



23 June 2017

Ben Gerritsen
General Manager Customer and Regulation
First Gas Limited
By email

Dear Ben,

RE: Gas Transmission Access Code Development: Emerging Views on Detailed Design of Access Products, Pricing, Balancing and Allocation May 2017 (the "paper")

We consider that a robust, single code that delivers fair, efficient and effective transmission access on the simplest terms possible would best serve the industry.

The conclusions from matters considered in the appendices to this letter (which describe Greymouth Gas' views on each consultation item in the paper) are:

- The only tenable way to progress the GTAC is to move away from the emerging views First Gas has *put* on industry, towards something that will enable the use of gas.
- First Gas needs to rework and refine matters.

Greymouth Gas is happy to work collaboratively with First Gas in creating the first draft of the full new code.

Yours sincerely

Chris Boxall
Commercial Manager

Appendix 1 – Access Products

The Greymouth Gas preference has always been for a Flow to Demand model and on the basis of the detail provided in the First Gas paper about the DNC model, we consider it is even more important that there is a partial or full shift towards Flow to Demand, for the following reasons:

1) Competition

Greymouth Gas wrote to First Gas in February 2017 about this. We noted the prevailing view, but said that it was imperative that First Gas ensured the design of DNC raise no competition issues. We do not consider that this point has yet been addressed.

Competition is not addressed in the paper because for an end-user with PR to switch away from its incumbent supplier, it would likely need to relinquish its PR for up to six months or risk its factory being shut down or regularly curtailed. End-users would therefore be unlikely to switch.

Greymouth Gas considers that the options for solving this could be:

- i) Making it mandatory to transfer PRs between shippers when end-users switch,
- ii) Having more frequent auctions, e.g. daily, weekly, fortnightly or monthly,
- iii) Having the end-users hold, and bid for, the PR, or
- iv) Getting rid of PR and relying on congestion management products.

The first option has historically proven to be difficult if not impossible depending on whether or how a shipper portfolio books capacity (or rights).

The second option would either be inefficient or still wouldn't give end-users enough certainty to switch suppliers.

The third option would be acceptable, but the fourth is our preference. Both of these approaches would put First Gas closer to its consumers, thus better enabling the use of gas.

2) Purpose of PRs

Notwithstanding the competition point, in February we thought that PRs would only be given effect to when a pipeline had no more operational capacity. Now the proposal is to give PR holders further rights by making DNCs firm in times of congestion.

This implies that First Gas is likely to use PRs as a daily pipeline management tool to avoid critical contingencies – perhaps in lieu of OFOs, and curtailments. These tools are used reasonably frequently – thus demand for PR would likely be akin to reserved capacity (i.e. quite high), particularly if weather or lake conditions deviate from that forecast for a short or long period of time. Those without PR would run a real risk of needing to turn down their production if there is a possibility of congestion, or incur overruns and associated risks. This:

- Is an inefficient / ineffective way of getting targeted demand reductions given the socialised nature of the approach, and
- Does not encourage the use of gas.

If First Gas does not want to remove further rights for holders of PR, then as drafted, DNC will not work. Also, DNC for those without PR will be interruptible (contractually) yet will be very difficult to enforce (operationally).

If First Gas agrees to remove further rights for holders of PR, then given that congestion management is already an unwritten chapter in the GTAC table of contents, it is difficult to see the value of the PR product.

3) Consumers

End users want simplicity. End users want to turn on their tap and use gas. Industry wants to encourage the use of gas. Therefore, we need to put consumers at the heart of the model.

Further, for any PR or congestion management regime to be workable, it should bypass shippers and involve end-users directly. Otherwise, both regimes risk changing money / risk, without guaranteeing improved efficiency and effectiveness of the pipeline operation.

Congestion management has value in being the last tool available before (and to prevent) a critical contingency. Pre-contracted end-users would turn off (or down) in times of operational congestion for a pre-arranged price. This would still give First Gas investment signals and it would not socialise demand reductions. This approach would thus be fairer on industry.

All this can be tied together with a Flow to Demand model.

4) Critical Contingencies

Following the May 2017 critical contingency, we thought that this type of supply / demand imbalance event should not occur in an efficient market.

Flow to Demand would probably have avoided such an event, as pre-contracted parties would have been called upon by First Gas to reduce demand to prevent the pressure thresholds from tripping.

It is unclear how DNC with PRs could achieve the same outcome.

5) Information

If First Gas intends to place stringent flow-to-nominations requirements on its users, it must ensure that appropriate and transparent information is available.

Appendix 2 – Pricing

In February 2017 there was little granularity on pricing. Some high-level data has now been tabled. However, our view is that the data is complex, and includes:

- A problematic DNC overrun regime, and
- An unusual HDQ overrun charge that doesn't seem to know its purpose.

To elaborate on this and other issues:

1) Two Sets of Numbers

First Gas is proposing that shippers (and therefore end-users) accurately nominate to within +3% of their demand on any given day at any Delivery Point, or face overruns of 5x or 10x the DNC charges.

We analysed the numbers for May 2017 on a per customer basis which would see Step 2 overruns apply 5% of the time, and Step 3 overruns apply 35% of the time. Few customers (or shippers), including direct-connects, can consistently be so accurate with nominations.

In the absence of an underrun charge, and assuming the cost of DNC will be relatively cheap, this will create two sets of numbers:

- One set a bit higher than is expected to mitigate the risk of DNC overruns, and
- One set that is more accurate so that shippers could try to balance properly.

We do not want two sets of operational numbers to juggle each day.

In addition, this would probably create perverse incentives to book PRs to mitigate against other parties overbooking DNC and there would be high uncertainty at G1M gas gates. Obviously this does not account for the pool nature of Delivery Points or of unders offsetting overs – but we don't think this changes the conclusion.

Greymouth Gas considers that the options for solving this could be:

- i) Adding DNC underrun charges,
- ii) Having more relaxed percentages, or
- iii) Removing DNC overrun charges.

The first option does not appeal and would create ambiguity as to the purpose of the nominations regime (i.e. is it for capacity or for balancing?). The second would be difficult to agree. Greymouth Gas favours the third option which would fit perfectly with a Flow on Demand access model.

2) Downstream Shift to Midstream

Another option is that end-users, and shippers, could continue to tweak their nominations throughout the day.

However, we do not want to deal with all customers tweaking every nomination in every cycle to try to avoid what is effectively a 3% balancing tolerance on the accuracy of individual demand forecasts.

More fundamentally, this would require commercial and industrial end-users to become experts in midstream shipping. There would be a shift from downstream to midstream expertise, and this would not encourage the use of gas. It would complicate gas use. Even under the current codes, end-users don't much like nominations / forecasts because of underlying uncertainties in their own production profiles.

Nominations can still serve a purpose – as a heads up / good faith forecasting tool for First Gas (this happens at present). There's just no need to design a whole access regime around it if that has no further purpose.

3) MHQ Overruns

First Gas says it considers that direct-connect end-users will have no reason for exceeding MHQ, which is set at 1/16th of DNC. Greymouth Gas disagrees because of deemed flow, unplanned peakiness and weighing up the lesser of DNC overruns, MHQ overruns, and balancing charges.

The purpose of MHQ overruns is also unclear and doesn't appear to be well justified in the paper. It could be a substitute for peaking charges. Greymouth Gas thinks that this should be addressed by removing the overrun charge, or by having a demand load-factor element to transmission pricing somehow.

4) GTPM

We consider that it would be desirable for First Gas to have some accountability on prices by:

- i) Adopting a 10% cap to price shock as First Gas itself proposes in 3.1.2 of the paper,
- ii) Allowing shippers to dispute the GTPM and transmission fees, and / or
- iii) Putting price policy granularity in the GTAC, given the Commerce Commission really only sets the aggregate recoverable revenue.

5) Delegation

In our view, First Gas has gone too far in proposing that decisions it can make outside the code be moved into the code. If there is a commercial element to the decision, that decision should be set in the code or subject to independent approval or scrutiny.

6) Worked Examples

We need to see some pricing worked examples before we can comment much more.

Appendix 3 – Balancing

We have separated comments on balancing and allocation into sections.

In February 2017 there was little granularity on balancing. We consider that the direction of the high-level data that has now been tabled is broadly acceptable. Having said that, the detail cannot be assessed due to lack of worked examples and there being too much (and no disclosed view on) discretion assigned to First Gas.

To elaborate:

1) General Direction

There are elements of B2B in the proposal and we accept these – i.e. shippers get cashed out if they're out of tolerance, but only if First Gas actually buys or sells balancing gas.

We are aware that an alternative balancing proposal may be gaining traction. Greymouth Gas is open to options, but we suggest First Gas workshop options so they receive industry consideration and input.

2) Package of Tools is Confusing

Overall, the package of tools is somewhat confusing, i.e. in addition to B2B cash-outs:

- i) A park-and-loan system is proposed. However, it is unclear when this would apply and when gas would be cashed-out. Also the success of this would depend on how close the daily fee is to \$0/GJ – if we're talking \$s/GJ then it will probably be unattractive. emsTP should be an efficient market so it is difficult to understand the economic rationale for park-and-loan.
- ii) MBB is retained for some parties / points. In our view, industry should move away from MBB completely.
- iii) There is also an Excess Running Mismatch charge, which looks like the old MPOC Excess Daily Imbalance charge. This concept is not really useful currently, and it is difficult to see why it is required in addition to a B2B cash-out regime.

Greymouth Gas proposes that the second and third tools be dropped, and considers that the first needs more work. In any case, we consider that it would be desirable to limit First Gas' discretion so that transparency and certainty is advanced.

3) Detail

Greymouth Gas is concerned about the following:

- Moving towards one balancing pool. This would limit commercial options if not definitively coupled with the same amount of tolerance as currently provided.
- How the detail of the new code will give effect to the general principle that "balancing requirements (tolerances) will not be tighter than they currently are under the MPOC

and VTC". Greymouth Gas has invested in assets and tolerances at Turangi, Kowhai, and indirectly in tolerances at TP Welded Points. We need to see some numbers, but expect that the cumulative benefit of our existing tolerances would be retained.

- The statement "shippers will continue to have an obligation to match gas receipts to deliveries ('primary balancing")" is not necessarily so – currently:
 - o The MPOC says that parties need to match receipts to deliveries, but may not, and if there is a mismatch the consequence is the cash-out regime.
 - o The VTC says that parties need to use all reasonable endeavours to match receipts to deliveries on a day, but may not for the purpose of tending towards zero which it shall do over a reasonable period of time (which is not straight away, nor on the day, but over a reasonable period of time in the future).
- Any initiative to make Shipper Running Mismatch positions publically available due to commercial sensitivities.

We also think that the RPO definition needs further scrutiny.

Balancing still has the potential to be more difficult than needs be.

Appendix 4 – Allocations

In 2016 Greymouth Gas expressed views on allocations. However, it seems that industry is still at the drawing board stage:

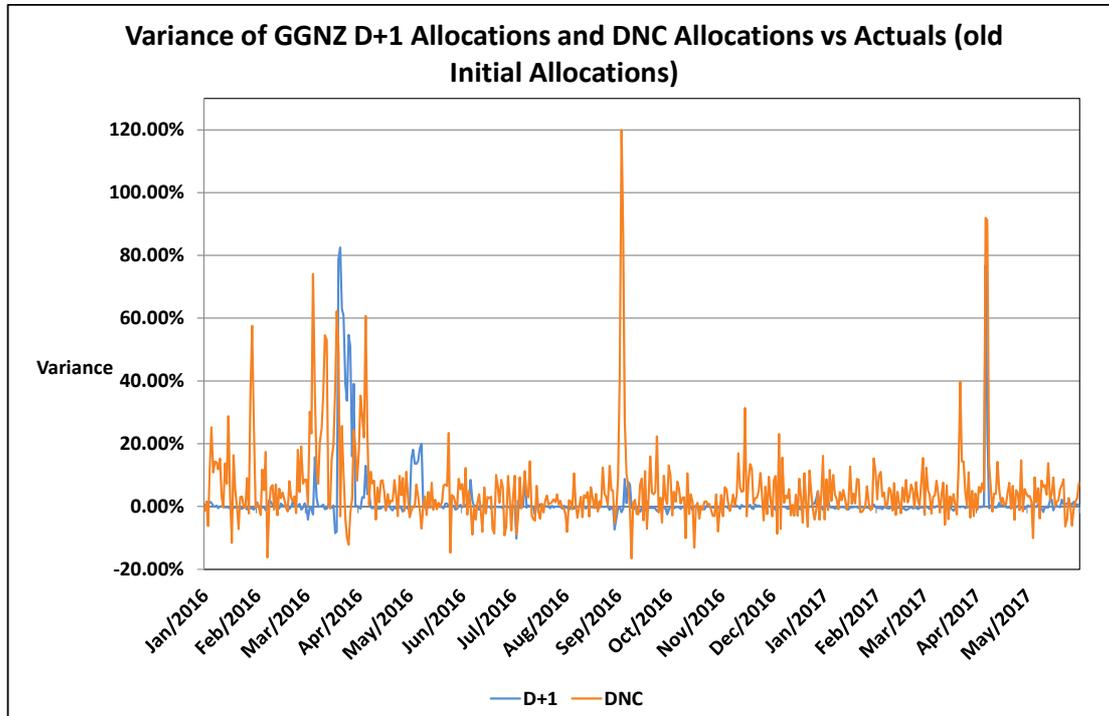
- The one allocation model proposed in the detail of the draft GTAC for shared Delivery Points is problematic.
- We understand that an outcome from the 14 June 2017 DAWG meeting is to consider further steps and that action points are with the GIC to scope different allocation options.

To elaborate:

1) Problematic Pro-Rated DNC Allocation Model

Following the May workshop we hypothesised that the allocation model proposed in section 5.16 of the draft GTAC would be more inaccurate than the D+1 model, based on the premise that we would be exposed to mass market swing to which we are not currently exposed.

We modelled this for 2016 and 2017 (to May) following this process: assuming our DNC to be the week-ahead shipper nominations, and assuming industry DNC to be the sum of relevant gas gates in current BPP pools plus or minus the change in ROI on a day (a proxy for DNC accuracy). Not perfect, but something to work with. The results, at aggregate level, are below:



Aside from the early blue spikes (teething issues with D+1 that were subsequently addressed), the conclusions and inferences are:

- Our old actual initial allocations are better than the current D+1 allocations, materially so on some days, but while there are daily cash-outs we continue to value this timeliness at the expense of a little inaccuracy and risk.
- We consider that the DNC allocation model is problematic. Not only would the volume of \$s and GJs going through wash-up processes be too high, but it would also impact on other areas of the business such as prudential requirements, cash flow and the short-term physical sourcing or putting of gas.
- Even with intra-day nominations, it is unlikely that the orange line will be close enough to the blue line. The only way to test this for certain is to run a real-time trial period.

D+1 is okay, if there is a fundamental need for it, and if it is made robust – otherwise monthly allocations will suffice. If an alternative to daily allocations is required then the relevant factors are:

- Cost: could be marginally better or worse than D+1.
- Timeliness: could be marginally improved, but only by a number of hours.
- Accuracy: could be marginally improved, but has major downside risk for one or a number of shippers.

2) Other Options and Subsequent Steps

Greymouth Gas has previously argued / established that it will be difficult, if not impossible, for GIC to continue to do special allocations post go-live of the GTAC for arrangements that, at that time, are still temporary in nature with either no end-date in sight or no consensus.

It is concerning to see First Gas, on page 26 of the paper, say the D+1 Agreement may need to be amended, replaced or incorporated within the downstream rules. If it is the best allocation model, we think it needs to be amended *and* incorporated within the *GTAC and* the downstream rules.

Allocations are complex. It might take significant time to work this through. And while it may be only a couple of clauses in the GTAC, they are key operative clauses.

3) If D+1 is Retained

Greymouth Gas has consistently said that if D+1 is retained in the new code, it needs to be made more robust up and down the supply chain. This includes:

- Formalising the business rules somewhere.
- Amending the downstream rules to replace the initial allocation process with the new methodology (rather than doing it via the special allocation process) and to progress any other related initiatives.
- Formalising / amending other supply chain contracts, such as with meter owners.

- Analysing the wash-up methodology (which would probably sit inside the GTAC), and analysing how the temporary arrangement has worked to date and renegotiate if required.
- Capping shippers' allocated balancing costs at its level of Running Mismatch.
- Codifying the position on corrections and data validation, and protecting shippers from unforeseen and uncontrollable shocks.
- Formalising Service Level Agreements with key parties, including the process and penalties for when data is not available.
- Capturing all AG1 and 2 data.

This is a long path and it could jeopardise First Gas' preferred go-live date of the GTAC.