



Transmission Pipeline Balancing - Analysis of Submissions on Statement of Proposal, and Decision

December 2009





About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy and Resources on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

Authorship

This paper was prepared by
Ian Wilson

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Introduction

Background

In October 2009, Gas Industry Co issued a Transmission Pipeline Balancing Statement of Proposal (Statement of Proposal). That Statement of Proposal contained details of Gas Industry Co's preferred option for providing an efficient, unified balancing arrangement on transmission pipelines. The option, known as the 'participative regulation option', was first described in the Transmission Pipeline Balancing Second Options Paper (Second Options Paper) in August 2009.

The participative regulation option allows transmission system owners (TSOs) an opportunity to appoint a single 'Balancing Agent' and propose a 'balancing plan' that meets criteria specified in statutory rules. If the TSOs cannot agree, the Draft Gas Governance (Balancing) Rules (Draft Rules) would require Gas Industry Co to appoint the Balancing Agent and develop the balancing plan. Gas Industry Co's assessment concluded that this option would achieve the Gas Act 1992 (the Gas Act) and the Government Policy Statement on Gas Governance (GPS) objectives better than a contracts based option, or the more prescriptive regulatory options it considered.

The Statement of Proposal also described an industry code development (ICD) process. A strong lobby of opinion in submissions on the Second Options Paper asserted that an industry solution was feasible. As a result, Gas Industry Co decided to run this process in parallel with the continued development of the participative regulation option. The ICD process involved an intensive set of industry meetings aimed at developing a contracts based balancing solution that limits the scope of regulation. 11 industry participants, including the two TSOs, participated in the ICD process and contributed significant executive time to achieving quality discussion and outcomes.

Submissions received

Submissions on the Statement of Proposal were received from:

- Contact Energy Limited (Contact);
- Genesis Energy Limited (Genesis);

- Greymouth Gas Limited (Greymouth);
- Maui Development Limited (MDL);
- Mighty River Power Limited (MRP);
- Multigas New Zealand Limited (Multigas);
- New Zealand Steel Limited (New Zealand Steel);
- On Gas Limited, Vector Gas Contracts Limited, and Vector Gas Limited (together, Vector); and
- Todd Energy Limited (Todd).

The submissions are available on Gas Industry Co's website www.gasindustry.co.nz.

Gas Industry Co thanks those involved in preparing these submissions.

Structure of this paper

This paper begins with a summary of submissions on the Statement of Proposal. It then follows the layout of the Statement of Proposal, briefly reviewing what the paper said on each topic, what submitters' views were, and gives Gas Industry Co's response to those views. It then provides an update on industry efforts to reach a contracts based solution. In conclusion, it sets out Gas Industry Co's decision on what will be recommended to the Minister.

A glossary of terms is listed at the end of this paper.

Next steps

Gas Industry Co will now advise the Minister that it intends to recommend 'participative regulation' option described in the Statement of Proposal. However, to allow the industry more time to fully engage in reviewing the draft rules and developing implementation plans, we will not send a formal recommendation until the end of February 2010.

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Overview of submissions

Contact

Contact does not support the Statement of Proposal. It believes that Gas Industry Co has failed to adequately assess the participative regulation option against the Gas Act and GPS objectives. In particular, it considers that the qualitative analysis presented in the paper was not sufficient and that Gas Industry Co must undertake a quantitative cost benefit analysis before it can make a recommendation to regulate. Contact expressed a number of concerns with Gas Industry Co's proposal, including that:

- there is a high risk of confusing the responsibility and accountability of each TSO and the Balancing Agent;
- the regime does not create the correct incentives;
- it does not capture wider balancing issues; and
- there is no comprehensive end goal captured in the proposal.

Contact remains of the view that a contracts based solution to balancing is preferable. However, while it supports Gas Industry Co's decision to pursue the ICD process, it considers that Gas Industry Co has not provided sufficient time for industry to resolve balancing arrangements within this forum. It is also notes that Gas Industry Co resources would be better directed to resolving the more difficult aspects of a balancing solution.

Genesis

At this stage, Genesis does not agree with Gas Industry Co's decision to pursue the participative regulation option. Genesis recommends that Gas Industry Co delay its decision on whether to proceed with Draft Rules until 2010. It notes that the ICD process is making good progress and the additional time would allow the ICD process to 'run its course'.

Genesis considers that the ICD process is capable of delivering on most of the outcomes Gas Industry Co seeks via regulation and it expects that the outcome of the ICD process will most likely be a significant reduction in the scope of the current regulatory concerns to the point where a different, more limited, regulatory intervention will be required. However, if Gas Industry Co is determined to pursue a regulatory option, Genesis agrees that the participative regulation option appears to be the best option to pursue.

Greymouth

Greymouth notes that most of its comments provided in its submission on the Second Options Paper are still applicable.¹ It believes that the ICD process has been beneficial in allowing for high-level discussions to take place amongst industry participants. However, it considers that time will tell whether the process has proven economically efficient and effective.

Greymouth notes that due to the timeframe, it will be difficult to progress the issues, many of which can be pursued outside of a regulated option.

MDL

MDL opposes the proposed Draft Rules and believes that they should not be recommended or made. It is also of the view that the Draft Rules cannot be lawfully recommended and that, if they were, they would be both costly and difficult to implement.

MDL considers that Gas Industry Co has failed to follow the correct process under section 43N(2)(c) of the Gas Act, as the Statement of Proposal did not contain an appropriate cost benefit analysis, nor did it consider all reasonably practicable options, such as evaluating options by pipeline. Instead it considers Gas Industry Co recommended a 'one-size-fits-all' solution applicable across all transmission pipelines, regardless of the differences between the two regimes.

In MDL's view, in respect of the Maui Pipeline and the MPOC, a contracts based option is a reasonable practicable option.

MDL also believes that the proposed Draft Rules would:

- override or confiscate property rights;
- place new and onerous obligations on TSOs; and
- be difficult for MDL to perform the role and functions under the Draft Rules due to the terms of the Maui Joint Venture.

¹ That the participative regulatory option was preferred, especially given its swift timeframe, but that the objective should be reworked to ensure that improvements will be realised.

MDL submits that Gas Industry Co should instead focus its efforts on the evolution of MPOC balancing arrangements, including giving careful consideration to MDL's upcoming Change Request² and focus its regulatory attention on wider balancing issues such as, daily allocations; the provision of real time information; and balancing tools. It considers that Gas Industry Co should work with the industry through the ICD process to ensure all balancing issues are identified and addressed, and appropriate objectives, work plan, and timeframes are set.

MRP

MRP believes that a contracts based solution is preferable to a regulated option noting that regulation should only be considered as a last resort.

MRP is supportive of the ICD process; however, it is concerned that the timeframe is too tight and that the outcome necessary to stop or delay regulation has not been adequately identified. It considers that the ICD process can achieve most, if not all, of the objectives that comprise the regulated option in the Statement of Proposal.

Its submission also highlights a concern that, to date, neither of the TSOs has shown any enthusiasm to be responsible for a single balancing regime. MRP considers that significant costs could be added to the industry if Gas Industry Co had to exercise its powers under subsection 2 of the Draft Rules to appoint the Balancing Agent and devise the balancing plan.

MRP notes its disappointment that the Statement of Proposal focuses solely on upstream issues, given that one of the principles of an efficient balancing regime is the availability of information to shippers to manage their imbalance positions. The move to back-to-back balancing, in MRP's view, must be complemented with the implementation of daily allocations.

Multigas

Multigas agrees with both the Statement of Proposal and Gas Industry Co's decision to pursue the ICD process. It considers that, as long as the fundamentals of the regime are designed properly, matters such as tolerances, curtailment, and provisions for damages become less critical and easier to determine.

In order for the balancing regime to be effective, Multigas believes both pipeline systems need to function and have identical nomination and balancing characteristics. It notes that it would favour regulation if the status quo were to stay in place. Multigas believes that the MDL nomination model appears to be the ideal and fairest model for the industry to pursue.

² In its submission (p3), MDL notes that it is preparing an MPOC Change Request that would make further improvements to balancing arrangements in respect of governance, allocation of balancing costs, and potentially wider participation in the balancing market.

New Zealand Steel

New Zealand Steel makes its submission from the 'perspective of an integrated industrial end user of natural gas with a unique profile of gas usage'. After having reviewed the Statement of Proposal and participated in the ICD process, New Zealand Steel is in general agreement with the proposal to adopt the participative regulation option. New Zealand Steel considers that it has become apparent, since the removal of Legacy Gas arrangements in the MPOC³, that the mechanics and outcomes of balancing are misaligned with the primary goals defined by Gas Industry Co in the Options Paper⁴.

It notes its support for the principle of attributing balancing costs to causers, but thinks that there needs to be consideration on how to accommodate end users with a very volatile consumption profile. New Zealand Steel believes the best possible way to accommodate users with this type of profile is to give them opportunities to 'self-balance' through the nomination process. It suggests that, if the timing of the intraday cycles were more user-friendly, pipeline users could provide additional adjustments to their scheduled quantities to match their consumption profiles resulting in better self-balancing.

New Zealand Steel proposes that there would be a lot to gain if the timings of the current nomination cycle times are amended and the nomination confirmation process compressed. It also notes its view that any reduction in tolerances should be progressively made, and that all end users capable of taking part in transactions with a Balancing Agent should be allowed to do so.

Todd

If regulation of balancing arrangements is pursued, Todd considers that the participative regulation option is preferable to the prescriptive options. However, it considers that a contracts based solution would be quicker to implement, less costly, and more efficient in the long term.

Todd has participated in the ICD process and believes that significant progress is being made. It considers that attendees will be able to agree substantive changes to current arrangements that should avoid the need for regulation. It notes that conceptually, attendees of ICD process meetings appear to support:

- back-to-back balancing;
- the inclusion of rights and obligations of the entity performing balancing actions within the MPOC;
and

³ Until recently, pipeline balancing was largely managed through gas supply flexibility from the Maui Gas field, at no explicit cost to pipeline users. Even after the Maui pipeline became an open access pipeline in 2005, the overhang of legacy arrangements prevented the true cost of balancing being passed through to the beneficiaries of balancing services. During this period, both the Maui and Vector pipelines experienced significant volatility in imbalance, well beyond linepack flexibility.

⁴ See p8 of the Transmission Pipeline Balancing Options paper available on Gas Industry Co's website.

- wider participation by users on the Vector pipeline in the MDL-operated balancing market.

Todd, like other industry participants, is concerned about the tight timeframes involved in running the dual ICD/regulatory process. As a result, it notes that it has had insufficient time to review the detail of the Draft Rules. In Todd's view, a better process would have been to provide for the ICD process first and then the regulatory process. It considers it questionable whether regulation is required at all, but notes that there has been a strong focus amongst industry to make changes that will lead to more efficient arrangements.

Vector

Vector supports the continued emphasis that Gas Industry Co gives to develop improved balancing arrangements. It supports the decision to pursue the ICD process in parallel with the continued development of a regulatory solution. Vector considers that the regulatory solution should be pursued if the ICD process fails to deliver a solution.

It is strongly of the view that if, the regulatory solution is pursued, a number of the Draft Rules would need to be reformed to ensure fair and efficient outcomes. Vector is particularly concerned with provisions for TSO appointment and indemnification of the Balancing Agent and paying for its establishment and ongoing costs. Vector also suggests that the purpose of the proposed Draft Rules should be changed as they believe it does not fully reflect the Government's objectives for the gas sector.

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ICD process

What the Statement of Proposal said

Conclusions from the consultation process

The Statement of Proposal noted that several submissions received by Gas Industry Co on the Second Options Paper relayed strong messages that regulation was not warranted and that balancing arrangements should continue to take place under the existing contractual arrangements. In the Second Options Paper, Gas Industry Co expressed its view on the status quo, or rather a contracts based option, including reasons why it was unlikely to work.

However, the Statement of Proposal also noted that, with the increased likelihood of regulation, a markedly different attitude towards progressing an industry-led solution amongst participants had emerged. For example, one company asked that industry be given an extension of three months and, if at the end of those three months, tangible progress had not been made, then it would accept a regulated solution. The Statement of Proposal also acknowledged MDL's submission on the Second Options Paper, in which it outlined a work programme to show Gas Industry Co the changes it has been progressing in order to meet balancing objectives. The Statement of Proposal encouraged these changes, but noted that the changes will not achieve a unified balancing regime, which is at the core of Gas Industry Co's proposal.⁵

Although Gas Industry Co has misgivings about the possibility of reaching a contracts based solution⁶, it accepted that the possibility had become more realistic, given the apparent level of industry support. Therefore, Gas Industry Co decided to propose a process aimed at minimising the scope of the Draft Rules, while targeting a more unified balancing regime.

ICD process

The Statement of Proposal proposed that the ICD process run parallel to the continued development of Draft Rules with the intention of making a recommendation to the Minister before the end of the

⁵ Appendix A of the Second Options Paper - Analysis of Submissions contains Gas Industry Co's complete analysis of and response to MDL's proposed work programme.

⁶ See section 5.4 of the Second Options Paper for the complete analysis available on Gas Industry Co's website.

⁹ Note that the ICD process attendees have determined that 'integrated' is a more appropriate word than 'unified' in relation to the balancing regime the group is aiming to achieve.

year. To allow for a intensive, facilitated effort Gas Industry Co appointed an independent chair to facilitate weekly ICD meetings.

To secure the commitment of industry participants, Gas Industry Co required each company to sign a form agreeing to:

- participate in the ICD process by, as a minimum, attending half-day facilitated workshops each week, starting in September 2009, until the end of the calendar year (if the objective is not achieved before then);
- accept the ICD process terms of reference; and
- contribute towards funding the process.

The Statement of Proposal noted that the outcome of the ICD process may have an impact on Gas Industry Co's recommendation to the Associate Minister at the end of the year. It also noted that, in the event that the outcome substantially changed the scope or content or the proposed rules, Gas Industry Co would issue a revised statement of proposal.

What submissions said

The majority of submitters agree with Gas Industry Co's decision to pursue the ICD process; however, some expressed concerns regarding the timeframe, objectives, and lack of sufficient detail of what outcome is required to avoid regulation.

MDL and Contact agree with the concept of the ICD process but believe it contains some flaws. The timeframe is of particular concern. Based on previous experience with the TSOs when attempting to agree on a Critical Contingency Management Plan under the Gas Governance (Critical Contingency Management) Regulations 2008 (Critical Contingency Regulations), both consider that the ICD process does not allow enough time to identify practicable plans.

Based on its participation in the ICD process, Vector believes that a contracts based solution is plausible. However, like New Zealand Steel, Vector points out that, in order for the process to be a success, parties must be prepared to commit to a set of deliverables that will give the Minister confidence the industry is committed to a contracts based balancing solution.

A number of submitters highlighted the benefits that would accompany a contracts based solution.

MRP expressed its full support for the process, noting that the ICD process will present the most cost effective solution and that regulation should only be pursued as a last resort. Contact considers that high cost, inflexible, regulated solutions should be avoided. Going further, it submits that Gas Industry

Co's decision to pursue the ICD process is consistent with section 43N of the Gas Act. However, it also acknowledges that the balancing plan in the proposed regulatory solution would address some of its concerns about low flexibility and lack of innovation.

Genesis points out that a successful ICD process has the ability to allow participants to develop preferred arrangements that will be able to evolve overtime and limit the scope of any future regulatory intervention. It also notes that, even if not successful, the process will still be seen as beneficial as it has given participants a good 'running start' on work that will be required under a regulated solution.

Todd also notes its support for the ICD process and a contractual based balancing solution. In its view, a contractual solution would be quicker to implement, less costly, and more efficient in the long term. Based on its participation in the ICD process, Todd has observed that, conceptually there appears to be a high degree of support for changes to contractual arrangements to provide for: back-to-back balancing; the inclusion of rights and obligations of the entity performing balancing actions within the MPOC; and, wider participation by users on the Vector pipeline in the MDL operated balancing market.

Greymouth considers that the process has provided a useful forum for high-level discussions, but only time will tell whether it has been economically efficient and effective.

Gas Industry Co comment

Gas Industry Co notes the high level of support for both the ICD process and a contracts based solution. We agree with Genesis that, even if the process does not deliver a successful outcome, it will have been a beneficial forum for industry to engage on balancing issues.

We also note concerns regarding the ICD process. The balancing work stream has been in progress for over a year and, in that time, industry has not shown that it could develop a contracts based balancing solution that addressed the issues Gas Industry Co has identified (with assistance from the Transmission Pipeline Balancing Advisory Group (TPBAG)). The matter does need to be brought to a timely conclusion.

Some participants also noted that the purpose and objectives of the ICD process were unclear. Yet in the Terms of Reference for the ICD process, Gas Industry Co identified both the purpose and the objective as follows:

Purpose

To provide a facilitated consultative forum at which pipeline owners, interested parties and Gas Industry Co can design a unified balancing regime for the open access transmission system, and the means of implementing that regime. The output of the ICD process will be considered by Gas Industry Co when it makes a recommendation to the Minister by the end of 2009.

Objective

To design and implement a unified⁹ balancing regime for the New Zealand gas transmission system that will avoid or minimise the need for regulatory intervention to achieve the relevant objectives of the Gas Act and GPS¹⁰.

In Gas Industry Co's view both were sufficiently clear. Gas Industry Co also made suggestions about what material attendees of the ICD meeting might cover in their discussions. Gas Industry Co even presented on the 'counterfactual' (the regulatory solution) to the group to help attendees understand what needed to be included in the ICD solution in order to influence Gas Industry Co's recommendation on the matter.. The emphasis, however, was on industry developing a solution for Gas Industry Co to consider, rather than Gas Industry Co dictating an outcome.

Gas Industry Co was present at every ICD meeting and, like Todd, we also observed that there appeared to be general agreement among attendees on a number of issues. However, we also observed the difficulty the group had in reaching agreement on other issues, and the lack of any 'deadlock breaking mechanism' to settle such matters.

¹⁰ For more information on the ICD process, including the Terms of Reference, please visit: <http://www.gasindustry.co.nz/work-programme/transmission-pipeline-balancing?tab=1511>

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Statement of proposal

What the Statement of Proposal said

This section contained details of Gas Industry Co's proposal for pipeline balancing arrangements as required by section 43N(2)(a) of the Gas Act.

Gas Industry Co's Statement of Proposal

The Statement of Proposal proposed proceeding with the participative regulation option. The option was first presented in the Second Options Paper as Gas Industry Co's preferred option. The option comprises of a set of Draft Rules for balancing arrangements. The Draft Rules provide for TSOs to jointly appoint a single Balancing Agent and develop a unified balancing plan. The Draft Rules establish the parameters to which the balancing plan arrangements must conform. If TSOs are unable to agree the appointment of the Balancing Agent or the details of a balancing plan, Gas Industry Co as the industry body¹¹ under the Gas Act, will step in to determine the outcome for both.

Reasons for the proposal

The Statement of Proposal concluded that the participative regulation option will best meet the Gas Act and GPS objectives based on its overall superior rating on efficiency, cost, and governance criteria when evaluated against other options. The option addressed balancing issues identified during the review by:

- providing for a single Balancing Agent and a unified balancing regime;
- increasing transparency of balancing actions and costs;
- ensuring the cost of a balancing action goes to the causer;
- providing for an open and competitive balancing market;
- allowing for the appropriate governance and dispute resolution; and

¹¹ The 'industry body' means the body approved by Order in Council under s43ZL of the Gas Act, which at present is Gas Industry Co.

- ensuring roles and responsibilities are clear and transparent.

The Statement of Proposal also noted that feedback from submissions on the Second Options Paper indicated a wide base of industry support for the option, if a contracts based solution was not achievable.

What submissions said

Multigas agrees with Gas Industry Co's decision to pursue the participative regulation option.

MRP agrees that it is the best of the regulated options but should only be pursued once the non-regulated options have been exhausted. Similarly, Vector agrees with the proposal as a 'backstop' to the ICD process. Vector notes that the participative regulation option is preferable to the more prescriptive options because:

- it allows for greater industry involvement;
- the details of the balancing plan take into account the current contractual arrangements;
- the option allows for a more targeted and adaptable approach;
- it provides for effective enforcement; and
- as demonstrated by Gas Industry Co, it is potentially superior when assessed against criteria.

However, if this option is to be progressed, Vector maintains that a number of Draft Rules need to be amended in order to achieve the intended outcomes.

Todd also agrees that the proposal would be the preferred solution to pursue if regulation is deemed necessary. However, it notes that industry discussions have shed light on how difficult it would be to execute the Draft Rules. It also notes that due to the simultaneous approach to progress of the regulatory option and ICD process, Todd has had insufficient resource to devote to both processes. Todd considers a better approach would have been to provide for the ICD process first, followed by the regulatory process if necessary.

Greymouth agrees to the proposal, subject to the outcome of the ICD process and the ability of any balancing plan to pass the test of rule 30.1.3 of the Draft Rules.

Contact, Genesis, and MDL do not agree with the proposal.

Contact considers that the decision to pursue a regulatory option seems to have imposed very tight timeframes on achieving an industry led solution. This tight timeframe has substantially increased the risk that the industry process will fail. Further, it notes that the regulated option is competing for scarce resources that would be better focussed on an industry solution.

Like Contact, Genesis considers that the ICD process needs to be given more time. However, Genesis expects that there will be some residual market failures that the ICD process may not be able to resolve adequately and that may require a regulatory solution. Genesis agrees that the participative regulation option would be the best option to pursue only if Gas Industry Co is determined to immediately adopt a regulated approach.

MDL disagrees with the proposal citing that:

- balancing costs are already low¹²;
- duplication of costs is likely to result from the proposal;
- no cost/benefit analysis has been undertaken (and the overall costs of the regime are likely to be underestimated);
- the benefits of the improvements to existing arrangements are already apparent;
- Gas Industry Co has not sufficiently justified the need for regulations; and
- efficiency gains associated with the 'unified' balancing concept are likely to be minimal.

Further, MDL notes that due to the Maui Joint Venture, its ability to accept additional balancing responsibilities may be limited.

¹² On p17 of its submission, MDL notes that 'the net cost of balancing gas used by the Maui Pipeline during 2009 will be approximately \$8m on a full cost basis, although actual net expenditure is estimated to be less than \$2m because a substantial portion of the balancing gas used during the year has been supplied at zero cost. This compares with the value of gas transported over the same period which will be approximately \$800m. In percentage terms the cost of balancing in 2009 is estimated to be less than 0.3 per cent of the total value of gas transported'.

Gas Industry Co comment

Gas Industry Co again notes the strong preference shown by submitters for a contracts based solution. We also note several submitters' views that, if the decision is made to progress a regulatory solution, the participative regulation option would be the most appropriate option to pursue.

Gas Industry Co acknowledges the comments made by those who disagree with the proposal, and believe that the timeframe has been tight, and have found resourcing the parallel process difficult.

MDL raises a number of concerns in its submission regarding the Statement of Proposal. Gas Industry Co has provided comments on the majority of these below.

First, MDL consider that balancing costs are already low. We assume it is referring to the cost of balancing gas that its Balancing Agent buys and sells. We do not consider this to be a good indicator of the true cost of balancing. For example, a penalty regime for cash-outs could result in even fewer balancing actions and lower balancing gas costs, but this would be achieved at the expense of pipeline users who would have to invest more to self-balance. An efficient regime requires that the price of residual balancing reflects its cost, allowing users to make rational decisions about how much to invest in self-balancing.

MDL believes that the duplication of costs will result from the participative regulation option; balancing actions may only be required a few days each month, but the Balancing Agent must stand ready to take balancing actions on a 24/7 basis, and be resourced for that purpose. However, Gas Industry Co notes that, if it were to appoint the Balancing Agent, it would seek a competitive price. There are many organisations that operate on a 24/7 basis who might tender for the work, including MDL's current Commercial Operator. So, rather than duplicating costs, the result is likely to be more transparency and competitive pressure on costs.

Gas Industry Co also notes MDL's view that the cost benefit analysis was insufficient. Others have similar views. However, we believe that the analysis in the Second Options Paper¹³, although not quantitative, was thorough and adequate, given the uncertainties of the outcome.

Regarding the comment of MDL and others that the case for regulation has not been well established, we can only observe that an exhaustive regulatory process to identify and describe the issues and options has been followed. Further, we consider the industry has been aware of these issues and the need to address them at least since they were described in the issues paper, with the assistance of the TPBAG. While some of those issues have been addressed by changes to balancing arrangements, as we point out in the Second Options Paper Submissions Analysis¹⁴, the changes do not yet go the full distance to addressing all our concerns.

¹³ Transmission Pipeline Balancing Second Options Paper, p61.

¹⁴ Transmission Pipeline Balancing Second Options Paper- Analysis of Submissions, Appendix A, p43.

It is also worth noting, in response to MDL and others, that while the industry apparently has many good intentions to improve balancing arrangements; Gas Industry Co can only evaluate what it knows about. We understand that MDL are likely to propose changes to the MPOC that will introduce such measures as back-to-back balancing, a balancing market open to users on the Vector system, and appropriate governance of balancing arrangements. We have yet to see these changes.

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The draft balancing rules

What the Statement of Proposal said

The proposed draft Gas Governance (Balancing) Rules

The purpose of the proposed rules is:

To achieve an efficient, unified balancing arrangement for managing imbalance in the transmission system.

The purpose is consistent with our regulatory objective:

To provide an efficient, unified balancing arrangement for managing pipeline imbalance.

There are four main parts to the Draft Rules and one schedule. A complete draft of the rules can be found in Appendix B of the Statement of Proposal.¹⁵ For ease, a brief description of the Draft Rules is provided in the table below.

Table 1 Outline of the Draft Rules

Section of Draft Rules	Provision	Description
Part 1: General provisions	Interpretation	A list of defined terms for the purposes of the Draft Rules.
	Users' obligations	Transmission pipeline users must use reasonable endeavours to balance within each balancing zone. If in aggregate they do not meet this obligation, the Balancing Agent may take balancing action. Note that TSOs may also be pipeline users.
	TSOs' obligations	TSOs must ensure their operating procedures and contractual arrangements are consistent with, and do not prevent users meeting the obligation to balance. Some of the other obligations include: providing certain information to the Balancing Agent; providing the Balancing Agent with transmission services for the transmission of balancing gas; and allowing the Balancing Agent access to information exchanges.

¹⁵ See Appendix B of the Transmission Pipeline Balancing Statement of Proposal available on Gas Industry Co's website.

Section of Draft Rules	Provision		Description
Part 2: Balancing	Balancing Agent functions		<p>The Balancing Agent's main functions are:</p> <ul style="list-style-type: none"> Managing the linepack of the transmission system (through buying or selling balancing gas); and Allocating title and cost of balancing gas. <p>These functions must be carried out independently.</p>
	Balancing market		The Draft Rules specify who the balancing market is open to; when the Balancing Agent must accept offers; when it may refuse offers; and how payment is made or received. This section also sets out the Draft Rules for transactions that occur outside the balancing market.
	Allocation		The section requires back-to-back allocation of balancing gas. It also outlines the process for notifying TSOs of adjustments to allocations and cash-out prices of gas, and how allocation errors are handled.
	Reporting		The Balancing Agent must, within 10 business days of the end of each month provide a written report to the industry body and to the TSOs identifying balancing actions that were taken within the month as well as any breaches that occurred.
Part 3: Appointment of Balancing Agent, development of balancing plan, and funding	Subpart 1 (this subpart applies subject to subpart 2)	Appointment of Balancing Agent by joint transmission system owners	This section specifies the joint obligations of the TSOs to prepare a balancing plan and to appoint a Balancing Agent.
		Process for approval of balancing plan	The balancing plan approval process includes the consultation process TSOs must complete prior to submitting the plan to the industry body. If approved, the plan will be published.
		Amendment to balancing plan	This section describes how balancing plans can be amended; including which parties can propose amendments, the consultation process that must take place, and the process for approving or rejecting an amendment.
	Subpart 2: (this subpart applied subject to subpart 1)	Appointment of Balancing Agent by the industry body	The industry body may appoint the Balancing Agent if TSOs fail to submit a draft balancing plan within 60 days of the commencement date, or if it has not been approved or if, in the industry body's view, the Balancing Agent is failing to carry out its functions.
		Balancing plan	This section describes the provisions for the industry body to write a balancing plan if this subpart were to apply. It includes the process for consultation and publication of the plan as well as amendments.
	Subpart 3	Funding	Describes the arrangements for funding the balancing regime under both subparts, including both development and ongoing fees.

Section of Draft Rules	Provision	Description
Part 4: Miscellaneous provisions	Audit of Balancing Agent's performance	Provisions for performance audits and reviews of performance by the industry body of the Balancing Agent are outlined in this section.
	Notices	This section sets out how and when notices, both ordinary and urgent are to be given.
	Miscellaneous	This section outlines the safety override, as well as the regulations relationship with transmission system codes and the Gas Governance (Critical Contingency Management) Regulations 2008.
Schedule	Requirements for Balancing Plan	The schedule specifies what the balancing plan must contain. Including provisions for the Balancing Agent, management of linepack, the provision of information, and other processes relating to balancing gas.

Source: Statement of Proposal, table 7, p39.

Major operational provisions

This section also includes an overview of the main operational provisions of the Draft Rules, including:

- Users' obligation in relation to balancing;
- TSO obligations; and
- Balancing Agent functions, in relation to:
 - The management of linepack;
 - The balancing market; and
 - The allocation process.

The Balancing Plan

This section also outlined the details of the Balancing Plan schedule contained in the Draft Rules, which included the three 'scenarios' that can occur. These are outlined below.

- Subpart 1 applies- TSOs jointly develop the balancing plan and appoint the Balancing Agent;

- Subpart 2 applies- the industry body develops the balancing plan and appoints the Balancing Agent;
or
- Subpart 1 applies, then subpart 2- TSOs develop the balancing plan and appoint the Balancing Agent but, at a later stage, the industry body determines it is necessary to take over.

The section also outlined the balancing plan approval and amendment process under these subparts.

Curtailment, damages and tolerances

As a result of the consultation process, including feedback received in submissions on the Second Options Paper, Gas Industry Co made the decision to remove provisions for curtailment, damages and tolerances in the Draft Rules.

What submissions said

Comments on Draft Rules

Todd agrees and Multigas moderately agrees that the Draft Rules adequately address issues with respect to residual pipeline imbalance. Todd offered several comments on the Draft Rules and Major Operational provisions, including that:

- ‘integrated’ should replace ‘unified’ in the purpose statement;
- the method employed in determining receipts and deliveries needs to be considered in relation to ‘Users’ Obligations’; and
- the case for marginal pricing of balancing is made difficult when considering how transactions occur.

Genesis considers that it is difficult to determine how effective the Draft Rules will be in advance of the TSOs developing and implementing a balancing plan. Like Todd, Genesis favours weighted-average pricing. It also notes that provisions made need to be consistent with balancing occurring on the basis of daily values. Genesis also believes that if the industry body were to suspend or terminate the balancing market, that it should provide reasons for doing so.

New Zealand Steel considers that the Draft Rules would adequately address issues in relation to pipeline imbalance if an adjustment to the timing of the nomination cycle was included in the scope to

enhance users' ability to self-balance. It also noted that the methodology for ensuring balancing actions and costs are kept to a minimum needed to be carefully designed.

Vector provided a marked-up copy of the Draft Rules, incorporating the changes that it believes should be made in order to ensure the Draft Rules meet their purpose. Its primary concerns are outlined below.

In Vector's view, Gas Industry Co has failed to provide any policy justification for the appointment of the Balancing Agent by the TSOs. It considers that such an arrangement is inconsistent with the following precedents:

- to date, service providers under other Gas Governance arrangements have been appointed by Gas Industry Co; and
- service providers for the electricity market are appointed by the Electricity Commission.

Another of Vector's concerns relates to the TSOs recovering the costs of the Balancing Agent. It claims that imposing the Balancing Agent costs on the TSOs is inefficient compared with charging:

- users and creating incentives for them to more accurately self-balance and thereby minimise the level of imbalance on the transmission pipeline systems; and
- the causers of the imbalance and the beneficiaries of the actions of the Balancing Agent.

Vector also claims there is no logical link between charging the TSOs and the origin of the costs being imposed. According to Vector, the logical link is strongest for imposing the costs on users.

It believes that Gas Industry Co's proposal to impose Balancing Agent costs on the TSOs stems from the draft recommendation of the Commerce Commission in its input methodologies paper¹⁶, that the administration of balancing functions should be included in the regulatory ambit relating to gas transmission service providers on the grounds of safety. Vector implicitly rejects this reasoning.

Vector also suggests that TSOs may not be able to pass the costs of the Balancing Agent on to users, due to the regulatory regime under the Commerce Act 1986 under which TSOs operate. Even if they can pass on the costs, Vector is of the opinion that it is inappropriate for TSOs to bear the risk of non-payment by users of Balancing Agent costs and liabilities. Vector claims it would be more efficient if Gas Industry Co paid the Balancing Agent's costs and liabilities directly, and allocated these costs and liabilities to users, as fees levied under the Draft Rules. Vector suggests an entitlement to off-set fees to pay for the Balancing Agent against cash-out payments owed to users could be included in the proposed rules and this would further facilitate payment.

¹⁶ See p53 of the Commerce Commission's Input Methodologies Discussion Paper. 19 June 2009.

Vector's last major concern is indemnification of the Balancing Agent for costs that it is unable to recover from users by TSOs. Vector believes that the Draft Rules contain an indemnity requirement and it should be removed and replaced by prudential requirements on users, akin to those required of participants in the electricity market.

In its submission, MRP notes that the function of the Balancing Agent to 'manage' linepack is too broad and should be clarified. Like others, MRP also opposed the use of marginal pricing, noting that it requires perfect competition in order to be optimal. It is also of the view that, when issuing an invoice, the Balancing Agent should be required to provide users with sufficient information for them to confirm that it is correct.

It considers that the Draft Rules should set out the TSOs' obligations to provide balancing tools to help users to balance themselves better.

Contact notes that it has not had sufficient time to adequately review the Draft Rules, but that it has made some preliminary comments on them, which it provided at the end of its submission. Contact also noted that it is unclear whether the Draft Rules will address issues raised throughout the review because the details of the balancing plan and operation of the balancing market are not specified and the limited scope means many issues are not addressed.

Greymouth believes that the provisions are largely similar to the current system but a bit better in terms of integration, transparency, and governance. Like Contact, Greymouth has concerns regarding the lack of user information citing that timely data is an impediment for users to balancing. It suggests that Draft Rule 8 is amended so that the word 'unreasonably' does not act to impede investment in information. It also noted that critical contingencies can be regional as well as national, so may not impact upon the operation of all balancing zones. Greymouth also provided comments on the Draft Rules at the end of its submission.

MDL does not believe the Draft Rules are adequate. Its main area of concern is that the Draft Rules appear to contemplate the continued existence of separate operating regimes yet seek to impose an obligation on TSOs to ensure that actual linepack matches target linepack, when adjusted for Running Operational Imbalance (ROI). Since there is a lack of consistency between TSO operating regimes in relation to the availability of information and the ability for users to self-manage positions during the day, this is likely to lead to uncertainty. It considers the 'imbalance' algorithm is unclear and the obligation to manage target linepack appears to create an atmosphere of competition between the TSOs. In addition to its main concern, MDL has noted several other concerns with Draft Rules including that:

- it is unrealistic and potentially unsafe to separate functions of controlling linepack as some situations require coordinated responses.

- the TSO imbalance concept contains many flaws as, essentially; it is making the TSO responsible for day-to-day metering errors.
- difficulties will result from having three parties responsible for managing linepack.

Comments on the balancing plan

Greymouth and Multigas both agree with the framework of the balancing plan. Multigas moderately agrees with the balancing plan. Greymouth notes further that Gas Industry Co must ensure that any balancing plan adopted delivers economic value.

MRP agrees with Gas Industry Co's decision to not make the balancing plan overly prescriptive. It also notes its agreement with the proposed process for approving and amending the balancing plan. However, one suggestion it makes is that the term 'unified balancing plan' is amended to what it considers to be a more accurate description: 'co-ordinated balancing plan'.

Genesis considers that the timeframe may prove difficult for the TSOs to reconcile their differences and devise a balancing plan. Genesis also notes its concern that it is unrealistic for the TSOs to develop a pre-estimate of critical contingency process, as required in the balancing plan, as it is both untested and reliant on expert evaluation of complex criteria.

Todd agrees with the details of the balancing plan, but notes that there needs to be a more explicit recognition of the need to deal with metering errors and estimations, and how that may affect the allocation of balancing costs through time.

MDL considers there to be insufficient detail to comment on the balancing plan but notes two issues:

- setting the target linepack midway between the line pack threshold limits may not be the optimal point; and
- that the requirement that a balancing action to balance a pipelines back to its thresholds is too restrictive.

Comments on curtailment, damages and tolerances

MRP and New Zealand Steel agree with Gas Industry Co's decision to not include provisions for curtailment, damages and tolerances in the Draft Rules.

Genesis believes tolerances should be included in the Draft Rules. It considers them a fundamental component and an optimal regime would allow for a small tolerance for each welded point, with the size reflecting the inherent operational limitations on users balancing accurately within a day.

Like Genesis, Greymouth also favours some tolerance to take account of natural swings associated with operating a production station.

Todd believes that the balancing plan should provide a mechanism to transition to the management of linepack under the Critical Contingency Regulations. It notes further that a fundamental protection for welded parties and shippers is the ability of the TSOs to curtail welded point offtakes and injections to maintain line services and, as such, should be provided for in the balancing plan. It considers that there should be some obligation on issuing Operating Flow Orders (OFOs) to at least attempt to ensure that the actions of a user do not adversely impact on other pipeline users prior to the curtailments of potentially innocent parties under the Critical Contingency Regulations.

Vector believes that, in order to enhance compliance by users, both curtailments and damages should be included in the Draft Rules. Tolerances, in its view, are better provided for in the balancing plan.

MDL again notes the difficulties that arise from splitting the curtailment function from the residual balancing function. It considers this should be addressed. In relation to damages and tolerances, it notes that these are being considered as part of the ICD process, but considers both should be addressed in the context of any balancing proposal.

Gas Industry Co comment

Comments on Draft Rules

Gas Industry Co acknowledges the view of several participants that there are more appropriate words than 'unified'. This has been debated throughout the consultation process several times already and Gas Industry Co still considers that the word is appropriate for the intended outcome. 'Unified' commonly means 'coordinated', 'interconnected', or 'operating as a unit'. These are the concepts we want to reflect.

We also acknowledge views that it is difficult to assess the merits of the Draft Rules until the balancing plan is complete. It is important to note that, in order to be approved, the balancing plan must meet the requirements set out in rule 30 of the Draft Rules, which states that the plan must include all of the information in the Schedule and comply with it. It must also be consistent with the purpose of the Draft Rules, including by containing processes and procedures that support a unified regime for balancing the whole transmission system. The balancing plan will also need to undergo a comprehensive consultation process prior to being approved.

We acknowledge the view that the marginal price of balancing gas may not have the intended effect. We note submitters' views that the 'pure' price signals that should occur from marginal pricing are made difficult by cash-out transactions occurring daily, rather than hourly or back-to-back. However, Gas Industry Co believes that marginal pricing provides an efficient price signal to both the supply and demand side of the market.

In practice, when the Balancing Agent is buying gas to remove an imbalance, each potential supplier of balancing gas will be incentivised to offer at the marginal value of the gas to itself. If the potential supplier offers at a higher value, it may end up not having its offer accepted. If the clearing price is higher than its own marginal value, then it will receive the clearing price, so has no incentive to offer above its own marginal value for gas.

If alternatively, each potential supplier is paid on the basis of its own offer, then each will offer at the maximum price it believes will be accepted by the Balancing Agent, provided that this price is above the value of the gas to it. There will be times when a supplier will overestimate the price and end up not providing gas when it would have been beneficial for it to do so. Because of this, Gas Industry Co remains of the view that paying all suppliers of balancing on the basis of the value of the marginal unit in the transaction, regardless of what each is offered at, will result in the lowest marginal cost provision of balancing gas. (The mechanism works the same when selling balancing gas).

We agree with Genesis that reasons should be provided if the balancing market is suspended and we have amended the Draft Rules to include this.

Changes to nomination cycles are not currently in the scope of our regulatory proposal, but we note that this issue has featured in several discussions at the ICD process. Any further progress will need to be led by MDL.

We note Greymouth's comment regarding regional contingencies and have since amended the Draft Rules to account for both types of contingencies.

We also note submitters' views regarding a lack of information available to users. Gas Industry Co does not consider the Draft Rules should specify the provision of information regardless of cost. It is for TSOs and users to agree what information can be made available cost effectively. Further we have carefully delineated and consulted on the scope of the Draft Rules and do not believe they need to provide for the provision of such tools.

Vector believes that there is no policy justification for the appointment of the Balancing Agent by the TSOs. However, we note that, while regulatory consistency is widely recognised as desirable for economic efficiency reasons, this is related to the predictability of outcomes of rules and regulations and not to the consistency between arrangements in different circumstances. Further, we note that there is nothing in the requirements of the Gas Act or GPS that suggests the consistency Vector seeks is a necessary or desirable feature for the Draft Rules relating to the Balancing Agent.

Vector's second concern relates to the funding of the Balancing Agent by TSOs. We acknowledge that Vector thinks it would be preferable if users, beneficiaries and/or causers pay for the Balancing Agent's development and ongoing operating costs by way of a levy imposed by Gas Industry Co. Vector is not very specific, however, about how these charges should be apportioned between these groups and among the members of them.

Gas Industry Co agrees with Vector that it is efficient for costs to be met by the parties who benefit from the service, the system users. This is certainly the outcome that Gas Industry Co intends. However, we believe that the most effective way of achieving this result is to pass the Balancing Agent costs to the TSO's in the first instance. There are two reasons for this. First, the TSOs have all the information necessary to on-charge their system users for the Balancing Agent costs. This is transactionally efficient because:

- Vector and MDL already invoice their users for transportation fees monthly. Gas Industry Co's Balancing Agent cost recovery would just become another line item on those invoices.
- it avoids the need for Vector and MDL to pass information to Gas Industry Co on the monthly throughput of each transmission system user; and
- the TSOs already have contractual arrangements with their customers to address non-payment issues.

Second, and more significantly, we believe that charging the TSOs avoids introducing a perverse incentive. If the TSOs appoint the Balancing Agent they will meet the Balancing Agent costs. If, on the other hand, the TSOs cannot agree, it will fall to the industry body to appoint the Balancing Agent, Gas Industry Co believes that the means of recovering Balancing Agent costs should be the same in both cases – through transmission fees. If this was not so, and the TSOs believed that they could avoid the cost if Gas Industry Co appoints the Balancing Agent, they may be less inclined to agree. Since the pipeline tariffs would take some time to adjust, they may have a windfall gain if Gas Industry Co appointed the Balancing Agent and recovered the costs directly from users, rather than through the TSO.

However, we do recognise that the Draft Rules did not specify that Balancing Agent costs were to be passed through to users, or how they were to be passed through. We will amend the Draft Rules to provide for the charges to be passed to users on the basis of the volumes of gas transmitted, or by some other means proposed by a TSO and approved by Gas Industry Co. We do not have any specific alternative charging schemes in mind, but we are aware that there are parallels between residual balancing of pipelines and the maintenance of spinning reserve on the electricity grid and it may be that a similar cost recover mechanism would be appropriate.¹⁷

A further benefit of addressing cost recovery in the Draft Rules is that it would ensure that the costs were specifically allowed for in any Commerce Commission pricing determinations.

¹⁷ The charging regime adopted for instantaneous reserves in the electricity market consists of an event fee paid by the 'causer' whenever instantaneous reserves are called upon by the system operator and an availability fee levied upon all those who can cause the need for instantaneous reserves set to cover the standing costs of having such a scheme. Event fees are rebated or distributed back to those who paid availability fees in the month of the event and the two preceding months on a pro rata basis.

Vector's other major concern is regarding TSO indemnification of the Balancing Agent. The proposed rule, which Vector claims incorporates a requirement that TSOs indemnify the Balancing Agent, is Draft Rule 29.1. However, the relevant part of this proposed rule states:

The terms and conditions of appointment of a Balancing Agent by the transmission system owners **may** provide for ... an indemnity by the transmission system owners of any costs incurred by the Balancing Agent that are unable to be recovered from users ... or contracting parties in relation to the purchase and sale of balancing gas and the profits or loss on trading of gas ...to be passed on to or indemnified by the transmission system owners ... *[Emphasis added]*

In short, the proposed Draft Rules in relation to TSOs granting indemnities are permissive, rather than obligatory. They allow the TSOs to grant such an indemnity to the Balancing Agent but do not oblige them to do so. The corresponding provision applicable when the industry body appoints the Balancing Agent is of the same nature.¹⁸ The industry body is also permitted to grant an indemnity to the Balancing Agent, but is not obligated to do so.

Nevertheless, Gas Industry Co considers that Vector's objection does raise the legitimate question of whether it would be of net benefit for the Draft Rules to set prudential requirements on users to reduce the default risks for the Balancing Agent.

The costs associated with imposing prudential requirements would be principally the transaction costs of negotiating the terms and conditions and monitoring them over time, and the opportunity and transaction costs imposed on participants complying with them. The principal benefits would be the reduction in costs for the Balancing Agent due to lower default risk because it is able to insist on parties meeting prudential requirements and lower transaction costs pursuing bad and doubtful debts.

There are also likely to be consequences for competition. If the prudential requirements are set high, this could impose a barrier to entry to being a gas pipeline user, and so limit competition in a range of markets. On the other hand, the existence of prudential requirements reducing default risk could increase the pool of potential Balancing Agents and competition for the role. These competition consequences will be largely transfers among users and between the Balancing Agent and users, and so not relevant costs and benefits from a New Zealand wide perspective; only efficiency gains or losses resulting from increased or reduced competition will provide a net benefit at the national level.

For the other costs and benefits, of relevance are the increments due to the imposition of prudential requirements for gas balancing. Costs that would be incurred and benefits that would be reaped anyway are not relevant to the assessment.

If, as Vector suggests, the prudential requirements are modelled on those used in the wholesale electricity market, this would constrain somewhat the incremental transaction costs of establishing and agreeing the prudential requirements; although, the costs of reaching a multilateral agreement on

¹⁸ Draft Rule 43.2.2.

this matter should not be under-estimated. Judging by the difficulties these provisions created when establishing the electricity market, and the costs of trying to reach a contracts based balancing solution, the costs are likely to be considerable.

Against this, each gas pipeline user generally has significant credit exposures with one or more other users, and with the TSOs or related parties. The parties undoubtedly already impose and monitor many credit requirements among themselves, and so the incremental opportunity and transaction costs imposed on participants to comply with prudential requirements are unlikely to be great. Indeed, some consistency in these requirements might reduce negotiation and monitoring requirements among the parties.

It is unclear whether the imposition of prudential requirements on users for the benefit of the Balancing Agent would generate a net benefit. We will consider whether further work on this option is warranted. In the interim, we see no substantive issue with the proposed rules, which effectively leave the indemnity issue up to the Balancing Agent to negotiate with either the TSOs or the industry body, as the situation requires.

We do not agree with MDL that it is unrealistic and possibility even unsafe to separate the functions for balancing and managing linepack. Transmission services are already subdivided and carried out by various operators. We believe that effective communication coupled with clear and transparent obligations and roles allow these parties to work seamlessly together.

Under the proposed definition of imbalance, any unallocated gas becomes TSO imbalance, which therefore incentivises the TSOs to ensure all quantities of gas are fully allocated. It also makes the TSO a user in respect of its own-use-gas, making it responsible for any imbalance it causes. The Draft Rules provide for allocation errors to be corrected, therefore, if one arises from a metering error, it can be adjusted to reflect the actual amount.

Comments on the balancing plan

We note Genesis' concern regarding the timeframe; however, we consider that there needs to be a deadline otherwise delay will continue. We believe that regardless of what balancing solution is pursued, the ICD process has been useful to identify areas of agreement and disagreement among the industry and most importantly, TSOs.

We acknowledge that a pre-estimate of critical contingency price may prove difficult. The setting of price caps are by nature uncertain and the pre-estimate will require an objective test to ensure it is reasonable. Including these numbers in the balancing plan will allow for them to be changed (including urgently if necessary) as the market matures through the balancing plan amendment process.

Gas Industry Co notes Todd's request that provisions for dealing with metering errors and estimations should be in the balancing plan. Despite not being included in the scope of the regulatory option, Gas Industry Co considers that provisions for either may still be included in contractual arrangements.

MDL raises several points about the setting the target linepack and how balancing actions should be made. Gas Industry Co considers it would be difficult to define the 'optimal point' when setting the target linepack as there would be many views on this. We therefore consider that the midpoint provides a useful reference for the Balancing Agent when taking balancing actions. We do, however, agree with MDL's second point that it may not always be efficient for the Balancing Agent to bring the linepack back to the target linepack and as a result we have amended the wording to Draft Rule 15 to allow for slightly more discretion.

Comments on curtailment, damages and tolerances

Gas Industry Co believes that the scope of the proposed rules should not be wider than is necessary to provide for the unified management of pipeline imbalance. Curtailment and damages are consequential matters related to transportation arrangements between TSOs and individual shippers, and between shippers, that can be effectively addressed in the codes.

We believe that tolerances can be efficient, and that a small tolerance can usefully avoid trivial balancing transactions. However, we acknowledge MDL's view, backed up by evidence provided by the MDL Commercial Operator during the ICD process, that current tolerances are too large and need to be reduced to avoid excessive socialisation of balancing costs. On balance, we favour a move towards small tolerances, or no tolerances, but believe this is most simply provided for in the codes.

6

Details of the proposal

What the Statement of Proposal said

In addition to the Draft Rules, the Statement of Proposal outlined details of the following:

- **Monitoring and enforcement** - Gas Industry Co outlined its proposal to amend the Gas Governance (Compliance) Regulations 2008 (Compliance Regulations) to include references to the proposed rules, Balancing Agent, balancing gas, and users. Disputes with respect to the proposed rules (including the balancing plan) would be handled in accordance with the procedures set out in the Compliance Regulations.
- **Performance auditing and review** - The Draft Rules contain a number of measures to ensure sufficient monitoring of the Balancing Agent takes place including: monthly reports, the ability to audit the Balancing Agent's performance and holding the Balancing Agent liable for any breach of its core functions.
- **Funding** - The costs arising from the Draft Rules would be recovered through two types of market fees, establishment and ongoing. Both will be levied on the TSOs and calculated on a pro rata basis based on the amount of gas each has entering into and out of its transmissions system from an interconnection point not with another TSO. It is at the TSO's discretion how these fees are recovered.
- **Interaction with current industry governance arrangements** - To ensure double jeopardy does not result, industry codes and any other contract relating to the transportation of gas in the transmission system, or the determinations of quantities of gas entering and leaving the transmission system are read subject to the Draft Rules (to the extent of any inconsistency). The Draft Rules also propose that the Balancing Agent ceases to carry out its functions when a critical contingency occurs under the Critical Contingency Regulations.

- **Amendments to the Draft Rules** - Amendments to the Draft Rules will follow Gas Industry Co's 'Guidelines for the management of proposed changes to gas governance rules and regulations'.
- **Timeline for implementation** - The timeline for implementation assumes that the Draft Rules would be gazetted in mid-2010 if the recommendation is approved in December 2009. It also assumes that the TSOs could begin work to identify any necessary code changes as soon as the recommendation was made. If this were the case, it is likely that the full implementation, including the balancing plan, would take place in the fourth quarter of 2010.

What submissions said

MRP asks for clarification on the timeframe in which balancing gas disputes can be raised. As a general comment on the proposal, MRP notes that the balancing situation within New Zealand cannot be effectively resolved by addressing upstream activities alone. Downstream issues must also be addressed. It is encouraged by the work Gas Industry Co has undertaken on D+1¹⁹ noting also that other developments such as extended nominations and virtual welded point concepts may assist in reducing balancing costs.

New Zealand Steel considers that there needs to be consideration given to the quality of shippers' data. It notes that some end-users have experienced problems with errors in mismatch correction as a result of the gas analysis not being validated on weekends.

Todd notes that it supports the idea that the parties responsible for developing the balancing plan are also responsible for the development and ongoing costs. It considers that this will ensure there are appropriate incentives to design an efficient balancing plan. It also considers that the timeframe for implementing the Draft Rules is ambitious and likely to be delayed due to the balancing plan.

As a general point, Greymouth notes that a significant amount of industry resource is being poured into a very small problem. It considers that the limited capacity in the North pipeline is a much larger problem that needs to be addressed.

In general, MDL thinks that the proposal did not contain enough detail for MDL to make a thorough assessment of the potential implications of the Draft Rules.

Gas Industry Co comment

Gas Industry Co reminds MRP and New Zealand Steel that the scope of the regulatory solution identified those matters that needed to be addressed. Items we identified as 'out of scope' are still

¹⁹ A D+1 allocation process will not remove the need for a residual balancing role, even if it may reduce its size. In addition it will take some time to determine the cost and practicality of D+1 allocations, with little expectation that the process would change any conclusions in this paper.

being worked on, but are not a part of our immediate regulatory option. We will continue to work on D+1 as well as looking at other areas to improve arrangements, such as upstream reconciliation and, as New Zealand Steel suggests, ways to improve shippers' data.

MRP also asked about the timeframes for reporting a breach. The Draft Rules do not explicitly refer to a timeframe but one is included in the Compliance Regulations, which states that a breach needs to be reported within three years of the date the incident occurred.²⁰

We again note the industry resource that has been devoted to developing a balancing solution. Gas Industry Co considers that the work needs to be done one way or another and, as some submitters have pointed out, regardless of whether or not a regulated or contracts based approach is followed.

We disagree with MDL that Gas Industry Co has not provided enough information on the proposal. We note that in addition to the Statement of Proposal, which included the Draft Rules, Gas Industry Co has presented on the proposal several times at ICD meetings at which MDL was present. We have also engaged with MDL staff on a number of occasions on the proposal. Gas Industry Co has consulted on the Draft Rules twice and to date, MDL has yet to provide any feedback on them. Therefore, it is difficult to understand what aspect of the proposal in MDL's view is insufficient.

²⁰ See regulation 6(2)(a).

7

Next steps

What the Statement of Proposal said

This section of the Statement of Proposal outlined the next steps of the balancing work stream. We noted that we would keep industry participants well informed of the progress of the ICD process, including by publishing any significant outcomes. We also stated that an analysis of the submissions received on this Statement Proposal as well as a Recommendation to the Minister will be released on 21 December 2009.

Table 2 Timetable for pipeline balancing arrangements

Item	Date
Issue Second Options Paper Analysis of Submissions and Statement of Proposal	1 October 2009
Closing date for submissions on Statement of Proposal	30 October 2009
Issue Analysis of Submissions on Statement of Proposal and Recommendation to Minister	21 December 2009

Source: Statement of Proposal, table 8, p63.

What submissions said

Multigas agrees with Gas Industry Co's next steps. If the ICD process does not deliver an outcome, then New Zealand Steel agrees with the proposed timetable.

Contact, Genesis and MRP request that Gas Industry Co allow the ICD process more time before deciding to pursue a regulated option.

MDL does not agree with the proposed next steps stating that the Draft Rules should be abandoned, MDL's upcoming Change Request processed, and the ICD process reformed into a more useful forum.

Vector supports Gas Industry Co progressing work quickly on the balancing proposal, but believes that Gas Industry Co should undertake a further short period of consultation if material changes are made to the Draft Rules.

Greymouth notes that the proposed next steps are primarily driven by external timeframes.

Todd notes that if the ICD process fails and a regulated approach is pursued then industry participants should be given more time to review and submit on the Draft Rules.

Gas Industry Co comment

We acknowledge submitters' views on Gas Industry Co's proposed next steps.

8

Decision

Regulatory process

Part 4A of the Gas Act requires the industry body, before recommending any regulations (or in this case rules) under that Part, to –

- undertake an assessment under section 43N that:
 - seeks to identify all reasonably practicable options for achieving the objective of the regulation (s43N(1)(a)); and
 - assesses those options by considering their benefits and costs, the extent to which the objective would be promoted or achieved by each option, and any other matters the industry body considers relevant (s43N(1)(b));
- ensure the objective of the regulation is unlikely to be satisfactorily achieved by any reasonably practicable means other than the regulation (s43N(1)(c));
- prepare a statement of proposal that contains –
 - a detailed statement of the proposal;
 - a statement of the reasons for the proposal; and
 - an assessment of the reasonably practicable options, including the proposal identified (s43N(1)(d) and (2));
- consult with persons representative of the interests of persons likely to be substantially affected by the proposed regulations (s43L(1)(b));
- give those persons an opportunity to make submissions (s43L(1)(c)); and

- consider those submissions (s43L(1)(d)).

Gas Industry Co has complied with all these obligations by way of the issues paper, options papers, and the Statement of Proposal, which contains our assessment of the options, proposed rules, and the associated amendments to the Critical Contingency Management and Compliance Regulations.

Update on anticipated MPOC changes and outcome of ICD process

In addition to the regulatory process, Gas Industry Co has facilitated the parallel ICD process aimed at developing a contracts based solution to balancing concerns. The Statement of Proposal noted that the outcome might impact on the recommendation in respect of the Statement of Proposal, but was quite clear that the participative regulation option was what is proposed and that if its scope or detail changed substantially as a result of the ICD process, a further Statement of Proposal would be issued.

Gas Industry Co has considered whether any recent industry initiatives would cause it to defer its decision to recommend the participative regulation option. It considered both the anticipated MDL change request (foreshadowed in p3 of the MDL submission on the Statement of Proposal), and the outcome of the ICD process. These matters are considered in a paper entitled 'Consideration of Recent Industry Balancing Initiatives'. That paper analysed the contracts based alternatives using both qualitative and quantitative techniques.

The qualitative analysis shows that:

- if the MOU were to lead to a balancing regime consistent with its intent, that regime could rate as high, on efficiency and cost criteria, as the participative regulation option, but that the governance aspects of participative regulation could be superior (section 4.13);
- the wider scope of the MOU proposal will not provide significant additional benefits (section 5.3);
and
- the MOU is well supported by participants in the ICD process, however, there are still has significant areas of disagreement, it does not contain the detailed changes necessary to implement it, it does not cover non-code shippers. In addition Vector does not believe the content of the MOU is achievable without regulation or by the set deadline of 1 October 2010.

The anticipated MPOC change request was not explicitly analysed because Gas Industry Co did not have sufficient detail on its content, and considered that its scope would be less than that of the SOP solution or the participative regulation option, and would therefore not score as well.

The quantitative analysis shows that:

- both participative regulation and the MOU proposal would achieve significant net benefits over the baseline scenario of gradual improvement through code changes;
- participative regulation is indicated to be the superior alternative by a significant margin; and
- if the MOU proposal is implemented later than October 2010, the net benefits would be significantly higher if it failed and was then replaced with participative regulation.

The conclusion is that it would be better to implement participative regulation as soon as possible than to extend the ICD process.

Although Gas Industry Co recognises that neither of these analyses is definitive, they do give it sufficient confidence to be satisfied that the conclusion of the Statement of Proposal, that the participative regulation option is preferred, remains valid.

Conclusion

Gas Industry Co has met its process obligations under the Gas Act, in respect of the proposed balancing rules and consequential amendments to the other regulations which are necessary to bring the participative regulation option described in the Statement of Proposal into effect.

Gas Industry Co is well aware that the participative regulation option will not address all aspects of balancing. Nonetheless, it will settle a central feature of balancing that has been the source of controversies which the industry has been unable to resolve, by providing an efficient, unified balancing arrangement for managing imbalance in the transmission system. This will allow the industry to shift its focus to the ancillary balancing issues that the ICD process began to consider.

Gas Industry Co will therefore recommend to the Minister that rules be introduced to put the participative regulation option into effect.

Process and timeframe considerations

Gas Industry Co is concerned that the industry may not have given its full attention to the detailed draft of the balancing rules. Our experience on the Gas (Downstream Reconciliation) Rules 2008 was that, because industry had not fully considered the drafts, some rules did not recognise industry practice and many avoidable breaches resulted. Although these were addressed by the use of exemptions, this was a costly process for the industry.

Considering how stretched industry resources have been over the past few months, it is prudent to pause before formalising the final recommendation to the Minister. This will allow time to consider the rules afresh, and discuss implementation issues.

Gas Industry Co has therefore decided to advise the Associate Minister of Energy and Resources of its decision to recommend participative regulation, but defer the formal recommendation until the industry has had an opportunity to give further consideration to the draft rules. We have scheduled time in February to work with the industry to finalise the rules.

Glossary

Balancing Agent	The party with the responsibility for the 'residual balancing role'.
balancing gas	Gas added to or removed from the transmission pipelines by the Balancing Agent in order to manage linepack.
balancing market	The market created by the Balancing Agent when sourcing or disposing of balancing gas, whether a contracts market or a spot market. This may be different from other markets due to the timeframes for dispatching gas.
BPP	'Balancing and Peaking Pool'. A mechanism in the Vector transmission regime to ring fence and allocate balancing costs via a trust account.
cash-out	A forced trade with the Balancing Agent, used to correct part or all of a user's imbalance position.
CCMRs	Gas Governance (Critical Contingency Management) Regulations 2008.
critical contingency	A low pressure event that is sufficiently severe to invoke the CCMRs.
ERGEG	European Regulators Group for Electricity and Gas.
extended nominations proposal	A comprehensive solution to balancing problems proposal by Vector in its submission on the Issues Paper.
Gas Act	Gas Act 1992.
GPS	Government Policy Statement on Gas Governance issued under the Gas Act published 18 April 2008.
ICD	Industry Code Development.
ILON	Imbalance Limit Overrun Notice as defined and used in the MPOC.
industry body	The body appointed under section 43ZL of the Gas Act.

Incentives pool	A mechanism in the Maui transmission regime to ring fence and allocate damage costs via a trust account.
imbalance	In this report the term imbalance refers to the difference between receipts and deliveries on the pipeline and can be Operational Imbalance of the Maui pipeline or Mismatch on either the Maui pipeline or Vector pipelines.
Issues Paper	Transmission Pipeline Balancing Issues, August 2008, Gas Industry Co.
MDL	Maui Development Limited (an agent company for the Maui Joint Venture that owns the Maui transmission pipeline).
MDL Commercial Operator	'Maui Development Limited Commercial Operator'. An agent to manage the commercial arrangements of the Maui open access regime, including balancing services.
mismatch	The difference between a Shipper's receipts and deliveries which is a form of imbalance.
MPOC	Maui Pipeline Operating Code.
NZGE	New Zealand Gas Exchange, the day-ahead gas trading platform currently under development by Gas Industry Co.
OATIS	'Open Access Transmission Information System'. The information system and internet site used to manage the day to day operations of open access on the Maui and Vector pipelines.
OFO	Operational Flow Order, an instruction to a user to curtail gas flow.
operating imbalance	The difference between scheduled quantities (gas entitlement) and actual flow at a welded point, which is a form of imbalance.
Options Paper	Transmission Pipeline Balancing Options, December 2008, Gas Industry Co.
residual balancing role	The role of managing linepack after the users have endeavoured to balance themselves, to ensure safe and reliable transmission services.
Second Options	Transmission Pipeline Balancing Second Options Paper, July 2009,

Paper	Gas Industry Co.
TOU	Time of use - generally used in reference to metering that records consumption on an hourly basis.
TPBAG	Transmission Pipeline Balancing Advisory Group.
transmission pipeline	High pressure pipelines used to transport natural gas which does not include distribution networks.
TSO	Transmission System Owner.
ICD	Industry code development, the industry process led by Gas Industry Co aimed at minimising the scope of the proposed balancing regulations.
UFG	Unaccounted for Gas, a change in linepack where the source is not identified largely due to metering or estimation errors.
User	The users of the transmission services—either a Shipper or Welded Party.
Vector	Vector Limited in its role as owner of the Vector transmission pipelines.
VTC	Vector Transmission Code.