

19 March 2018



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Dear Ian

Submission on the GIC's Preliminary Assessment of the GTAC

This is Vector Limited's (Vector) submission on the Gas Industry Company's (GIC) *Preliminary Assessment of Gas Transmission Access Code (GTAC)*, issued for consultation on 13 February 2018.

Vector welcomes the GIC's preliminary assessment that the GTAC, in its entirety and current form, is not materially better than the existing code arrangements for gas transmission access.

We agree with the GIC that while the GTAC is better than the status quo in many respects, and offers real benefits, there are areas of concern that degrade its effectiveness and mute incentives for efficient behaviour by pipeline users.

We set out below our responses to the consultation questions. It is our desire that this consultation will result in a GTAC that is more efficient, fairer, and better enables the use of gas.

No part of this submission is confidential. Vector's contact person for this consultation is:

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Yours sincerely
For and on behalf of Vector Limited

A handwritten signature in black ink, appearing to read "Luz Rose".

Luz Rose
Senior Regulatory Specialist

Questions

Preliminary Assessment of Gas Transmission Access Code (GTAC)

Submission prepared by: Vector (Contact: Anna.Carrick@vector.co.nz)

QUESTION	COMMENT
Q1: Do you have any comment on our approach to the analysis?	Vector is generally satisfied with the GIC's analytical approach in making its preliminary assessment of the GTAC.
Q2: Do you agree with our assessment of the GTAC gas transmission products?	<p>We generally agree with the GIC's assessment of the GTAC gas transmission products.</p> <p>We do, however, disagree with the GIC's view that the GTAC will result in increased administration costs. Our gas trading business estimates that likely reductions in administration costs will result in the payback of our investment in new IT systems in approximately 5 years (see our response to Q15).</p> <p>In light of expected (countervailing) increases in operational efficiency, the GIC's assessment on efficiency should be changed from a "moderate" to a "modest" deterioration.</p>
Q3: Do you agree with our assessment of the GTAC pricing arrangements?	<p>We generally agree with the GIC's assessment of the GTAC pricing arrangements.</p> <p>In relation to Daily Nominated Capacity (DNC) charges - Daily Overrun and Underrun Charges incentivise Shippers to make their Delivery Point/Zone nominations as accurate as possible. However, we share the GIC's concerns regarding the potential for imbalance in Daily Underrun and Overrun Charges that creates inefficiencies in Shippers' behaviours.</p> <p>The GIC has expressed concern about the level of incentive fees that are likely to be levied in uncongested Delivery Points/Zones. Given this, we are surprised that the GIC has not made any comments on the punitive nature of incentive fees, or the appropriate levels that should apply, at a Congested Delivery Point at times when there is no congestion.</p> <p>There is uncertainty around whether (or when) a Delivery Point is congested. The determination of whether a Delivery Point will be congested is normally made by First Gas by 30 June each year. We would be surprised if a Delivery Point will potentially or actually be congested every day of the year. We therefore question whether applying a 10 times incentive fee on days when there is a very low likelihood of congestion is efficient.</p>

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	<p>We continue to question why only a select few End-users should be subject to an Hourly Overrun Charge. That it is easier to identify the larger End-users to whom such a charge can be applied is, in our opinion, not a justifiable reason to apply the Hourly Overrun Charge only to those End-users.</p> <p>Under the Maui Pipeline Operating Code (MPOC), all parties are consistently exposed to peaking charges, which relate to the hourly over taking and over injection of gas (not capacity). The Vector Transmission Code (VTC) does not require this incentive. Under the GTAC, this incentive charge is not imposed fairly across all parties.</p> <p>In our opinion, these considerations should result in a change to the GIC's assessment on efficiency from a "moderate" to a "substantial" deterioration. In terms of fairness, the GIC's assessment should be changed from a "minor" to a "moderate" deterioration.</p>
<p>Q4: Do you agree with our assessment of the GTAC energy quantity determination?</p>	<p>We agree with the GIC's assessment of the GTAC energy quantity determination.</p>
<p>Q5: Do you agree with our assessment of the GTAC energy allocation arrangements?</p>	<p>We agree with the GIC's assessment of the GTAC energy allocation arrangements.</p> <p>We note, however, the significant piece of work that the GIC intends to undertake with industry participants to formalise the daily allocation processes both within the GTAC and the <i>Gas (Downstream Reconciliation) Rules 2008</i>.</p>
<p>Q6: Do you agree with our assessment of the GTAC balancing arrangements?</p>	<p>We generally agree with the GIC's assessment of the GTAC balancing arrangements.</p> <p>We share the GIC's concerns about the potential impact that a Park and Loan service may have if revenue from such a service lies outside First Gas' revenue cap.</p> <p>We are concerned about the discretion that First Gas will have over the setting of running mismatch tolerance. As stated in our submission on the GTAC, dated 22 January 2018, the methodology in the GTAC for allocating tolerance to Shippers has some serious flaws that will result in perverse outcomes:</p> <p>...a Shipper who purchases gas from a producer at a Receipt Point that is on OBA and then sells that gas to an End-user at a Delivery Point on OBA will be entitled to a share of tolerance for that gas sale. That Shipper will not be exposed to any mismatch risk due to both Receipt Point and Delivery</p>

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	<p>Points being on OBA. Further, the OBA parties will be entitled to tolerance as well; so, in effect, there will be a 'doubling up' of tolerance allocation.</p> <p>...In addition, by limiting the distribution of tolerance to DNC and OBA parties, Shippers supplying End-users on supplementary or interruptible agreements will get allocated no tolerance yet they take on the same imbalance risk that a Shipper nominating DNC does. Further to this, a buyer of gas from an Interconnected Party that is not on OBA who trades gas with another Shipper will get no allocation of tolerance, despite taking on the mismatch risk at the Receipt Point where the Interconnected Party injects the gas.</p> <p>As stated in our 22 January submission, tolerance should be used for unintended deviations between receipts and deliveries due to changes to End-users' demand.</p> <p>In relation to Excess Running Mismatch (ERM) fees, our view is that First Gas must remove itself from setting F_{NERM} and F_{PERM} to ensure there is an 'arm's length' treatment between Park and Loan fees, Excess Running Mismatch fees, and Excess Running Mismatch Tolerances. These fees all relate to access to pipeline flexibility, whether accessed intentionally or unintentionally, and are inter-related.</p> <p>As F_{NERM} and F_{PERM} are purported to be based on section 12.12(d) of the MPOC, we propose the straightforward solution of replicating the MPOC formula in the GTAC for "adjustment".</p> <p>Given the above concerns, the GTAC balancing arrangements, as assessed for efficiency, should have a stronger negative countervailing impact than the GIC's assessment (page 51 of the consultation paper - Criteria 1, 2 & 14).</p>
<p>Q7: Do you agree with our assessment of the GTAC curtailment arrangements?</p>	<p>We agree with the GIC's assessment of the GTAC curtailment arrangements.</p> <p>We share the GIC's concerns regarding a Shipper's compliance with an Operational Flow Order (OFO). A Shipper may take all the appropriate steps to comply with an OFO; however, it is the End-users who ultimately determine a Shipper's compliance. We think it is unfair to determine that a Shipper is not an RPO if it has taken all reasonable steps to comply with an OFO.</p>
<p>Q8: Do you agree with our assessment of the GTAC congestion management arrangements?</p>	<p>We generally agree with the GIC's assessment of the GTAC congestion management arrangements.</p> <p>We believe, however, that in addition to the design of auctions (including terms and conditions), further</p>

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	<p>development work is required on the concept of Priority Rights. That work should include the development of a clear definition of when a Delivery Point is congested.</p> <p>First Gas will normally determine that a Delivery Point is a "congested" Delivery Point by 30 June each year. Delivery Points that are determined to be "congested" are highly likely to become physically congested only during the peak winter months of the year. First Gas should therefore make determinations on congestion for specific months rather than for the whole year.</p>
<p>Q9: Do you agree with our assessment of the GTAC gas quality and odourisation arrangements?</p>	<p>We generally agree with the GIC's assessment of the GTAC gas quality and odourisation arrangements.</p> <p>Whilst we recognise that there are minimal differences between the MPOC/VTC and GTAC relating to odourisation requirements, a right to audit First Gas' processes and procedures would enable retailers to more fully comply with their requirements under the <i>Gas (Safety and Measurement) Regulations 2010</i>. In previous odourisation audits, retailers have been criticised for not auditing transmission and distribution network operators' odourisation measurement processes and procedures.</p> <p>Alternatively, First Gas could commit to commission an independent audit of its odourisation processes and procedures, say every five years. The results of these audits could be published on OATIS/the new IT system.</p> <p>We believe that the above proposal will not be contentious. Its adoption should enable the GIC to amend its assessment from "neutral" to a "moderate" improvement.</p>
<p>Q10: Do you agree with our assessment of the GTAC governance arrangements?</p>	<p>We generally agree with the GIC's assessment of the GTAC governance arrangements.</p> <p>Whilst we accept that the code change process under the GTAC is a significant improvement on the MPOC process, we do not agree with the GIC's assessment that the GTAC is an improvement on the VTC. The GTAC is a commercial, contractual arrangement. As such, decisions on code change requests should remain with the GTAC signatories, to the extent possible. The GTAC signatories, after all, are the parties bound by the terms and conditions of the code.</p> <p>We agree with the GIC's assessment that the provisions on liabilities in the GTAC will have a negative impact on Shippers.</p>

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	<p>In our opinion, the above considerations should result in a change to the GIC's assessment on efficiency from a "moderate" to a "substantial" deterioration.</p>
<p>Q11: Do you agree with our top-down analysis?</p>	<p>We agree with the areas identified by the GIC that are causing concern. The current liability arrangements in the GTAC particularly create a significant barrier to the GTAC being determined to be materially better than the current code arrangements.</p> <p>We agree that Interconnection Agreements (ICAs) must be negotiated and signed prior to the GTAC going live.</p> <p>We share the GIC's concerns regarding how the proposed Park and Loan service will be operated and priced.</p>
<p>Q12: Do you agree with our overall assessment?</p>	<p>We generally agree with the GIC's overall assessment of the GTAC.</p> <p>We agree with the GIC that the GTAC is better than the status quo in many respects, and offers real benefits. However, in its entirety and current form, it is not materially better than the current code arrangements for the reasons stated above.</p>
<p>Q13: Do you agree that with our analysis of ICAs?</p>	<p>We agree with the GIC's analysis of ICAs.</p> <p>We prefer the arrangement whereby the GTAC is focused on the transportation/shipping of gas on the transmission pipeline, and ICAs are separately agreed with Interconnected Parties.</p> <p>ICAs should be negotiated with all Interconnected Parties, including the distribution network operators prior to the GTAC commencement date.</p> <p>In our opinion, the GTAC cannot and should not be implemented until ICAs with all relevant Interconnected Parties are signed.</p>
<p>Q14: Do you agree with our analysis of SAs?</p>	<p>We disagree with the GIC's assessment that there are no benefits from Supplementary Agreements (SAs) also being made available for the Maui Pipeline.</p>
<p>Q15: Do you agree with our analysis of nominations?</p>	<p>Whilst we are in general agreement with the GIC's conclusion on nominations, there are aspects of the GIC's rationale that we do not agree with.</p>

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	<p>For the following reasons, we would have expected the GIC's assessment to be more favourable to the GTAC than it currently is. We believe that nomination workload does not increase for Shippers that serve TOU customers, which will account for approximately 90% of system load.</p> <p>We do not agree with the notion that there would be "increased workload overall, with associated increased costs". We expect all Shippers to be currently forecasting at an ICP level for TOU customers to manage gas purchase requirements, and manage reserved capacity on the non-Maui system.</p> <p>In our experience, forecasting at aggregate levels for TOU customers is troublesome when ICPs are switched in and out. What we are suggesting is, whilst on the surface it may look like just an Oaonui to Rotowaro nomination, behind the Rotowaro number will be detailed forecasts at an ICP level aggregating to a Rotowaro quantity. Whether a system upload involves one line or ten, it makes no difference whatsoever to the workload.</p> <p>Furthermore, the GTAC completely removes capacity reservations, replacing it with DNC which (if incentives were balanced correctly) would require the same nomination that is used to determine gas purchase requirements. So, we expect to see a reduction in nomination workload and costs.</p> <p>When looking at the non-TOU customer base, there is some merit in shifting the forecasting obligation onto the transmission system operator. We question why First Gas has not offered some form of common carriage option for mass market Shippers, the price of which would reflect the flexibility and security associated with this type of arrangement. The DNC arrangements are not as well suited for Shippers of non-TOU customers compared to Shippers of TOU customers.</p>
<p>Q16: Do you agree with our analysis of daily overrun and underrun charges?</p>	<p>We agree with the GIC's analysis of Daily Overrun and Underrun Charges.</p> <p>It was our understanding that the purpose of including a Daily Underrun Charge was to maintain a balanced incentive to nominate expected gas use. The GIC's analysis, which we agree with, demonstrates that it is not balanced. As such, in its current form, this charge does not achieve its intended purpose.</p> <p>We agree with the GIC's assessment that the magnitude of incentive fees is greater under GTAC. As the incentive charges are credited back to parties (see our response to Q21), and benefits of improved nominations are not really known, it is difficult to say whether this is better or worse.</p>

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	<p>Addressing the unbalanced incentives by adjusting the Daily Underrun Charge formula to "F-2" instead of "F-1" would seem to be a logical way to deal with the issues raised by the GIC.</p>
<p>Q17: Do you agree with our analysis of hourly quantities?</p>	<p>We agree with the GIC's analysis of hourly quantities.</p> <p>In our view, further analysis is required on Hourly Overrun Charges, which are incurred by only a limited number of parties.</p> <p>Currently, there are 17 parties on the Maui Pipeline that are charged for peaking. This number could be reduced to potentially 4 parties, and if Supplementary Agreements were offered to some of these parties, that number could be reduced further. The costs of operating to avoid Hourly Overrun Charges for the limited number of parties charged, and Shippers who supply them, would be significant.</p> <p>The removal of Hourly Overrun Charges would reduce the complexity of the GTAC, and remove the requirement for Agreed Hourly Profiles (AHPs).</p>
<p>Q18: Do you agree with our analysis of liabilities? In particular, do you have any particular comments on whether the proposed liability arrangements in relation to the injection of Non-Specification Gas better meet the efficiency, reliability and fairness objectives when compared to the MPOC and the VTC?</p>	<p>We strongly agree with the GIC's analysis of liabilities.</p> <p>Efficiency: we agree that an efficient set of liability arrangements must be legally robust and certain in order to minimise the risk of disputes. The GTAC does not achieve this when compared to the VTC and MPOC.</p> <p>The GIC also raises a very useful point about the GTAC having no equivalent to the incentives pool or balancing and peaking pool. On reflection, this is a very clear and useful mechanism that gives a user the ability to efficiently claim against a wrongdoer if the user is unable to take its gas. This is another example of the GTAC lacking clarity on remedies for its users.</p> <p>Our view is that where a user is unable to take its gas because of another's actions, GTAC must clearly set out a process for recovery whether by way of access to a monetary pool or otherwise.</p> <p>Reliability: we agree that the GTAC falls short of the clear contractual chain provided for in the VTC and MPOC, and that this uncertainty could have a negative impact on reliability.</p> <p>Fairness: we agree that the GTAC's proposed allocation of risk is not as fair as the VTC and MPOC. First Gas owns, controls, and operates the transmission system and must</p>

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	<p>stand behind this. First Gas cannot take all the benefits of operator responsibility without also assuming the risks.</p> <p>The GIC acknowledges that the subrogation provisions are a step in the right direction in terms of fairness (see page 77 of the consultation document), but we note that these sub-optimal rights have only been offered by First Gas following its abandonment of the back-to-back indemnities.</p>
<p>Q19: Given that the current, tighter, drafting in the MPOC still results in excursions outside of the 42-48 bar gauge range, what is your view of the revised drafting under the GTAC?</p>	<p>We have no firm view on the current or proposed drafting about excursions outside of the 42-28 bar gauge.</p>
<p>Q20: Do you agree that comparing the ERM charges with bid/ask spreads is a sound method for testing the appropriateness of the quantum of those ERM charges? If not, what would be a more appropriate comparator?</p>	<p>Whilst it is useful to look at recent bid/ask spreads for comparison purposes, care needs to be taken in extrapolating historical behaviour and choosing what spreads to use (i.e. market closing time).</p> <p>We believe the relevance of reviewing ERM charges lies in its comparison with the current Market-Based Balancing (MBB) under MPOC, the implementation and refinement of which required a considerable amount of industry participants' time. Despite MPOC cash-outs changing title and GTAC not, within the MPOC mechanism there are built-in incentives on either side of the market price that could be used.</p> <p>We believe the GIC's analysis could have gone further to look at the appropriateness of a fixed fee <i>vs</i> a variable fee (as is the case in MBB), and whether the asymmetric nature of ERM charges is warranted. In addition, the possibility of any unintended consequences could have been examined and possible solutions explored, such as incentivising parties to act towards incurring a positive running mismatch.</p> <p>The analysis did not seem to consider that failure by Shippers to take actions to return Running Mismatch to 'within tolerance' levels will result in ERM charges being applied repeatedly to the excess gas position. This is quite different to gas title changing hands with cash-outs that mean you can only incur the cost once for the excess gas.</p>
<p>Q21: Do you agree with our analysis of the incentive charge rebates?</p>	<p>In our view, the GIC's analysis shows that revenue from incentive fees gets recycled immediately to Shippers, and Shippers who nominate more accurately will pay a lesser</p>

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	<p>proportion of incentive fees relative to what they pay in capacity charges.</p> <p>We do not agree with the assessment that smaller Shippers face a higher marginal cost. In the GIC's example, what is not recognised is that for the small Shipper to have the same incentive cost increase as the large Shipper, the small Shipper had to have been 90% more inaccurate in its nominations than the large Shipper (with inaccuracy represented by the proportion of incentive fees to capacity charges). All we think this demonstrates is that the more accurate you make your nominations, the less incentive fees you will pay.</p> <p>What we believe has not been assessed is whether the rebates are equitable in terms of who pays First Gas and who is eligible for rebates from First Gas. Understanding this is complicated by a lack of clarity on whether DNC can exist in existing or new SAs.</p>
<p>Q22: Do you agree with our analysis of First Gas' discretion?</p>	<p>We generally agree with the GIC's analysis of First Gas' discretion.</p> <p>We agree with the GIC's assessment regarding the discretion First Gas will have should Park and Loan revenues sit outside its revenue cap.</p> <p>In our opinion, Park and Loan should be removed from the GTAC until this concept is fully developed.</p> <p>We disagree with the GIC's assessment regarding the discretion First Gas will have relating to ERM charges. We are concerned about the unintended consequences of First Gas changing ERM charges and its inter-relationship with gas bought and sold on emsTradepoint.</p> <p>The MPOC and (by its pass-through nature) the VTC base MBB charges on a market price plus or minus an adjustment, which incentivises Shippers to not rely on cash-outs as a mechanism for providing flexibility. This incentive is weakened under First Gas' proposal of a fixed charge for using pipeline flexibility.</p>
<p>Q23: Do you agree with our analysis of public information disclosure?</p>	<p>We agree with the GIC's analysis of public information disclosure.</p>
<p>Q24: How far away from the materially better standard do you think we are?</p>	<p>Given the GIC's assessment, we strongly believe that the GTAC can be amended to make it materially better. In our opinion, however, there are critical issues that First Gas must</p>

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<p>For example, do you think we need to fundamentally re-work the access products and concepts; significantly re-work a few items and adjust a range of other items; adjust a range of items; or adjust a few key items?</p>	<p>address before that assessment can be made. These include:</p> <ul style="list-style-type: none"> • the liability arrangements currently proposed within the GTAC itself; • tolerances and ERM charges used in balancing; and • negotiation of the ICAs with Interconnected Parties. <p>As a minimum, we recommend that First Gas reinstate the liability rights that Shippers currently hold under the VTC and MPOC. Specifically, we would like to see the reinstatement of Shippers’ rights with regards to back-to-back indemnities.</p> <p>We believe there needs to be a focus on the balancing arrangements to ensure that tools available are fair across parties accessing pipeline flexibility, and that the incentive fees do not have unintended consequences.</p> <p>As stated in our response to Q13, we do not believe that the GTAC can be implemented until all the ICAs with Interconnected Parties are negotiated and agreed. We recommend that First Gas make a commitment to the industry that the GTAC will not be implemented until all the relevant ICAs are signed.</p> <p>We recommend that the Park and Loan service be removed from the GTAC until this concept is fully developed. We are interested in this concept, as proposed by First Gas, but believe that in its unfinished state, it is a distraction to the adoption of the GTAC.</p> <p>Finally, with regards to the GIC’s concerns over the nature and size of incentives charges, we initially suggest that the Daily Underrun Charge formula be adjusted to “F-2” to correct the unbalanced incentives, as detailed in our response to Q16. If the quantum of incentive fees still creates concerns, then the number of Delivery Zones could be reduced to allow greater offsetting of underruns and overruns.</p> <p>We recommend that First Gas focus on key issues and the second-order issues identified above that have significant impact on the operational workability of the GTAC.</p> <p>We prefer the discussion and resolution of issues one at a time over a 6-month period, rather than discussing multiple issues at every workshop. While First Gas and industry participants have been discussing the GTAC for a considerable period of time, the point from which the first draft of the code was released until the Final GTAC was submitted by First Gas to the GIC for assessment only spanned 4 months – from August to December 2017. This is a very short period of time by any measure for such a significant, new code.</p>

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<p>How long do you think it will take to re-engage and achieve materially better? For example, a similar amount of time as spent so far (August 2016 to November 2017); about half as much time as spent to date; six months; or three months? Do you have any views on an appropriate go-live date for the new code, given the other steps involved (GIC assessment and IT implementation)?</p> <p>Q25:</p>	<p>If First Gas is prepared to address and compromise on the issues the GIC has identified to be the main barriers to the GTAC becoming materially better, then we believe that re-engagements can be completed within 6 months, and the GTAC can be approved within a further 3 months.</p> <p>From our perspective, we cannot emphasise strongly enough the need to resolve the liability issues within the GTAC.</p> <p>Given First Gas has advised that the new IT system requires a minimum lead time of 9 months, plus the potential for the GTAC approval process to take up to a minimum of 3 months, we would be looking at a GTAC commencement date of 1 October 2019.</p>
<p>Do you have any preferences on how the process should be run from here on in? For example, in terms of the pathways shown in the decision tree above, should we revise and consult on the GTAC to address the reasons the GIC concluded it is not materially better, should we discontinue the process, or should we start from a blank sheet of paper? Should we use workshops like we have previously; focused work group sessions; one-on-one discussions; or a mix of the above?</p> <p>Q26:</p>	<p>Given the significant progress that has been made in the development of the GTAC, to date, our preference is to continue with the current workshop process.</p> <p>We would, however, recommend that the re-engagement process be made less intense than the 4-month consultation processes on the draft GTAC from August to December last year.</p> <p>As indicated in our response to Q24, we recommend that the workshops be focused on specific issues, with the critical issues such as liabilities taking priority in the scheduling of workshops. We support the proposed use of an independent facilitator for these workshops.</p>