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TRUSTPOWER SUBMISSION: GAS TRANSMISSION ACCESS CODE DEVELOPMENT– EMERGING VIEWS ON DETAILED DESIGN OF ACCESS PRODUCTS, PRICING, BALANCING AND ALLOCATION

1 Introduction and Background

1.1.1 Trustpower Limited (**Trustpower**) thanks the Gas Industry Company (**GIC**) and First Gas for the opportunity to submit on the “emerging views” for the detailed design of the Gas Transmission Access Code (**the Code**): *Gas Transmission Access Code Development – Emerging Views on Detailed Design of Access Products, Pricing, Balancing and Allocation (the Report)*.

1.1.2 Trustpower entered the gas market in 2013. We have successfully grown our customer base to around 30,000 customers. We are a multi-product retailer, participating in the electricity, gas and telecommunications industry in New Zealand, and have generation assets in both New Zealand and Australia. As a result we have extensive experience operating under a number of different market arrangements and a broad understanding of what is required to ensure an open, competitive gas market in New Zealand.

1.1.3 The Report presents emerging views of four key aspects of the Code’s design:

- a) Access Products - Daily Nominated Capacity (**DNC**) is proposed to be the principal product for access, with the option to make DNC firm through the acquisition of Priority Rights offered through regular auctions. DNC and Priority Rights are intended to be linked to delivery points¹.
- b) Pricing
 - i. DNC charges are stated to be set on a postage stamp basis to recover the regulated revenue of First Gas each year. These charges will be set for each Delivery Zone, and will increase further away from the Receipt Zone².
 - ii. Overrun charges will apply to delivery points and be set at a level to encourage accurate nominations.
 - iii. Priority Right fees are intended to be determined by auction outcomes and will be “pay as bid”. Revenue earned from Priority Right auctions will be socialised across all DNC charges.
- c) Balancing
 - i. Primary Balancing Obligation of Shippers proposed to apply across the whole of the transmission system. Automatic cash-outs (as currently occur) are not proposed to be

¹ We note that where a shipper has no control of the load it supplies, then it will be compelled to purchase both products.

² We note that this appears to be more like a zonal charging approach rather than a postage stamp approach.

maintained under the Code. Instead deviations from a balancing position of gas injections and withdrawals beyond a defined tolerance (“Excess Running Mismatch”) will attract an incentive charge. First Gas will retain the right to buy and sell Balancing Gas to maintain line pack and to cash out Shipper and any other interconnected party’s running mismatches when it does so.

- ii. Park and Load services are being considered. These would enable Shippers and interconnected parties to meet temporary surpluses or shortages of gas, without being exposed to balancing gas costs and incentive charges.
 - d) Allocation – The current D+1 Pilot Agreement is proposed to be replaced by an alternative method for calculating the initial allocation for points covered by the Downstream Reconciliation Rules (**DRR**). The interim and final allocations made under the DRR will continue and their results used for wash-ups.
- 1.1.4 We understand that the governance arrangements for the Code will be informed by a final report from Concept Consulting and will take into account the matters raised during the consultation process on Concept Consulting’s “think-piece” that was undertaken in May 2017.

2 Trustpower’s views

- 2.1.1 We appreciate the opportunity to provide feedback on First Gas’s emerging views with respect to design of the new Code. We thank First Gas for meeting with us on 9 June to directly discuss our initial views on the Report. Following that meeting we have now finalised our views, as presented in this written submission.
- 2.1.2 We are not convinced that the proposed arrangements presented in the Report would represent an improvement on the current arrangements outlined in the Maui Pipeline Operating Code (**MPOC**) and Vector Transmission Code (**VTC**).
- 2.1.3 While having a single transmission Code would be valuable, we are concerned that, when compared to the current arrangements, the proposed new arrangements would:
- a) Introduce operational inefficiencies;
 - b) Create a potential barrier to accessing gas transport which could act to reduce overall competition in the downstream gas market;
 - c) Assign risks associated with pipeline congestion to parties who are not best able to manage that risk; and
 - d) Increase costs of transporting gas, which will ultimately be passed through to end users.
- Details of our specific concerns are outlined in more detail in section 3 of this submission.

Consistency with the objectives of the Gas Act and GPS

- 2.1.4 We do not have confidence that the GIC will be able to confirm that the proposed new arrangements (in their current state) would, as a whole, be consistent with the Gas Act and Government Policy Statement (**GPS**) objectives³. This is because in our view the new arrangements would, as a whole, be inconsistent with the following objectives outlined in the Gas Act:
- a) The facilitation and promotion of the ongoing supply of gas meets New Zealand’s energy needs, by providing access to essential infrastructure and competitive market arrangements (*refer to 2.1.3(a) and (b)*);

³ We note that it is not clear whether the test is that the arrangements as a whole are materially better, or that each significant aspect of the design is materially better, i.e. balancing, pricing, governance. Clarification of this important matter will be required as part of the relevant MPOC and VTC rule change, which will address matters relating to the transition to the new Code. Our preference would be for the later stronger test to be applied given the importance of the application of the test as a proposed trigger for moving to the new Code arrangements.

- b) Barriers to competition in the gas industry are minimised (*refer to 2.1.3(b)*);
- c) Delivered gas costs and prices are subject to sustained downward pressure (*refer to 2.1.3(d)*); and
- d) Risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties (*refer to 2.1.3(c)*).

2.1.5 We also do not consider that the proposed new arrangements (in their current state) are consistent with the regulatory objective of the Code⁴:

“To promptly establish a new non-discriminatory gas transmission open access regime that facilitates safe, efficient and reliable operation and use of the gas transmission system, including:

1. *Competition in the production and marketing of gas;*
2. *Efficient investment; and*
3. *Transparency of information.”*

2.2 Commerce Commission approval of new Code

- 2.2.1 We strongly support First Gas working directly with the GIC and Commerce Commission to determine whether authorisation of the new Code should be sought under section 58 of the Commerce Act. It is important that participants do not find themselves in the position of inadvertently being in breach of the Commerce Act as a result of adhering to the new Code.
- 2.2.2 We note that authorisation of certain provisions of the original MPOC was sought previously but declined by the Commerce Commission as the arrangements were considered to not lessen competition when comparing the factual to the counterfactual (where the counterfactual was that the same arrangements would be implemented by the GIC through regulation). As a result the Commerce Commission decided it did not have jurisdiction to determine whether authorisation should be granted.
- 2.2.3 The proposed new Code would differ significantly from the original MPOC and contains features that may have implications for ensuring competitive outcomes eventuate. As outlined in section 2.2 above, we don’t consider the GIC will be able to assess the arrangements (in their current form) as being consistent with the Gas Act and GPS objectives. On this basis we would anticipate the factual and the counterfactual would not be the same if the Commerce Commission were to assess the new Code (in its current form), as the counterfactual would be a regulated access arrangement that ensured consistency with the Gas Act and GPS objectives (as developed by the GIC).
- 2.2.4 The advice of the Commerce Commission on this important matter will be required and we look forward to receiving further updates from the GIC and First Gas around how they are progressing with this matter.

2.3 Importance of transparency

- 2.3.1 We continue to strongly support greater transparency of information in the New Zealand gas market and consider that it is an integral part of achieving all the Gas Act and GPS objectives.
- 2.3.2 Transparency of information has significant benefits in ensuring a competitive and efficient gas market through enabling more efficient decision making and reducing information asymmetries (to name a few benefits). Information transparency can also have an important role in facilitating monitoring of the development and level of competition in the gas market, along with identifying any incidents of potential market power abuse⁵.

⁴ We note that the regulatory objectives which represents a more “targeted” objective for the code development but should be considered to be subordinate to the Gas Act and GPS objectives from the perspective of the GIC’s review

⁵ We note that market power abuse can be both directly monitored by an independent market power and by market participants themselves (who can then report any concerns to the market monitor. The independent market monitor may also be able to obtain additional information directly from parties to aid in any investigation.

2.3.3 Trustpower note that the concept of greater transparency underpins the proposed arrangements presented in the Report and we are highly supportive of this approach. We consider:

- a) Transparency of both near-term and historical information should be sought across the gas industry, including with respect to special transmission rights, capacity outlook information (line pack information and forecast capacity of pipelines, gate stations, production facilities⁶ etc.), forecast and actual flow information (DNC, unplanned production outages, aggregated consumption information etc.) and details relating to Priority Right auctions (bids, outcomes etc.)
- b) The timeframes for publishing information require careful consideration. Publication of the right information at the right time can ensure the market is well aware of events that may impact congestion or pricing in advance.

2.3.4 At this stage it is uncertain how greater transparency will be achieved under the new arrangements, however we urge First Gas to consider implementing arrangements similar to those adopted in Australia with the Gas Bulletin Boards (GBB) for the east and west coasts⁷. The GBB arrangements provide a significant amount of valuable information for new entrants, existing participants and government alike in an easily accessible and understandable format. The Western Australian GBB also provides a useful tool for managing scarcity events and ensuring all interested parties are well informed during any event.

2.4 Cost Benefit Assessment required

2.4.1 We note that while the GIC's assessment will confirm whether the arrangements are consistent with the objectives of the Gas Act and GSP, it will not necessarily consider the costs. We consider that tools such as a cost-benefit assessment play an important role in ensuring best-practice decision making.

2.4.2 Prior to making any final design decisions we recommend that First Gas undertakes a cost-benefit assessment of the arrangements, along with any alternatives that have been identified including Trustpower's alternative Interruption Call arrangement (explored further in section 3.3 below). This will ensure that a cost-effective solution for achieving the objectives of the Gas Act and GSP can be achieved. Ensuring costs to industry as a whole are minimised should be an important consideration in making any final decisions, i.e. not just that First Gas's costs are minimised.

2.4.3 We acknowledge that due to significant time restrictions the assessment may only be able to be relatively high level, but we consider that it will provide a useful tool for assessing the design options available for the new Code and ensuring a least cost outcome is achieved for the market overall.

3 Detailed comments on proposed Code design features

3.1 Nominations process

3.1.1 We consider that the proposed new arrangements will introduce significant complexity for Shippers and encourage First Gas to consider alternative, simpler arrangements.

3.1.2 Under the proposed new Code, Shippers will be required to provide two sets of nominations (one for energy⁸ and one for capacity) at every delivery point, of which there are approx. 70 in total. Shippers would need to manage both sets of nominations as they will have direct implications for any overrun charges. When combined with the requirement for a Shipper that retails to the mass market to procure

⁶ This would capture planned outages.

⁷ We note that a recent rule change request will seek to move the information published on the east coast GBB to align with the greater transparency provided by the west coast GBB: <http://www.aemc.gov.au/News-Center/What-s-New/Announcements/AEMC-fast-tracks-rule-change-request-to-improve-Ga>

⁸ Based on demand expectations.

Priority Rights at every delivery point⁹, a significant amount of complexity will be introduced into the New Zealand gas market which will create a barrier to entry.

- 3.1.3 We also note that new entrants have, by definition, the smallest portfolio and could conceivably have a gas gate with one or few customers. The smaller the number of customers, the higher the forecast demand inaccuracy, and the less meaningful the forecast information which will be provided to First Gas.
- 3.1.4 This issue was identified in the New Zealand electricity market, when all parties, including retailers, had to submit bids each day to assist the System Operator in determining forecast prices. The resulting uncertainty lead to the System Operator only requiring non-conforming load to provide estimated off-take forecasts, whilst conforming, mass market, load forecasts were determined by the System Operator in aggregate. The resulting aggregate forecasting greatly improved the accuracy of load forecasts.
- 3.1.5 It is likely that requiring Shippers with mass market customers to forecast to the gate level will increase the level of uncertainty with respect to pipeline demand. Having the ability to aggregate customers' demand forecasts provides significant benefits to forecasting accuracy overall.
- 3.1.6 We consider that a preferable approach would be for:
 - a) Below a set threshold (per customer/GJ) then DNC should be required at an aggregated zone level for Shippers (the threshold level should capture mass market customers) and overrun charges should not apply (this is explored further in section 3.2 below); and
 - b) Above the set threshold then DNC should be provided at a delivery point level for transparency purposes and to assist First Gas in scheduling¹⁰.

3.2 Pricing

Overrun charges

- 3.2.1 We have given some thought to the proposed overrun arrangements and their interaction with the supporting market arrangements. Under the current arrangements participants are provided with a daily estimate of what their market position is at various Maui Pipeline points. This is similar to a zonal estimate of off-take, for the purposes of managing market imbalances. Trustpower believes that this estimate will be less important under the proposed global balancing arrangement, however the associated improvement will be negated by the introduction of a complex delivery point-based nominations system.
- 3.2.2 First Gas proposes that each Shipper nominate their off-take to a delivery point, which will require a high degree of knowledge on their off-take. Accurate delivery point consumption data for each Shipper will be vital for informing parties that their nominations do not accurately reflect their offtake.
- 3.2.3 Trustpower is also of the view that having a two tiered overrun charge is too complex, and assumes that parties will intentionally nominate below their actual off-take. The proposal will lead parties to over-nominate to avoid overrun charges arising. This will distort the consumption signals that First Gas will receive from Shippers, and potentially result in inefficient market signals of congestion. It is also unclear what the two-tiered overrun charge is attempting to achieve.
- 3.2.4 As outlined above in paragraph 3.1.6, we support implementation of a de minimis threshold where participants who are below the threshold level do not have to make nominations at a delivery point level or pay overrun charges.

Throughput charges

⁹ Note we consider retailers will need to purchase Priority Rights as a risk mitigation requirement.

¹⁰ We note that any decision as to whether nominations are provided to a delivery point or zone level will need to take into account the arrangements for managing congestion. If PR are maintained then nominations need to be at a delivery point level (as suggested in this paragraph), however if our alternative congestion management arrangement is adopted then zonal nominations could be provided.

- 3.2.5 We do not support the inclusion of a throughput fee, set initially at zero, being included in the initial Code.
- 3.2.6 The rationale stated by First Gas for doing this, i.e. to avoid the necessity of a change request, undermines the work being undertaken to develop a robust change process and decision making criteria and does not align with regulatory best practice.
- 3.2.7 We consider that putting in place additional fees in the future can potentially have a significant impact on participants. An appropriate level of scrutiny should be applied to any decisions to include a new fee, or significantly vary a fee.
- 3.2.8 If a throughput fee is required at a later date, then a change request should be developed and assessed on its own merits, following robust debate with industry. First Gas should not be able to change the pricing structure without robust debate having occurred.

3.3 Priority Rights

Complexity not warranted and could send distortionary signals

- 3.3.1 The proposed arrangements will require auctions for Priority Rights to be run at approximately 70 delivery points every six months, to enable the consumer to have firm capacity rights. This seems overly complex and administratively burdensome given the size of the New Zealand gas market and the limited congestion that occurs currently.
- 3.3.2 It is not entirely clear whether Priority Rights are intended to be a physical or a financial product. Gas retailers and large users will however be encouraged to purchase Priority Rights to ensure they are not exposed to significant over-run charges (or potentially being physically curtailed during a congestion event). Shippers who retail to mass market will be compelled to purchase Priority Rights as a matter of prudent risk management practice, regardless of whether congestion is anticipated, as there is always the risk of unexpected events causing congestion. We consider that the proposed arrangements could provide distortionary signals in the following scenarios:
 - a) Shippers who retail to mass market will need to over-purchase Priority Rights through an auction (or at least will seek to) to cover variability of their load. Similarly, the proposed arrangements will also encourage Shippers with mass market load to over-nominate on a daily basis to ensure significant overrun charges are minimised, or avoided entirely.
 - b) The pay-as-bid auction structure will not send an efficient signal of the true value of congestion to the market. There is a large distinction between the market value of congestion, and the value that an individual party may assign to congestion, particularly given it will form part of a mass market retailer's risk management approach and pricing outcomes may be the result of competitive restrictions in the auction.
 - c) It is possible that Priority Rights could be viewed as a signal for congestion when this might not actually be the case as a result of Priority Right auctions being run, regardless of whether there is anticipated congestion. We consider it is important that the design arrangements only signal congestion when it is actually anticipated. It would therefore be preferable for Priority Rights auctions to only be run if there is congestion, or there is anticipated to be congestion, at a delivery point during the next 6 months.
 - d) If Priority Rights do not apply in a contingency event then retailers who have not acquired any Priority Rights, or only have acquired a limited amount, will be potentially encouraged to exacerbate any issues to guarantee that a contingency event is declared. This will ensure they do not incur excessive over-run charges (and theoretically that their mass market customers are not turned off) and potentially reduce their own level of curtailment.
 - e) By having a single-shot auction arrangement, parties will have to purchase Priority Rights through a more aggressive bidding structure to ensure that their firm capacity is purchased.

- f) Not only will a Shipper who supplies mass market customers have to purchase more Priority Rights for their highly variable load, they will end up paying too much for it as well.
- 3.3.3 We also consider that the relationship between Priority Rights and Critical Contingency arrangements needs to be explored further with respect to the incentives to curtail users, i.e. if a Shipper has secured Priority Rights and yet it is curtailed, will they receive compensation?
- 3.3.4 It would also be useful to understand whether the gas contingency event procedure will be updated to reflect the existence of any Priority Rights. We note that if the order of curtailment outlined in the procedure changes to account for Priority Rights then this will be quite a different scenario for retailers to manage.

Transparency of congestion required

- 3.3.5 Transparency of the delivery points at which congestion is anticipated to occur (ex-ante), or is actually occurring (real time), will be vital for the Priority Right auctions to deliver efficient prices, assuming First Gas reverts to a standard auction clearing approach of marginal pricing (refer to paragraph 3.4.12 below), and the price floor is removed (refer to paragraph 3.4.10 below). This will ensure costs are not simply being created for retailers. Further details of our views around the importance of transparency are outlined in section 2.3 above.
- 3.3.6 When congestion physically occurs, and is anticipated to not just be a short term issue, then we consider it is important that there are appropriate links through to the First Gas's regulatory arrangements to ensure it is addressed in a timely manner. As an aside, we would prefer to see any money earned through an auction used to address congestion, however we realise this would not necessarily fit within the current regulatory arrangements in which First Gas operates.

Assigns risk to parties not best placed to manage risk

- 3.3.7 The Priority Right arrangements assign the risk of being impacted by congestion to those parties that do not manage to secure any Priority Rights within the auction, or through any off-market arrangements following the auction.
- 3.3.8 We consider that the risks of congestion are not assigned to the party best able to manage them, i.e. a retailer who doesn't secure any Priority Rights is not able to easily manage the risk of significant overruns arising or potentially having their customers turned off, other than by encouraging a contingency event to occur.
- 3.3.9 There are gas users who would be able to turn off during an actual congestion event in response to an appropriate price signal. We consider that the Code should incorporate arrangements that enable these users to come forward and offer to physically manage the risk of congestion for the market. This would be preferable to implementing the proposed Priority Rights auction which we understand would simply provide a financial protection against overrun charges. This will result in parties who cannot physically respond to congestion issues being assigned the risk associated with congestion arising, i.e. retailers with mass market customers.
- 3.3.10 The overall responsibility for ensuring gas is transported around the system belongs to First Gas. We consider that First Gas should focus on developing products which will physically manage congestion on the system and reduce complexity to existing participants and potential new entrants. This would ensure that the role of First Gas in managing gas transport is not diluted at all, while providing effective additional tools to First Gas for managing any congestion event.

Alternative arrangements to valuing firm/un-firm capacity

- 3.3.11 We have sought to outline an alternative congestion management arrangement ("Interruption Call auction") that aligns with the design objectives for access products and pricing in the new Code and would:

- a) Provide greater flexibility for both First Gas and other parties to manage congestion, while ensuring those parties who can best manage congestion risk are assigned any risk around congestion;
 - b) Reduce operational burdens by ensuring unnecessary complexity is not introduced;
 - c) Remove the barriers to entry that could be potentially created if competitive issues arise within an auction (i.e. ensure a level playing field); and
 - d) Provide a physical response to system constraints.
- 3.3.12 At a high level, the Interruption Call auction would require First Gas to undertake a Dutch style auction where Shippers and other users of gas can offer to be interrupted at any time during a three month period via providing a congestion management service. In return for providing greater flexibility to First Gas, providers of congestion management services would receive a discount on their transport costs. This could be likened to receiving an “availability” payment for the three month period.
- 3.3.13 Other key aspects of the Interruption Call auction option include:
- a) Interruption call auctions would only be run if congestion was anticipated to occur during the three month period. First Gas would have an ongoing monitoring role to determine when an auction would be called. There would however be an ability for First Gas to call an auction at any time if congestion is anticipated and an auction had not been previously called that covered the relevant period (all or part), i.e. if they identify a need for congestion management services within the three month period.
 - b) First Gas (or other parties) would bid to get additional flexibility, while Shippers (or other parties) would offer to sell their flexibility - agreeing to a potentially more variable capacity service for a three month period. Those parties who sell their flexibility via a congestion management service would be required to be available to have their gas supply interrupted at any time during the three month period should an “Interruption Call” be issued. We believe that a maximum buy price (or auction cap) for First Gas should be set to limit the financial exposure of the market with respect to the purchase of congestion management services. This could be determined as a fixed \$/GJ/km type limit on the congested part of the system.
 - c) Parties other than First Gas can also seek to purchase congestion management services, essentially displacing the other party’s gas at a delivery point in order to ensure they can receive delivery of gas during the three month period. This would enable gas market participants to take steps to avoid contingency events themselves, not just First Gas.
 - d) The Interruption Call auction would provide strong incentives for all players (if they are capable) to offer to provide congestion management services as they would receive compensation for potentially being interrupted as opposed to receiving nothing if a critical contingency occurs and they their gas consumption is curtailed.
 - e) The proposal would allow for zonal based transmission system arrangements.
- 3.3.14 Our alternative is intended as a straw-man to enable discussion on options that could ensure a level playing field and that those parties who can best manage risk are assigned any risk under the design. It would also provide a more flexible mechanism for valuing firm/variable capacity than the proposed Priority Rights auction.
- 3.3.15 Details of our proposed Interruption Call auction are outlined in Appendix 1 of this submission. An assessment of both the Priority Rights auction and Interruption Call auction against the relevant design objectives for the Code is provided in Appendix 2.
- 3.4 Specific details of the issues with the Priority Rights auction design**
- 3.4.1 We consider that there are a number of important design considerations for the Priority Rights auction that have not yet been worked through. These include:

- a) Determining the timelines for various steps in the auction, i.e. when bids must be provided, the time that the auction will be run on auction day (second Monday of defined month);
 - b) Developing appropriate market power mitigation arrangements to ensure a level playing field is achieved;
 - c) Defining the parameters of the auction; and
 - d) Developing appropriate pricing arrangements for ensuring least cost outcomes to the market.
- 3.4.2 We consider that even if a Priority Rights auction was designed, which successfully addressed the matters we have outlined in the remainder of this section, the outcomes would still only be second best to implementing an arrangement for effectively procuring physical congestion management products. This is because the design would still be fundamentally flawed – it would assign risk to parties who are not best able to manage that risk (refer to 3.3.9 above) and not result in any sort of physical response to a congestion issue.
- 3.4.3 For completeness we have outlined in detail in the remainder of this section those particular matters around the Priority Rights design which require consideration. Our strong preference would however be for First Gas to work directly with industry to further develop a congestion management product rather than reviving the Priority Rights auction design.

Market Power considerations

- 3.4.4 It is conceivable that there could be only one Shipper bidding for Priority Rights at a delivery point. In this case Priority Rights will be priced very low, even if congestion is an issue at that delivery point. Larger Shippers, who procure Priority Rights at lower cost in these circumstances, would be able to smear costs of acquisition across their entire portfolio and keep overall transport costs down to all customers even if congestion is occurring. As a result larger Shippers will have a significant advantage over smaller Shippers and new entrants.
- 3.4.5 As there may only be a few Shippers at other delivery points, it is also conceivable that larger Shippers would be able to price smaller Shippers out of the market for Priority Rights, essentially enabling them to hoard capacity¹¹. A smaller participant who is not able to obtain Priority Rights could face significant overrun costs as a result which, given their size, could be hard to absorb as a business. It is also conceivable that their customers could get turned off first during a congestion event¹² – should this occur it would be very difficult as a business to recover from the resulting negative publicity.
- 3.4.6 Even the perception that the relatively high level of market concentration in the New Zealand gas market could result in limited competitive pressure would create a potential barrier to entry, regardless of whether any non-competitive behaviours actually eventuate. As a result it is imperative that market power mitigation arrangements are incorporated.
- 3.4.7 We suggest that the following important related matters would require consideration:
- a) Whether ex-ante vs ex-post mitigation arrangements should be adopted, or a mixture of both.
 - b) What tools should be used for mitigation, i.e. independent review of bids? Inclusion of a price cap?
 - c) Who should be tasked with monitoring behaviour? Note that they will need to be independent. One option would be for the GIC to monitor and report to the Commerce Commission.

¹¹ We note there will be incentives for larger Shippers to hoard capacity even if there is not anticipated to be physical congestion as it is always possible that an anticipated event which causes congestion could arise, i.e. an unexpected production plant outage.

¹² We acknowledge that this would be difficult physically, but there is significant uncertainty as to whether Priority Rights are a physical or financial product – as explored earlier in this submission.

Parameters of the auction

- 3.4.8 Currently there is no limit on the exposure of Shippers who want to procure Priority Rights through an auction; theoretically prices could go to infinity. While prices would in reality not be pushed to infinity, the existence of market power (explored above) and need for Shippers who retail to mass market to procure Priority Rights¹³, raises concerns that prices could still be unnecessarily high.
- 3.4.9 This is not consistent with the design promoting least cost outcomes for end users. A price cap would act as a tool to limit this potential behaviour and place a limit of Shipper's potential exposure.
- 3.4.10 There is anticipated to be a price floor included into the auction parameters. While we appreciate that this is to ensure that First Gas can recover its costs associated with running the auction, it will be distortionary and will result in Shippers paying for Priority Rights¹⁴ when they have no actual value. There are more appropriate ways for First Gas to recover its costs that do not involve distorting the auction price for Priority Rights, such as including as an additional separate charge. We consider that this should be further explored.
- 3.4.11 Finally, there could be value in allowing Priority Rights to be allocated to part of a tranche. This would require more sophisticated tie break rules than currently specified in clause 3.9(c). There are examples of tie break rules used in other jurisdictions that could easily be adopted to enable this.

Auction Pricing.

- 3.4.12 We are concerned "pay-as-bid" pricing will result in higher costs overall and consider marginal pricing arrangements would be more appropriate.
- 3.4.13 The arrangements will require Shippers with retail load to purchase Priority Rights at all delivery points despite the fact that there may not actually be congestion. As outlined earlier, Shippers will also tend to over-procure Priority Rights to cover the variability of their loads. This conservative bias towards over-procuring Priority Rights, regardless of whether congestion is anticipated, combined with any potential market power issues, will result in prices being higher than necessary and not reflecting the true value of firm capacity. Ultimately end-use customers will pay more for gas than is necessary as a result of the proposed pricing arrangements and additional complexity. This is not consistent with promoting the use of gas to customers.

3.5 Implementation

- 3.5.1 We support First Gas providing a "sand pit" for gas market participants to test the new systems for a period of time, potentially as part of a parallel run between both arrangements. This will enable any issues to be addressed prior to the new arrangements officially commencing.
- 3.5.2 We also support First Gas in working closely with the potential IT vendors to develop an optimal solution. In our experience making ex-post changes to very specific systems can be very expensive and so we commend First Gas in being conscious of the potential costs of incorporating future enhancements etc. into the design from the offset within its IT risks document¹⁵. Ensuring that a robust and flexible IT system is implemented is vital.
- 3.5.3 Finally we support First Gas including provision within its project plan for the IT system to be audited against the Code requirements as part of the implementation process. This will ensure that the system that is implemented is compliant with the new Code requirements from the offset. Similar ongoing audit requirements when a change is made should also be adopted by First Gas as a matter of good practice.

¹³ Those parties with the least control of their off-take will assign the highest value to procuring Priority Rights.

¹⁴ The rationale as to why a Shipper would have to procure Priority Rights was explored earlier in this submission.

¹⁵ Refer: <http://gasindustry.co.nz/dmsdocument/5545>

We look forward to continuing to work directly with the GIC and First Gas to address the matters raised in this submission and develop an effective congestion management product. For any questions relating to the material in this submission, please contact me on 07 572 9888.

Regards,

A handwritten signature in black ink, appearing to read "C. Schubauer".

CRAIG SCHUBAUER
WHOLESALE MARKET MANAGER

Appendix 1: Overview of proposed alternative Interruption Call auction

A basic overview of Trustpower's proposed alternative Interruption Call auction follows.

As outlined in the body of this submission it is intended to act as a strawman to enable First Gas and industry to further explore implementing a mechanism for procuring congestion management services.

Interruption Call auction – monitoring and holding an auction

- Every three months First Gas makes an assessment as to whether there will potentially be any congestion arising along the pipeline during the following three month period, i.e. the assessment will be made three months ahead of the relevant period.
- If there is anticipated congestion then First Gas will notify the market they will be requiring congestion management services for the three month period via a notice which would cover the following matters:
 - the amount of congestion;
 - the location of the congestion;
 - the gates where offers for congestion management services are requested; and
 - the deadline for offers to be submitted.
- Parties can place offers for up to 5 tranches of congestion management services on a bulletin board. Partial clearance of offers can occur and needs to be accounted for when making offer. Parties can lower the price for a tranche at any time, but cannot increase the price.
- The auction platform will rank the offers from lowest to highest price. This will ensure that parties participating in the auction have visibility as to where they sit in hierarchy. Note that the party's names will not be published but details of their price and quantity will be published at this stage.
- Once the deadline for offers to be submitted is met, all details of the auction offers and bids will be published. First Gas will clear all offers up to the desired quantity, subject to their price cap not being exceeded. This means First Gas has first priority for purchasing congestion management services for its pipeline.
- First Gas will then open the platform for other parties to purchase congestion management services, including potentially at prices above the First Gas price cap (refer to the next section for details), and for sellers to potentially rescind their offers. A standard form bilateral contract would apply to any purchases that do take place.
- After the auction all providers of cleared bids and offers will be notified. Note that those offers cleared by First Gas or purchased by other parties will be paid their offer price (pay as bid). This will ensure least cost outcomes.
- Details of all congestion management services that are purchased will be published, including the disclosure of who the buyer and seller was, along with the price paid and the quantity that was cleared.
- Following each auction that is run, First Gas (or another independent party such as the GIC) would be responsible for undertaking an ex-post assessment of whether any competition issues may have arisen during the auction and would be required to report these to the Commerce Commission for further consideration. The outcomes of any assessment should be ultimately made public, though a time delay to enable Commerce Commission investigation of any behaviour may be required.

Auction Detail

- If a non-Shipper is offering to provide congestion management services, then they need to notify First Gas who their Shipper is and notify their Shipper they will need to adjust their DNC should an "interruption call" be issued. Note that an Interruption Call will be issued directly to the Shipper.

- A market price cap would apply for First Gas of \$x/GJ/KM of congestion. Note that the price cap is intended to provide certainty to the market as to the maximum liability they can face for congestion. Other parties may place a higher value on congestion management and therefore should not be limited in the price they can offer to pay. For example, a gas fired generator or dairy factory may place a higher value on non-variable supply during a particular period of the year. There would be no price floor.
- If no one offers to provide congestion management services, then First Gas would manage any actual congestion using the current Critical Contingency management arrangements. In this circumstance all users at the impacted delivery points risk curtailment with no compensation provided.
- First Gas would have the ability to run additional auctions closer to real time if the need arises, i.e. if the initial assessment indicated congestion wouldn't be an issue but a circumstance has arisen subsequently that means physical congestion will likely occur, i.e. a large unscheduled outage of a producer.

Interruption Call made (coming into real time)

- First Gas continues to have a role of continually monitoring the status of the pipeline on a day-to-day basis.
- An outage notification process would be established to assist First Gas in better understanding periods of potential congestion in advance. Full and partial curtailments of gas usage would need to be notified to First Gas, particularly by providers of congestion management services. Note that where a provider is on a notified outage (regardless of whether an interruption call has been issued) then they will simply refund the quantity of congestion management services impacted at the purchase price for the duration of the notified outage.
- Where First Gas becomes aware that congestion will occur (or potentially occur) and congestion management services will be required to ensure a critical contingency is avoided, then it will issue an Interruption Call.
- Shippers (including for a load providing congestion management services) will be notified that an Interruption Call has been issued and required to adjust their DNC to reflect the agreed quantity of curtailment. There will be a penalty applied if they do not adjust their DNC or have failed to notify First Gas in advance that they would not be consuming gas at this time(i.e. on outage). The penalty would equate to being charged for the non-delivered quantity at the price cap.
- Performance will be assessed on the day against the DNC that had originally be nominated, i.e. if had originally nominated 100 GJ then reduced to 50GJ, then performance will be assessed to ensure that a 50GJ reduce in consumption of gas has been made. Overruns will apply if a party do not reduce consumption to reflect its updated DNC and a penalty of the non-provided quantity (within a reasonable tolerance range) of curtailment priced at the cap will apply (same as if had not updated DNC in the first place).
- At the end of each auctioned period then First Gas will report on the performance of providers i.e. volume called and delivered, number of days called. This will be made public and published on First Gas's webpage.





Settlement





- The costs of the auction volume purchased by First Gas will be socialised to all shippers over the following three months (or some other period), subject to an adjustment being made for any refund or penalty amounts applied. Note that it will be based pro-rata on consumption quantities to preserve the regulated income of First Gas.
- Any bilateral agreement between other parties that eventuates following an Interruption Call auction, would be settled between the parties in accordance with the details of the standard form agreement.
- Where First Gas has procured congestion management services, the relevant party will receive the agreed discount to their transport costs for the three month period, subject to any adjustments for refunds or penalty amounts applicable to that party.



Note that an alternative approach for settlement would be for costs to be recovered in the next transmission year. This would require discussion with the Commerce Commission.







Appendix 2 - Assessment of Priority Rights auction (as proposed by First Gas) and Interruption Call auction against the design objectives



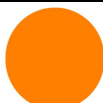

Key: Green – strongly promotes the objective; Orange – neutral against the objective; Red – does not promote the objective; White – cannot assess.



Objective	Priority Rights auction	Interruption Call auction
Enable use of gas by:		
Minimising transactions and simplifying arrangements and processes	 <ul style="list-style-type: none"> • Auction held at each delivery point (approx. 70) regardless of whether congestion is an issue. • Shippers will need to bid into the auction in order to secure Priority Rights. 	 <ul style="list-style-type: none"> • Optional Shipper or other party involvement. Strong incentive to provide congestion management services provided. • Only held when congestion anticipated to occur.
Promoting flexibility and increased choice by making access products available that suit different needs	 <ul style="list-style-type: none"> • Only Shippers can participate. Opportunity to purchase Priority Rights not available to other parties wanting to manage their risk. • Doesn't suit needs of Shipper with mass market customers. Those Shippers with retail load will end up purchasing Priority Rights even if there is no congestion at a delivery point to mitigate risk of overrun charges (and 	 <ul style="list-style-type: none"> • Load can offer to reduce flexibility as well as Shippers. • Risk of congestion assigned to parties who are well place to manage it.



Objective	Priority Rights auction	Interruption Call auction
	<p>avoid customers potentially being turned off).</p> <ul style="list-style-type: none"> The proposed arrangements are not fit for purpose, will impose unnecessary costs and will create unnecessary complexity. Risk of congestion will potentially fall on parties who have no way to manage the risk, i.e. mass market retailers. 	
Removing many of the restrictions inherent in the access products provided under the MPOC and VTC, including any barriers to short term trading of gas	 <ul style="list-style-type: none"> Creates perceived barrier to entry into the gas market for new retailers due to increased cost of operation, and potential issues as a result of limited competitive pressures. It is possible that Priority Rights could be viewed as a signal for congestion when this might not actually be the case as a result of Priority Rights being run, regardless of whether there is anticipated congestion. 	 <ul style="list-style-type: none"> Addresses the issues associated with limited competitive pressures we have identified with the Priority Rights auction proposal, through enabling Shippers and loads the ability to offer to provide the service (as opposed to buying a Priority Rights in a restricted market). Includes a price cap to provide certainty to First Gas (and broader market) as to cost of addressing congestion.
Promote competition by		
Minimising barriers for new entrants to use the gas transmission system		







Objective	Priority Rights auction	Interruption Call auction
	<ul style="list-style-type: none"> • Multiple products required to be purchased, DNC and PR (more complex than status quo). • Creates perceived barrier to entry into the gas market for new retailers due to limited competitive pressure as a result of the relatively high market concentration in the NZ gas market. • Increases complexity as all parties will need to assess constraints on the system. 	<ul style="list-style-type: none"> • Only purchasing one form of capacity (via DNC) until congestion occurs then have option to provide variability to First Gas at a price (or other parties who may be more willing). • Only auction for congestion management services when congestion anticipated to occur. No need for new entrants to monitor congestion separately – an auction being held will clear signal there is a risk of congestion.
Making capacity more accessible	 <ul style="list-style-type: none"> • Doesn't have a robust link between the type of capacity being made available and the actual or anticipated system conditions. 	 <ul style="list-style-type: none"> • The Interruption Call auction approach would make the "right" form of capacity more easily accessible when it is required based on system conditions. • There is a risk that there are not a large number a customers who can manage their gas consumption. Demand side response within the gas industry is a less tested mechanism for addressing congestion. There is however significant experience from the electricity industry which should be able to inform discussion of any technical performance concerns. Likewise having


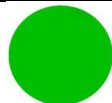

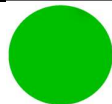


Objective	Priority Rights auction	Interruption Call auction
		correct pricing signals should assist in gas consumers in making appropriate decisions around providing gas congestion management services.
Removing preferential rights to capacity unless they are based on different willingness to pay		
Preventing capacity hoarding and contractual scarcity that does not reflect underlying physical conditions of the system	 <ul style="list-style-type: none"> • Competition issues could arise. For example larger participants could purchase all Priority Rights at a delivery point to limit competitive pressures. • Priority Rights not linked to actual underlying physical conditions. 	 <ul style="list-style-type: none"> • An Interruption Call auction would only held if congestion likely to occur and an interruption call will only be issued for providers of congestion management services to reduce their usage of capacity when there is physical congestion anticipated within the next 24 hours.
Increase transparency by		
Making key information readily available and easily accessible	 <ul style="list-style-type: none"> • Due to the design of the Priority Rights arrangements, particularly with an auction being held every six months for each delivery point, there will be a 	 <ul style="list-style-type: none"> • Congestion may not be signalled in advance always, i.e. where First Gas determines within a three month period to hold an Interruption Call







Objective	Priority Rights auction	Interruption Call auction
	<p>signal that congestion is anticipated being provided, regardless of the underlying system conditions.</p> <ul style="list-style-type: none">Anticipate information published on congestion.	<p>auction. This can be addressed through the timely publication of information.</p>
Adopting as a default position that information should be public unless there is a compelling reason why it shouldn't be	N/A	
Publishing the full content of all non-standard transmission agreements and interconnection agreements made under the Code	To avoid asymmetry of information all information around congestion needs to be published.	
	N/A	
Promote efficient investment by		
Making both firm and non-firm capacity available	<div></div> <ul style="list-style-type: none">While providing both firm and non-firm capacity, the proposed arrangements will require Shippers who supply mass market customers to purchase firm capacity when it may not be required.	<div></div> <ul style="list-style-type: none">Default position of opting to accept a lower level of firmness
Providing better price signals and better discovery of the value of access to different parties (willingness to pay)	<div></div> <ul style="list-style-type: none">Because there is a price floor included into the Priority Rights auction design this means that even when there is no	<div></div> <ul style="list-style-type: none">All parties who have identified value in firm capacity availability will be able to

Objective	Priority Rights auction	Interruption Call auction
	<p>anticipated congestion at a delivery point there will still be a value assigned to Priority Rights.</p> <ul style="list-style-type: none"> • Only First Gas can provide firm capacity. This may be unnecessarily restricting the potential supply of firm capacity. • Pay as bid does enable willingness to pay to be identified, however limited competitive pressures could result in this information being distorted. Refer to section 3.4 of our submission for further details of our broader concerns with the auction design. • Assigns risk of congestion to party who potentially cannot manage it. 	<p>actively seek supply from Shippers/other parties.</p> <ul style="list-style-type: none"> • Ability to buy and sell congestion management services available to entire market. Not just First Gas being able to purchase congestion management services from another party. • Price cap applies only to First Gas so that other parties are aware of the maximum liability that First Gas can face (and by default the market as costs are socialised). • Dutch auction format enables price preferences of suppliers to be revealed efficiently. • Risk of congestion assigned to party that can best manage any congestion issues.
Putting in place mechanisms that better signal future capacity requirements	 <ul style="list-style-type: none"> • Cannot be assessed at this time as two material questions need to be answered: <ul style="list-style-type: none"> • Is the issue a short term or longer term issue • How material is the issue. 	 <p>Same as for First Gas assessment.</p>

Objective	Priority Rights auction	Interruption Call auction
	<ul style="list-style-type: none"> The question of how the issue is resolved also needs to be worked through. For example there might be other more cost effective mitigation options available such as congestion management services. 	
Promoting the allocation of capacity to parties who value it the most in the event of congestion or scarcity	 <ul style="list-style-type: none"> Will have to buy Priority Rights even if there is no anticipated congestion which will impose additional costs. Only will reveal the buyers willingness to purchase a limited supply of Priority Rights. Assigns risk of congestion to those parties that cannot manage it, i.e. mass market retailers. 	 <ul style="list-style-type: none"> Opt to provide firmness (via congestion management service) to First Gas or other parties. The buyer of congestion management services is displacing the seller's gas and paying a premium which will reflect the buyer and the seller's willingness to pay. This will give information on both the buy and sell side for congestion management services. Note that an Interruption Call auction is not limited in supply like a Priority Rights auction would be, but rather could potentially equate to 100% of a user's demand level. For example a point with two large industrial users might result in one user shaping their usage differently for example delaying a shift by 2 hours. The incentive for the user to delay the shift is the reduced capacity cost (based on the price they

Objective	Priority Rights auction	Interruption Call auction
		<p>had accepted in the auction) and the avoidance of a contingency event where there is no premium received and production is potentially curtailed.</p> <ul style="list-style-type: none"> • Can address congestion at disaggregated delivery point level while still enabling DNC at zone level. • Assigns risk of congestion to party that can best manage it.
Recover our allowable revenue in a consistent way by		
Applying the same GTPM to the “combined” transmission system (i.e. Maui and non-Maui)	 <ul style="list-style-type: none"> • Applied to every delivery point irrespective of whether congestion is occurring 	 <ul style="list-style-type: none"> • Only applies when congestion is anticipated.
Complying with regulatory requirements and guidance (such as the pricing principles found in the Gas Transmission Information Disclosure Determination 2012)		
Continuing to charge prices in accordance with non-standard agreements signed prior to the GTAC	N/A	N/A
Avoid “price shock” for our customers by		
Taking a pragmatic approach to pricing		

Objective	Priority Rights auction	Interruption Call auction
	<ul style="list-style-type: none"> Complicated and costs will be incurred when no congestion is anticipated as a result of the inclusion of a price floor and requirement for Shippers with mass market customers to procure Priority Rights. 	<ul style="list-style-type: none"> Costs only incurred when there is anticipated congestion
Considering existing pricing relativities	 <ul style="list-style-type: none"> DNC same price, just purchasing Priority Rights. 	 <ul style="list-style-type: none"> DNC same price, just selling variability
Removing any anomalies in transmission fees where they exist, while minimising step-change for individual customers	 <ul style="list-style-type: none"> Step-change in complexity. 	 <ul style="list-style-type: none"> Similar to current arrangements. Reduces number of nomination points if at zonal level which will increase forecast accuracy.
Set efficient prices by		
Enabling scarce transmission capacity to go to users who value it the most	 <ul style="list-style-type: none"> Competitive issues will distort valuations if they arise in the future. Even in the absence of competitive issues, new entrants will be uncertain if valuations correctly reflect the value 	

Objective	Priority Rights auction	Interruption Call auction
	existing Shippers place on having firm access to transmission capacity.	
Keeping pricing simple so that our customers can make decisions on value/cost trade-offs	 <ul style="list-style-type: none"> • Complicated process for determining value of firm capacity given auction held at 70 points. • Potentially distorted value assessments due to limited competitive pressures. 	 <ul style="list-style-type: none"> • Simple Dutch auction applies if congestion anticipated. • Limit on the price First Gas can pay to minimise cost exposure of all participants
Aligning transmission fees with the “access products” available under the Code	Not able to be assessed as Code under development.	Not able to be assessed as Code under development.
Having a positive impact on Shipper behaviours	 <ul style="list-style-type: none"> • Competitive issues will potentially surface under the proposed arrangements. Refer to section 3.4 of our submission for further details. 	 <ul style="list-style-type: none"> • Penalties will be applied for non-performance. • Possible public reputation issues for market manipulation.
Signalling capacity scarcity to the extent practicable	 <ul style="list-style-type: none"> • It is possible that Priority Rights could be viewed as a signal for congestion when this might not actually be the case as a result of Priority Rights being run, 	 <ul style="list-style-type: none"> • Interruption Call auction only held when scarcity of transmission capacity anticipated.

Objective	Priority Rights auction	Interruption Call auction
	<p>regardless of whether there is anticipated congestion.</p> <p>Note information on congestion required to support arrangement..</p>	Note information on congestion required to support arrangement.
Signing new non-standard agreement where such arrangements benefit all users of the transmission system	N/A	N/A