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31 January 2012

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Dear Ian,

13 October 2011 Change Request – cross submission

Introduction

MDL submitted a balancing-related MPOC Change Request application to the Gas Industry Company (**GIC**) on 13 October 2011 (**Balancing CR**). The first round of industry submissions on the Balancing CR closed on 14 November 2011. This cross submission sets out MDL's comments in response to those first round submissions.

Having carefully considered the first round submissions and noting the continued improvement in nomination accuracy, MDL remains of the view that the Balancing CR strikes the optimum balance between accounting for the many and varied commercial realities the industry faces; facilitating reasonable, incremental change; and meeting the efficiency enhancing objectives of the Gas Act.

To the extent that there are what are perceived in the industry to be stumbling blocks – the most obvious example being the limitations of the Vector balancing and peaking cost allocation systems – we are working proactively with the relevant stakeholders (where applicable) to find solutions.

During the MDL-led industry consultation process there was clear feedback from customers that MDL should propose small, focused Change Requests, and not group together too many changes covering different matters at once. While MDL is in the process of investigating submitter suggestions for additional MPOC changes we firmly believe that such suggestions should be considered on an individual, case-by-case basis, outside of the GIC's consultation process on the Balancing CR, and certainly not as conditions precedent for its approval by the GIC.

Current balancing activity

Now that 2011 has past we have the benefit of another year's experience of the balancing market's operation post-Maui Legacy Gas Contract. In brief: MDL purchased 278.6TJ of call Balancing Gas in 2011 at a total cost of \$1,377,680. Note however that 40TJ of that was used in restoring stability to the Pipeline following the Critical Contingency of 25 – 30 October. Removing this "outlier" from the equation, MDL purchased only 238.6TJ of Balancing Gas, a 25% reduction on 2010 call volumes of 321TJ. 2011 volumes were 9% of the volumes in 2008 (2,513TJ).

Why implement the Balancing CR?

Despite this sustained improvement MDL remains of the view that by more effectively targeting costs to the “causers” of balancing transactions the industry can continue to put downward pressure on the costs of balancing – without any associated reduction in system reliability. MDL also continues to believe – consistent with the basic economic principles reflected in section 43ZN of the Gas Act and the GPS – that the limited level of flexibility that the Maui Pipeline offers should be allocated to the Parties that value it most, to maximise benefits to the gas market and the New Zealand economy generally. These are the very types of considerations that the GIC is mandated to take into account in carrying out its role in the Change Request process. We refer specifically to the Memorandum of Understanding between MDL and the GIC dated 5 October 2006 (**MOU**) (in particular, to paragraphs 2.2 and 2.3).

There are also risks and benefits that warrant specific consideration. For example:

- Proposals for the commissioning of new peaker facilities may result in:
 - A change in the profile of intra-day supply and demand that may not be able to be managed through the current balancing and peaking cost allocation systems. This is particularly so given that Welded Parties currently have effectively two Days (and in some cases wide tolerances) to balance their position to avoid incurring cash-out charges.
 - An increase in various Delivery Point Welded Parties’ capacity to take Gas at short notice and cause call balancing transactions, then balance their positions by the end of the Day thus avoiding charges.

While it has been argued that MDL should “wait and see” if these risks are more actual than perceived, we remind industry of the growing industry preference for full consultation processes, and the temporal implications this preference has in terms of getting a change through when required. In short MDL would prefer to close off a risk before it crystallises, rather than attempting to rush a change through once it does, especially as there is no cost in taking such a preemptive action.

- Operating costs in some areas are likely to increase. For instance, in the near future all Balancing Gas and fuel gas will have to be purchased at market prices. The counterfactual to the Balancing CR is not the current situation but one where these additional costs will have to be taken into account. A balancing cost allocation regime that more accurately assigns costs to “causers” will assist in placing downward pressure on these costs as well as enhancing system reliability.
- The Balancing CR if approved would introduce a system that better manages over-pressure situations. It will allow daily cash-outs whereas the current system allows Welded Parties to remain in positive imbalance for up to two Days without consequences.

MDL also notes that by implementing the Balancing CR, industry will be further incentivised to pursue complementary system enhancements. Extension of a nominations regime to large users on Vector’s transmission pipelines, a daily (as opposed to monthly) allocation system downstream and streamlined dispute resolution procedures are all improvements that would benefit the industry as a whole. That the proposed regime disincentivises bad practice within the status quo is not a reason to reject it.

Interoperability and the Vector ICA

MDL and Vector have had a number of informal but productive meetings over the summer months to discuss interoperability of the two regimes. While progress continues, MDL prefers not to comment on the various “material adverse effect” assertions raised by Vector in its submission, given this is a purely contractual matter between two Parties. Industry will be apprised of developments at the appropriate time. For now we continue to work with Vector to resolve the issues at play in accordance with the mechanisms prescribed by the Vector ICA. We trust the GIC’s approach to its assessments will reflect this and be confined to the considerations set out in the MOU. There is a risk however that notwithstanding GIC approval, MDL may not be in a position to effect the proposed code changes if prevented from doing so by Vector’s position.

Submitter requests

Submitters made a number of specific requests during the initial submission round. Some requested that the scope of the Balancing CR be expanded to include other workstreams which, in their view, are in some way connected to balancing. We respond to the most common requests in turn below.

- **BGX2**

MDL has undertaken a project to develop a spot gas exchange, commonly referred to as the BGX2. While a large portion of the work is complete, difficulties have arisen with respect to the ownership and governance structure of the exchange.

Methanex suggested that BGX2 should be operational as a condition of the Balancing CR being implemented. Genesis is open to suggestions as to the ownership question. Contact has indicated that the proposed system may be too complex in its current form and questions the level of use that the BGX2 would in fact attract. Support, or at least appetite, for the platform is by no means uniform.

MDL continues to consider options for structuring BGX2, and once again invites industry to put forward their own suggestions as to how the Settlement Manager role may be owned and governed.

For its part, to some extent, MDL shares Contact’s reservations in relation to the level of use for as long as the existing transmission regime has: wide tolerances, long duration tolerances for correction of imbalances, and incentives fees which are contingent only on balancing actions occurring.

Recognising the “chicken and egg” situation, MDL considers the Balancing CR is the appropriate first step to breaking the dilemma, and incentivising the development of a trading market.

- ***TPWP participation on the BGX***

MDL does not currently permit Shippers to trade on the BGX through TP Welded Points (**TPWPs**), (i.e. Frankley Road and Rotowaro). This restriction was put in place because of the complexity of operations beyond the TPWPs and the difficulty that MDL would have in ascertaining whether a supplier actually flowed the gas they were contracted to flow, with the risk that the actual flow might occur days after MDL's need for the gas, owing to the excessive flexibility provided at the TPWPs (as indicated in the previous section). When MDL undertakes a balancing transaction it is invariably a result of physical conditions on the pipeline which need to be rectified as a matter of urgency. MDL is aware that there are a number of producers (and a storage facility) connected to Frankley Road which could add greater depth to the balancing market. The case for considering relaxing this restriction would be strengthened if the Balancing CR were implemented and, ideally, if improvements were made downstream – for example, the introduction of a fully transparent nominations regime for large users, daily allocation and a commitment to adhere entirely to OBA allocation principles. The question of limited recourse that has been raised against MDL in relation to downstream balancing and peaking charges would also have to be unambiguously resolved.

- ***Fifth Intra-Day Cycle***

Methanex and the Major Gas Users Group submitted that they would support the Balancing CR if (among other things) MDL were to provide Shippers with a fifth Intra-Day Cycle. MDL empathises with these requests and has already given them consideration. Although no changes to MPOC would be required the matter is not necessarily settled. For example, not all stakeholders support the proposal in principle, and others do not support the revised timeframes proposed by the Major Gas Users Group. The required alterations to OATIS may prove to be too expensive given that this software is near the end of its life.

- ***Title transfer for peaking***

MDL has been aware for some time that certain stakeholders believe that title transfer should be incorporated into peaking charges in the same way that title is transferred under cash-outs. The Balancing CR does not include title transfer for peaking as peaking charges do not relate to Running Operational Imbalance (which relates to Gas quantities that can be bought or sold); they relate to an obligation to keep the flow of Gas reasonably constant through the Day and may not be accompanied by any Running Operational Imbalance on the Day. Any title transfer would have to be ultimately matched by another market transaction by the Balancing Agent and the price adjusted accordingly.

Under the Balancing CR, the peaking charge is calculated as the Negative Mismatch Price less the Positive Mismatch Price; thus the peaking party is not required to pay the spot price but only the spread. This formula contemplates that title will not pass. With the introduction of a spot market for gas, the spread and therefore the peaking charges should reduce.

The changes envisaged would also require both MPOC and OATIS changes – the latter at significant cost and both at potentially significant delay.

- ***Peaking charges limited to under-recovered amounts***

Limiting peaking charges to unrecovered amounts would result in unpredictable balancing cost recovery for MDL. Pipeline users should not be concerned about MDL profiting from peaking charges as income from these will come within MDL's overall revenue cap.

MDL has proposed a very moderate incentivisation mechanism which applies only in circumstances where a large pipeline imbalance already exists.

- *Cap on balancing transaction price*

Vector suggested in its submission that the lack of a cap on cash-out or peaking charges could be seen as an undue risk and that MDL should consider capping its charges. MDL has considered this request but notes that if the price of Balancing Gas exceeded the cap, then MDL would likely chose not to purchase the gas.

In this way a price cap would distort market efficiency. MDL prefers to have discretion to take all matters into consideration at the time balancing decisions are made. In some instances sourcing a small volume of Balancing Gas (albeit at high prices) can significantly enhance service reliability by preventing curtailments.

- *Fuel Gas*

Some submitters suggested that fuel gas should be separately accounted for. This will be required under the Commerce Commission Determinations due to come into force later this year. Fuel gas use can be monitored on OATIS through the Mokau Welded Point.

- *Threshold balancing codification of Standard Operating Procedures*

MDL has conducted a number of studies of this option. All have concluded that the introduction of compulsory balancing requirements at specific Line Pack values will significantly increase balancing costs compared with the current practice. MDL does not support the codification of its Standard Operating Procedures.

Implementation costs

From MDL's perspective the cost of implementing the Balancing CR is low. There are no required system changes to OATIS or the BGX, and MPOC changes have already been drafted. MDL has been careful not to introduce any new concepts that would require significant changes to documents relying on MPOC definitions.

Drafting errors

It has come to our attention – through submissions lodged on the Balancing CR and following informal conversations we've had with industry on the subject – that the marked up MPOC submitted on 13 October contained several drafting errors. We identify these errors in the Appendix and request that they be rectified for the purposes of the Balancing CR going forward. We believe these small changes can be accommodated within the current consultation process.

General

We thank the GIC for the opportunity to prepare this cross-submission and look forward to playing our part in the consultation process as it moves forward. MDL is more than happy to discuss the content of this document or any matter in connection with the Balancing CR.

Yours sincerely,

Blair Robertson

Commercial Manager

for Maui Development Limited



APPENDIX – DRAFTING ERRORS

Section 3A.4(a)

Insert “to” after “Balancing Agent” –

3A.4 MDL will:

- (a) *instruct the Balancing Agent **to** use all reasonable endeavours to buy and sell Balancing Gas in accordance with the following principles...*

Section 11.3

Replace section reference “8.31” with “8.30” –

- 11.3 *Because the Maui Pipeline operates using the Primary Allocation Agreement’s OBA Principles at all Welded Points, Mismatch does not generally arise. Accordingly this section 11 shall apply only in the circumstances described in section ~~8.31~~**8.30**.*

Section 12.10(b)(v)

Replace the reference to “Positive AEOI” with “Running Operational Imbalance” and the reference to “24:00” with “23:59”–

- 12.10 *If, at the end of any Day_n, a Physical Welded Point has a Negative AEOI then:*

...

- (v) *reduce the ~~Positive AEOI~~**Running Operational Imbalance** at that Welded Point by the Cash-Out Quantity,*

*with all such transactions being completed, and title in such Gas deemed to pass from MDL to the Welded Party, at ~~24:00~~**23:59** on that Day_n.*

Section 12.11(b)(v)

Replace the reference to “Positive AEOI” with “Running Operational Imbalance” and the reference to “24:00” with “23:59”–

- 12.11 *If, at the end of any Day_n, a Physical Welded Point has a Negative AEOI then:*

...

- (v) *reduce the ~~Negative AEOI~~**Running Operational Imbalance** at that Welded Point by the Cash-Out Quantity,*

with all such transactions being completed, and title in such Gas deemed to pass from MDL to the Welded Party, at **24:0023:59** on that Day_n.

Schedule 7, Peaking Limits

In the second column, reinstate "Tolerance" and delete "Limit" (restoring the status quo).

Welded Point (Large Stations only)	Peaking Limit <u>Tolerance</u> (% of HSQ)	Peaking Limit (GJ)
Oaonui Meter Station	150%	0