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25 October 2018

Gas Industry Company
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Attention: Ian Wilson

Dear Ian

Submission on First Gas Documents

Please accept our submission on First Gas' draft arrangements proposed for gas transmission. We acknowledge that this submission is sent after the requested date of October 23rd, but request that our views are nevertheless considered.

In principle, Shell supports a single new code to replace the existing VTC and MPOC codes. Further, Shell agrees with the GIC that considerable efficiencies could be realised by a new code that eliminates the VTC's capacity reservation contract and introduces daily nominations on the VTC system.

However, notwithstanding the potential efficiency advantages of a unified system, Shell remains of the view that First Gas' revised "Gas Transmission Access Code" (GTAC2) and associated arrangements do not satisfy the criterion of being "materially better" than existing arrangements. While the drafting of the proposed GTAC2 is now improved, its design remains flawed. The flaws have arisen because the development of the codes have not been carried out with appropriate reference to proven gas industry practice as operated internationally (the Reasonable and Prudent Operator standard under MPOC). As a consequence, not only do we have arrangements that are more complicated than they need to be, there is a risk that significant costs will be imposed on the industry if GTAC2 is implemented (through more curtailments to production and potential disputes).

Shell acknowledges that the concerns it expressed relating to the lack of certainty of interconnection arrangements have not been ignored. In particular we acknowledge First Gas efforts to allay our concerns about GTAC2's technical requirements However, in respect of regime design, we can only suppose that First Gas has been prevented from adopting good transmission practice because of the constraints of Existing Agreements (existing ICAs in the VTC system). We think that the preservation of Existing Agreements in the proposed new arrangements is contrary to basic principles of non-discriminatory open access for gas transmission, and for this reason alone GTAC2 could be rejected by the GIC.

Shell has submitted on the problem areas before, the primary areas are:

1) RPO Operator standard;
2) Management of Taranaki pressure;
3) ERM Mechanism;
4) Inadequate protocols and standards for managing nominations, confirmations, and allocations at Receipt Points.

In this submission, we seek to convey our view that the level of analysis performed in respect of points 3 and 4 above as outlined in the GIC's Final Assessment Paper (the FAP) has not been adequate to justify these significant and unproven design choices. Because the design of the transmission regime is fundamentally important for the health of the gas sector, we think the GIC should seek to adopt the standards of a regulator in assessing the GTAC2 arrangements and accordingly should:

- Prefer the use of proven practices rather than approve mechanisms which have not been rigorously analysed by parties with appropriate expertise;
- Require evidence-based analysis to inform its decisions in preferring one mechanism versus another;
- Prefer non-discriminatory arrangements.

While acknowledging GIC itself provided some analysis of the issues, we were surprised that First Gas did not provide the GIC with expert analysis to justify its design choices over standard practice. In general we consider the overall level of the analysis fell well short of what is required for such fundamental departures from recognised good practice in the areas identified above.

In summary, Shell considers that the GTAC2 arrangements do not meet the standard required to satisfy the conditions for the termination of MPOC, not only because the arrangements are discriminatory against MPOC interconnected parties, but also because they have not been proven in practice or thorough analysis, and so cannot be claimed to be more efficient or reliable than current arrangements.

As requested, we set out in the attachment why we think these issues require the GIC's attention.

Finally, while the emphasis in this submission is in respect of those elements of the GTAC2's design that were not incorporated into our October 3rd submission to First Gas, we highlight two elements of that submission that we request GIC's particular attention:

- Clause 6.17 of Schedule 6: the phrase "any injection by it of Non-Specification Gas" should be deleted because inclusion of this phrase means it departs significantly from the standard of MPOC in this matter. These "deeming" provisions have been the subject of previous submissions and we had understood that First Gas had undertaken to remove this instance.
- Clause 19.2, Term of Code: The term should be at "17 years" from September 2019. The life of code should reflect the life of current gas production assets, which will be operating after 2029. Moreover, GTAC2 should explicitly require any new code to be "materially better", as now exists under MPOC.

Yours sincerely

M E Jackson
Shell New Zealand (2011) Limited

Attachment 1: Matters for GIC attention

1) **Reasonable and Prudent Operator Standard (RPO standard)**
   a) Shell has submitted previously on the importance of the pipeline operations being designed to good gas industry practice that has been proven and applied in a manner that meets standards applied internationally.
   b) We are concerned that First Gas will not meet the requirement for termination of MPOC if First Gas has not developed replacement arrangements that are in accord with the standards required of a Reasonable and Prudent Operator as defined in the MPOC.
   c) The most significant areas where First Gas has not applied the RPO standard required by MPOC are in:
      i) The proposed replacement of the daily balancing (mbb) mechanism with the ERM fee arrangement;
      ii) Poorly specified protocols and standards for gas scheduling, allocation, and reconciliation.

2) **Management of Taranaki Target Pressure (TTP)**
   a) The GTAC2 – Final Assessment Paper (FAP) expressed the view, in relation to the first GTAC2 proposal, that "*We have seen no evidence supporting a change to the TTP or justifying a relaxation of the management standards. Accordingly, it would appear efficient and prudent to maintain at least the level of scrutiny and control that is currently required by the MPOC*."
   b) FG state that revisions in GTAC2 that relate to the TTP are consistent with MPOC. However, in our view, this is not the case.
   c) In our view, there is a clear relaxation of the performance standard required on First Gas. GTAC2 places only a "reasonable endeavours" obligation, versus the absolute obligation required in MPOC under clause 2.19, to plan operations to achieve the TTP (TTP is defined as a **planned** pressure in both MPOC and GTAC2 (emphasis added)). Adopting only a reasonable endeavours obligation to operate to a planned target pressure creates uncertainty for us and the industry as a whole as it suggests, at least to us, that First Gas might not take practical steps in the form of selling gas to maintain the planned target pressure if, for example, prices were in its opinion too low to justify taking a balancing action to sell line pack. It makes no sense for it to use reasonable endeavours to adopt such a plan. It is recognised that having committed to adopting such a planned pressure, the actuality might be different owing to the balancing position imposed on First Gas by shippers. First Gas obligation is only to adopt and operate to a plan that is likely to achieve the target pressure in Taranaki that First Gas selects within the specified range of TTP (given that Shippers all manage their mismatch position).
   d) Following the practice over the last 13 years, MPOC has been interpreted and applied on the basis that planning to control TTP as required by clause 2.19 for each forthcoming day means controlling the prevailing pressure on the prior day by undertaking balancing actions e.g. sale of excess line pack. That is, balancing actions during the day prior are necessary to set up the pipeline to meet the planned target pressure for the following day.
   e) The primary mechanism that has been preferred under MPOC for managing line pack is by the acquisition and disposition of line pack by Balancing Actions. The primary mechanism has not been curtailment. Under MPOC curtailment is not the first or default means for control of the TTP.

While curtailment is explicitly referenced as an option in 2.20, it only applies for the management of planned pressure by applying the procedures in section 8 of MPOC that establish Schedule Quantities prior to the subject day. Curtailment during the course of a day to address high pressure is not referenced in MPOC except as might be implied as a measure of last resort, force majeure, or near Emergency (section 15.1 of MPOC);

f) GTAC2, as drafted, does not adequately replicate the TTP provision, does not include the balancing objectives, does not promise to maintain SOPS to assure compliance with objectives, and introduces new rights for curtailment for control of TTP pressure that do not exist in MPOC except for emergencies. As a result, users of First Gas system under the proposed GTAC2 can no longer be reassured that First Gas will apply all available balancing alternatives before resorting to OFOs or curtailments.

g) In addition, the replacement of daily balancing by the ERM mechanism significantly undermines the TTP provisions of MPOC because its inherent uncertainty will significantly reduce First Gas ability to successfully plan for a pressure for the following day. This is because First Gas will not know the extent to which mismatch balances will be resolved by Shippers during the following day (see section below).

h) We consider therefore that the FAP finding for Target Taranaki Pressure has not yet been satisfactorily dealt with in GTAC2, and the means by which GTAC2 establishes for its control remains a risk to Industry and to Shell.

3) **ERM Mechanism**

a) We consider that the GIC has erred in its assessment of the economic efficiency of the ERM mechanism as it provided in the FAP. In particular, we disagree with the GIC's characterisation of the ERM mechanism as providing Shippers a choice as to whether they should balance or not (Ref. Section D.5 of the FAP where the GIC examines a shipper in the pipeline within a mismatch, that is offset in the system by an opposite mismatch position held by another user). In the course of the recent consultation process, First Gas made it clear that there is no such choice available to Shippers, because First Gas must ensure that primary balancing obligations prevail at all times and cannot be discharged by a Shipper choosing to simply pay the ERM fee.

b) We also do not consider that a system of daily balancing by cash outs is inefficient, particularly if done at close to the best estimate of a market price applicable to the day. The GIC has expressed a view that there is an inefficiency where the gas cash-out price is seen to depart from the gas price as perceived by the cash-out party. We fail to see any such inefficiency in daily balancing by cash-outs at the system level. In this situation, all that occurs is the transfer of ownership from one party to another, and this has no efficiency implication at all if carried out at the market price, the only potential inefficiency is the cost difference between the positive and negative cash-out prices, and we are advised that the ERM fees are designed to replicate those costs that have prevailed under the MBB daily balancing mechanism of MPOC. We expect that with such a significant issue it would be appropriate for the GIC to seek an economic analysis by an economist to properly determine where the inefficiencies actually lie as between the ERM mechanism and the MBB daily balancing mechanism.

c) The need for some improved analysis is now more apparent given the recent pipeline circumstances where average daily volatility has exceeded the planned ERM fee by a factor of 2, and the prices for balancing gas have occasionally been 20 times greater than the proposed maximum ERM fee. We have yet to see any analysis which proves the ERM mechanism will do a materially better job than MPOC's daily balancing.

d) As alluded to in the previous section, we are concerned with the potential change in behaviour that might significantly reduce pressure stability in Taranaki. With the GTAC2's abandonment of daily balancing (as applied via MBB under MPOC), and the resulting carryover of mismatch from day to day, First Gas as pipeline operator will find itself facing considerable uncertainty in circumstances where it cannot predict when or if a Shipper will unwind his mismatch position. This uncertainty will, in our view, inevitably lead to operational dilemmas where the operator will be reluctant to take a balancing action (specifically: - to sell excess line pack gas through the gas market); because the operator is not certain of the Shippers intentions. This dilemma will be worse to the extent that any party to the system has the view that carrying over mismatch is a choice that is available only by payment of the ERM fee. In our view this operational dilemma will mean the Operator will delay in taking pro-active balancing actions and that delay will likely mean the operator will resort to curtailment actions. Such a tendency for increased use of operator curtailment will likely place producers such as Shell and others at increased risk of higher pressure volatility, and the associated production loss or shutdown.

4) Standards and Protocols for Nomination, Management, and Reconciliation

a) The GIC expressed in the FAP (section 4.4. p68) that " *we see no reason why the upstream reconciliation arrangements under GTAC2 would be any less accurate, efficient, and timely than the arrangements that currently exist under the MPOC. This indicates that the comparative assessment should find no change under this criterion.*". However this view ignores the operational benefit of having all allocations derived by the application of standard allocation algorithms such as: pro-rata on nomination, swing, ranking, and OBA, with a default algorithm of "pro-rata" specified as applying in the absence of agreement between all parties. Without such standard allocation, First Gas will have no proper basis for determining the mismatch position of its users in real time during a Day. In addition, there is a significantly greater risk of disputes around reconciliation that could potentially impact operational efficiency on the pipeline. The GIC has not carried out an adequate review of best practice (such as COPAS) to validly arrive at a view that the GTAC2 arrangements are acceptable

b) During the course of the GTAC2 development, Shell has advocated that First Gas must adopt the RPO standard consistent with internationally recognised good gas industry practice for nominations/confirmations, and standard allocations (e.g. see Shell submissions of 23/12/2016, 17/03/2017, 22/01/2018, 19/03/2018). On each occasion Shell has stressed the importance of these standards and protocols for gas scheduling, allocation, and title reconciliation, and the necessity for these to be at the heart of any gas transport arrangements. In our view these are essential requirements for components of the system to be *coherent (i.e. "work together) (ref.* App D.1 "*GTAC - Final Assessment Paper" by the GIC, May 2018) .*

c) We acknowledge that First Gas has incorporated requirements for Shippers to make Nominations in GTAC2, and for Interconnected Parties at Receipt Points to "approve, curtail, or reject" those nominations. First Gas have explained that they have needed to establish this requirement because of its importance in monitoring the real time mismatch position of users for operational decision-making (such as who and when to curtail). We agree that such functionality is necessary. However, we do not consider the GTAC2 requirements are sufficient and note that:

i) The requirements of the GTAC2 Schedule 1 for Gas Transfer Agreements are inadequate for operational purposes. First Gas characterises the lack of specification of requirements as providing flexibility to Shippers. The GIC appears to agree and said in the FAP: "*we continue to believe that introducing a choice of allocation methods is positive*". However, unless First Gas applies as yet undisclosed requirements for Gas Transfer Agreement it has not been demonstrated how the GTAs of Schedule 1 and Allocation Agreements of Schedule 2 will deliver the accurate information First Gas has said it needs to manage pipeline inventory, whether those means are by sale of line pack or curtailment of production. Schedule 1 requirements for GTAs as so deficient that it entirely plausible that GTAs can be created which are not practicable for First Gas to estimate in real time. If First Gas argues that it would not agree to GTAs which are deficient, then any such requirement should be specified upfront in the schedule. If the undisclosed requirement is that GTAs must enable real-time allocations to be calculable by First Gas using information available and on-hand to First Gas then the GTAC2 should specify this. We suggest the only effective solution to such a requirement is to require the application of standard allocation algorithms to confirmed nominations.

ii) GTAC2 lacks the detailed specification of functionality[1] that is set out in MPOC for separate approval options for some or all nominations, and provides for approval of only the aggregate of confirmed Shipper NQs (rather than any individual Shipper nominations). We have therefore no assurance that this functionality will be incorporated in OATIS and can only assume it will not be incorporated. The functionality is important if producers are going to have the ability to properly confirm nominations. For instance: there will be no ability for a producer to choose to flow to the proposed Scheduled Quantity in the circumstance where it cannot confirm individual nominations. Confirmation of individual nominations would not be possible if buyers have developed GTAs to on-sell to other parties at the receipt point which the producers are not a party to.

iii) There is no obligation under GTAC2 for an Interconnected Party to actually flow to the aggregate of confirmed nominations. Because there is no consequence for failure to flow to the aggregate of confirmed nominations under GTAC2, there is no need for Interconnected Parties to be particularly concerned as to what they confirm nor if they do not flow to their confirmed nomination. There will be no accountability of Interconnected Parties to Shippers in respect of flowing to the aggregate of Shippers NQ. Any such obligation would only exist under a GSA, but the details of any such obligation would not be transparent to First Gas and not enforceable by First Gas. This circumstance would reach an extreme if an OBA party decided that it was going to sell all its gas in the "receipt zone" by applying the provisions of clause 6.6 of GTAC2 (Secondary Trading of Gas). In this case no gas received by its buyers would need to have nominations, and the producer would have no need to make nominations because it would be selling only its accruing mismatch position.

iv) There is no need or even a basis for an Interconnected Party to declare Force Majeure in the event of a supply outage, as they would under the provisions of MPOC. This is because a failure

[1] See the functionality required of OATIS in MPOC clauses 9.3, 9.4. 9.6, and 9.7.

of supply to match the aggregate of Shipper's NQs is not breaching any obligation under GTAC2 and so there is no basis to declare force majeure. There is also no incentive to do as there is under MPOC because: (i) allocations need not be driven by confirmed Shipper's NQ; and (ii) GTAC2 has no equivalent provision to MPOC 15.2 that enables Welded Parties under MPOC to reduce their Schedule Quantity to closely match their expectation of what gas will be flowing during the relevant Day, e.g. in circumstances of force majeure.

v) Existing Agreements seemingly escape any obligations under the GTAC2 rules for nominations and curtailment, and this places an undue risk and burden on those interconnected parties who will have had their existing MPOC arrangements terminated.

d) On the basis of the above, we have concerns about the ability of First Gas to meet its own expectations, as set out in its draft SOPs, to manage inventory and Taranaki pressure:

i) The lack of obligation, lack of incentives, and lack of means for Interconnected Parties under GTAC2 to signal what they will be flowing means that we can have little confidence that that First Gas will have the real-time information it needs to properly manage the pipeline inventory and fairly target curtailment actions. This has negative implications for First Gas being able to adequately control TTP.

ii) First Gas will not have a satisfactory basis to effect any necessary curtailments because any Shipper NQ or Interconnected Party could reasonably assert that because notification and allocation requirements are so poorly specified, First Gas will not be in a position where it could have a satisfactory estimate of the targeted Shipper's mismatch position, and thus a user could refuse to accept there is a proper basis for First Gas to issue it a targeted OFO order.