



GREYMOUTH GAS

14 September 2015

Ian Wilson, Ian Dempster, Steve Bielby, Andrew Walker, Pamela Caird, Patrick Wilson
Gas Industry Company Limited
By email

Dear Sirs / Madam,

RE: Consultation on special allocations to replace initial with D+1 allocation results

Greymouth Gas New Zealand Limited ("Greymouth Gas") is pleased to make a submission on the above consultation (the "paper") following an invitation from the GIC on 26 August 2015.

Greymouth Gas Position

Greymouth Gas supports the:

- Vision of having daily cash-out contributions on the Vector Tx system known daily (the "vision"),
- D+1 trial, and the long-term view to explore adopting the same into the Gas (Downstream Reconciliation) Rules 2008 ("downstream rules") via normal policy change processes including cost-benefit analysis, and
- Intent of having the D+1 trial outputs become the special allocations to replace the initial allocations (the "proposal") – as under MBB we value certainty / timeliness over accuracy as long as there is a fair wash-up process and inaccuracies are not too big.

However, Greymouth Gas opposes the GIC's proposal as set out in the paper at the present time.

There are just too many holes, too many risks and too many unknowns. Instead of describing the proposal as reckless, it simply reads as if it is at first draft stage. For example (refer to the appendices for more detail):

- 1) Legal questions – including the lack of legal opinion and whether the proposal is ultra vires,
- 2) Timing catch-22 – special allocations must be considered and / or made a month in arrears rather than ahead of time,
- 3) Basic weaknesses – including no definition of 'D+1 allocation result' and a work-in-progress understanding of the proposal as an enabler,

- 4) Specific Procedures Missing – including in relation to the methodology, when the D+1 results are due and what happens if the D+1 results are late or not made available, and
- 5) Analysis of Unfairness – timing appears to be the underlying reason justifying unfairness, when it is perhaps not allowed to form part of the test.

Hopefully none of these issues will prove to be insurmountable.

But it is preferable to do things properly and it is critical that the proposal in the paper is robust.

Despite supporting the vision and the intent of the proposal, it is important not to unnecessarily risk disputes or to jeopardise successful gas governance arrangements or reputations by fast-tracking a special allocation work-around which is currently not far enough advanced.

GIC may, of course, decide to grant the special allocation as-is, per the proposal in the paper. This would be risky in our opinion and could have unintended consequences.

Ultimately, GIC and industry have been trying to squeeze a 12 – 18 month process into 6 months, and what we have on the table reflects that. Things actually appear to be on track, but not for 1 October 2015.

Recommended Way Forwards

Four elements are needed to achieve the vision:

- The VTC needs amending to process daily receipts – this process has started, appears to be supported in principle and appears on track for 1 October 2015.
- Assuming that GIC and / or the industry does not accept the current D+1 special allocation proposal, then GIC could do a 2nd version of that proposal addressing all points raised in consultation. It should be possible to consult on this late September / early October with a view to a 1 November 2015 start (assuming everything stacks up).
- The VTC may need amending (or at least industry needs to contemplate) daily demand allocations for direct-connect gas gates that are exempt from the downstream rules. There has been little discussion about this to date.
- Vector Tx will need to consent to providing daily cash-out contributions daily. Vector Tx has yet to revert with a proposal and it remains unclear whether (and on what terms and conditions) it would consent to the vision. In any case, Vector Tx has informally signalled that the earliest it could adopt the vision is 1 November 2015.

While the paper rightly just canvasses the second point above, there is more to the vision than D+1 demand allocations under the downstream rules.

Yours sincerely,

Chris Boxall
Commercial Manager

Appendix 1 – Legal Questions

While r51 of the downstream rules provides for special allocations, two red-flags are:

- i) That GIC has not obtained a written legal opinion (not even an internal one) that explores whether the proposal has legal merit, and
- ii) That the proposal fails the simplicity test – i.e. that there is nothing special or unique about wanting to enact a new policy, hence why use a *special* allocation.

It does not make sense why GIC would not obtain a written legal opinion, especially when industry requested it and when GIC initially committed to obtaining one¹. Not that we think this is the case (partly because the GIC can be subject to judicial reviews), but the impression the GIC gives is one of being less than prudent.

There is also the risk that the GIC's proposal is ultra vires of the Gas Act 1992 ("Gas Act"). In theory if the intention is to enact a new policy then a full assessment of the proposal should be made in accordance with s43N of the Gas Act, and then it should go through the Minister for final approvals. GIC's proposal does neither – and rests the sole decision with itself.

Greymouth Gas simply wants a proposal that is robust.

Hopefully neither of these points will be an issue because we support the intent of the proposal and the GIC has invested significant resource into this approach. But if the points above are an issue, then the proposal should be discussed in more detail and / or reconsidered.

It is prudent to get these boxes ticked given that millions of \$ and PJs of gas are being reconciled and that if things go wrong it is unclear who would be held financially accountable.

¹ This contrasts with when Vector Tx was considering bringing D+1 into the VTC – it obtained an external legal opinion and shared this opinion with its Shippers.

Appendix 2 – Timing Catch-22

For the GIC to consider making a special allocation it must:

- i) Wait until after the initial allocation has been performed in respect of a month per r51.1 of the downstream rules, and
- ii) Only proceed if the issue passes the tests in r51.2 of the downstream rules (more on this later).

An issue with the proposal is that it seeks to make a blanket assessment under r51.2 when r51.1 does not permit this to be made ahead of time². r51.1 requires the numbers from the initial allocation to be available and analysed as part of the decision making process. This therefore appears to be a litmus test which perhaps shows the difference between a one-off / ad-hoc *special* allocation vs. a change in policy.

This may not be insurmountable, but it should at least be covered off by the GIC. Our main concerns are that if a blanket special allocation was made:

- Would this stack up as being in accordance r51.1 of the downstream rules?
- Would the D+1 numbers effectively only be pro-forma until they were ratified and the processes in r51.1 and r51.2 could be done each month after each initial allocation?
- What protection does Vector Tx or its Shippers have if they are balancing and allocating to real-time pro-forma D+1 numbers which may not get ratified after month-end³?

GIC seems to imply that if the r51.2 test passes in the paper, then it will pass in respect of all future months. Whether this conclusion is 100% correct should be debated. With only 2 – 3 months' of trial outputs available the conclusion is not currently backed by much evidence.

Given the way the downstream rules are worded, Greymouth Gas would like some certainty with regard to timing risks.

² This is supported by GIC's Guideline note for rules 44, 46A and 51 – correction of allocations by allocation agent, correction of an annual UFG factor and special allocations, dated 1 June 2013 ("guideline note")

³ There must, by implication that there needs to be a process that is not fait accompli, be some risk that the r51.2 assessment might not justify a special allocation in any particular month – for example this could be a) intra-month catastrophic metering issues (which are sorted at month-end) which give very poor D+1 outcomes but accurate initial allocation outcomes, or b) GIC not ratifying the D+1 numbers until such time as Vector Tx had its processes wholly in place.

Appendix 3 – Basic Weaknesses

The introduction of the proposal appears to have some basic weaknesses (which should be easy to overcome). For example:

- The concept ‘D+1 allocation result’ is not defined – currently the D+1 trial gives three such allocation results in respect of a day: D+1 am, D+1 pm, and D+1 rolling changes throughout the month⁴.
- Reference is made to the duration of the D+1 trial – but there is no discussion of an end-date.
- The proposal is for the initial allocations produced by the allocation agent to be replaced with D+1 numbers produced by the GIC (not by the allocation agent⁵), but:
 - A question arises about whether this makes the GIC an allocation agent and what implications this might have, and
 - There is no description of (or appendix containing) an agreement between the GIC and the allocation agent which would contractually give effect to this (including timings) if the allocation agent will be the party producing the real time D+1 numbers.
- GIC notes that the reason for the proposal is the vision. But the proposal is only an enabler and achieving the vision is subject to separate Vector Tx approvals on a separate proposal which is not yet available in draft form.
- GIC notes that there are material differences between the initial allocations and D+1 allocations – this is true, but often the outcome of the latter is materially worse than the initial allocations. I.e. the numbers are less efficient (but have more utility).
- GIC suggests that if Vector Tx used initial allocations for billing and balancing invoices, but if Shippers balanced to D+1 allocations, then this would be patently unfair (thus justifying special allocations). However, this is a manufactured unfairness because if Vector Tx did not use the D+1 numbers, then neither would its Shippers⁶.
- GIC proposes that special allocations replace the initial allocation with D+1 on / from the October 2015 consumption month. However, there is nothing in the paper that commits GIC to making a decision before 30 September 2015 – this date is not far away and it feels like there is a lot for GIC to consider.
- Analysis of D+1 trial results appears light and it is unclear on which trial data set the numbers relate to.

⁴ GIC has verbally confirmed that it is the D+1 am numbers and that these are locked in and not subject to change – but this should be included in the written proposal.

⁵ We understand that the intention is that the allocation agent will produce the D+1 allocations using the GIC’s model or results, but this is not what the proposal says.

⁶ I.e. to balance; but some mass market Shippers may use D+1 as a tool even if those numbers are not live.

Appendix 4 – Specific Procedures Missing

Given the materiality of the proposal, it is effectively missing the 'specific procedures' that the GIC should determine in accordance with r51.3 that would apply to special allocations.

Without this there is a lot of uncertainty, for example:

- While the mechanics of the current bottom-up approach to initial allocations is heavily prescribed in the downstream rules, there is nothing written⁷ that sets out the mechanics of the D+1 trial.
- There is also nothing written that:
 - Confirms that the D+1 outputs will be by ICP or by gas-gate⁸,
 - Obliges parties (often third parties) to submit TOU data,
 - Notes that the outputs are based on unvalidated (not validated) data,
 - Pertains to confidentiality,
 - Confirms what the policy or mechanics is for TOU-estimated data,
 - Confirms what the process is around back-dated switches,
 - Confirms what the timing obligations are for the publication of D+1 results,
 - Confirms what happens if the allocation agent does not publish, or is late publishing, the D+1 results,
 - Confirms what happens to UFG including AUFG and G1M,
 - Explores the impact of not requiring TOU data from retailers on the accuracy incentives for the interim and final allocations,
 - Discusses the implications on pass-through quantities and timings to end-users, and
 - Counts as sign-off by an independent auditor⁹.

Greymouth Gas considers that the 'specific procedures' should be written and that proposal should be expanded upon to address the missing points above.

⁷ The paper does refer to the development of the D+1 allocation methodology, but this references a draft report from March 2015, it does not reflect the current trial's iterative updates, and nor is it a final report.

⁸ I.e. not by BPP pool; thus any Vector Tx pipeline reconfigurations will sit with Vector Tx to manage.

⁹ E.g. one who did retailer audits under the downstream rules – not that this is necessarily required but it probably is a good idea.

Appendix 5 – Analysis Of Unfairness

In relation to the unfairness test in r51.2.1 and r51.2.2 of the downstream rules:

- MBB will change the balancing environment, but MBB does not change the downstream rules itself. This means that:
 - o It is not the allocation results (i.e. the quantities) that are unfair – they are equally as fair with or without MBB, and
 - o What is *arguably* unfair is the timing of provision of the allocation information – but not the allocation information itself.
- GIC suggests, in the paper, that a change in a Shipper's allocated quantity at a gas gate of > 1 TJ/month, or at all gas gates of >2 TJ/month would be material – thus it would be potentially unfair not to allow special allocations to go ahead. It then concludes that most Shippers have a material change. However:
 - o If you dig beneath the numbers, in Greymouth Gas' case, where our initial allocations are ~100% as accurate as our interim and finals, then any deviation in the D+1 result could be considered 'unfair' from a quantity perspective¹⁰.
- s3.8 of the guideline note requires GIC to consider the financial impact on participants, and the degree to which 'unfairness' would be remedied in interim / final wash-ups. Unfortunately, it is not possible for GIC to assess this at the moment because Vector Tx has yet to table a proposal to industry in relation to the vision.
- There are commercial reasons why the initial allocation should be retained, including:
 - o For Greymouth Gas, that the initial allocations are as accurate as final allocations and the D+1 allocations are materially worse,
 - o The lack of robust written policies and procedures in relation to the proposal and the risk that something material could go wrong, and
 - o The inability to dispute daily cash-out contribution quantities with Vector Tx or to dispute D+1 allocation numbers with the owner of that model.

r51.2.1 of the downstream rules also has a test that it is not appropriate to wait until the interim or final allocation before the impact of a special allocation flows through. The special allocation simply gives a different initial allocation. It does not correct a mistake, nor does it require any part of the initial allocation to be corrected for at interim or final stage.

Greymouth Gas is prepared to accept slightly less accurate D+1 data¹¹ to facilitate the vision and to get more certain data sooner. However, GIC and industry must be sure that the r51.2 unfairness test genuinely passes.

¹⁰ Early analysis of the trial suggests that our D+1 results are between 2% and 20% different to our initial allocations per BPP pool per month when ignoring early trial errors re pipeline reconfiguration.

¹¹ Subject to further analysis, supporting a second version of the proposal and supporting Vector Tx's proposal.