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Attention: Steve Bielby

Shell welcomes the opportunity to submit in relation to Maui Development Limited's (MDL's) October 10 change request (CR) to apply to the Maui Pipeline Operating Code (MPOC), to initiate market based balancing (MBB) with daily cash-out (DCO). Shell also welcomes the opportunity to comment on Covec's draft report "Daily Cash-Outs on Maui Pipeline: Outline of a Cost-Benefit Analysis", 22 October 2014.

As requested by the GIC in their consultation documentation, this letter shares Shell's view on:
- MPOC Cost Benefit Analysis (CBA) Counterfactual
- Comments on CBA Evaluation Framework

MPOC Cost Benefit Counterfactual

When conducting the CBA for the CR, Shell's view is that MDL's MBB/DCO proposal should be compared against the MPOC currently in force. This is because Shell believes it is unlikely that MDL would implement back to back balancing (B2B) in the event that MBB is not implemented.

It is Shell's understanding that MDL's position not to implement B2B, in the event that MBB/DCO is declined by the GIC, would be driven by users having made clear over the course of 2013 and 2014 that they will seek to dispute MDL's balancing charges on the basis of its choice of balancing platform over a market platform.

MDL's choice of balancing platform is driven by a requirement to acquire balancing gas from a platform that identifies any differences between delivery timing and title-transfer. Given the role of balancing gas in maintaining stable pipeline pressure, and therefore the importance of delivery timing, Shell believes that this is a legitimate requirement from MDL.

Comments on CBA Evaluation Framework

In reviewing the CBA framework Shell has focussed primarily on areas where it is affected as an upstream producer and Shell assumes that other submissions will advocate from the point-of-view of pipelines, the market and various gas end users. Having said that, it will be difficult to understand Shell's points-of-view on the efficiency benefits of MBB/DCO without first making a clarification about Shell's interpretation of the MPOC as it relates to the "economic characteristic of a common pool resource" (Section 2.1.3 of the CBA).

MPOC Clarification

Shell does not understand spare pipeline capacity to be a "common pool resource" by right. We believe that Shell, MDL's other welded parties and Vector's shippers are all obliged to manage imbalance positions at all times using reasonable endeavours.

As a result of the above Shell, as an upstream producer, contracts with customers to provide the flexibility in their daily offtake and where buyers indicate demand via their nominations Shell flows to meet those nominations within a tight tolerance. Therefore, at least from a Shell point-of-view, the statement that "physical flows delivered by upstream producers tend to be flat whereas many customers have demand profiles that 'swing'..." is not correct. From our perspective, suppliers can only follow demand if they are provided reasonably accurate forecasts of demand (nominations) from their customers.

Pricing of Flexibility

Currently, MPOC flexibility, which enables free access to short-term gas through the ILON process, high tolerances and weak enforcement and incentives for shippers to fulfil obligations to balance, will continue to mute price signals and be a significant barrier to wholesale market development. Proper primary balancing incentives increase incentives for parties to access the wholesale market to meet their flexibility requirements.

The best outcome for New Zealand is one where flexibility is provided by the lowest cost source. Bilateral arrangements between buyer and seller, as is common practice, may not be the most efficient outcome because providing flexible gas supply imposes a high cost on producers because throttling back gas production not only defers gas, but also the production of condensate and LPG, and causes underutilisation of expensive production facility capacity. For these reasons, to compensate for these costs, contracts with high swing will generally command a premium price over contracts with no provision of flexible supply.

A healthy wholesale market, that reflects the value of gas at the time of use, has the potential to generate significant allocative efficiencies for New Zealand as it may be more economic if upstream producers supply gas flatter and cheaper with the swing being provided by the market from the cheapest source on the day (e.g. demand modulation or from the field with the cheapest swing) with the net result being lower overall prices for the NZ consumer.

Maximising Economic Recovery of Hydrocarbon Resources

Maximising the economic benefit of New Zealand's Hydrocarbon resource base is achieved by a low and stable pipeline pressure which increases Hydrocarbon recovery and condensate production (relative to gas). These are efficiency benefits, either enabling recovery of resources which would not otherwise be recovered or directing products to their highest value use.

Recovery is enhanced by lowering the final abandonment pressure of hydrocarbon producing fields. Condensate production is increased because at lower pressures more condensate can be extracted from the gas.

It is Shell's belief that the cost of unnecessarily high backpressure that arises because of poor primary balancing is of a significant magnitude and must be taken into account.

Other Benefits

Additionally, the following factors should be taken into account in assessing the benefit of MDL's MBB/DCO over the status quo:

- security of supply;
- gas quality implications of Taranaki pressure exceeding the MPOC TTP limit;

- higher system capacity, capacity of the system is low if current balancing performance is factored into the capacity calculation;
- The reduced cost of contract negotiations, e.g. if the value of swing can be objectively inferred from market data, it would reduce the time to resolve differences in perception of value on this important issue. The existence of the market may even avoid any need to provide swing in some contracts.

In short, we support MBB provided that it is implemented with daily balancing (DCO) and in accord with good international practice, as MDL has proposed. We see that the potential efficiency benefits for New Zealand of MDL's proposed regime are significant, are in accord with the government policy objectives.

Shell will share information the magnitude of the effects described above with the GIC on a confidential basis.

Yours sincerely,

Dylan Reid

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Shell NZ limited