

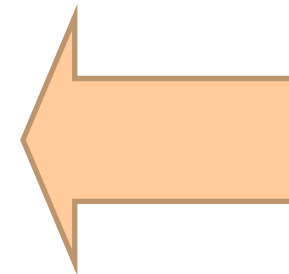


Draft Recommendation (DR) on MPOC Market Based Balancing Change Request (MBBCR)

10 March 2015

Process timetable

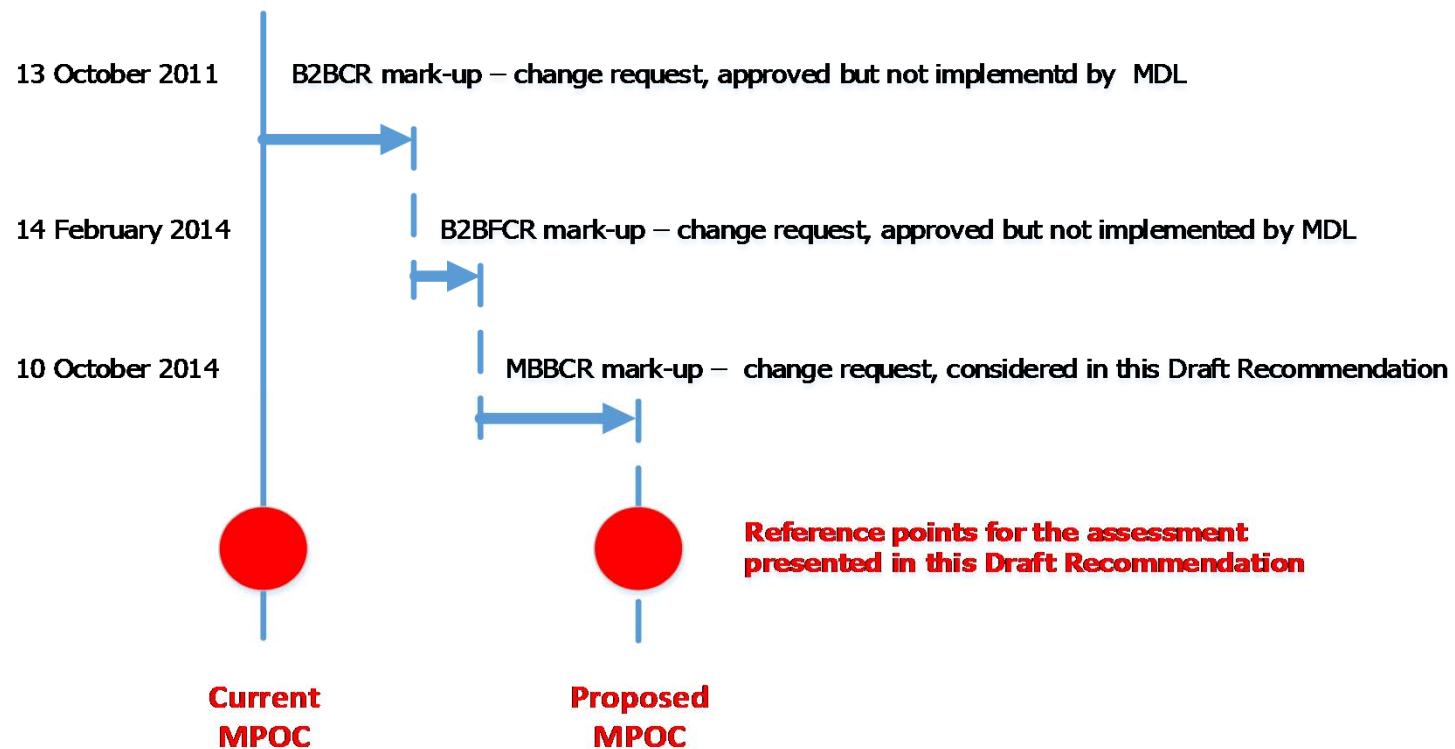
	Target Dates
Call for initial submissions	24 October 2014
Workshop	5 November 2014
Submissions due	24 November 2014
Cross-submissions due	12 January 2015
Draft Recommendation	25 February 2015
Submissions due	30 March 2015
Final recommendation	27 April 2015



Context – a reminder

- **Since 2006**
 - on-going efforts to improve balancing
- **2009**
 - GIC developed Balancing Rules for a single unified balancing regime
 - Industry lobbied for time to develop its own solution
 - GIC and Minister agreed to 'wait and watch'
- **2009-2014**
 - MPOC and VTC changes approved to allow introduction of 'back-to-back' (B2B) balancing
- **2014**
 - MDL proposes MBBCR in place of B2B

Comparison is with current MPOC



Main features of MBBCR

- **MBBCR would:**

- Replace ILONs with Daily Cash-Out of any excess imbalance
- Allow MDL to obtain Balancing Gas on a more open market

- **MBBCR would not:**

- Address improvements to reconciliation (like D+1)
- Increase # of nomination cycles

GIC's analysis concludes MBBCR should:

- **Improve Balancing Gas procurement**

- Allows MDL to source Balancing Gas on an open Balancing Platform
- Reduces barriers to competition in the supply of Balancing Gas, creating downward pressure on prices

(Other ways of getting there... but could take several years...)

- **Improve price signals**

- Parties more accountable for excess imbalance with daily Cash-Outs than with ILONs
- Costs directed to users who use pipeline flexibility outside tolerance
- Cash-Out prices referenced to a more liquid market

Covec's Cost-Benefit Analysis concludes:

- **Benefits**

- Reduced cost of compressor fuel gas (related to balancing)
- Reduced cost of balancing actions
- Cost savings estimated at about \$1m per annum
- Other benefits were identified but not quantified, including dynamic efficiency gains from better price signals and increased market liquidity

- **Costs**

- Increased administrative cost of processing more cash-outs
- Estimated at \$150,000 per annum

DR chapter 2: Process/Legal issues

- **GIC can only 'support' or 'not support' proposal**
- **Can't reject/amend because:**
 - Not comprehensive
 - Not ideal
 - Better alternatives
 - Additional tools needed

DR chapter 3: Approach to Analysis

- **Components of MBBCR identified and considered**
 - Balancing Agent role
 - Balancing Actions
 - Cash-Outs
 - Peaking
 - Daily tolerances
 - Incentives Pool
 - TP Welded Party Balancing Gas scheduling rights

DR chapter 3: Approach to Analysis

- **Related issues also considered**

- MDL's recovery of balancing costs
- Absence of balancing tools: nomination cycles and D+1
- Effect on downstream users
- Barriers to entry
- Misalignment of codes
- International best practice
- Proportionality
- A better solution through a co-operative approach

**Note that the following slides summarise points made in the DR.
Refer back to the full document to get the complete picture.**

SUPPORT SLIDES

Balancing Agent Role

- **Proposed change**

- Proposal is less specific about the role of the Balancing Agent
- Balancing Agent added to the list of Open Access Personnel

- **GIC assessment**

- Little purpose in naming the roles if their functions are unclear
- All Open Access Personnel are subject to the same confidentiality and ring-fencing requirements... but if roles are vague it is unclear what is being ring-fenced or kept confidential

Balancing Actions (BAs)

- **Proposed change**

- Objective of BAs clarified:
 - to maintain Line Pack and/or pressure (MPOC s3.1(a)), and
 - to manage Line Pack, including to support transportation of Approved Nominations (MPOC s3.1(b))
- Preference for sourcing Balancing Gas specified (MPOC s3.5(d))
 - First: Trading Platform (an electronic wholesale trading market that meets the eligibility criteria)
 - Next: Balancing Platform (eg BGX where MDL is counterparty to all trades)
 - Last: Bi-lateral contracts

Balancing Actions (BAs) continued...

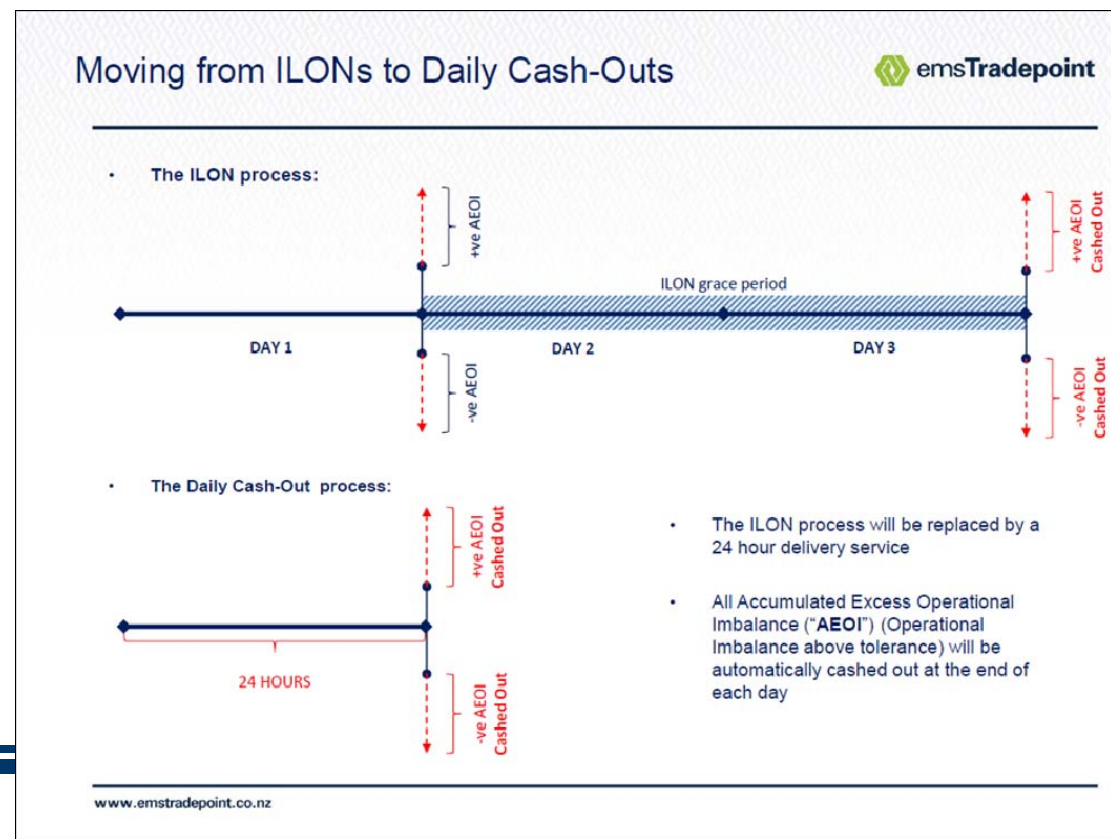
- **GIC assessment**

- Clarifying purpose of BAs is helpful
- Setting out the types of product and priority would improve transparency and may reduce the potential for disputes
- Sourcing Balancing Gas on a more liquid market could bring significant benefits (note that emsTradePoint calculates that if MDL had used emsTradePoint market since its inception in 2013, it would have saved over \$1m)

Cash-Outs (COs)

- **Proposed change**


- From ILON to Automatic Daily Cash-Out of excess imbalance



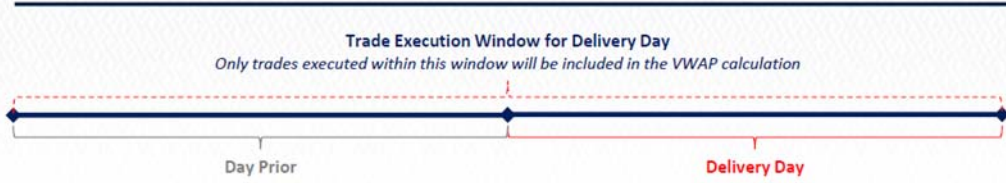
Cash-Outs (COs) continued...

- From prices referenced to BGX to prices referenced to Trading Platform prices (or Balancing Gas transaction prices)

The Daily Cash-Out Mechanism: Prices



Trade Execution Window for Delivery Day
Only trades executed within this window will be included in the VWAP calculation



Cash-Out Prices:

- **+ve Cash-Outs, the lower of:**
 - Volume Weighted Average Price of trades on the Trading Platform^A for delivery on the relevant day and executed on that day or the day before (see above) **minus A**; OR
 - The lowest price paid for Put balancing gas (if sold) **minus B**.
- **-ve Cash-Outs, the higher of:**
 - Volume Weighted Average Price of trades on the Trading Platform^A for delivery on the relevant day and executed on that day or the day before (see above) **plus A**; OR
 - The highest price paid for Call balancing gas (if purchased) **plus B**.

A = [0-10%]* of VWAP + Cash-Out Transmission Price + Cash-Out Trading Fee Price

B = Cash-Out Transmission Price + Cash-Out Trading Fee Price


^AemsTradepoint will be considered a 'Trading Platform' under the MPOC, so will set this price
^{*}The percentage is set unilaterally by MDL

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Cash-Outs (COs) continued...

- Following year D2 Tariff adjustment continues as before (with somewhat different inputs)

End of Year Wash-Up



- On an annual basis, the TSO calculates the overall recovery of balancing gas costs/incomes and cash-out costs/incomes:
 - + Monies received from Welded Parties for -ve AEOI
 - + Monies received from consumers of Put Balancing Gas
 - + Monies received from Peaking Charge
 - Monies paid to Welded Parties for +ve AEOI
 - Monies paid to suppliers of Call Balancing Gas

Net = Overall Recovery

If:

- **Overall Recovery > 0:** The TSO redistributes this to users by lowering the tariff in the following year.
- **Overall Recovery < 0:** The TSO shares the cost evenly with all users by increasing the tariff in the following year.

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Cash-Outs (COs) continued...

- **GIC assessment**

- Misallocation of costs inherent in the ILON process would be reduced
- Costs would be better directed towards users with excess imbalance (signalling value of pipeline flexibility)
- Cash-Out prices would provide an incentive for investment (in equipment, processes and information systems) where that is efficient
- The “adjustment factor” signals that use of the pipeline for “park and loan” is not free. The 10% upper limit is reasonable - sufficient to encourage good balancing behaviour without being needlessly punitive

Peaking

- **Proposed change**

- All stations would have Peaking Limits (not just Large Stations)
- Bundling of Rotowaro Pokuru, and Pirongia TPWPs would end
- New/adjusted limits would be set >>>>>>
- New Peaking Charge would apply where there was an IP claim, Low Line Pack Threshold breached, and a Balancing Gas Call made

Welded Point (Large Stations only)	Peaking Tolerance (% of HSO)	Peaking Limit (GJ)	Change
Oaonui Meter Station	150%	0	Same
Frankley Road	125%	3,000	Same Peaking tolerance, Peaking Limit reduced by 500GJ
Bertrand Road (Waitara Valley)	125%	1,500	Same Peaking tolerance, Peaking Limit reduced by 2,000GJ
Faull Road	125%	1,500	New
Tikorangi Mixing Station	150%	0	Same
Tikornagi #2	150%	0	New
Kowhai Mixing Station	150%	0	New
Ngatimaru Road (Receipt)	150%	0	New
Ngatimaru Road (Delivery)	125%	3,500	New
Tikorangi #3 (Receipt)	150%	0	New
Tikorangi #3 (Delivery)	125%	3,500	New
Turangi Mixing Station	150%	0	New
Mokau Compressor Station	125%	500	New
Poluru	125%	1,000	Split out, same %, combined total reduced by 2,000GJ
Pirongia	125%	500	Split out, same %, combined total reduced by 2,000GJ
Rotowaro	125%	6,500	Split out, same %, combined total reduced by 2,000GJ
Huntly Power Station	125%	3,500	Same Peaking tolerance, Peaking Limit reduced by 500GJ

Peaking continued...

- **GIC assessment**

- Peaking Charge would apply in very restricted circumstances
- Peaking Charge should discourage overuse of intraday flexibility and encourage more efficiently management of risk

Daily tolerances

- **Proposed change**

- ROILs currently equal the DOILs, but MBB proposal set ROIL at greater of 1% of SQ or 1TJ (mostly one third of the DOILs)
- ROIL multiplier introduced to allow:
 - a temporary ROIL increase for events like contingencies
 - a 'soft landing' for the introduction of daily Cash-Out: the ROIL Multiplier set at 2 up to 1 March 2016, and 1.5 for six months beyond

- **GIC assessment**

- 'soft landing' useful in allowing time for pipeline users to adapt
- reduction of tolerances would reduce the quantity of free Line Pack flexibility provided, somewhat improving efficiency

TP Welded Party Balancing Gas scheduling rights

- **Proposed change**

- TP Welded Party rights to schedule Balancing Gas outside the standard nominations cycle would be removed

- **GIC assessment**

- Vector has never made a nomination for Balancing Gas and it seems unlikely that Vector would begin to actively trade Balancing Gas, so loss of Balancing Gas scheduling rights should be minor

Incentives Pool

- **Proposed change**

- Balancing Agent would no longer be able to claim against the Incentives Pool
- Pool would continue to provide a liquidated damages arrangement for Welded Parties who suffer damage when other Welded Parties have exceeded their Peaking Limits or their DOIL

- **GIC assessment**

- Under MBBCR it would be logical that the Balancing Agent should no longer be able to claim against the Incentives Pool
- It appears that Welded Parties would not lose any rights as a result

DR chapter 5: Related Issues

- **Related issues**

- MDL's recovery of balancing costs
- Absence of balancing tools: nomination cycles and D+1
- Effect on downstream users
- Barriers to entry
- Misalignment of codes
- International best practice
- Proportionality
- A better solution through a co-operative approach

MDL's recovery of balancing costs

- **Issue**

- Concern that:
 - MDL could over-recover balancing costs
 - Commerce Commission may rule Cash-Outs are not “recoverable costs”

- **GIC assessment**

- Any over-recovery would be temporary
- Appropriate and reasonable for MDL to ask for the MBBCR to be processed before recoverable costs issue is determined
- Outcome should not significantly alter GIC's analysis or prevent GIC deciding whether or not to support the MBBCR in the meantime

Absence of balancing tools

- **Issue**

- Concern that:
 - WP transfers no longer an effective tool
 - More nomination cycles are needed, and/or the current cycle times need to be altered to allow for improved primary balancing
 - Without 'D+1' allocations risk to mass market shippers is increased

- **GIC assessment**

- Balancing positions are managed continuously, so WP transfers would still be useful to avoid a cash-out on the following day (D+1)
- Cycle times would be more significant if ILON 'grace period' is removed... but cost of OATIS improvements may not be justified
- D+1 would benefit mass market retailers if cost is justified

Effect on downstream users

- **Issue**

- Difficult to estimate the cost to end users since:
 - The response to changed incentives is difficult to estimate
 - Effect of MBBCR on end user contracts is not yet clear

- **GIC assessment**

- MBBCR would not require pipeline users to invest in equipment, processes, or information systems...but incentives to invest would become sharper

Barriers to entry

- **Issue**

- Concern that cost, complexity and risk for new entrant retailers will increase

- **GIC assessment**

- In some respects the situation for new entrants would become more certain. Where they contribute to an imbalance over tolerance they would automatically be cashed-out, and Cash-Out would occur at a market related price.
- Daily Cash-Out is the norm in many jurisdictions, so a new entrant coming from such a background would find MBB arrangements easier to understand and work with.

Upstream benefits

- **Issue**

- It is claimed that hydrocarbon recovery and condensate production would be enhanced by low and stable pipeline pressures

- **GIC assessment**

- It will be difficult to assess how much more stable pipeline conditions would be and it would be costly to obtain a reliable assessment of the resulting effect on reserves and condensate production
- At this stage we are not convinced that this work would add significantly to the analysis

Misalignment of codes

- **Issue**

- Concern that 'misalignment' between MPOC and VTC may lead to perverse outcomes

- **GIC assessment**

- We do not believe that misalignment would render the MBBCR amendments unworkable or undesirable on their own
- If misalignment issues do undermine industry improvements, we would have to address that issue in our regulatory capacity

International best practice

- **Issue**

- MBBCR has drawn on the design of the European Code

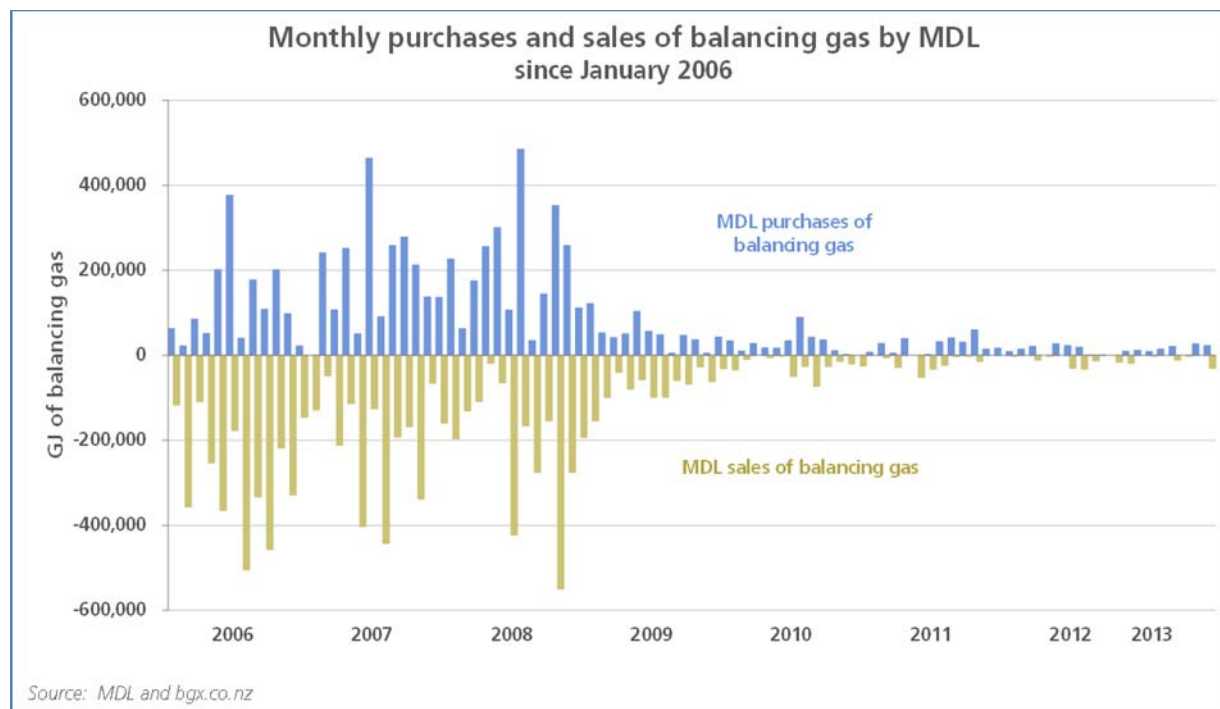
- **GIC assessment**

- GIC acknowledge the extensive experience and work that went into development of the European Code.
- However, submitters point out that the MBBCR adopts only parts of the European Code model and that, in any case, some New Zealand market conditions are markedly different to those in Europe. We agree that we should be cautious.
- We believe alignment with common overseas industry practice would bring a benefit in relation to the OATIS replacement

Proportionality

- **Issue**

- Concern that the MBBCR is out of proportion to the scale of the problem



Proportionality continued...

- **GIC assessment**

- Balancing is central to many arrangements (gas purchases and sales) so distortionary practices such as offering services as a 'free good' and cross-subsidies will have knock-on effects
- Even ignoring dynamic efficiency benefits, the Covec Cost-Benefit Analysis indicates that the benefits of implementing the MBBCR will exceed the costs
- It appears that excess imbalances have not materially reduced since 2007/2008 and volatility of pipeline pressures remains high. MDL notes that on about half of the days in 2013 and 2014 the Target Taranaki Pressure envelope of 42 to 48 bar was breached.

A better solution through a collaborative approach

- **Issue**

- Many submitters would prefer that the MBBCR is rejected to allow time for an alternative solution to be developed collaboratively among stakeholders

- **GIC assessment**

- MDL and Vector have a history of not seeing eye-to-eye on balancing arrangements
- If Vector and MDL cannot work collaboratively we don't think a collaborative approach can succeed

B2B	MBB
Promoted by MDL (pre 2014)	Promoted by MDL (now)
Loosely based on GIC's 2009 SoP	Based on EU arrangements
Cash-out of excess imbalance only when balancing agent intervenes and user does not correct its balance	Cash-out of excess imbalance every day
Small imbalance tolerance	Smaller imbalance tolerance
MDL continues to buy and sell balancing gas on BGX	MDL gives priority to using an open trading market where possible
Cash-out at average price	Cash-out close to marginal price