22 January 2018

Ian Wilson
Principal Adviser - Infrastructure Access Group
Gas Industry Company
(via email to info@gasindustry.co.nz)

Dear Ian

RE: Submission on final draft GTAC: Materially Better Assessment

1. This is a submission on behalf of the Major Gas Users Group (MGUG). It responds to the Gas Industry Company (GIC) request for industry feedback to assist the GIC in determining whether the final draft GTAC released on 8 December 2017 (proposed arrangements) is materially better than the current terms and conditions of access for use of the gas transmission pipelines.

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

3. MGUG was established in 2010 as a consumer voice for the interests of a number of industrials who are major consumers of natural gas. Membership of the Group includes:

    - Ballance Agri-Nutrients Ltd
    - Oji Fibre Solutions (NZ) Ltd
    - Fonterra Co-operative Group
    - New Zealand Steel Ltd
    - Refining NZ

4. MGUG's submission reflects "End-use" concerns in the gas supply chain.

5. Throughout this submission we refer to gas retailers as synonymous with shippers.

6. To provide context to our submission, our members are currently not contracted directly to existing transmission access arrangements; they are not shippers. Rather, gas transport arrangements are an integral part of negotiated gas sale agreements where retailers act as shippers on behalf of end users. The terms of those arrangements are confidential between the retailer and the end user. This makes it difficult to arrive at a consensus view on whether the proposed GTAC arrangements will be materially better for individual members than the current arrangements:

    a. Current arrangements are unique to each end user. This includes the degree of transparency on transmission charges, and whether transmission charges are truly service based and cost reflective.

    b. The impact of proposed arrangements have not yet been translated into new contractual provisions between the retailer and end user. Whilst some members

have discussed the possible impacts of the proposed arrangements on their operations with their retailers, it is also apparent that retailers are still undecided on arrangements with end users.

7. Nevertheless, having participated in the GTAC process we can offer our views on how the proposed arrangements might affect our members. In general we are caught between two competing possibilities. The first is that our members are well informed about the intended workings of the code and are sufficiently astute to negotiate good trade-offs between risk and reward. We believe that this should be the case for our current members. The second possibility, where we offer a wider end user context, is that the new arrangements are not well understood by end users in general and that retailers arbitrage the new arrangements to further commercial objectives other than enabling the use of gas. We suspect that this may be the case in practice and we focus our comments further in the section on fees and charges.

SUMMARY

8. The following table provides a summary of MGUG's view of the proposed arrangements against key assessment criteria suggested by the GIC.

9. We believe the proposed arrangements should deliver a better outcome for our members over current arrangements. However this opinion is heavily caveated on the willingness of retailers to "pass through" access provisions rather than capitalise on them to improve on objectives outside of their gas customer interests.

EFFICIENCY	**End User Impact**	**Reason**
Promoting the efficient use of gas pipelines to deliver gas to consumers.	Better	Maximises physical capacity of the pipeline on the day.
Improving the incentives for investment.	No Change	Investment incentives are set by the Commerce Commission and First Gas' business objectives.
Reducing barriers to competition	Better	• New entrants not required to hold an annual capacity product before they can enter the market. • Incumbents do not have legacy rights to capacity to prevent competition.
Facilitating competition in upstream and downstream gas markets	Better	• DNC facilitates gas commodity trading across whole system. • Brokered platform trading promotes easier access between upstream and downstream parties without requiring an intermediary wholesaler.

Increasing downward pressure on delivered gas costs and prices	Better/ Worse	<u>Better</u> • Physical capacity constraints, not contractual capacity constraints determine investment timing. <u>Worse</u> • Incentive charge rebate policy undermines FG incentives to keep incentive revenue on a service based/ cost reflective basis. • Incentive charges seem more likely to be higher under the proposed arrangements. Retailers can repurpose rebates to objectives other than enabling the use of gas, resulting in overall higher transmission prices to consumers.
Promoting access to essential infrastructure and competitive market arrangements.	Better	Combination of above points • Reduction of entry barriers. • Greater alternative in gas contracting arrangements.
Signalling the full costs of transporting gas to consumers	Better/worse	• Depends on how transmission charges and fees are collected by the retailer and whether end users also access rebates to which they have contributed. • In principle the GTAC should be better at signalling full cost by removing cross subsidies between different user load profiles. • PRs/ Interruptible Load (IL) provide a better price signal of scarce physical capacity.
Enabling consumers to make trade-offs between quality and price.	No Change	Determined by First Gas through willingness to offer supplementary arrangements including PR quantity and IL agreements.
RELIABILITY	**End User Impact**	**Reason**
Reducing the risk of interruption or contingency	Better/worse	<u>Better</u> • DNC/ PR focuses FG more on forecasting demand to make timely capacity investments to avoid congestion. <u>Worse</u> • By making all physical capacity available it reduces system buffer to cope with daily fluctuations that exceed physical capacity.

SAFETY/ ENVIRONMENT	End User Impact	Reason
Reducing the risk of harm to people, property, or environment	No Change	Function of AMP rather than access code. Other implied code provisions (ICA, RPO) that manage harm stay the same.
FAIRNESS	**End User Impact**	**Reason**
Being more fair to industry participants	Better	• Code governance allowing wider industry input (vs VTC) is better. • Greater transparency and disclosure on special arrangements. • Concern however that code provisions may not be applied in neutral way by retailers.

GAS TRANSMISSION PRODUCTS

GTAC s2 Transmission Services

10. Transmission capacity under the proposed arrangements is being provided as a standard daily nominated capacity (DNC) product. This contrasts with the VTC where the standard product is an annual capacity reservation based on a nominated MDQ. The new arrangements also allow for non-standard products that may be substantially different from the DNC product. Provided DNC is the dominant product on the system, we believe that this can offer a materially better outcome under the new arrangements.

11. DNC appears to offer more economically efficient capacity utilisation of transmission assets. DNC allocates all the daily physical capacity of a pipeline to users requiring the physical capacity on the day.
    a. DNC is therefore more procompetitive in that new entrants are not impacted by sterilised commercial capacity awarded on an annual basis. This includes the removal of grandfathering rights embedded under the current VTC arrangements.
    b. DNC is also considered procompetitive because the capacity to transport gas is booked on the day that it is needed. For end users looking to competitively tender for gas supply agreements this means that they are not restricted in their choice to suppliers who hold annual capacity reservations as under the VTC. This overcomes a competition problem experienced in 2010 with the commercially constrained Vector North system.
    c. Similarly DNC widens the opportunities to contract for both long and short term gas via brokered gas trading platform such as emsTradepoint. The practical ability to trade on a brokered platform is currently restricted under the VTC regime to holders of annual capacity at designated delivery points. This also introduces a practical constraint on direct brokered arrangements between large suppliers and end users, and has a further impact on limiting price information in the gas commodity market. The proposed arrangements would improve competition in both upstream and downstream markets by providing greater connection between suppliers and

consumers and by providing more gas price information to the market to better inform consumers on the value of the gas commodity.

d. DNC is in our view more dynamically efficient on pipeline asset investment. This is because investment would be based on physical capacity needs, rather than commercial capacity needs. The VTC has demonstrated that commercial capacity constraints are reached ahead of the pipeline's physical ability to deliver increased demand. By delaying investment until it is physically needed it keeps the value of the Regulated Asset Base (RAB) lower for longer meaning lower allowable revenue and lower consumer prices for the same level of demand.

GTAC s3 Transmission Products and Zones

12. The zonal approach to pricing is a modest rationalisation of the existing price structures and zones largely reflect the current pricing zones under the VTC. For end users in fixed locations this has little impact in terms of the new arrangements.

13. The introduction of Priority Rights (PRs) has proved a contentious topic during the development of the code with questions around its effectiveness to curtail demand on constrained systems. We share those concerns particularly the potential impact on large users who may be forced to curtail as a consequence of congestion caused by other users[1]. However we accept that a DNC regime puts all physical capacity on the table and that this is part of the trade-off for lower long term prices mentioned in our point 9 d.

14. Despite PRs being an imperfect mechanism for managing physical congestion, our view is that PRs can be an effective early price signal for investment in capacity that is currently absent and/or less transparent under current arrangements[2].

15. We are disappointed that under the proposed arrangements PRs do not automatically follow the end user where the end user switches suppliers during the term of a PR. This is at variance with an expectation created in August 2017 that PRs could be tagged to the end user in the IT system to give practical effect to the benefits of PRs being held by the end user. The proposed arrangements overall are better than the current arrangements in preventing anti-competitive behaviour by retailers but the opportunity has been missed to completely remove our anti-competition concerns. Nevertheless, the anti-competition impacts of not having PRs follow the end user are being mitigated by the shorter term of PRs, the removal of legacy rights to capacity, as well as that PRs only apply to a portion of daily capacity and then only on days where there is congestion forecast.

[1] These include Operational Flow Orders where large users are mandated to reduce their intakes to compensate for congestion caused by other parties.

[2] The current system relies on a request for capacity queue held by the TSO, or a declared system constraint. New demand may simply be discouraged by the lack of commercial capacity and thereby not enter the queue in the first place.

GTAC s7 Additional Agreements.

16. The availability of supplementary agreements including interruptible agreements reflect current arrangements under the VTC, so in itself these provisions are not necessarily different under the new arrangements.

17. Where the proposed arrangements are an improvement is that they offer better transparency on when these agreements may be contemplated, and by fully disclosing the agreements and their terms entered into. Transparency reduces information asymmetry and helps build trust that the commercial arrangements entered into by First Gas are fair to all users of the system. This is particularly important to our members who tend to have standard arrangements and who have felt the unequal impact of annual price adjustments created out of the distortions of non-standard arrangements under the VTC.

GTAC s4 Nominations

18. We see little material difference in nomination arrangements under the proposed code other than the potential for additional intra-day nomination cycles subject to IT system limitations.

19. If additional nomination cycles are made available this will be an improvement over current arrangements by allowing mitigation of potential over/under-run charges as well as excess running mismatch charges.

PRICING TERMS

GTAC s11 Fees and Charges

20. MGUG has a significant concern with S11.13 and S11.14 of the proposed arrangements. The proposal to credit certain transmission charges including incentive charges and excess running mismatch charges to shippers on a monthly basis has the potential to raise total transmission charges to end users above the nominal revenue cap for transmission line services set by the Commerce Commission. This concern arises out of the way that charges flow through the value chain. Whereas retailers can recover incentive and penalty charges from end users through their gas sale agreements, and in practice can recover more than First Gas imposed penalty and incentive charges[3], there is no obligation on retailers, other than through the gas sale agreement, to redistribute all of the rebated charges back to end users.

21. We base this on our view that retailers are not neutral on transmission fees and charges. Retailers selling gas have multiple objectives including maximising demand across their

[3] Retailers can recover more than invoiced by First Gas by not crediting portfolio effects to end users. E.g. whilst delivery points will have under and overrun quantities for which they may be charged by the retailer in an apparently transparent way, First Gas only calculates under and overrun fees to be paid by the retailer by zone. Where several delivery points in a zone are managed by one retailer the net nomination variance of the delivery points are likely to be less than the sum of the absolute variances at these delivery points.

entire product portfolio, including gas market share, electricity market share as well as profit maximisation. Recovering actual transmission fees and charges and fully refunding rebates is a matter of choice and negotiation between end users and retailers. Although some end users may be well equipped to understand how transmission charges are levied and rebated and have sufficient leverage to bargain to negotiate true pass through provisions, a large part of the market below the tier of major users are not expected to be as knowledgeable or suitably prepared to bargain on equal terms with their supplier.

22. Unlike current arrangements, since the rebated charges are both invoiced and rebated by First Gas there is no incentive revenue component to the First Gas' revenue cap. Rather incentive charge revenue is collected from retailers and rebated back to them. Although retailers will be collecting incentive charges from end users there is no obligation on retailers to redistribute the rebates. In practice rebated fees may be used by retailers to subsidise their electricity price to their customers, or to improve company profitability. In either case this defeats the main objective of the code "to enable the use of gas".

23. Under a rebate policy, end users also face a higher DNC fee since First Gas has to collect all its revenue through booked capacity rather than through a DNC fee set after budgeting for penalty fees and incentive charges.

24. Our concern about the possible treatment of rebates by retailers is compounded by the potentially greater amount of revenue generated from those fees. This includes, new charges; underrun fees, hourly overrun charges, and overflow charges. The amount of overrun fees collected is also expected to be substantially more than under current arrangements.

25. Whilst we wouldn't expect all retailers to behave exactly the way that we have described it, there is a greater capacity by retailers to arbitrage transmission charges under the proposed arrangements than under the current arrangements. This makes the proposed arrangements in our view, materially worse for end users compared to the current arrangements.

26. To some extent deciding on a rebate scheme after setting the incentive regime seems to have undermined the logic behind incentive charges. Incentive charges are meant to align end user behaviour with good pipeline management practice. Whereas unrebated incentive charges signal shipper primary obligations on important operation parameters through a penalty structure, returning all those charges back to a retailer pool to be redistributed as seen fit by shippers, (including to the causer), signals a lack of interest in these charges by First Gas. Rather incentive charges become a revenue gathering exercise for retailers. A more efficient, and potentially less distorting alternative would have been for First Gas to have a flow on nomination regime and to recover additional system charges through recoverable expenses. Compared to the MPOC, a DNC structure with rebated incentive charges appears to be a worse outcome for end users.

27. In some instances the selective application of charges to dedicated delivery points but not shared delivery points further highlights the inconsistency in the importance of these charges to First Gas. For instance it is difficult to see why an hourly overrun charge, or an overflow charge on a dedicated delivery point should be imposed to seek to modify

behaviour where the same peak and overflow through a shared gate is not being penalised. Shared gates such as; Westfield (6.9 PJ pa), Papakura (3.4 PJ pa), Hamilton Temple View (1.2 PJ pa), are larger than most of the dedicated delivery point sites, including some from our major user members. Yet an hourly peak of 1.6 TJ at Westfield would incur no charge whereas NZ Steel would face a penalty charge equivalent to about 1,100 GJ at twice the DNC fee[4] for the same effect on the zone.

28. In a similar line of argument it is more likely that a shared gate would exceed overflow limits through un-forecasted demand growth and daily demand fluctuations, than an established facility with a stable demand pattern. Again the shared gate incurs no charge even if exceeding the capacity of the gate results in higher costs to First Gas.

29. In summary, the combination of rebate policy and additional charges under the proposed arrangements compare unfavourably (are materially worse) to the current arrangements in terms of administration and potential cost to end users.

SYSTEM OPERATIONS

GTAC s5 Energy Quantity Determination

30. No material difference applicable to MGUG members noted.

GTAC s6 Energy Allocation

31. No material difference applicable to MGUG members noted.

GTAC s8 Balancing

32. The use of a single zone for determining First Gas balancing gas charges is an improvement over current arrangements. In particular the proposed arrangements avoid the situation where an end user may be cashed out for a multiple of their imbalance quantity based on a sub network imbalance that required no balancing action by First Gas.

GTAC s9 Curtailment

33. No material difference applicable to MGUG members noted.

GTAC s10 Congestion Management

34. The detailing of congestion management arrangements including a hierarchy for curtailment is an improvement over current arrangements by giving greater certainty and understanding as to how First Gas intends to manage these events.

[4] Westfield highest daily quantity in 2017 was 25,494 GJ, 1/16 of which is 1,593 GJ. NZ Steel's maximum daily quantity in 2017 was 7,537 GJ, 1/16th of which is 471 GJ. This is conservative as actual hourly quantities have not been analysed.

35. Provisions requiring notification and assessments of new loads by First Gas and retailers is an improvement over current arrangements by providing greater assurance that potential congestion is pre-empted.

GTAC s12 Gas Quality

36. No material difference applicable to MGUG members noted.

GTAC s13 Odorisation

37. No material difference applicable to MGUG members noted.

GOVERNANCE

GTAC s14 Prudential Requirements

38. No material difference applicable to MGUG members noted.

GTAC s15 Force Majeure

39. The strength of the Force Majeure provision under the proposed arrangement is an improvement over current arrangements because of the adoption of internationally accepted wording of "Reasonable Prudent Operator" in GTAC s1. We support the reasoning supplied by First Gas in their memo of 20 December 2017 for this change.

GTAC s16 Liabilities

40. We are uncertain whether the liability provisions under the proposed arrangements are an improvement over the current provisions under the VTC or MPOC. Legal advice sought by Fonterra suggests that the drafted provisions, including subrogation clauses, are complex and confusing, and more costly for shippers to pursue. We suggest that the GIC consider its own legal advice on this matter.

GTAC s17 Code Changes

41. We support the code change request process under the proposed arrangements as an improvement over current arrangements. In particular the widening of industry input, the GIC acting as independent body to recommend a code change, and pragmatic provisions for correction amendments and urgent changes should ensure better balance of interests represented in the code amendments as well as offering better efficiency in the process itself.

GTAC s18 Dispute Resolution

42. No material difference applicable to MGUG members noted.

OTHER MATTERS

Annual Code Review Forum

43. The articulation of code objectives and principles, with a process to review the code performance on an annual basis, are measures outside of the code that MGUG considers to be an improvement over current arrangement and practise. By referring to the original design principles and regularly reviewing how the code performs in practise it encourages a more proactive and optimal evolution of the code over time.

Yours sincerely

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