19 March 2018

Ian Wilson
Gas Industry Company Ltd
WELLINGTON 6140

Dear Ian,

Re: MGUG Submission on GIC's Preliminary Assessment of Gas Transmission Access Code (GTAC)

1. We attach our submission on the GIC's Preliminary Assessment Paper (PAP) on the template provided. This submission is being made on behalf of the Major Gas Users Group (MGUG):

    a. Ballance Agri-Nutrients Ltd
    b. Fonterra Co-operative Group
    c. New Zealand Steel Ltd
    d. Oji Fibre Solutions Ltd
    e. Refining NZ

2. Nothing in this submission is confidential and some members may choose to make separate submissions.

3. Our main points, outlined in more detail in the submission template are:
    a. While the assessment done by the GIC has been detailed and thorough, there are some missing features we expected to see that would have made it more comprehensive and transparent, including:
        i. A better discussion of the comparisons between MPOC specifically, and the GTAC. These are the two codes most similar to each other in terms of basic design features and which, on the surface, deliver similar outcomes. This type of analysis would help draw out the key distinctions between them, as it appears to us that the MPOC is a strong alternative contender to the GTAC for the design of a regulatory backstop should the GTAC continue to fail the materially better test. This also follows on from earlier assessments made by the GIC as part of the PEA outcomes, where a Flow on Nomination design seemed the better solution to the PEA identified issues.
        ii. Recognising that some provisions work synergistically with other provisions and shouldn't be assessed in isolation.
        iii. A clearer explanation, and more transparent demonstration, of the assessment done in step 3 of the analysis.

b. While we support an opportunity to improve the draft GTAC we neither agree nor disagree that the GTAC is materially better than current arrangements. This reflects our view that the assessment hasn't included the (regulatory) objectives of the code as developed in SCOP1 and SCOP2. If an overall assessment had been done against these objectives we believe the assessment outcome might have concluded that the GTAC was materially better.

c. We disagree with parts of the GIC's assessment including:
    i. The comparisons are not all like for like. The GTAC design, like MPOC, is focused on maximising physical capacity. This makes a closer comparison between GTAC and MPOC more relevant in a number of instances, particularly in the context of GIC's responsibility determined at the start of this process of *Ensuring that all reasonably practicable options have been considered*. We believe this is essential if there is a failure to move the GTAC across the materially better line, and a regulatory backstop is needed.
    ii. We believe incentive charges are more than just "a significant concern". The subtext of the analysis suggests a stronger statement is needed, i.e. that incentive charges are not demonstrated to be cost reflective, and are therefore inefficient.
    iii. We disagree with the assessment that incentive charge rebates have no detrimental effect on stakeholders. We further believe that there is an error in the assessment in not considering that there should be a fundamental linkage between regulated services, and components of regulated revenue driving those services.

4. We are concerned that the industry may still be some distance from achieving a code that is materially better. We also do not believe it is acceptable to fall back on the current arrangement if the process fails to deliver a revised code. The preceding processes including the extensive period that delivered the PEA outcomes, clearly identified areas that needed improving. We suggest that unless the GIC believes that a revised, acceptable version, of the GTAC can be achieved by October this year, that the GIC starts a parallel process to develop the regulatory backstop.

Yours sincerely

Richard Hale/Len Houwers
Hale & Twomey Ltd/Arete Consulting Ltd
Secretariat for the Major Gas Users Group

Questions

Preliminary Assessment of Gas Transmission Access Code (GTAC)

Submission prepared by: Major Gas Users Group

QUESTION	
Q1:	Do you have any comment on our approach to the analysis?

Whilst we understand the GIC's assessment approach is to consider whether the GTAC is materially better than the current access arrangements as a whole, i.e. VTC and MPOC together, the question of whether the GTAC is materially better than either the VTC or MPOC is left unanswered. Both the VTC and MPOC represent reasonably practical alternatives to the GTAC. Under the process established in August 2016 the GIC agreed it had responsibility for "*Ensuring that all reasonably practicable options have been considered*". It is a missed opportunity to not have weighed the GTAC provisions against the best and worst features of either code separately. This may become more important if the GIC has to develop a regulatory backstop.

In general the assessment approach taken by the GIC seems logical, and systematic, but we note a number of points that might have improved the clarity of the analysis and made the conclusion more transparent to the industry:

1. Whilst it is clear that the GIC considers its assessment against the Gas Act and GPS we note that the broader regulatory objectives were defined through SCOP 1 and SCOP 2:

   To promptly establish a new non-discriminatory gas transmission open access regime to replace the MPOC and VTC that facilitates:
   1. efficient operation of the transmission system and use of pipeline capacity;
   2. competition in upstream and downstream markets; and
   3. efficient investment in pipelines.
   And;

   The objectives of a single code, proposed in SCOP 2 are:
   1. Enable the use of gas
   2. Minimise the cost of transporting gas
   3. Keep it simple
   4. Promote flexibility
   5. Increase transparency

   These statements provide a useful overall assessment test, but seem largely missing in the assessment. This is one of the main reasons why MGUG is uncertain about the GIC's overall conclusion on the materially better test. For example when comparing the GTAC arrangements against SCOP1 and SCOP2 statements of the regulatory objective, it would appear to us that the GTAC is materially better on most of these dimensions as compared to the combined codes.

QUESTION
2. This lack of transparency on how the overall assessment was made features in Step 3 of the GIC's assessment. It is unclear how the individual assessments in step 1 and step 2 are distilled into a final conclusion. Our suggestion is that Step 3 should explicitly address the SCOP1/ SCOP2 objective statements. 3. Some components seem to have only been evaluated against one code or the other but not both. For example the very large improvement noted of the GTAC in terms of product design is only because it is being compared against the VTC. The philosophy of the VTC is to sell annual capacity so it is not surprising that a code that contracts daily capacity should perform better on a number of efficiency and market dimensions. By ignoring a more direct comparison with MPOC which also has a daily product, the assessment fails to answer the questions as to why FG started with an unfamiliar DNC product rather than the familiar ANQ product. This is particularly because the PEA process did not identify many transmission system arrangement weaknesses due to MPOC. This type of assessment becomes more important if the GIC has to develop a regulatory solution. 4. By comparing provisions in isolation of other code arrangements, the synergies achieved between different provisions within the code are overlooked. Some examples include energy allocation mechanisms and congestion management. Energy allocation needs to be seen and assessed in context of basic product design (e.g. ANQ + OBA vs DNC + OBA + over/under run).Congestion management should be assessed in context of physical capacity (greater probability of congestion) vs contractual capacity (physical congestion less likely).
Q2: Do you agree with our assessment of the GTAC gas transmission products?

QUESTION	
	We agree with the assessment based on comparing a single day product, against arrangements where two fundamentally different products exist on different parts of the transmission system. However the assessment lacks some important discussion on drawing distinctions between the similar products of the GTAC and MPOC. The assessment is primarily based on comparing the VTC against the GTAC. Whilst we broadly agree with the assessment, the comparison is between a day capacity product vs an annual capacity product. It's not surprising that the GTAC compares favourably on efficiency and market dimensions when this is done. It would have been useful to compare two competing day products, i.e. MPOC vs GTAC. The benefits of GTAC seem less obvious to us if these two products are compared. For example whilst DNC has similar features as ANQ under MPOC, we suspect that there are subtle differences that would have been worth drawing out in the analysis had an equivalent comparison with MPOC been made. For example ANQ + OBA seems to be less problematic (and possibly superior to) than DNC + over/under run arrangements. While the GTAC might still seem better than the combined arrangements this type of analysis is more revealing in terms of GTAC's weaknesses.
Q3:	Do you agree with our assessment of the GTAC pricing arrangements?

QUESTION	
	The zonal approach to pricing simplifies arrangements, particularly the use of a single receipt zone of which the notional trading point is also a part. However much of the pricing assessment seems to have been done primarily against the VTC. Whilst the assessment suggest that zonal pricing and a price for the basic product (DNC) are positive features, the level of incentive charges to promote positive behaviour are noted as a "significant concern". We share the concerns about the level of incentive charges, but we would put it more plainly by arguing that the incentive charges are *not cost reflective*, and therefore *inefficient*. The GIC limited its concerns to incentive charges in non-congested situations, however we see no evidence that the level of incentive charges are cost reflective in congested situations either. Incentive charges also need to be considered together with the different rebate policies (annual wash-up vs monthly rebate). From a consumer perspective the significant concerns about the level of incentive charges are amplified by arrangements that do not guarantee that people paying those charges would also receive the rebates. We discuss this further in our response to Q21. While the GIC's overall assessment is that pricing is neutral (equal up and down impacts), we believe that the potential impacts on consumers under the combination of inefficient incentive charge pricing, and a rebate policy that doesn't guarantee rebates to consumers paying those charges, is an overall worse outcome than under the current arrangements.
Q4:	Do you agree with our assessment of the GTAC energy quantity determination?
	Given that there isn't much contrast between the arrangements which are primarily related to technical standards we don't see this as an important issue. However we do think that the points raised against the GTAC by Methanex (lack of clear metering requirements and reduced frequency of testing) are valid, and for the moment outweigh any benefits of having a single standard for metering arrangements.
Q5:	Do you agree with our assessment of the GTAC energy allocation arrangements?

QUESTION	
	We don't agree with the assessment. The GTAC is rated as an improvement by the GIC mainly because it offers a choice of allocation methods. We don't believe that allocation arrangements can be viewed in isolation of other features of the access arrangements. For example the exclusive use of OBAs under MPOC appear to us to be a feature of the design that helps avoid the issue of over/under-run on daily nominations. Given that under/over-run incentive charges are considered to be a problem in the draft assessment of the GTAC, it would appear that OBAs are a positive feature of the MPOC arrangements, outweighing the mixed arrangements under the GTAC where offering OBAs has created "wrinkles" for OBA parties.
Q6:	Do you agree with our assessment of the GTAC balancing arrangements?
	In general we support the assessment. The use of a single balancing zone is a positive feature. However other conclusions need to be tempered by the number of uncertainties discussed: 1. Impact of Park and Loan on available tolerances for ERM and development of spot trading market depth and liquidity 2. What the actual tolerance for ERM actually is likely to be (our understanding is that FG have not gone beyond the concept and have little feel for whether this tolerance will be material or not) The primary balancing mechanism (ERM) lacks discussion on a number of other key points. This includes greater uncertainty for the TSO as to whether it should take balancing action itself (since it doesn't know whether or when parties with ERM would look to clear their position). ERM charges also interact with the gas trading market to create gaming incentives in a thin market.
Q7:	Do you agree with our assessment of the GTAC curtailment arrangements?
	We agree with the assessment.

QUESTION	
Q8:	Do you agree with our assessment of the GTAC congestion management arrangements?
	We think that the benefits of the congestion management products are more theoretical than real until the rules around PRs are known and parties willing to take on an IA can be identified. We would therefore disagree that these products are a substantial improvement over existing arrangements and exceed the identified downsides of the arrangements.
Q9:	Do you agree with our assessment of the GTAC gas quality and odorisation arrangements?
	We agree with the assessment.
Q10:	Do you agree with our assessment of the GTAC governance arrangements?
	We agree with the assessment.
Q11:	Do you agree with our top-down analysis?

QUESTION	
	Our comments regarding the top down arrangements are generally included in the previous questions and further summarised here: 1. Assessment methodology misses some of the synergies between different provisions. 2. It's not always appropriate to compare both codes against the GTAC since some of GTAC's features fall out of a code that looks to maximise physical capacity, rather than contractual capacity. In these instances a comparison needs to be made against MPOC rather than VTC to ensure like for like comparisons. Allowing for these subtleties alters some of our view on an appropriate assessment, more generally in a less supportive way on the GTAC. However there is one area where we believe the GTAC is being substantially underrated. We disagree with the rating of gas transmission products as only having a moderate up improvement (despite our other comments on how the assessment was made). In our view the GTAC offers a substantial improvement over the current arrangements, rather than moderate as assessed by the GIC. We believe this because despite other limitations, having a day product relieves a major barrier in the gas commodity market. Although the GIC mentions improvements in gas market competition (and reducing entry barriers) we believe it has underestimated the impact this might have on creating downward pressure on gas price. The DNC product (or an ANQ) removes transport frictions in the spot market (and term trading through product strips). End users have a wider choice of who to buy gas from, and upstream parties have a low cost mechanism to trade with smaller users. This puts competitive price pressure on gas aggregators who currently intermediate between upstream and downstream parties.
Q12:	Do you agree with our overall assessment?

We neither agree nor disagree. This reflects two concerns we have:

1. The lack of clarity on how the GIC distilled its list of assessments to the crucial points it considers need addressing to make the GTAC materially better.
2. The sense that a reductionist approach in breaking down the codes into component provisions has overlooked the more holistic regulatory statement developed at the start of this process in SCOP 1 and SCOP2 (as noted in our response to Question 1)

We do think that the outcome of not assessing the GTAC as being materially better is useful. It allows some clearly unattractive features to be corrected. Assessing the GTAC as not being materially better, provides some motivation for the industry to achieve a better outcome, and the draft assessment conclusion seems to have at least achieved broad support from the industry (other than from FG).

We have difficulty however in understanding how the GIC arrived at its final outcome. We agree that some matters are more fundamental than others and that it is not useful, or helpful, to simply average an arrow-based system. However thefinal priorities identified by the GIC don't seem obvious from the two step assessment. We think that this is a weakness in the paper. Instead we think that the final step should have considered the broader objectives from SCOP 1 and SCOP 2.

By way of illustration on this point, If the list of objectives in SCOP1 and SCOP2 had been used as an overall test, our superficial assessment would suggest a possibly different final view (arrow size not an indication of relative merits).

Objective	**GTAC relative to MPOC**	**GTAC relative to VTC**	**GTAC relative to combined codes**
SCOP 1 – CODE OBJECTIVES			
efficient operation of the transmission system and use of pipeline capacity;			
competition in upstream and downstream markets; and			
efficient investment in pipelines.			
SCOP2 – REGULATORY OBJECTIVES			
Enable the use of gas			

QUESTION				
	Minimise the cost of transporting gas			
	Keep it simple			
	Promote flexibility			
	Increase transparency			
	We do believe that the GTAC can be substantially improved, and if industry has the opportunity, FG should “fix” those features that are seen as problematic and important to the industry. We also believe that the GIC should be progressing a regulatory solution in parallel, as it is not apparent to us that the necessary improvements will be made in a timely fashion.			
Q13:	Do you agree that with our analysis of ICAs?			
	Yes.			
Q14:	Do you agree with our analysis of SAs?			

QUESTION	
	We agree with the analysis and reinforce our position that SAs should be a marginal product in order for provisions in relation to standard products to be meaningful. Whilst we do not wish to prescribe the arrangements for when SAs are justified we agree with FG's broad principles for assessing the request that it receives. The SAs are going to be public documents so we see no reason why FG couldn't also publish its analysis and reasons for agreeing to an SA as a tangible and transparent demonstration in support of its assessment principles.
Q15:	Do you agree with our analysis of nominations?
	Yes. The example of practices in the UK is interesting and we would encourage FG to consider whether it offers a better alternative to shipper nominations for non-daily metered flows.
Q16:	Do you agree with our analysis of daily overrun and underrun charges?
	Yes. The key point appears to be that under/overrun charges are not demonstrated to be cost reflective and are therefore inefficient.
Q17:	Do you agree with our analysis of hourly quantities?
	There is a stronger point that needs to be made and that is that the need for an MHQ charge has not been demonstrated. This feeds back to the broader issue of whether incentive charges are cost reflective.

QUESTION	
Q18:	Do you agree with our analysis of liabilities? In particular, do you have any particular comments on whether the proposed liability arrangements in relation to the injection of Non-Specification Gas better meet the efficiency, reliability and fairness objectives when compared to the MPOC and the VTC?
	This is a legal question. Fonterra has provided its own submission on this legal point.
Q19:	Given that the current, tighter, drafting in the MPOC still results in excursions outside of the 42-48 bar gauge range, what is your view of the revised drafting under the GTAC?
	We support the GIC's concerns that the GTAC provisions for maintaining TTP are less stringent than under MPOC. The potential for production stations to shut in as a result of high pressures in the pipeline is an obvious concern for end users in terms of reliability and security of supply. High back pressure also potentially affects the total resources recovered from a gas field which impacts on longer term issues of gas price and overall supply.
Q20:	Do you agree that comparing the ERM charges with bid/ask spreads is a sound method for testing the appropriateness of the quantum of those ERM charges? If not, what would be a more appropriate comparator?

QUESTION	
	In general the analysis appears reasonable. However we would note that there is an assumption that parties have a choice to trade on the spot market. We are not convinced that this is a reasonable assumption for all parties in the gas value chain. For example a shipper or end user may be under an exclusive gas purchase arrangement that prevents it trading on the trading platform. Under some scenarios MBB could offer a lower cost than ERM (when gas contract buy price = trading platform price) The discussion seems to ignore some of the other features of ERM charges, i.e. that it functions as a no notice park and loan arrangement (paying $0.20/GJ/day to park, and $0.60/GJ/day to loan in the pipeline). If ERM is simply Park and Loan by another name, and the GIC is not clear whether Park and Loan fees fall under a revenue cap or not, then the same issue of skewed incentives to set balancing tolerances arise. Secondly, ERM fees also raise the question of what it does for gas trading behaviour. ERM interacts with the gas trading platform as it provides an option on speculating on gas price volatility. We suspect that some of the incentives on primary balancing may be undermined if there are opportunities to game the trading market. While we don't have a particular view on either of these two additional points, as it falls outside our area of expertise to comment on, we do think that these are reasonable questions to consider before finalising the assessment on this topic.
Q21:	Do you agree with our analysis of the incentive charge rebates?

We do not agree with the GIC's analysis.

The GIC's conclusion that the rebate mechanism has no detrimental effects on stakeholders are caveated on incentive charges being set an "efficient level", and on a further assumption that retail markets are also efficient. We believe that the first caveat has been demonstrated not to be true by the GIC. The second assumption ignores the distinction between a *gas retail* market and an *energy retail* market (the way in which gas and other energy products may interact). The proper conclusion is that the rebate policy does have a detrimental effect on some stakeholders, particularly gas consumers. Separate from these points is whether incentive charges, which are integral to regulated services, should be allowed to fall outside of the regulated revenue cap through the rebate mechanism. This seems wrong in principle, and a slippery slope in practice.

In our view an efficient pricing level for incentive charges is synonymous with those charges being cost reflective. The foregoing analysis by the GIC has already raised doubts as to whether that is the case and we are of a similar view that the level of incentive charges have not been justified by FG.

The second assumption of efficient retail markets seems to ignore the point made in our earlier submission that there is a distinction between energy retail markets which includes gas, LPG, electricity, and in some cases even internet broadband services, and gas retail markets (Gas Act focus). Energy retail competition, particularly at residential, small commercial, and possibly even small industrial level is based on bundled pricing arrangements of various energy products (and other services) where the consumer considers the overall pricing of a product mix. While the GIC may conclude that this distinction is unimportant so long as consumers have a choice in suppliers, and can assess what represents lowest overall cost in energy, an efficient energy retail market does not imply an efficient gas retail market. The rebate policy as proposed under the GTAC no longer caps gas transmission revenue and it is doubtful that if this arrangement was allowed to remain that it would meet the objective of S43ZN(b)(iv) of the Gas Act (-delivered *gas costs and prices* are subject to sustained downward pressure).

The GTAC rebate arrangements need to be assessed against a consumer perspective not a shipper/ retailer perspective. The current code arrangements incentivise FG to keep incentive charges low. This is because predicting user nomination behaviour affecting incentive charge revenue, is much more difficult, and has greater uncertainty on overall revenue, than calculating annual physical demand for gas. By keeping incentive revenue within the revenue cap this provides a natural discipline on FG to keep incentive charges as low as possible, meaning at a level that minimises overall recoverable system costs. Secondly the current code arrangements are purer in maintaining the principle of attributing incentive charges to causers (they are not partially rebated back). Thirdly, any wash-up of over/ underestimating incentive charge revenue is reflected transparently in the overall DNC charge that automatically flows back to consumers, ensuring that excess rebates do flow back to people paying for those.

QUESTION	
	Finally there is an important point to make regarding the role of incentive charges as an integral part of providing regulated services. Incentive charges are a fundamental feature of the design of the regulated service i.e. they support and are linked to the workings of the basic product (DNC). The purpose of incentive charges are to incentivise individual behaviour on behalf of a wider industry good, and to ensure that the overall service being provided meets the requirements of the Commerce Act and quality provisions under the default price path *to benefit consumers*. Putting the incentive revenue outside of the revenue cap puts an obligation on consumers who pay these charges, and the rebate in the hands of retailers who have no regulatory obligation to recycle those charges back to consumers. This seems to undermine key objectives of competition regulation to improve and protect consumer outcomes, and is a materially worse outcome for consumers compared to the current arrangements.
Q22:	Do you agree with our analysis of First Gas' discretion?
	We have no comment on the analysis
Q23:	Do you agree with our analysis of public information disclosure?
	We don't disagree with the analysis but would have like to have seen a list of disclosures that are available to shippers and ICA parties but not to other interested parties. This is because we also believe that "information transparency is key to facilitating efficiency in the gas transport and energy markets", and we might further add "trust" to that sentence.

Additional questions posed by First Gas

QUESTION		COMMENT
Q24:	**How far away from the materially better standard do you think we are?** For example, do you think we need to fundamentally re-work the access products and concepts; significantly re-work a few items and adjust a range of other items; adjust a range of items; or adjust a few key items?	
		Our principal concerns with the current version of the draft code relate to the level of incentive charges and the rebate policy. 1. FG needs to design charges for non-congested and congested parts of the transmission system that are cost reflective. 2. The rebate policy needs to alter – preferably to keep all revenue as part of the revenue cap. Our reasons are explained in the submission above. We support the GIC's preliminary assessment on other matters including: 1. Liability provisions 2. Certainty on ICAs 3. Ensuring that Park and Loan (and possibly ERM) are part of regulated revenue cap.
Q25:	**How long do you think it will take to re-engage and achieve materially better?** For example, a similar amount of time as spent so far (August 2016 to November 2017); about half as much time as spent to date; six months; or three months? Do you have any views on an appropriate go-live date for the new code, given the other steps involved (GIC assessment and IT implementation)?	
		We think that re-engagement will not be productive until the current submission process is complete (end of April 2018). The main reason for waiting until then is because the final assessment may either change GIC's view on materially better, or alter their list of issues to address. For the same reason we can't assess how long it would take to achieve a materially better decision. We would hope for a relatively short list of items to address with broad agreement and alignment on solutions, but given experience to date we are somewhat doubtful that this can be dealt with quickly. Our view is that if the GIC senses a revised draft code cannot be achieved by end of October this year, then it should start developing the regulatory backstop while industry continues to try and improve the GTAC.

QUESTION		COMMENT
Q26:	**Do you have any preferences on how the process should be run from here on in?** For example, in terms of the pathways shown in the decision tree above, should we revise and consult on the GTAC to address the reasons the GIC concluded it is not materially better, should be discontinue the process, or should we start from a blank sheet of paper? Should we use workshops like we have previously; focused work group sessions; one-on-one discussions; or a mix of the above?	
	Our preference is to revise and consult on the GTAC to address reasons. The list of issues will determine the best approach. We would be comfortable with FG continuing to hold the pen and drive the process to another iteration of the code.	