MEMORANDUM

TO: GTAC Stakeholders

FROM: First Gas

DATE: 24 July 2018

RE: Block 1 Outputs – 10 Supplementary Agreement Scope

Discussion at the workshop on Thursday, 12 July 2018 raised the question of whether Supplementary Agreements (SAs) should be limited in scope to only varying price. In this memo we consider the issues relating to the scope of SAs and set the First Gas position in relation to SA scope and their relationship to Priority Rights (PRs).

Points raised during discussion

First Gas to consider whether the scope of new SAs should be limited to the price of the transmission service. If SAs are not limited to price, then First Gas will provide a proposal on how supplementary capacity ranks in comparison to other capacity.

Findings

First Gas has considered this proposition and does not believe that it would be in the best interests of stakeholders to limit the scope of SAs to price. This change would constrain the ability to develop new transmission capacity where the new load underpinning that investment required certainty of capacity to support the investment (e.g. in new gas-fired generation or gas boilers). The investment in transmission capacity benefits all system users through increased system usage. This change would also not allow First Gas to offer Interruptible Capacity that would increase system utilisation without the risk of Congestion.

The current provisions of the GTAC specify that First Gas cannot offer SA if there is an adverse impact on other users or if there is a likelihood of Congestion. The mechanisms in the GTAC also allow for various treatment of Supplementary Capacity – including making it subject to the Priority Rights regime. Given the idiosyncratic nature of SAs, we think it is important that First Gas retains this flexibility for the treatment of Supplementary Capacity in relation to Congestion to ensure it can continue to offer SAs that are beneficial to all system users.

The current drafting of the GTAC provides for additional transparency in the decision making relating to SAs. This includes publishing of SAs and clear guidance on the criteria for entering into an SA. The GIC Final Assessment Paper (FAP) found that there was no requirement for First Gas to publish their analysis relating to the assessment of SAs (163). Subject to commercial confidentiality, First Gas is comfortable with publishing this analysis which would ensure that all parties understand the basis of offering (or not offering) an SA in a particular instance. We look forward to discussing this point on the governance of SAs at the workshop on 23 August.

Current numbers and scope of Supplementary Agreements

First Gas expects there to be 23 Supplementary Agreements (including Interruptible Agreements) on 1 October 2018. This number may change during 2018-19. The current Supplementary Agreements exist for several reasons as shown in the table below.

Reason for SA	Number
Inflexibility of current transmission regime	8
Physical bypass opportunity (at the time of negotiation)	5
Alternative fuel bypass opportunity (at the time of negotiation)	4
To provide marginal capacity above firm capacity limit	1
To recover costs of additional transmission capacity	2
To provide end-user with capacity certainty	2
To encourage a new use of gas	1
ALL SAs	**23**

We expect the number of SAs to reduce once the GTAC is in place due to the greater flexibility of its daily capacity regime. Only 7 of these agreements have expiry dates that are after the likely GTAC implementation date. It is likely that the only SAs that will remain are those where the end-user has a demonstrable alternative fuel choice or bypass opportunity, or where the agreement remains necessary to ensure First Gas recovers its capital expenditure in providing additional capacity.

Pricing

Of the above 23 SAs, 6 apply standard transmission fees, so price differentiation is not a defining characteristic of these agreements.

Where an SA does contain non-standard fees, they are not always discounted: they may be just a different structure of fixed and variable. In addition, an SA with fully-fixed fees may result in the average transmission charge ($/GJ) being either higher or lower than if standard prices applied, depending on the annual delivery quantity (GJ). This simply reflects a different allocation of risk, with some end-users of gas preferring to lock in a fixed transmission charge for several years that does not vary with demand.

Where First Gas needs to recover capital expenditure (see below), it is likely that transmission fees will be predominantly fixed. The fees payable under such an SA may be higher than standard fees, due to the capital-recovery component.

Recovering significant investments in the transmission system

The largest single capital investment made in the transmission system in the last 20 years was for the Henderson compressor station, commissioned in June 2017. That investment was undertaken to remove Congestion and provide firm capacity to Refining New Zealand at Marsden Point. Previously, transmission capacity for Refining New Zealand had been 100% interruptible, and the delivery quantity had been much lower.

To provide certainty to Refining New Zealand as to future transmission capacity, and to First Gas (and other users of the transmission system) in relation to cost recovery, Refining New Zealand and First Gas entered into a Transmission Pricing Agreement (TPA). The TPA provides for an SA between First Gas and NZRC's current gas supplier (Shipper), under which First Gas makes the firm capacity available to the Shipper, who pays the transmission fees set out in the TPA.

The TPA contains provisions that, in effect, allow either party to reallocate defined amounts of firm capacity to other End-users in Northland in the event of future Congestion affecting that part of the transmission system. As Refining NZ has an alternative source of fuel, they are able to accommodate future changes in use of the transmission system.

We see the Refining New Zealand TPA/SA example as a useful model for large investments that may be made in future. The arrangement has been beneficial for all system users by increasing aggregate system usage and therefore lowering transmission fees for other users. At the same time, the structure of the agreement ensures that the cost of system expansions is recovered from those using those system improvements.

In accordance with the Commerce Commission's Pricing Principles, First Gas is committed to undertaking investments in the transmission system that are beneficial to users of the system. We believe that this could be limited if First gas is unable to offer firm capacity in return for firm pricing.

Supplementary Capacity and Congestion

Section 7.1(a) of the GTAC is intended to convey that First Gas will not enter into an SA where that would create Congestion or adversely affect other transmission system users. First Gas takes a long-term view of the network in its Asset Management Plan (AMP), and therefore congestion is expected to be signalled in advance of actual occurrence.

Moreover, SAs typically have a term of only 1-3 years. Where First Gas considers Congestion could arise we can keep the term of the SA short (i.e. 1 year). SAs do not have "capacity grandfathering", so they do not permanently sterilise capacity. At the end of its term, capacity under an SA is again contestable.

Where SAs require a longer term to allow for recovery of investment, this will be linked to increasing capacity at some point in the network. It is therefore unlikely that Congestion would occur after the investment has occurred, and as highlighted above with the example of the Refining NZ arrangements, such an eventuality can be explicitly dealt with through the SA.

There are in fact a range of mechanisms that can be used in an SA to deal with Congestion that may arise during its term, e.g.:

- Allowing the Shipper or the End-user to make capacity available to others on the same part of the transmission system, temporarily or permanently (see Refining NZ example above)
- Making capacity under the SA subject to a nominations process (ref. section 7.4(f) of draft GTAC)
- Making capacity under the SA partly interruptible
- Requiring a separate Interruptible Agreement in addition to the SA, where the firm capacity under the SA is < the End-user's maximum requirement

- Making Supplementary Capacity partly or wholly subject to the Priority Rights provisions of the GTAC (ref. section 7.4(g) of draft GTAC).

These mechanisms have been used in existing agreements.

Given the need to tailor SA terms to the situation of the end-user, we do not feel that a single mechanism for dealing with Congestion arising during the term of an SA is appropriate. We believe that the current drafting of the GTAC allows First Gas enough flexibility to manage Congestion and enter into Supplementary Agreements that are beneficial to system users.