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Matthew Wilson
General Manager
Commercial Operator – Maui Pipeline
By email: matthew.wilson@mauipipeline.co.nz

Dear Matthew

Market Based Balancing Change Request pre-consultation

Vector is pleased to have the opportunity to provide feedback on MDL's proposed Market Based Balancing (MBB) change request through this submission, as well as through the industry workshop and other opportunities to meet which MDL has provided.

Introduction

Vector recognises that some unresolved issues around pipeline management remain but does not believe that all of the outstanding issues have been properly identified or defined. Vector therefore considers that it is not possible to form a proper view about the appropriateness of the proposed MBB change request without a better understanding of all of the unresolved pipeline management issues.

The causes and effects of balancing issues occur throughout the industry, including downstream (end users) and upstream (producers). Balancing issues are not confined to transmission, so solutions should not be confined to transmission arrangements.

Vector believes that only a collaborative approach by industry will provide a robust and lasting resolution to pipeline management issues. Significant progress has been made in addressing transmission access issues through a Vector and MDL convened industry working group set up for the purpose. Vector submits that a similar approach, encompassing wider industry stakeholders to represent the various interests affected by balancing, could draw on the momentum and success experienced by that working group to produce a collaborative solution.

Vector acknowledges that MDL has immediate balancing concerns caused by high pressure incidents on its pipeline but as stated above believes that these issues are best addressed through a collaborative industry approach rather than the proposed MBB change request, which does not improve information available to Shippers to manage their nominations. We also consider a collaborative industry process is the best mechanism to understand the problems that MDL is seeking to address and implement efficient "interim" solutions in order to address these problems.

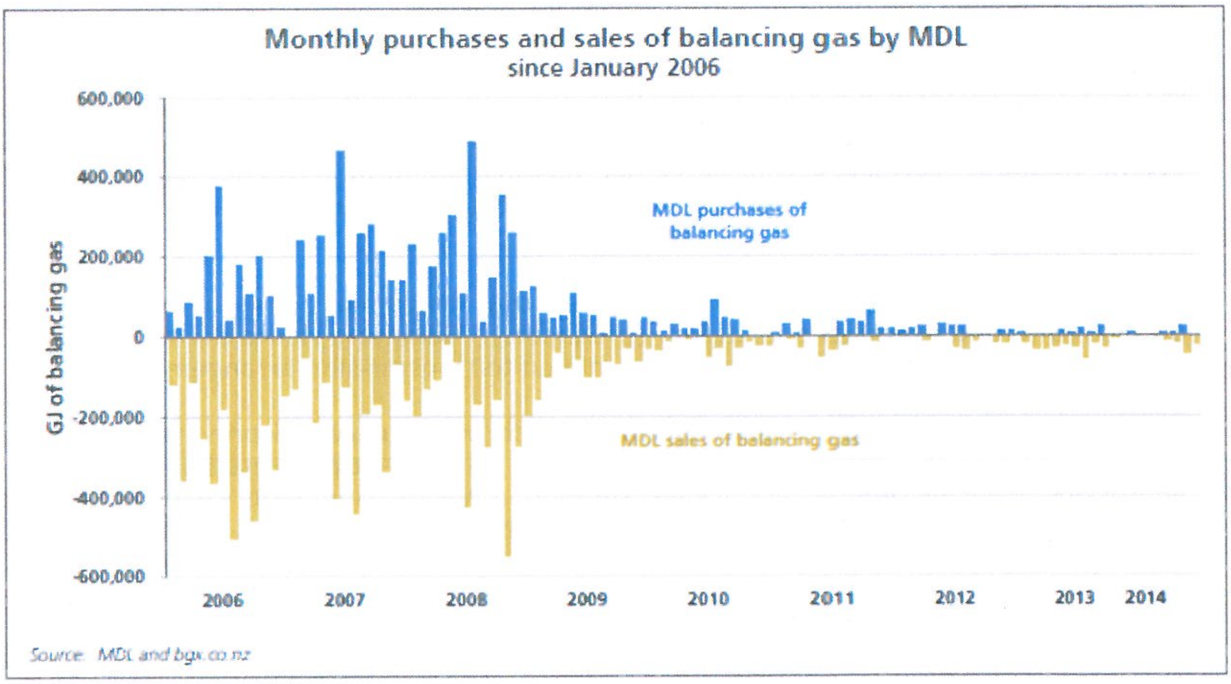
Although MDL has asked at this stage only for feedback on its proposed MBB change request, we do not want to confine our submission only to that change request. Vector does not support the change request. However, we believe that a submission that only disagrees with a proposal without offering constructive alternatives is unhelpful. We have therefore attempted to set out what we understand to be the problem definition, together with some analysis and potential solutions.

Problem definition
It is difficult to properly assess any proposed solution without a problem definition. Vector acknowledges that the issue is complex, and a comprehensive problem definition can only be achieved through full industry involvement. However, we have been able to identify some aspects of the problem definition through discussions with MDL and Shippers, and through the MDL balancing workshop.

Pipeline management requires an RPO to keep pressure at a level at which it can ensure reliable, efficient and safe transport of gas. Where pressure levels are too high or too low, balancing action is required.

Although any system should accept some level of residual balancing as inevitable, balancing becomes an issue needing resolution if the frequency, volume and/or cost of balancing becomes too large a burden on system participants.

In 2008, balancing transactions amounted to over $5 million. As the industry has become more familiar with balancing, and some initial improvements have taken effect, annual transaction values have reduced significantly. In 2013 total transactions amounted to $344,150. The graph below, from the GIC's quarterly report to 30 June 2014, shows the change in transaction volumes over time.



We believe this shows that significant improvements have been made to balancing since the issue was first addressed. However, MDL is still experiencing pressure issues on its pipeline, particularly incidents of high pressure, which are a cause for concern. MDL also asserts that the true costs of balancing are not represented in the GIC's graph. However, it has not specified those costs to the industry.

Vector believes there are a number of underlying causes and aggravators contributing to high pressure incidents and associated costs, including:

- *Information gaps*
  Lack of information available to Shippers to enable them to accurately manage their nominations to the level MDL would like, on a daily basis. No amount of balancing incentives will improve the accuracy of nominations if the information gap is not also addressed. This would require:

- improvements/modifications to downstream reconciliation rules; and/or
    - improvements to validated metering data; and/or
    - telemetry on more metering including mass market customers (which is not feasible at present); and/or
    - an improved open access IT system (i.e. an OATIS upgrade)

- *Inflexible nominations*
  Inflexible nominations, both in terms of timing and the inability to profile nominations to account for peaking, prevent Shippers from better managing their positions and exposure to balancing costs. The current nomination cycles also put restrictions on MDL's ability to carry out balancing actions between nomination cycles.

  We note that the EU regulations, on which the MBB change request is based, provide for hourly nomination cycles on the day (excluding the last few hours of the day). We do not believe that Daily Cash Outs should be considered unless such increased nomination cycles are available. Vector is currently investigating options for a replacement system for OATIS. A new system could potentially offer more frequent nomination cycles, and allow for profiling within nominations.

  In the meantime, we do not believe it is feasible to increase the number of number of nomination cycles in OATIS, although we would be willing to investigate this further if industry believes it could help address the issues. However, cycle times can be changed, if this would help better manage balancing in the short term. We would also like to discuss whether MDL would be prepared to take balancing actions outside the current cycle times, on the basis that OATIS could be updated at the next cycle or post the gas day.

- *Producer station operational restrictions*
  We believe that the level of flexibility at producer stations affects the ability of industry participants to keep the pipeline in balance. The flexibility offered to the system by older production fields is predicted to decrease significantly in the near future, and this could exacerbate pipeline pressure (particularly high pressure) issues. .

- *Market restrictions*
  Current restrictions on access to the BGX mean that balancing transactions are not necessarily made at market prices. Further, our analysis shows that MDL may have difficulty at times accessing "put" gas transactions – i.e. when high pressure on the pipeline requires them to sell gas. If the market were open to participants on the Vector side of the pipeline, MDL may be able to shift this gas more easily. In particular, the existence of gas storage facilities on the Vector pipelines should alleviate this issue, if MDL was able to access them as part of its balancing portfolio. MDL could contract with storage owners directly in situations where the BGX did not provide adequate options.

- *No link between costs and cause*
  Under the current arrangements, there is little link between balancing costs and causers due to the ILON process, Daily Incentive Pool Debits only being one sided and Peaking being one sided. We agree that incentives should be improved, but they must be improved in a meaningful and effective manner. Vector also fails to understand why the Peaking Tolerance for a producer is 150% of their Hourly Scheduled Quantity. Surely this does not assist MDL in managing high pressure on the Maui Pipeline. In the opposite position Delivery Points are only allowed a Peaking Tolerance of 125% or a GJ amount, therefore meaning a mismatch between the two could aggravate the situation.

Vector believes that no single change request to the MPOC, or to the VTC, can resolve all of these issues. A robust solution can only be achieved through an inclusive industry-led process.

The MBB Change Request

Vector believes that the MBB Change Request does not address any of the issues listed above, or at least not effectively or efficiently. In particular:

- *True balancing costs are not properly signalled to industry participants or end-users*
  The MBB Change Request removes the already weak link between balancing actions taken by MDL, and their associated costs, and the costs charged to Welded Parties and then onto Shippers on the Vector Pipeline. Daily cash out charges are not related to whether any balancing action needed to be taken on a particular day and are essentially an artificial cost. This is contrary to the GPS principle that full costs of producing and transporting gas are signalled to consumers.

- *"Market price" is not true market price*
  One of the reasons given for the proposed change request is the expressed desire of industry participants for balancing transactions to be carried out at market price. The calculation of market price in the proposed change does not reflect actual market price:
  - Cash-out prices are set with reference to market prices, but are subject to an adjustment which could mean they are higher or lower than market price;
  - The reference "market price" is the highest or lowest (depending on whether it is a positive or negative cash-out) price achieved for any sale or purchase that day. So even if the majority of balancing gas was purchased at a lower market price, if a small amount was purchased at a premium market price, it is that price which applies.
  - As mentioned above, the cash-out transactions are not related to balancing actions so even if cash-out prices were truly set to market prices, Welded Parties and Vector's Shippers would not be paying for balancing at the market price of balancing transactions actually taken. That is, they will be paying what is essentially an imbalance charge irrespective of the actual balancing cost.

- *Investment incentives are inefficient*
  As mentioned earlier, some Shippers do not have access to the information required to improve nominations to the extent required to minimise their exposure to Daily Cash Outs. Depending on the level of those cash outs which eventuate, Shippers may be incentivised to invest more in forecasting tools, metering and demand side management. However, this does not recognise the fact that Daily Cash Outs are not the only solution to balancing and that existing investment exists (e.g. gas storage facilities) which could alleviate the problem if utilised effectively.

  The GPS principles require investment incentives to be maintained or enhanced. A change request which ignores existing investments which could assist balancing issues, and the fact that medium term IT investment is planned which could address some of the information issues identified, does not meet that requirement.

- *Daily Cash Outs will not achieve a solution*
  MDL's reasoning for using Daily Cash Outs is that they will incentivise Welded Parities and Vector's Shippers to change their behaviour and better manage their own balancing positions. This may be true to an extent. However, Vector's Shippers who do not have access to the information necessary to improve their nominations or manage their position daily, will not be in a position to change. Those Shippers will be unduly penalised, and their cumulative imbalances and inability to manage will impact on other Shippers, even those able to better manage

their daily position. The underlying causes of pipeline imbalances will not be addressed.

- *Daily Cash Outs pose a barrier to competition*
  The proposed daily cash out regime has the potential to be overly punitive, particularly on Shippers who do not have access to real time data to improve their forecasting on an immediate daily basis, or manage their position. This would be a disincentive on new entrants to the market and contrary to the GPS principle to minimise barriers to competition.

  If Daily Cash Outs are to be progressed, that should be done on the basis of solutions which rely on notional allocated data, which would allow Vector's Shippers without real time information to manage their balancing position without being penalised for not having access to real time data.

- *The proposed change request does not result in sustained downwards pressure on delivered gas costs and prices*
  Our calculations indicate that without addressing the lack of information issues, the proposed Daily Cash Outs will result in significant costs on Vector's Shippers, particularly those with mass-market customers. Those costs will either have to be absorbed by Vector's Shippers or, more likely, passed on to end users. Because the proposed change request does not address all the underlying causes of balancing issues (as identified above) this increased cost delivers very little value to the industry.

Interim measures
Vector acknowledges that an industry-led solution will not provide immediate relief to balancing problems currently being experienced. We are very willing to discuss with MDL short term fixes which could be put in place pending a comprehensive solution. For example:

- Nomination times could be changed to better recognise peak usage times;
- Vector could provide MDL with additional information relating to the Vector pipeline, to give MDL more comfort about delivery of "balancing gas" if it were to open the BGX to all industry participants;
- Vector could work with its Shippers to look at providing comfort that balancing actions taken on the emsTradePoint market would not be disputed if an action was found not to have immediate effect on the Maui Pipeline, though we accept that this direct link between balancing action and linepack movement is currently an issue with the BGX; and
- Vector would be willing to discuss other changes to the back to back balancing change request to give MDL confidence to adopt that change request.

Material adverse effect
Vector's preliminary view is that the MBB change request could have a material adverse effect on Vector's pipeline business, or compatibility of MDL and Vector's open access regimes. In particular:

- If validated metering data will be required earlier on the next day and on every day, including weekends and public holidays, our existing metering team resource and system will need significant expansion, at a substantial cost. If validated data is not provided daily, any inaccuracies will be cumulative, which will affect all Welded Parties and Vector's Shippers' ability to manage their position.
- Moving Cash Outs to a daily calculation will increase the amount and number of Cash Outs. Vector bears a portion of those costs along with its Shippers as it

manages its UFG and fuel gas on a daily basis. Our initial calculations show that these costs could increase significantly under the MBB change request.

- It is not clear whether further changes would have to be made to the VTC – in addition to, or instead of, those made in connection with the back to back change request – to ensure compatibility between the Codes.

Because the MBB change request is still in draft, and Vector does not believe it should be pursued, we have not investigated these issues fully. We believe resources are better used in finding a robust and comprehensive industry-led solution.

We look forward to discussing these issues constructively with MDL after it has had a chance to review all submissions received.

Yours sincerely

Brenda Talacek

Brenda Talacek
Group Manager, Commercial Relationships – Networks