23rd January 2018

Gas Industry Company

(via email to info@gasindustry.co.nz )

**Attention: Ian Wilson - Principal Adviser – Infrastructure Access Group**

Dear Ian,

Re: Submission on the final draft Gas Transmission Access Code : Materially Better Assesment

Fonterra thanks the Gas Industry Company (GIC) for the opportunity to provide feedback on the consultation, final draft GTAC released on 8th December 2017

Fonterra is a major gas user and used approximately 4.9PJ of natural gas last season (1 August 2015 to 31 July 2016, aka FY17). Fonterra’s sites using natural gas are located across the North Island of New Zealand, resulting in Fonterra having significant utilisation of the gas transmission system.

Fonterra is a member of the Major Gas User Group (*MGUG*) and supports the points raised in that submission on this draft, except where they may differ by any points raised in this submission by Fonterra.

Fonterra is overall supportive of the draft GTAC as it currently stands as it is materially better than the existing Vector Transmission Code and Maui Pipeline Operating Code. The one area that we feel needs further analysis to confirm that the GTAC is materially better is around the Governance and Liabilities as outlined in our submission below.

Fonterra looks forward to further engagement with the GIC on this topic and is willing to discuss further any matters regarding this submission.

**Submission on Gas Industry Company Assessment of the GTAC**

**Introduction**

Our submission on the Gas Industry Company's ("**GIC**") assessment of the Gas Transmission Access Code ("**GTAC**") is limited to the clauses covering liability for non-specification gas.

As GIC will appreciate, Fonterra has a strong interest in ensuring it has a reliable supply of specification gas.

Several submitters on the first draft GTAC expressed concern about its liability clauses. Fonterra shares these concerns, and, while appreciative of First Gas' attempts to rectify the situation in the latest draft, it remains unconvinced that the proposed new liability provisions are "materially better" than those currently provided for in the existing arrangements.

In its *Proposed approach to GTAC assessment* framework document, the Gas Industry Company ("**GIC"**) said that in order to facilitate a robust assessment, it would consider each element of the regime individually before making an overall assessment of whether the GTAC is "materially better".

In Fonterra's view, the implication of assessing aspects of the GTAC individually (following, for example, the "suggested breakdown" for submissions provided by GIC on 12 December), is that the GTAC is not necessarily more than the sum of its parts. That is, if enough of its separately considered aspects are worse than the provisions they are replacing, it will not be possible for the GTAC as a whole to be materially better than its predecessor. In short, aspects of the GTAC that are demonstrably worse than the status quo should be fixed before GIC can declare that the GTAC is a material improvement on the current arrangements.

As we explain below, the proposed liability regime for non-specification gas could lead to a less reliable and less efficient supply to industry participants. It therefore fails to meet the objectives of the Gas Act 1992 and Government Policy Statement.

**Governance arrangements and liability**

In common with submitters on previous drafts, Fonterra is concerned that the liability framework for the injection of non-specification gas is unwieldy, unnecessarily complex, and may compromise the principled objectives of the regulatory scheme by reducing administrative efficiency and allowing breaches of the code to pass unsanctioned.

The Maui Pipeline Operating Code ("**MPOC**") (and the Vector Transmission Code ("**VTC**")) currently indemnify shippers for the receipt of non-specification gas. The existing codes recognise that the lack of a contractual nexus between shippers themselves makes it necessary for the operator to function as a direct intermediary in situations where shippers and interconnected parties are damaged by each other's breaches. The operator assumes responsibility for the quality of gas in its pipelines, and when it delivers a non-specification product, compensates the receiving party and recovers its costs from the injecting one. This is a simple and efficient allocation of responsibilities.

The revised GTAC, on the other hand, proposes something much more complex and convoluted. While the recent addition of clause 16.12 now allows shippers and interconnected parties to recover losses from each other, it only permits them to do so by way of a subrogated claim taken in the name of First Gas. In the absence of a direct contractual relationship between the injecting and receiving parties, a person who takes non-specification gas into its pipeline will only be entitled to a remedy by "piggy-backing" on the ICA between First Gas and the injecting party, while First Gas itself remains wholly insulated from any direct liability.

*Operator responsibility*

At clause 2.5, the GTAC says:

First Gas will have control and possession of, and risk in, all Gas present in the Transmission System at any time

The proposed GTAC guarantees "possession" and "control", while dramatically reducing "risk". That is, it affirms the principle of operator responsibility in one place, while denying it (or at least drastically undermining it) in others.

The effect of the proposed liability clauses is to eliminate the entirety of First Gas's exposure to the financial and legal risks entailed by the injection of non-specification gas. First Gas operates the transmission system and has (unlike receiving parties) a direct contractual relationship with the parties that inject gas into that system. It is responsible for ensuring that the parties with whom it enters ICAs are under an obligation to ensure that injected gas will meet the specifications, and it is required to satisfy itself that the facilities and procedures of the injecting party are sufficient to ensure that that is the case.

Given this state of affairs, it is appropriate that First Gas would be the party with upfront liability when the transmission service that it owns, operates and oversees fails by delivering non-specification gas. This does not mean that First Gas needs to have "caused" the problematic injection or delivery. It simply means that the nature of the contractual ties that bind the various parties makes it more logical for First Gas to compensate receiving parties in the first instance, before then dealing with the breaching party on its own terms. This arrangement guarantees the quality of the service, and ensures that responsibility is appropriately allocated in the event of a breach.

*Practical considerations*

In contrast to the relatively simple indemnity clauses of the MPOC, the cumbersome subrogated claims arrangement in the GTAC creates a number of potential inconveniences for shippers and interconnected parties. These are not just impracticalities or nuisances: they may also undermine the wider principled objectives of the regime and contravene accepted regulatory best practice. In particular:

Shippers will have to fund their own claims and indemnify First Gas against any liabilities arising from them (as well as paying any costs incurred by First Gas). Electing to pursue a claim could become an expensive prospect: smaller entities in particular may be deterred from doing so, meaning that breaches of the Code which affect party may not be compensated. A regime designed to promote efficient and reliable supply of quality gas needs to be backed up by the real possibility of enforcement. The current MPOC provides a strong regime in this respect; the GTAC does not. It is materially worse.

The proposed process adds an extra and unnecessary layer of cost and complexity in order to seek a similar result as the status quo. That is, if the GTAC's subrogated claims process works seamlessly (unlikely), the injecting party will pay First Gas, which will then compensate the receiving party. This is what happens under the MPOC, but First Gas takes the risk that the party at fault fails to pay, for which it has significant powers to ensure compliance. In addition to transferring risk of non-payment to customers, the proposed GTAC places a new set of bureaucratic obstacles between loss and recovery, meaning that:

Claimants will now need First Gas's help to make a claim, and it is only required to collaborate with a claiming party on a "best endeavours" basis. This raises the prospect that First Gas could refuse assistance where it is "reasonable" (ie advantageous) for it do so; and

Even when assistance is readily offered, it will inevitably take a claimant much more time and money to recover its losses.

Even though it is currently liable upfront to a shipper who receives non-specification gas, existing arrangements ensure that First Gas is very well protected from serious financial liability. Under the MPOC, for example, shippers are required to pay a security deposit. In the event that a shipper fails to pay an amount pursuant to the Code, First Gas can then draw down that amount from the cash deposit. A subrogated claimant, on the other hand, has a much weaker set of rights. The right to bring claims in the name of First Gas does not bring with it access to the remedies that are currently available to an Operator under the MPOC. The end result is that recovery of loss is much less certain under the GTAC: there is a real possibility that shippers will not be compensated for losses caused by other parties' breaches.

**Conclusion**

First Gas has drafted liability provisions that effectively eliminate the risk of it being liable for non-specification gas (a risk that, as we have explained, it is logical for it to share with its shippers). The upshot is that the only purpose of this complicated new arrangement is to insulate First Gas from any responsibility for the failures of its own transmission system.

This more costly, complicated and weaker enforcement system will prejudice the reliable supply of gas and the efficient operation of gas transmission. A stronger and simpler enforcement regime provides a better incentive for injectors to ensure that their gas meets specification. The existing MPOC liability regime is fairer to industry participants.

This is why it is Fonterra's view that the liability clauses in the GTAC, when assessed against the objectives of the Gas Act 1992 and Government Policy Statement, are materially worse than the current ones. The price of shielding First Gas from responsibility for the quality of its transmission service is complexity, uncertainty and potentially a lower quality of service. In Fonterra's view, the generation of extra regulatory cost and uncertainty for no demonstrable benefit represents something "materially worse" than the status quo.

This issue could be resolved by adopting the indemnity provisions of the MPOC. These have worked well. They are simple and effective, make principled and practical sense, and are fair to industry participants.

Yours sincerely,

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