change Request

Thank you for inviting submissions on the draft recommendation on the Market Based Balancing change request (MBB CR) submitted by Maui Development Limited (MDL).

Nova has reviewed the Cost-Benefit Analysis (CBA) undertaken by Dr John Small of Covec. Nova acknowledges the difficulty in breaking down a complex market system to identify the underlying true economic costs and benefits that can be attributed to the proposal. Having reviewed the Covec paper, Nova believes that the net benefits of the proposal are somewhat less than what has been presented:

- a) The benefit arising from the prospective reduction in fuel gas used at the Mokau compressor station to balance pressure in the pipeline is overstated.
 - The reduction in fuel gas usage is the primary benefit arising from the MBB CR. MDL has assumed that all compressor gas used when nominations are less than 250TJ is used for balancing purposes. While Nova understands the difficulty in isolating compressor usage between transportation and balancing, it seems unlikely that compressor usage for balancing has no benefits for gas transportation.
 - It is likely that the high average pressure in the pipeline contributes to reducing the work required of the Mokau compressor station for transportation purposes. If the proposal does indeed result in a reduced average pressure, then the fuel gas required at the compressor station is likely to increase as a result.
 - The net effect is that the supposed savings in terms of expected compressor gas usage should be significantly discounted.
- b) The process of managing pipeline imbalances has an economic cost that must be taken into account in the cost benefit analysis.
 - While the profits from MBB are to be returned to market participants through reduced transmission charges, it is still incumbent on market participants to reduce their individual cash-out costs by managing their daily nominations.
 - Nova has already submitted that the MBB CR is expected to cost it around \$50,000 - \$100,000 p.a. to actively manage its daily balances under the MBB CR. Nova expects that on average a similar cost would be incurred by all 10 shippers on the Vector pipeline.
 - This additional cost is only incurred under the MBB CR and therefore must be taken into account in a CBA that compares MBB CR to the status quo.

- This cost is not recoverable by shippers, excepting reducing their daily cash-out costs. That does not represent a saving for the industry however; as any savings made merely reduce the contra-credit on the following year's shipping charges.
- c) Indeterminate effects of the MBB CR should also be recognised in the CBA.
- Nova believes that the increased complexity and increased uncertainty of balancing costs under MBB will present an additional barrier to new entrants who wish to retail gas on the New Zealand market. The costs of MBB will be weighted towards retail customers whose demand profile is uncertain (i.e. the mass market), this will potentially discourage competition for those customers and provide those larger retailers that can manage portfolio risk with a competitive advantage.
 - Nova believes that because the CBA includes non-quantifiable upstream benefits then the non-quantifiable costs to the industry as stated above, and such as the reduction in security arising from lower average gas storage, should also be considered in the CBA.

Nova favours improved balancing arrangements, and as the Gas Industry Company has determined, the concept of a market based approach has merits. The small size of the New Zealand market and relatively small volumes of gas being traded, however, means that the net benefit of the added complexity of the MBB CR is barely, if at all positive.

Nova would be pleased to see elements of the MBB CR worked through with market participants in conjunction with D+1 reconciliation and an upgrade of the OTIS system. Working on these elements together in a coordinated way is more likely to realise a sustainable benefit for both shippers and gas consumers.

Yours sincerely



Paul Baker
Commercial & Regulatory Advisor