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Ian Dempster

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Dear Ian

# **Second Revised Draft GTAC**

Genesis Energy Limited (**Genesis**) welcomes the opportunity to provide comments to the Gas Industry Company (**GIC**) on the “Second Revised Draft GTAC”published 3 November 2017 (**second revised draft**).

**Executive summary**

Genesis acknowledges the work of First Gas and the GIC to continue evolving the gas transmission access code (**GTAC**) through a collaborative process with industry and appreciates the progress made to-date, including the improvements in the second revised draft compared with the draft published in September 2017 (**first revised draft**).[[1]](#footnote-1)

We have commented in previous submissions that this is a once in a generation opportunity to develop transmission arrangements that are robust and fit for purpose. This is a common goal for all industry stakeholders, and we are on the right path forward in our view.

Unfortunately, with the pressures of time, Genesis remains concerned with the amount of ‘red ink’ still coming through each iteration of the GTAC and what appears to be an insufficient timeline for addressing what we consider to be outstanding material concerns with the merits and/or workability of the code provisions. To return to Ben’s [Gerritsen] Eiffel Tower analogy from the 9 November workshop, we believe the foundations are still looking shaky and more time would provide the refinement needed.[[2]](#footnote-2)

Our concerns - some of which are shared by other stakeholders; some of which are specific to Genesis - are highlighted in this submission along with proposed alternatives that we consider would fairly balance our incentives with that of First Gas and other users of the transmission system.

Combined with accompanying legal mark-ups, our intention is to provide constructive revisions to the GTAC’s design and/or drafting that lay the best foundations for the gas sector’s Eiffel Tower: a GTAC that is ‘materially better’ than the status quo. We welcome any opportunity to comment further or provide any clarification necessary.

**Best intentions don’t make a business case**

Most of the matters of concern Genesis raised in its submission on the first revised draft will not be addressed until 2018 as per First Gas’ current timetable, including:

* Notification of final pricing and fees;
* Further clarification on the proposed park and loan product;
* Determination of specific maximum hourly quantity (**MHQ**) and specific hourly quantity/daily quantity (**HQ/DQ**) allowed at dedicated delivery points (**DDP**);
* Negotiation as to how to administer existing supplementary agreements under the GTAC;
* Negotiation of new supplementary agreements;
* Negotiation of interconnection agreements at Kupe and Huntly; and
* Notification of the parameters for running mismatch tolerance.

This places Genesis in a difficult position where today we are still unable to assess whether the GTAC will be materially better for our customers, our business and our shareholders, despite this being the last drafting opportunity prior to the GIC’s review of the GTAC. Further clarity and/or formalisation on First Gas’ intentions as to these matters is essential to finalise the business case for the new GTAC.

Commercially for Genesis, of particular significance is the determination of specific HQ/DQ and the treatment of existing and new supplementary agreements. On these matters, we appreciate the productive conversations we have had with First Gas to-date and are reassured by First Gas’ willingness to negotiate favourable terms for both parties: we consider the path to 2018 is paved with good intentions. That said, until we progress these conversations further we have no guarantees, and this uncertainty presents an unacceptable risk to Genesis.

As a solution, we seek written agreement from First Gas of the shared intentions on these matters, by way of a letter of understanding. This is something we will pursue with First Gas bilaterally, but have included our intention in this submission in the interests of transparency with other stakeholders.

**Maximising flexibility for peaky loads**

Genesis has advocated for reasonable maximum flexibility for DDPs under the GTAC, with optimising gas use at the Huntly power station our primary concern. In doing so, we have explored the different options for operating Huntly under the GTAC, of which (broadly speaking) there are three. Below we explore the issues we perceive with each of these options, coupled with what we consider to be workable solutions.

But first, why does it matter?

Huntly is a unique and important infrastructure asset, not just to Genesis, but also New Zealand. There is no question that it plays a key role in the electricity sector currently, providing a secure supply of thermal energy generation into the market that is especially important during periods of weather variability (e.g. dry periods). When the rain is not falling and the wind is not blowing, having a large dual-fuel generator is valuable, as was evidenced by the 2017 dry winter.

First Gas has said one of its overarching objectives is to enable the use of gas, and has noted there is an opportunity to displace coal use at Huntly with more gas. We agree this is achievable, and Genesis supports establishing targets for the industry that reduce emissions while ensuring that the lights stay on for New Zealanders. Unfortunately, our analysis of peaking charges proposed under the GTAC (assuming the status quo of 1/16th of the relevant maximum daily quantity) indicates a strong financial incentive to favour generating with coal during peaks, which is contrary to this shared objective and has a ripple-effect on the energy sector’s emissions profile.

Already, Genesis uses an average 25 petajoules of gas per annum to power Huntly, which makes it one of First Gas’ largest single-site transmission customers. For this to increase in the order of magnitude that would be needed if Genesis – or other large users – were to invest in expanded gas use will require First Gas to strike the right balance between providing for optimised (i.e. economically rational) gas use at DDPs with fair access to gas capacity for other pipeline users. The only way to achieve this is to ensure the three options described below are workable.

1. **Standard access product: Daily nominated capacity limited by MHQ**

In submissions on previous versions of the draft GTAC, we modelled the peaking charges we would incur under the then standard MHQ (i.e. we would be liable to pay an hourly overrun charge whenever we breached the default 1/16th MHQ) and the results indicated the perverse incentive to favour coal over gas for peaking. We have shared this analysis with First Gas, GIC and other stakeholders.

In more recent versions of the GTAC – the first revised draft and second revised draft – the specific HQ/DQ we are exposed to will be determined for the Huntly DDP. That specific HQ/DQ has yet to be determined, but will be set at First Gas’ discretion and subject to change on an annual basis. It may – and we believe should – be set within parameters that avoid the perverse incentive discussed above, but until we are assured of First Gas’ intentions we have no certainty, which again as discussed, is unacceptable to Genesis.

By way of solution, as a first preference Genesis urges First Gas to provide us with its indicative specific Huntly MHQ for the 2018/2019 gas year. If this is not possible, we consider it reasonable that First Gas commits to providing the objectives, principles and processes it will have regard for when setting specific MHQs, and codify these in the GTAC.

We have made some drafting suggestions in our accompanying mark-ups, including that the determination of the specific MHQ is linked to the physical capacity of the transmission system, and that First Gas may determine the specific MHQ following appropriate consultation with the relevant shipper, having regard to unique demand profiles. We also note that only shippers at DDPs are subject to hourly overrun and overflow charges, despite modelling showing that many shared delivery points breach the default MHQ on more than 50 per cent of days. This is a failure of pricing efficiency because DDPs are required to self-interrupt gas demand (i.e. operate as a partially interruptible contract) but receive no more favourable pricing than delivery points that have the benefit of unlimited MHQ.

1. **Temporarily varied MHQ: Agreed hourly profiles**

Within the GTAC, agreed hourly profiles (**AHP**) are intended to provide an option for shippers to temporarily agree to a variation of the MHQ.[[3]](#footnote-3) This product has potential to be a useful tool for shippers with peaky loads, but as currently drafted is lacking in flexibility, making it of little value to most shippers. For example, Genesis considers that AHPs should be linked to the nominations cycle so that, with notice, shippers have the flexibility to use AHPs to vary the shape of their peak. We have provided drafting that reflects this and we understand that the GIC has proposed that the next GTAC version will include AHPs in the nomination cycle.

We have also included drafting that provides for First Gas to determine a factor of tolerance that can be provided before a shipper is liable for hourly overrun charges should it exceed its AHP from hour-to-hour. The proposed two times DNC charge for exceeding the MHQ creates an incentive for shippers to increase their DNC relative to their gas nomination – the tolerance should incentive shippers to have a single capacity and gas nomination. The drafting also provides discretion to First Gas to determine the degree of tolerance it can reasonably provide within the physical limits of the pipeline.

Further, as drafted, First Gas currently has too much discretion to decline an AHP, making it difficult for shippers to rely on access to AHPs in the course of their day-to-day operations. We do appreciate that First Gas needs to keep the gas flowing to all users and so should necessarily have absolute discretion to reject AHPs that would risk the physical capacity of the pipeline – i.e. the Available Operational Capacity and the physical MHQ – but not in other circumstances, as per our drafting suggestions.

1. **Non-standard access product: supplementary agreement**

In section 7 of the GTAC shippers have the opportunity to request First Gas to enter into a supplementary agreement that may vary the terms and conditions of the code in relation to some matters, including the amount and variability of capacity available and the transmission fee payable for access to that capacity.

Genesis would like to explore further with First Gas our options to operate Huntly under a supplementary agreement and seeks to get this process underway as soon as possible: we simply cannot wait until 2018 to resolve this. Written confirmation from First Gas that Genesis may negotiate a supplementary agreement for Huntly will be sought in the letter of understanding referred to above.

**Incentivise, don’t punish**

Genesis has noted in previous submissions that we support daily capacity nominations and the use of over and underrun charges to incentivise accuracy.[[4]](#footnote-4) We remain concerned however that First Gas’ proposals are punitive and disproportionate to the true costs of service i.e. to what extent is granular information required by First Gas to manage the transmission system; to what extent is shipper accuracy matched by the savings in First Gas’ transmission costs. The key is to strike the right balance.

What is needed is a ‘right-sized’ solution to provide First Gas with what it needs to manage physical flows on the pipeline without imposing unnecessary cost burdens on shippers. It is worth noting that when changes were made to the Maui Pipeline Code in 2015 some tolerances (ROIL) were transitioned over time, and a similar transition should be considered under the GTAC.

The introduction of either a small daily tolerance that is based on a percentage of DNC or fixed gigajoule amount per delivery zone is an option, or alternately using the net position in the same direction of all shippers in a delivery zone to charge DNC over or underruns each day.[[5]](#footnote-5) If First Gas thinks it is appropriate a clause of this nature could be included as a sunset provision that expired when shippers had adjusted to operating under the new arrangements.

**A robust code change process is crucial**

Genesis considers a robust code change process will be crucial to the success of the GTAC, and that taking time now to carefully design the code-change process will ensure timely and efficient improvements can be made as needed further down the track.

We have commented in previous submissions that in our view this should include a code signatory vote in addition to an oversight role performed by the GIC. This best accounts for the interests of all transmission stakeholders proportionate to the commercial interest they carry, and offers appropriate checks and balances on the incentives of any one party.

Unfortunately, as currently drafted, the GTAC does not provide for a shipper vote; rather it relies on the GIC to review code change proposals and offers First Gas an exclusive right to veto recommended changes in limited circumstances. We consider it is important to challenge this process to ensure it is workable and fit for purpose, providing drafting suggestions to clarify and improve the intent of section 17.

This includes defining what ‘appropriate consultation with the Gas industry’ means, such as allowing for a minimum consultation period and considering whether there will be disproportionate effects on any one party. We would also like First Gas to make assurances that there will be safeguards in place regarding the role of GIC (e.g. by way of memorandum), including that the Gas Act 1992 and Gas Policy Statement(s) review of any code changes is to be undertaken by independent directors of the GIC board only.

In previous submissions, we have also suggested developing guidance for the interpretation of the principles in section 43ZN of the Gas Act e.g. to determine how ‘efficient’ should be understood in s. 43ZN(a). This is important not only for future code change requests, but also for the forthcoming GIC assessment of whether the GTAC is ‘materially better’ than the status quo. We strongly suggest the GIC seeks input from industry on the questions it should be asking during its GTAC assessment e.g. does the GTAC fairly balance the economic incentives of First Gas with its pipeline customers?

Further, Genesis considers the GTAC should include provision for an independent review process to be followed with a view to ensuring the code is performing as per its objectives. We suggest it is codified that GIC should commission an independent review after the GTAC has been in place for two years.

**Next steps: the best path forward**

Genesis’ submission, and those provided by our industry counterparts, will now be considered by First Gas as it prepares to submit the GTAC to GIC for review. While we are hopeful the extensive efforts of all parties through this latest round of consultation will get the GTAC over the materially better threshold, it is possible we have simply run too close on time on the current timetable.

Should this be the case and the GIC review finds the GTAC on the whole it is not yet materially better than the status quo, Genesis hopes there will be an opportunity for all stakeholders to come back together in 2018 to continue talking constructively on the areas where there is further room for improvement. Genesis has no desire to return to the drawing board having come so far and remains committed to developing the GTAC.

Please read this submission with our accompanying code mark-ups. If you would like to discuss any of these matters further, please contact me by email: margie.mccrone@genesisenergy.co.nz or by phone: 09 951 9272.

Yours sincerely



Margie McCrone

Regulatory Advisor

1. For example, we are pleased that First Gas has clarified how it will identify and propose to manage congestion ahead of each gas year, and that it has included a requirement to interpret the GTAC consistently with the Gas Act and Government Gas Policy Statements. [↑](#footnote-ref-1)
2. Ben’s [Gerritsen] Eiffel Tower analogy aims to explore the theory that there is always nervousness that comes with change, and that parties may have a bias for the status quo in their reluctance to embrace the unknown. While we agree this may be the case, in this context, Genesis is eager to transition to the GTAC provided it is ‘materially better’ than current arrangements. [↑](#footnote-ref-2)
3. We note and appreciate First Gas providing an additional opportunity to comment on the design of AHPs before 8 December (Item ‘B’ in the 23 November memorandum). [↑](#footnote-ref-3)
4. Again, we note and appreciate First Gas providing an additional opportunity to comment on the design of overrun/under charges before 8 December (Item ‘C’ in the 23 November memorandum). [↑](#footnote-ref-4)
5. We note First Gas currently has committed to a degree of tolerance for daily balancing, but not for daily DNC bookings. We suggest aligning the tolerances for both nominations of capacity and gas flows. [↑](#footnote-ref-5)