GREYMOUTH GAS

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

Submissions close 27 April 2010

Greymouth Gas New Zealand Limited (Greymouth Gas) is pleased to make a submission on the Transmission Pipeline Balancing: Supplement to the October 2009 Statement of Proposal (the paper) published by the Gas Industry Company Limited (GIC) in April 2010.

1. Do you have any comments on the Draft Rules?

The comments Greymouth Gas provides on the summary of amendments to the draft Gas Governance (Balancing) Rules 2010 (the rules) are set out in the following paragraphs.

- *3: Purpose*

The purpose of the rules has changed from achieving "*an efficient, unified balancing arrangement for managing imbalance in the transmission system*" to achieving "*an efficient, unified management of aggregate imbalance in the transmission system*"

As the purpose of the rules will be used to construe the rules themselves, it is important that the stated purpose is clear, unambiguous and consistent with the accepted application of the rules.

With this context in mind, Greymouth Gas disputes that the proposed amendment to the purpose is desirable.

Greymouth Gas' position is that the amended purpose is more complex and shifts the goal posts on two fronts:

  - An arrangement/plan has now become active management
  - Managing imbalance has now become managing aggregate imbalance

The shift is subtle, but has the following consequences:

- First, it indicates that the balancing plan is to encompass the active management of imbalance in the transmission systems, rather than operating as a back-stop arrangement if imbalance gets out of hand. This opens the door for TSOs to outsource more imbalance management functions than would perhaps have been the case under the old purpose. This may or may not be a problem depending on the balancing plan/s presented.

- Secondly, management of imbalance now encapsulates the concept of aggregate imbalance. This gives a steer that the balancing plan must only have regard to the overall picture, not individual users or the impact on concepts like barriers to entry for new participants.

Both changes shift the balance towards TSOs [and large shippers] on the continuum of participation under the participative model. Prima facie the change in purpose is a problem with regard to momentum, positions and platforms during the envisaged consultation process re the balancing plans.

Acting on concerns about this ambiguity, Greymouth Gas confirmed with the GIC on 7 April 2010 that the GIC would still have regard for the mix of tools and penalties when approving the balancing plan and it wouldn't just be a pure test of whether the balancing plan is better for the industry as a whole or not. Rather, the GIC indicated that consideration of balancing plans would factor in section 43ZN of the Gas Act 1992 (the act) and the Government Policy Statement on Gas Governance dated April 2008 (the GPS).

This essentially addresses the latter concerns about managing imbalance vs. managing aggregate imbalance as Greymouth Gas notes that any increased costs resulting from the rules will be passed onto customers. The central tenet at play here continues to be lead by section 43ZN(b)(iv) of the act, *delivered gas costs and prices are subject to sustained downward pressure*.

Regarding the former concern though, Greymouth Gas notes with interest what impact, if any, this will have on thinking in behind development of the balancing plan, and whether this will add value or will add cost, both of which will ultimately impact customers and NZ Inc.

- *5: Interpretation – Balancing Action*

The new definition defines Balancing Action as being the purchase/sale of balancing gas committed to at the *same time*; but at the same time as what? This could be interpreted as being at the same time as the purchase/sale is made; but what happens if the commitment to buy/sell is made at a different time to the contractual purchase/sale of said balancing gas? In this case the rules strongly imply that this would not be a balancing action, ergo parties may dispute such invoices.

- *8: TSO obligation to facilitate balancing*

Greymouth Gas disagrees with the GIC's statement in clause 3.5 of the paper: *GIC is concerned that a higher obligation could imply that the TSOs should invest in additional 'tools' to ensure users are in balance. The intent of this obligation is not to impose additional cost on TSOs, but rather to ensure their arrangements are not constraining users from meeting their obligations*.

This statement from the GIC does not accommodate a situation where investment of additional 'tools' to allow users to balance is necessary in order to enhance efficiency. That is, the added value is greater than the investment.

Neither does GIC's statement recognise that TSOs should be required to incur expense to correct inadequacies in the arrangements provided by them to enable users to meet their balancing obligations.

A relevant example is the provision by TSOs to Shippers of data on non-Business Days. If users are subject to back-to-back balancing on non-Business Days, then users must have tools to allow them to balance on non-Business Days to the same degree as if the same occurred on Business Days. From the perspective of a Vector Shipper, this must be addressed or exposure to balancing should not occur across non-Business Days when Vector Shippers have little ability to control their exposure.

- *19: Rules for allocation of balancing gas*

Essentially the balancing operator is now bound to allocate costs to causers as soon as practicable after a balancing action based on the best information available at the time they do so.

What this means is that, subject to the balancing plan, the balancing operator will either:

  - Allocate at month end when all delivery information is in, or
  - Allocate a number of days after a balancing action, taking some sort of commercial guess at users' exposures [which is still the best information at the time]

If the latter is done, then it may benefit users to know their cash-out quantity – this would represent a significant improvement to the status quo. However, coupled with this is the undoubted increase of reallocations when billing quality delivery information is made available after month-end.

The balancing operator will then have to decide whether they have sufficient information to allocate cash-out costs to a user. Greymouth Gas considers that, on the Vector system at least, you either allocate to every user or none at all on the basis of the current allocation model continuing. Therefore the consideration may be whether to allocate to TSOs the entire quantity as soon as practicable, or whether to wait until month-end as per current arrangements.

The key issue will be cash flow, and interpretation of this section by the balancing operator will determine cash flow impacts for each user. Greymouth Gas notes that invoices issued sooner rather than later that appear to have a materially incorrect adverse impact on cash flow may be disputed by users.

Accordingly, perhaps information and allocation timeframes need to be worked through within the balancing plan to reflect pragmatic operations.

- *25: Amendments to allocations – now allows for inaccuracy, not just error when assessing whether to reallocate cash-out costs*

Greymouth Gas considers that the mop-up allocations and cash-out amounts is a positive addition to the rules, particularly given the scope for interpretation of timing of allocations with regard to rule 19 of the rules.

- *32: Criteria for approval of balancing plan – wording issues and easing of requirements*

This clause sets out the criteria (not the process) for approval of a balancing plan. However, a balancing plan is defined as a plan that has already been approved and is in force. If interpreting the rules technically, one could consider that there is therefore no criteria for approving draft balancing plans that have yet to be approved. Greymouth Gas suggests that the word 'draft' should be added in various places within clause 32 of the rules.

Furthermore, Greymouth Gas has discussed this ambiguity with the GIC and it appears that the intention is for this clause to also apply to draft balancing plans. Hence it is perhaps just a drafting error.

Another issue with clause 32.1.2(a) of the rules is that no longer does a proposed balancing plan have to be consistent with the purpose of the rules; it now has to assist in meeting the purpose. This creates a subtle change in emphasis that is not apparent until clause 32.1.2(b) of the rules is digested.

This latter clause mentions that an amendment to a balancing plan should assist the plan to better meet the purpose of the rules. But what is the reference point? Does an amended plan need to better meet the purpose of the rules compared with the most recent draft balancing plan or compared with the status quo?

Greymouth Gas has also discussed this ambiguity with the GIC and it appears that the intention is for the comparison to be made against the status quo balancing arrangements. Henceforth the inference is that clause 32.1.2(a) contains an element of assessment of improvement against status quo in addition to assisting to meet the purpose of the rules.

- *55: Payment of fees between TSOs and shippers*

Appendix D of the paper states that this clause clarifies how TSOs will recover fees, including that costs of any fees are to be passed onto shippers in proportion to the quantities of gas transmitted by the shipper in the TSO's part of the system or on another basis agreed by the industry body.

However, clause 55.4 of the rules *explicitly* says that a TSO <u>may</u> pass on the cost of any fees payable under these rules to shippers. It does not say that they must do so, ergo whether this requires VTC and MPOC changes is moot.

Irrespective of the above, Greymouth Gas notes the intent of the definition of 'shipper' to include the TSOs when they transport fuel gas for use in compressors. It may therefore have been more appropriate to use the word 'user' rather than shipper, especially when the mechanism is based on transmitted gas.

It is positive to see retention of the ability for the GIC to agree an alternative method of divvying up fees payable. Greymouth Gas notes by inference that such agreement must be either with the party submitting an alternative for consideration or with the alternative submitted for consideration.

Greymouth Gas reiterates the following concerns:

  - TSOs are outsourcing most of the costs/risks of this function, which is a core cost of business for gas transportation. TSOs should wear a fixed % of all costs, with the rest split between users.

- However, a split between users based on % of gas transported means funding of the balancing operator function will be socialized. Essentially shippers that are good at balancing will subsidise the cost for those who are bad at balancing. A fairer model may be to allocate all costs based on the proportion of use of the function – just like for M-co and the Gas Registry.
- The rules should say, or TSOs should anyway reduce existing tariffs by the amount of any new balancing operator tariffs. If this is not done then this whole work-stream is adding value to the bottom-line of Maui and Vector at the expense of customers and NZ Inc.

At the end of the day, if Greymouth Gas faces increased costs from development or ongoing fees then these costs will be passed onto customers. If this is done based on transmission flows, not contribution towards the need for a balancing action to be taken, and TSOs don't reduce existing transmission fees by the amount of the increase in pass-through balancing operator fees, then this work-stream will not achieve section 43ZN(b)(iv), that *delivered gas costs and prices are subject to sustained downward pressure*.

2. Do you have any comment on the NZIER cost-benefit analysis attached in Appendix B?

Greymouth Gas commented on the cost-benefit analysis during the re-analysis phase and we commend NZIER for a report that seems to more accurately capture industry concerns. However, the whole cost-benefit analysis as it is now written paints a picture of uncertainty, for example:

- The unit costs and benefits modeled in the CBA are uncertain (page 60 of the paper)
- The magnitude of efficiency benefits is particularly uncertain (page 61 of the paper)
- [The cost-benefit analysis] is not stating that the efficiency benefits **will be** 0.5% and 0.25%, but rather that **if** they are 0.5% and 0.25%... (page 75 of the paper)

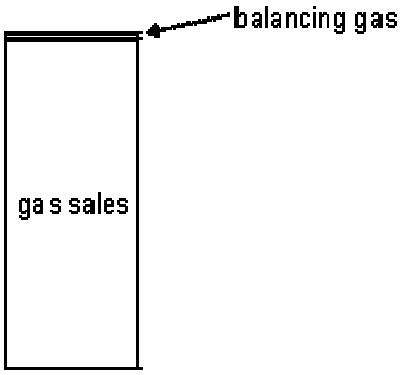
If this work-stream was a company's business case and the key drivers were: small indirect benefits with significant uncertainty regarding efficiencies – would you invest? Prima facie the uncertainty appears to outweigh the reward and the benefit numbers lack robustness.

In the answers to submitters' responses, NZIER notes the following with regard to efficiency benefits:

More efficient levels of balancing and more accurate allocation of balancing costs would promote more efficient use of pipelines and provide greater certainty about actual costs and benefits of buying and selling gas, in turn supporting more economically efficient production and consumption decisions and potentially increased market participation and competition. These efficiency benefits extend to the market for gas, not just balancing gas (page 75 of the paper).

With due respect to NZIER, this economists' language is more theoretical than operational. Greymouth Gas presents a more operational perspective similar to our submission to the GIC on NZIER's first cost-benefit analysis:

Gas is produced and sold, with balancing gas being the residual function related to operations – at maybe 0.1% of total gas production/throughput; MDL can confirm figures.



It seems likely that any changes to the balancing gas market will affect the quantum of balancing gas bought or sold, and have a corresponding impact on other gas sales. The thing is though, that from a NZ Inc. perspective, total gas production will not change because of this, but perhaps the price of the gas will? We consider there to be two major schools of thought on this:

1) Balancing gas, cash-outs etc. are an ancillary service and thus the gas prices are locked in, and any cash-out costs that shippers receive are passed onto NZ Inc. Under this scenario, any benefits would only affect the small quantum of balancing gas rather than the actual price of gas. Further, it is likely that after looking at the net costs and other net benefits, then additional costs will be passed onto NZ Inc, thus increasing the overall price of gas.

2) Balancing gas, cash-outs etc. are included within the price of gas at the moment. It would be very difficult to assume that if there was a reduction in cash-out costs that this would be passed onto NZ Inc. if it is already included in the price of gas. This is because most gas sales quantities are locked into medium-long term contracts for the sale/purchase of gas at fixed prices. At the end of the contract when parties go out for tender, will new prices be affected by changes in a small ancillary service (0.1% of total market), when factoring in inflation, considering historical pricing trends or will they be affected by supply/demand considerations about the majority of gas that has been produced? Commercially speaking the latter would be the biggest influence, meaning that any reduction in the price of gas in the future would likely be due to supply and demand. Prima facie, it is unreasonable to say that the balancing work-stream would drive a decrease in the price of gas. Gas prices will be driven by the market based on supply and demand.

Greymouth Gas would be much more comfortable if decisions on the rules were made by or at least supported by parties with a financial exposure to the rules.

At the moment most of the savings look like they are going to go to the parties who are outsourcing their risk for free – Maui and Vector. All the risk, both upside and downside will ultimately sit with consumers.