Shell New Zealand (2011) Limited

Level 10, ASB Tower
2 Hunter Street
P O Box 1873
Wellington 6011
New Zealand

19 March 2018

Gas Industry Company
Level 8, The Todd Building
95 Customhouse Quay
PO Box 10-646
WELLINGTON 6143

Attention: Ian Wilson

Dear Ian

We appreciate being given the opportunity by the Gas Industry Company (GIC) to submit on the GIC's assessment of First Gas Limited's (First Gas') "Gas Transmission Access Code" (GTAC).

Format of this Submission

The GIC has provided a template inviting submitters to present their comments against questions posed by the GIC. We provide comments in the Attachment.

Assurance of Continued Connection

As with our submission from January, we reiterate that GIC cannot make a determination that the New Code is "materially better" than the current terms and condition for access to the gas transmission pipelines. This is due to the proposed GTAC failing to properly address the terms of access of interconnected parties and their interaction with shipper parties. We are pleased that the GIC has also recognised that the specification of interconnection arrangements is a crucial consideration in its Preliminary Assessment.

Reasonable and Prudent Operator Standard

Once again, we reiterate the importance of the standard for managing the MPOC as a Reasonable and Prudent Operator by the definition of MPOC (requiring changes to conform with good gas practice recognised internationally). In addition to the reasons set out in our January proposal and previous submissions, we believe the GTAC development and assessment process has suffered by not having this standard being applied as the criterion for developing changes. In our view, as a result of not developing solutions based on proven experience (e.g. in respect of upstream allocation protocols and "daily balancing"), the process has resulted in significant time and resource expense without positive results.

We were pleased to learn that whatever the next step may be, First Gas Limited has advised it will develop the new code by iteration between code design and TIETO's IT (causing us to expect costs to be lowered as well as resulting in conventional practical solutions).

Yours sincerely

M E Jackson
Shell New Zealand (2011) Limited

RESPONSE TO GIC QUESTIONS

Preliminary Assessment of Gas Transmission Access Code (GTAC)

Submission prepared by: Shell New Zealand (2011) Limited (Shell)

Contact Name: Murray Jackson

Note*: Please assume that where no comment is made, Shell either agrees or considers the matter immaterial to the conclusion.*

QUESTION	COMMENT
Question 1: **Do you have any comment on our approach to the analysis?**	a) <u>Meaning of "materially better" standard</u> While we might accept the sentiment behind the GIC's statement that "*a single flaw in the GTAC should not be a stumbling block to implementing the GTAC if it is, overall, "materially better*"", we consider that MPOC interconnected parties should not be expected to accept the numerous flaws and uncertainties in order that flaws in the VTC regime are overcome. Moreover, some single flaws are undoubtedly unacceptable, such as GTAC's early termination date with no standard for code replacement. b) <u>Relative benefits</u> We consider too much weight is given to the benefits of "unification" of the two regimes, because much of the benefit attributed to "unification" could be achieved by some simple changes to the provisions and/or operation of the VTC regime. (e.g. cash-outs arising from the mode of operation of multiple balancing pools). c) <u>Unnecessary Disruption to commercial arrangements</u> GIC has not given sufficient weight to the disruption to long-standing access terms, relationships and responsibilities that will be imposed by the GTAC. To paraphrase paragraph 5 of Methanex's submission, to avoid unexpected consequences arising from radical and untested changes the GIC should prefer evolutionary changes, and should mark down areas which represent revolutionary redrawing of operational and commercial arrangements.

QUESTION	COMMENT
Question 2: **Do you agree with our assessment of the GTAC gas transmission products?**	Criteria 1,2 and 14 (p21) We agree with the GIC that the PR mechanism applied to nominations is a significant improvement over the current VTC capacity reservation mechanism with Overrun fees. However, GTACs overrun and underrun fees seem quite excessive and we think it is because the GTAC does not use the "DNC product" to drive allocations at delivery points. Criterion 16 (p 23) We consider the arrangements for short term trading of gas to be insufficiently specified for GIC to assess it as *moderate benefit*, and is an unnecessary change (see comment in Q1c). We suggest there could be potentially legal and governance issues arising for parties seeking to trade gas under GTAC because: (i) there has been no articulation of legal concepts underpinning trading gas within the pipeline; (ii) and there has been no articulation of the mechanics of trading such as how First Gas approvals for trades will be efficiently and promptly effected. The mechanism for trading gas in GTAC also appears anomalous with First Gas's statement that it will always own all the gas in its pipelines. Moreover, while section 6.8 of the GTAC puts the onus on the buyer and the seller to inform First Gas, trading parties also need certainty and commitment from First Gas, specified within GTAC, that it will provide the functionality within its IT system to record and confirm acceptance of trades between parties with no delay. We think these deficiencies should result in a negative assessment in respect to trading.
Question 3: **Do you agree with our assessment of the GTAC pricing arrangements**?	Criteria 1,2, and 14 page 32 As with response in Q2, we think the overrun and underrun fees are excessive despite the rebate mechanism. We disagree with GIC's assessment as to the relative efficiency of the unproven and unconventional ERM mechanism for incentivising balancing. The GIC's problem with the current daily balancing mechanism is that "*users can be driven to incur costs to balance their own positions even though the system does not require any balancing action*" is inconsistent with the principle of parties being responsible for their imbalances at all times, and seemingly reopens the gas balancing debate. Moreover, we see that there is no need for a change in the balancing regime given the primary purpose is to make changes to those aspects that are needed to enable system and regime "unification". If the balancing regime is proposed to be changed, it should be the subject of a process of analysis to the same standard as was applied to the implementation of MBB (daily balancing). The GIC report in December 2016 concluded that MBB had brought about improvement in balancing, there should be a proper justification for putting that improvement at risk.
Question 4: **Do you agree with our assessment of the GTAC energy quantity determination?**	We shall be seeking that energy quantity determination and allocation requirements in the ICA to be negotiated do not require additional investment before interconnection agreements can be executed for continuation of production.

QUESTION	COMMENT
Question 5: **Do you agree with our assessment of the GTAC energy allocation arrangements?**	Criteria 1,2 and 14 page 42 We might agree that having other allocation methods available in addition to OBA would be beneficial but only if it were very clear in a proposed GTAC that: - The receipt point party determines the allocation mechanism to apply at the Interconnected Point, and GTAC were to have been confined to requiring only that shippers confirm their acceptance of that allocation mechanism prior to nominating from or to the relevant interconnection point; and - The allocation mechanism is driven from approved nominations, with approval given by the receipt point party who should have the right to curtail or refuse each provisional nomination; and - There is a list of approved allocation mechanisms (i.e. pro-rata, ranking, swing, as well as OBA); and - Approved nominations are summed to a Scheduled Quantity which can be compared to the actual flow quantity during a day by the publication of a graph on the IT system. We think such standardisation will be efficient and enable allocations to be available almost in real time (at least on an interim basis). We consider that the removal of the ability to operate Displaced Gas Nominations (as defined in MPOC) has negative implications for gas trading, and this should be factored into the GIC's assessment. Criterion 17, p43 We consider that the GIC is incorrect to state that there is only a weak relevance between criterion 17[1] and energy allocation. The proposed GTAC's lack of meaningful protocols and standards for proper gas allocation will necessitate the GIC to put in place proper regulated requirements, in accord with the Gas Act and GPS requirement. In summary, we do not agree that the GTAC represents increased flexibility in this area, rather it represents uncertainty and risk of disputes. We see that the overall position of this section must be assessed as worse, and a retrograde step.

[1] Criterion 17 is in relation to the provision of accurate, efficient, and timely arrangements for the allocation and reconciliation of upstream gas quantities.

QUESTION	COMMENT
Question 6: **Do you agree with our assessment of the GTAC balancing arrangements?**	We disagree with the GIC's view that the proposed balancing arrangement under GTAC will be more efficient (see comment under Q3). We see no justification for this mechanism versus daily balancing which is good gas practice internationally. There is no need for the wholesale change to gas balancing, the GTAC initiative should have confined itself to changes which are necessary to support the "unification" of systems and regime. The likely ineffectiveness of the ERM mechanism to maintain system line-pack variability adds to our concern about the reduced protection by the change in TTP obligations. We agree with the GIC in its comment 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*.". By the same standard we see no basis for change from daily balancing to the ERM mechanism. The burden of proof should not be on submitters to prove that the ERM mechanism is worse, it should be on the GTAC proposer to demonstrate that it is better than the current system of daily balancing, and in is accord with good gas practice that has been proven elsewhere (see also our comment in Q1c). Criteria 1,2 and 14, p49 and Criteria 13&18 p52 We disagree with the GIC assessment, and see the ERM mechanism as unproven and likely to be worse (see also comment under Q3). We find it difficult to accept the GIC assessment (p47) that a shipper could have "positive positions in one or more BPPs and negative positions in the rest" to the frequency and extent that would justify the GIC assesses a significant benefit in favour of GTAC. From our perspective, we do not think that a shipper is at any significant or unavoidable risk of being "cashed-out for having both positive and negative mismatch on the same day". We also find it difficult to accept that the cash-outs that take place at TPWPs can be of "*a magnitude that exceeds the aggregate of the downstream shipper mismatch and VRI*". To the extent that these issues are significant they can be mitigated, and any significant negative assessment of the existing codes relative to GTAC should have more quantified analysis to justify the benefit attributed to GTAC. Criterion 5, p49 There is no basis for the GIC's assertion that the GTAC proposal for balancing has the "*potential for increased activity in the spot market*". With the reduced incentive for shippers to balance, the GTAC proposal will likely reduce the activity on the spot market. While we see that the use of the gas market by non-traditional players might arise because of regime unification, it cannot be attributed to the gas balancing incentives mechanism. We consider that while incentive costs might be lower, the overall costs to the system will be higher because of the worse outcomes in respect of system pressure fluctuations that would: impose costs on producers, reduce reliability by increased frequency of critical contingencies, and reduce trading volumes on the gas market.

QUESTION	COMMENT
Question 7: **Do you agree with our assessment of the GTAC curtailment arrangements?**	Criteria 1,2, and 14 We agree with Methanex's view that shippers are poorly placed to respond to curtailment directions, especially at receipt points. We agree with the GIC, but only in respect of shippers at shared gate stations into distribution systems, and even so we would expect shippers to say they are helpless to control retail demand as they have asserted in relation to congestion issues. We are concerned with the inefficiencies and costs that will arise if shippers seek to discharge their obligations under the proposed GTAC by seeking to modify their requirements under their gas supply contracts. Only by removing these obligations on shippers will this new inefficiency be avoided. We agree with the GIC that curtailment is efficient where it "*better matches supply/demand to the capability of the system*". From this perspective the loss of the right of the Interconnected Party to curtail in force majeure circumstances would be a significant loss of efficiency. We would be seeking this right to be retained in the ICA to be negotiated. We consider that the proposed arrangements represent a moderate deterioration rather than a neutral outcome.
Question 8: **Do you agree with our assessment of the GTAC congestion management arrangements?**	We agree that the GTAC's congestion management mechanisms are an improvement over the VTC.
Question 9: **Do you agree with our assessment of the GTAC gas quality and odorisation arrangements?**	We note an error in the first line of Table 13. We have no comment, other than to repeat our previous submissions that the potential for a party to be "deemed" not to be a Reasonable and Prudent Operator is unacceptable.
Question 10: **Do you agree with our assessment of the GTAC governance arrangements?**	Prudential We note that there are no restriction or prescription in GTAC as to what might be acceptable prudential arrangements under any ICA to be negotiated. Term and Termination The expiration date of the proposed GTAC is unacceptable when production assets depending on assured access last well beyond this. Such an early termination should be seen by GIC as a *substantial deterioration* in access terms for current MPOC parties. As a separate but related concern, there is no provision setting out what will be an adequate standard for what follows the termination of GTAC. MPOC has a standard of "materially better" as assessed by GIC, whereas GTAC has nothing. This must be a *substantial deterioration.* We disagree with the GIC's assessment about the termination provisions in GTAC, we consider these provisions alone should be a major impediment to the GIC making a positive assessment of GTAC. Because of concerns about termination provisions of GTAC, we suggest that the overall assessment in respect of both efficiency and fairness is a *substantial deterioration*.

QUESTION	COMMENT
Question 11: **Do you agree with our top-down analysis?**	Energy Allocation should be assessed as a net deterioration for reasons mentioned in Q5 Balancing should be assessed as a *substantial deterioration* in both efficiency and fairness owing to the uncertainty that ERM incentives will work and the seriously weak provisions in relation to managing TTP. Additionally, the benefit of system wide balancing is overstated. Term and Termination: the early termination date, and the lack of standard for what follows, each represent a *substantial deterioration* in access terms.
Question 12: **Do you agree with our overall assessment?**	We agree with the GIC's assessment that the GTAC is not "materially better", and with the GIC's assessment of the following aspects: • the streamlining of transmission products and processes (positive assessment) • the widening and improving the tools available for management of pipeline congestion (positive assessment) • transport incentive charge structure (negative assessment) • workability of liability provisions. (negative assessment) We disagree with the GIC's positive assessment in respect of • "a system-wide" approach to gas balancing; • grandfathering provisions given that the GTAC retains Existing Interconnection Agreements. • Facilitation of gas trading.
Question 13: **Do you agree that with our analysis of ICAs?**	We agree the uncertainty in interconnection terms as being a "substantial negative factor. MPOC requires the New Code to provide terms of interconnection. The proposed GTAC fails this test, irrespective of how it might be assessed to improve terms of access for some shippers.
Question 14: **Do you agree with our analysis of SAs?**	We agree with the GIC's assessment and see the need for some oversight of arrangements, e.g. arrangements should be subject to review by GIC to ensure, among other things, that SAs are not being entered into on a discriminatory basis. We see limited efficiency benefits relative to MPOC which has a $/GJ/km tariff. With only $/GJ tariff only, SAs will likely be needed for efficiency.
Question 15: **Do you agree with our analysis of nominations?**	No comment.
Question 16: **Do you agree with our analysis of daily overrun and underrun charges?**	As with Overrun Fees in VTC, we see that Overrun and Underrun fees in GTAC are inefficient. Such arbitrary fees, and the anomalies resulting from their rebate, would be unnecessary if DNC nominations were replaced by simple gas nominations, and approved gas nominations were applied to drive allocations at every point.
Question 17: **Do you agree with our analysis of hourly quantities?**	Yes.

QUESTION	COMMENT
Question 18: **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?**	No party considering entering into gas transmission or interconnection arrangements should be expected sign an agreement which states there are circumstances where the party can be "*deemed not to have acted as a Reasonable and Prudent Operator*". Such a determination should be determined by the facts. Any necessity for such a "deeming" is indicative of a flawed design in the liability provisions.
Question 19: **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 see the provisions of the proposed GTAC in relation to the Taranaki pressure limits are weak and unjustified. The frequency of excursions outside the range will only increase under the weak balancing provisions of the proposed GTAC. We agree with the GIC's conclusion: "*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*.". First Gas have recently announced that they have acquired the Ahuroa Gas Storage, and have issued an Open Letter to industry on how they would separate the businesses and how the business may work. Unfortunately, this communication does not provide us with confidence as to the way in which First Gas will manage pressure and line pack. As we see it, there is a strong incentive for First Gas to minimise compression costs by having higher pressure in Taranaki. Given the above, we shall be seeking terms relating to TTP to be at least as strong (if not stronger) as existing MPOC terms in any new transmission code and/or in any ICA negotiations.
Question 20: **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?**	We appreciate the GIC has done the analysis. However, we do not agree that comparing ERM charges with bid/ask spreads is sufficient. While the analysis might reflect incentives on a day, it does not adequately consider ERM incentives over several days when gas prices are likely to change. That is, we think the two-tiered asymmetric ERM incentives regime will lead to high volatility in primary balancing while parties store or borrow gas in the pipeline to arbitrage their expected price increases or reductions in the following days. We are concerned that the reduced daily balancing incentives that would be introduced by the GTAC will increase backpressure volatility, reduce liquidity on the market, and will unnecessarily re-open the issue of balancing. The two-tiered asymmetric ERM mechanism is too open for gaming to make analysis reliable.

QUESTION	COMMENT
Question 21: **Do you agree with our analysis of the incentive charge rebates?**	We agree with the comments by "The Lantau Group" that was submitted to the GIC by Trustpower (http://gasindustry.co.nz/assets/Consultations/Uploads/TLG-Paper-for-Trustpower.pdf), which we paraphrase as follows • If recycling is over a short (enough) period (short rebate cycle), then participants will benefit from greater certainty of getting their expected rebate (and to the extent that the cycles are short enough it may assist in participants learning how best to game the system). • If the recycling is over a longer period (such as a year), the result is less clear and therefore may reduce concern over gaming, but the overall cost of the rebate programme increases, as it holds liquidity out of the market for a longer period. • Ultimately both approaches (frequent recycling with greater risk of gaming and less frequent recycling with greater overall costs) fail because recycling without regard to value introduces unavoidable pricing distortions. We agree with the GIC's observation that the strength of the marginal costs will be inverse to a shipper's market share, and we are concerned by this. Under GTAC these issues are more significant and influential. This observation is also important in assessing the inefficiencies of the ERM incentives relative to the existing MBB balancing regime. The GIC identifies the issue with asymmetric ERM charges influencing people to balance higher, which can lead to high line-pack / pressure. However, there is no GIC comment on other key differences (specifically being no title transfer and rebate the next month). The fixed nature of the charges and publishing of each parties ERM will enable parties to continually calculate their exposure, and their rebates. Towards the end of the month, a party could decide that its share of the rebates is going to be so high that the marginal cost of an underrun / overrun is negligible, and they will get the money back a few days later (as opposed to the following year). GIC doesn't appear to have included the time value of money element in their analysis. In short, we disagree with the GIC's assessment that the proposed rebate arrangements will not have detrimental effects.
Question 22: **Do you agree with our analysis of First Gas' discretion?**	We disagree with the GIC's assessment (#39,40,41) in regards defining upper and lower Line Pack limits because we consider clause 8.5 is vague as to whether the acceptable line pack limits will adequately recognise the TTP limits. We think the protection of TTP limits are inadequately specified and too open to First Gas' discretion.

QUESTION	COMMENT
Question 23: **Do you agree with our analysis of public information disclosure?**	In terms of the commitment to publish information, we agree that the GTAC is not as open as MPOC, - to the extent that we consider that the GTAC is *materially worse* than MPOC. In contrast to MPOC, GTAC does not commit to publish in real time: • The then-prevailing hourly Scheduled Quantity (SQ) established for each receipt or delivery point (or delivery zone in GTAC) • The metering quantity for each hour at each receipt point or delivery point (or the aggregate delivery quantity in each delivery zone in GTAC); • The imbalance between scheduled and actual flow at each major receipt or delivery point. We believe the real-time availability of information as to planned flow versus actual flow is in assessing gas requirements for balancing, and this informs the gas market. The IT system will have the capability to display this information similar to Maui information under OATIS, we are surprised that First Gas has not committed in GTAC to replicate this practice.

Additional questions posed by First Gas Limited

QUESTION	COMMENT
Question 24: **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?	We do not consider that First Gas needs to re-work the access products and concepts, except to remove the underrun and overrun penalty fees. However, in too many other areas the GTAC has opened-up controversy and negative comparisons that were not necessary to open in order to achieve a single unified regime. Accordingly, to reach the "*materially better*" standard, we consider that the GTAC will need revision in the following areas: • Reinstate TTP pressure management obligation and line-pack management obligations; • Reinstate daily balancing (re-use MPOC balancing (MBB)); • Re-establish clearer protocols for Interconnected Party approvals for all provisional shipper nominations (approve/curtail/reject); • Re-establish the right for Receipt Point Interconnected Parties to specify the allocation methodology to apply (provided that standard algorithms are chosen), such they do not require separate Shipper agreement to ensure compliance to the protocol prevailing at the relevant interconnection point; • Reinstate ability of Interconnected Parties under MPOC to reduce schedule flow to capability in circumstances of force majeure; • Establish ICAs as part of the required New Code which work as a system with the GTAC even after GTAC is modified. • Re-establish clearer liability regime, • Remove all "deeming" provisions in regard to RPO responsibilities; • Reinstate MPOC standard for termination of GTAC, any replacement of GTAC must be "materially better" for the industry; • Reinstate RPO standard of MPOC to require conformance with international good practice.

QUESTION	COMMENT
Question 25: **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)?	Assuming First Gas continues to pursue MPOC termination under clause MPOC 22.16, and assuming there is no controversy, and requirements were agreed at the outset (e.g. such as those suggested in Q24 above), it will nevertheless take at least 18 weeks from the publication of a new first draft until a draft can be presented to GIC for assessment under that provision. In comparison, a reduced scope involving aligning the VTC and MPOC (e.g. by using cl 29.4 of MPOC) could establish the PR rights and a common over-arching nomination regime that would substantially align the two codes within a much shorter timeframe.
Question 26: **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?	The simultaneous termination and replacement approach (of the replacement of VTC and MPOC by the GTAC) has been expensive. A change to the process would be seem advisable to reduce the risk of a repeated costly failure. Evolutionary changes are to be preferred. As suggested in Q1 c above, the industry should avoid "*revolutionary redrawing of operational and commercial arrangements"* so as to avoid *"unexpected consequences arising from radical and untested changes*." We consider workshops operating to a "road map" for incremental changes to existing codes will avoid the problem of having to weigh up the overall benefit of unrelated issues in one large and difficult change decision. By way of simple summary, we consider the road map steps could be as follows: - Obtain MPOC code change to: simplify nominations and capacity curtailment along GTAC lines to enable new TIETO IT to replace OATIS by Oct 2018; - Remove capacity fees and overrun fees from VTC, changing to simple throughput fees, by Oct 2018; - Obtain MPOC code change to apply shipper mismatch provisions as per GTAC and provide the choice by IPs to select other standard allocation algorithms other than OBA; April 2019 - Replace VT regime with new regime requiring nominations compatible with then prevailing MPOC, by Oct 2019 - Develop IT interface so that parties can make nominations across the two systems in one step, by Oct 2019. - Align VT interconnection arrangements with the revised MPOC arrangements, by Oct 2019 - When two regimes have converged, then merge them, (Oct 2020)