MEMORANDUM

TO: GTAC Stakeholders

FROM: First Gas

DATE: 15 August 2018

RE: Block 3 Support Materials – 4 Change Request Veto

This memo summarises First Gas' proposed approach to using its veto right on GTAC Code Change Requests. This information is a response to stakeholder requests for clarification on this issue given that it may influence how likely it is that any outstanding issues or perceived deficiencies in the GTAC can be addressed through future changes. This material will be discussed at the workshop on Change Requests on 23 August 2018.

Final Assessment Paper (FAP) Findings

The FAP presented the following analysis of the rights of veto under the GTAC in comparison to the existing codes.

On what grounds may First Gas veto a final change request that is otherwise valid?

GTAC (s.17)	MPOC (s.29)	VTC (s.25)
First Gas may *only withhold its consent* if First Gas has given prior notice of not supporting a draft change, and it considers the change request would *cause a party to breach its RPO obligation*, or if First Gas is required to *incur expenditure it could not recover*, or be likely to *adversely affect* current or future *provision of transmission services, pricing structure or revenue recovery*	First Gas may *withhold its consent* to a change request provided that it *does not do so unreasonably*. Specific grounds on which First Gas may withhold consent are: if First Gas required *to incur capex, or opex that cannot be recovered*, or materially adversely affect pipeline business or tariffs, or open access compatibility.	First Gas may *withhold its consent* to a change request provided that it *does not do so unreasonably*. Specific grounds on which First Gas may withhold its consent are: if First Gas is required to *incur capex, or opex that it cannot reasonably expect to recover*, or be likely to *adversely affect* structure of transmission services, business structure, transmission revenue, or open access compatibility. First Gas may also withhold consent if it considers *any shipper has not acted in good faith* during the change process.

The GIC assessed that '*First Gas' right to block a code change is tighter than in the VTC and MPOC'* (p.102).

We agree with this assessment. First Gas is only able to withhold consent in specific circumstances under the GTAC, while the MPOC and VTC provide a broader requirement not to unreasonably withhold consent. This change is important to ensure that the GTAC can adapt to changes in the business environment. Furthermore, we think that all users will benefit if code settings are allowed to change if the intended behavioural outcomes are not being realised. We want the Code to be a living document that is improved upon in a measured, data-driven manner so that the objectives of the Gas Act are met.

What does the GTAC say about our right of veto?

Section 17.14 of the GTAC states First Gas' rights as follows:

17.14 First Gas may decline to approve a Recommended Change Request if it has previously given notice under section 17.7 that it does not support the proposed change and:

(a) *it considers that the Change Request would cause either the Change Requestor or First Gas to breach its obligation to act as a Reasonable and Prudent Operator; or*

(b) *the proposed Code change would:*

(i) *require First Gas to incur expenditure it could not recover; or*

(ii) *be likely to adversely affect First Gas' current or future provision of transmission services, pricing structure or revenue recovery,*

provided that First Gas must publish its reasons on OATIS within 5 Business Days of receiving GIC's decision pursuant to section 17.11.

Timing

In order for First Gas to exercise its right of veto, we would need to notify users that we objected to the Code Change Request within 20 Business Days of the publication of the Draft Code Change Request. As per section 17.7 we would need to include reasons for this objection.

If, following consultation with stakeholders and a positive GIC assessment of the Code Change Request, we continued to object to the Code we would need to object within 5 Business Days of the GIC decision and publish reasons for this objection.

Hence, any objection by First Gas will be informed by stakeholder consultation and the GIC analysis.

Grounds for veto

There are three grounds for veto: causing the Change Resquestor or First Gas to breach the Reasonable and Prudent Operator (RPO) standard; imposing costs on First Gas that are not recoverable; and causing an adverse impact on transmission services. While we are not able to foresee all possible situations where these veto rights would be in play, we explain our views on the likely scope of these rights in the following sections.

Causing a breach of the RPO standard

The application of the RPO test will depend on the nature of the situation in question. It is therefore difficult to predict in advance what the specific situations might be. However, we would assume that our right of veto would extend to situations where in the ordinary course of business First Gas or the Change Requestor acting in good faith would breach the RPO standard.

This could relate to unintended impacts of the change request on other users, which might involve a change to:

- the treatment of certain parties on the system that gave special treatment to those parties in breach of our obligations in s. 2.7 of the GTAC
- the operation of the transmission system that adversely affected other users – e.g. changes to TTP adversely affecting Receipt Point Interconnected Parties, or a change affecting our ability to meet TTP
- the provision of information to users where some users received information at different times than others which could give them a competitive advantage (excluding treatment of confidential information).

Alternatively, this could involve a change where the degree of skill, prudence and foresight practiced was diminished below ordinarily exercised by experienced operators in the same line of business. This could potentially involve changes to:

- technical standards that no longer meets industry norms
- information provision that does not allow judgement or foresight to be exercised appropriately
- terms that lead First Gas or the Change Requestor to breach another law or regulation.

We believe that this veto right safeguards the integrity of the obligation on all parties to act as an RPO by ensuring that no change causes the party to breach that standard.

Imposition of unrecoverable costs

The second ground for veto is where First Gas would incur expenditure that it could not recover. The Commerce Commission Input Methodologies (IMs) are important in understanding this point[1].

Capital expenditure that results in a commissioned asset is added to the First Gas Regulated Asset Base (RAB) and recovered through transmission fees to customers that reflect the regulated rate of return (currently 6.41%). If the costs impacts flowing from any change can be capitalised, then these costs are likely to be recoverable and not subject to the veto right.

While the timing of any investment in the regulatory cycle can affect this broad position (since the RAB is only reset for actual capital expenditure at each price-quality path reset), the financial impact of timing differences would only be material for very large investments. Our general philosophy is that since code changes will be subject to extensive customer consultation, any capital expenditure required following a change process should reflect a high priority use of capital.

In terms of operational expenditure under the IMs, First Gas can add forecast Pass Through and Recoverable Costs to our allowable transmission revenue. Such costs include:

- Pass Through Costs (s. 3.1.2) – rates and levies to a local authority, Commerce Commission Levies, GIC Levies, Electricity and Gas Complaints Commissioner Scheme costs or other costs that are outside the control of First Gas, come into effect during the DPP period and is appropriate to be passed through.

[1] https://comcom.govt.nz/__data/assets/pdf_file/0028/59716/Gas-Transmission-Services-Input-Methodologies-Determination-2012-conso....pdf

- Recoverable Costs (s. 3.1.3) – balancing charges, compressor fuel associated with Mokau, specific fees relating to meeting Commerce Commission requirements, capex wash-up adjustments, revenue cap wash-ups.

The veto right would not arise from cost impacts that are classified as passed-through or recoverable costs. In the event of any disagreement over regulatory treatment, we would seek advice from the Commerce Commission (as previously done for balancing costs relating to MBB).

The remaining situation is if the Draft Change Request imposed operating costs that could not be recovered or passed through. We would assess such cases at the time and would only exercise the veto where the costs were sufficiently large and certain. As discussed in relation to capital expenditure, the change process itself would provide an indication of the priority attached to the expenditure.

Adverse impact on transmission services

The final grounds for veto are that the Draft Change Request would be likely to adversely affect First Gas' current or future provision of transmission services, pricing structure or revenue recovery. It is difficult to describe exact circumstances that would lead to a veto on this ground. However, we could anticipate that we would be concerned where a Draft Change Request:

- Made First Gas' recovery of revenue less certain to the extent that the 20% limit on the revenue cap wash-up was likely to be breached. This would involve a change that made forecasting transmission volumes inherently more difficult
- Changed the nature of transmission services such that First Gas was unable to provide the service and could not adapt its services to meet the standard
- Changed the balance of risk to an extent where First Gas was no longer able to operate the pipeline efficiently/safely if the Change Request were implemented.

These grounds would likely be cases where First Gas could not reasonably foresee a way to mitigate the impacts of any change that we considered likely to have a material impact on current or future users of the transmission system. We consider it highly likely that any such concerns would be dealt with through engagement with the Change Requestor and the GIC through its evaluation process, with the veto right only acting as a last resort.

Summary and Next Steps

The provision for First Gas veto of Change Requests have been deemed to be more limited than those existing in either the MPOC or VTC. We believe that this strikes a good balance and will allow the Code to adapt to future business conditions. We also believe that the limited grounds for veto should not discourage parties from proposing changes to the GTAC where they consider the objectives of the Gas Act will be better promoted by different terms.

As a general philosophy, we are prepared to prioritise capital expenditure and operating expenditure arising from a well-considered and robust code change process. First Gas intends to use the various steps in the change process to highlight and resolve any concerns that we have about the potential adverse impacts of any change, which we think will confine the veto right to truly exceptional circumstances.

We look forward to discussing this issue with stakeholders at our workshop on 23 August.