



27 April 2010

Mr Ian Wilson
Gas Industry Company Limited
Level 8
The Todd Building
95 Customhouse Quay
P O Box 10 646
Wellington 6143

Dear Ian

Transmission Pipeline Balancing: Supplement to the October 2009 Statement of Proposal

Introduction

1. Contact appreciates the opportunity to comment on the GIC's paper "*Transmission Pipeline Balancing: Supplement to the October 2009 Statement of Proposal*" issued April 2010.
2. Contact and other industry participants have already commented extensively on the GIC's Statement of Proposal. Contact remains of the view that it is unnecessary and too soon to propose regulation to address balancing. Such a recommendation should only be made consistent with an open access design framework and when an issue arises that shows that regulation is necessary and the benefits of the regulation exceed the costs of implementing the proposal.
3. The second two requirements are requirements of section 43N of the Gas Act. We note in particular subsection 43N(1)(c) of the Gas Act

"ensure that the objective of the regulation is unlikely to be satisfactorily achieved by any practicable means other than the making of the regulation"

and subsection 43N(1)(b)(i)

"assess those options by considering (i) the benefits and costs of each option"

4. The GIC has failed to meet these requirements. The GIC is struggling to meet the second requirement because it has not defined the reason for the proposed regulation.

Contact Energy Limited

PO Box 10742, Wellington 6143
New Zealand

➤ Level 1 Harbour City Tower
29 Brandon St, Wellington

☎ Phone: 64-4 499 4001
☎ Fax: 64-4 499 4003

🌐 www.contactenergy.co.nz

Other Practicable Means of Improving Balancing other than the Making of Regulation

5. Both MDL and Vector currently provide balancing services. The GIC has not identified the aspects of those arrangements that cause sufficient concern to require it to propose regulation to address those issues.
6. There are some aspects of balancing services that could be improved but that could be achieved without resort to regulation. There is considerable unexplored and unexploited scope to develop code change requests to improve balancing arrangements.
7. MDL shows willingness to address many of those improvements through change requests. We believe other parties are also preparing change requests to address balancing issues. The GIC could play a role in consolidating those change requests before the change requests are formalised.
8. The GIC has commended MDL for its initiative. There are deficiencies in MDL's proposal, some of which are noted by the GIC. Deficiencies, identified by the GIC, include the lack of a simple low cost process to produce timely resolutions of disputes and the inability of parties interconnected to Vector's transmission pipelines to provide balancing services to the Maui pipeline.
9. The GIC overlooks that a further simple change to the dispute resolution sections of the MPOC would allow use of the Rulings Panel if the Rulings Panel was set up to allow that.
10. MDL rightly points out that the lack of MPOC contractual arrangements between it and other parties interconnected to Vector's transmission pipeline presents some difficulties in it accepting balancing services from those parties. However, we understand that MDL is working up a solution based on remote welded points.
11. The ICD process also offered a framework for improving balancing arrangements. The industry spent significant resource on the ICD process. That process delivered a good result. For the first time the industry largely agreed a framework for open access including balancing services. The scope of the agreement from the ICD process is much wider than the scope of the GIC's proposed Balancing Rules. It will be very disappointing and wasteful of resources if the GIC abandons the progress made by that process.
12. The GIC points to lack of agreement between MDL and Vector as another reason why regulation is necessary. That overlooks that the current VTC contains measures that are coordinated with MDL's arrangements. The GIC's concerns would only seem to arise if Vector withdrew its current arrangements.
13. There appears to be some risk that Vector may withdraw its residual balancing service. That seems unlikely but could be addressed at the time that occurred through the GIC's emergency regulation powers.

The GIC's Proposal lacks Factual Context

14. The balancing debate lacks any factual context. The GIC has not provided any quantitative analysis to demonstrate why balancing is a significant issue.
15. Quantitative analysis is required to:
 - isolate and quantify the significance of balancing issues;

- identify the improvements that could be made to reduce the level of balancing action;
- quantify the margin paid for balancing services and measures that would reduce those margins.

16. Such an analysis should include, and where possible, quantify the following:

- the volume of gas bought and sold through balancing action and how that has changed relative to new balancing initiatives such as the availability of the BGX;
- the number of curtailments (alternative to balancing action) and how the volume of curtailments has changed over time;
- the relationship of balancing services to the Critical Contingency Regulations and critical contingency prices;
- the cost of balancing services and the margin paid for balancing flexibility;
- the relationship between the price of balancing gas and the market price of gas;
- the features of the MPOC and VTC that determine the volume of balancing transactions and changes that could be made to reduce the volume of balancing transactions;
- the reasons why users nominations are inaccurate and lead to balancing transactions;
- the main reasons why disputes have arisen and the value of those disputes.

Cost/Benefit Analysis Flawed

17. The GIC has provided a cost/benefit analysis developed by NZIER. Unfortunately, the analysis is fundamentally flawed. We understand that NZIER is only responsible for the arithmetic and not responsible for the assumptions.

18. At this stage there is no reason to believe that a regulated approach would yield a significantly better outcome than an unregulated approach. It is speculation that an unregulated approach may somehow fail.

19. There is risk that a regulated outcome would result in higher costs because of:

- the appointment of an independent balancing operator;
- an increased level of balancing activity required by prescription of the circumstances in which balancing activity must be undertaken;
- reduced flexibility to amend and improve the arrangements;
- confusion about who is responsible for providing transmission services.

20. From the analysis the main benefit of balancing rules are attributed to efficiency gains. For this reason the GIC must fully explain how these gains arise.

21. We do not understand why regulation would lead to greater efficiency gains than the baseline scenario. Both arrangements involve use of an open market for offering balancing services. MDL has already established the BGX.
22. In addition, we do not understand how offers of balancing services will influence the price of gas sold under other short and long term sales agreements. The two kinds of services are completely different.
23. Purchase of a balancing service is essentially a purchase of instantaneous gas supply flexibility. The gas also bought or sold is largely peripheral. That is clearly shown by the prices paid for balancing services.
24. The cost/benefit analysis provides for two baseline scenarios. One is termed the code change process and the other the ICD MoU. The essential difference between these two baseline scenarios is the assumption that the ICD MoU scenario would take more time to reach a conclusion. This distinction is misconstrued.
25. The ICD MoU scenario could only be implemented through code changes. If all the matters within the scope of the ICD MoU were addressed then that would clearly take longer to achieve than code changes limited to improving allocation of balancing costs and related matters. Achieving the same outcome from the ICD MoU process should take no longer than the code change process because essentially they are the same process.
26. As indicated above the cost/benefit analysis also lacks credibility because there is no reference to any facts. For example, there is no reference to actual levels of balancing activity and the cost of balancing services offered under those arrangements. There is no mention of the current value of disputes. The GIC has not obtained quotes from potential balancing operators.

Redraft of balancing rules

27. The GIC has provided a redraft of the proposed balancing rules. The balancing rules are technically complex and involve complicated interactions with the parties involved in open access including the regulator, with the balancing plan, the pipeline codes, the Critical Contingency Regulations and the Downstream Reconciliation Rules.
28. The extensive list of changes that the GIC has made in its redrafting raises doubt about the GIC's working knowledge of the MPOC, the VTC and the proposed rules. The complexity of the balancing rules demands a detailed clause by clause review of the balancing rules by experienced industry participants.
29. We note the GIC's concern that industry has not engaged in developing the balancing rules. In January, Contact provided a detailed analysis of the balancing rules and sought to work through that with the GIC and other industry participants on a clause by clause basis. The GIC did not take up that offer nor has it responded to Contact's analysis. That lack of response has not encouraged Contact to repeat the exercise in relation to the April redraft of the balancing rules.

Conclusions

30. We do not understand the GIC's determination to pursue balancing rules at this time when clearly there is unexploited potential to develop and improve balancing arrangements through other means.

31. The outcome that the GIC hopes to achieve from balancing rules is unclear but the GIC implies in its paper that regulation is necessary to address disagreement between MDL and Vector. In our separate discussions with Vector and MDL we find that they largely share the same end-goal objective. We think their differences related to some of the detail can be reconciled.
32. The GIC should develop an end-goal for open access arrangements similar to that developed by the European Regulators Group for Electricity and Gas (EREG) for balancing. That could be more developed than the EREG principles because of the framework and experience that the existing codes have established. In addition it would be wasteful to compromise investment already made in open access arrangements and processes. Much of the detail of the principles has already been established through the ICD process although quantitative analysis is required to confirm matters that should be taken up and matters that should be discarded.
33. An objective should be implementation of the same arrangements across the whole transmission system. Running separate MPOC and VTC regimes creates additional costs and greater risk of dispute.
34. In respect of balancing the end-goal should be to make the party responsible for injection at each receipt point and offtake at each delivery point responsible for imbalance at those points (the party in control at those points). Those parties should have no responsibility for imbalance that arises while gas is in transit, for example, at interconnection points between transmission systems with different owners where they have no control. Pipeline capacity flexibility should be fully exploited. Balancing services should be sourced at market rates. The costs of balancing services should be allocated to the users of those services. The tools to manage imbalances should be made as widely available as possible. Users should have clear rights to claim compensation for delivery failure.
35. The GIC should identify through quantitative analysis the deficiencies in current balancing arrangements and the improvements required to meet the end-goal. For example, the current Downstream Reconciliation Rules with allocations made on a monthly basis with 15 month wash-ups are a fundamental impediment to workable open access arrangements.

Yours sincerely



Alex Love
Senior Adviser