

Gas transmission access code – governance options

April 2017



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Concept has undertaken a wide range of assignments, including market development, market analysis, technical evaluations, regulatory and policy analysis, and project management.

Preparation of this report

This report was finalised in April 2017.

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1 What this paper is about

1.1 Purpose

Gas Industry Co Ltd (Gas Industry Co) is currently working with First Gas Ltd (First Gas) and stakeholders to develop a new single gas transmission access code (GTAC) for New Zealand. This code would replace the existing Maui Pipeline Operating Code (MPOC) and the Vector Transmission Code (VTC). The target 'go live' date for the GTAC is October 2018.

As a potential input to the development process, Gas Industry Co asked Concept to develop a 'think piece' on governance issues. This report responds to that request and sets out Concept's views on the key issues that should be considered in designing governance arrangements.

This paper should not be construed as representing the view of any other organisation, including Gas Industry Co or First Gas.

1.2 What we mean by governance

In this paper, the term 'governance' means the provisions in a transmission code that determine how the code itself can be modified over time. Arguably, the design of code enforcement or dispute resolution arrangements could also fall under the governance heading. Similarly, the process for bringing a code into force might be considered a governance issue. However, these issues are not considered within this paper, and we focus instead on the processes for amending the code once it has been established.

1.3 Objective of code amendment process

A transmission access code cannot remain frozen in time. The gas sector will continue to evolve, and this will likely prompt a need to modify the code in the future. Similarly, modifications may be desirable to address issues that were not identified when the code was drafted.

We think the overall objective of the code change process should be to promote timely and efficient improvement to the code. As we discuss later, this objective should guide the design of the code amendment process.

1.4 Code amendment process has three key elements

We think it is useful to separate the code amendment process into three elements:

1. Initiation – how does a potential code change get initiated?
2. Consultation and refinement – what process is applied to share information about a code change proposal and allow for its evolution to the point of final decision?
3. Decision – once a proposal has been crystallised into a final form, what is the process for deciding whether it will take effect?

The following chapters discuss each of these elements. While all are important, we focus especially on the final decision element, because the governance design in this area has the greatest practical impact on outcomes.

The final chapter discusses some broader issues, such as whether arrangements should provide for urgent code changes.

A summary of the existing code change processes for the MPOC and VTC is included in Appendix A.

2 Initiation of code change proposals

This chapter discusses the process for initiating code changes. We briefly describe the current MPOC and VTC provisions (summarised in Appendix A). We then consider the principles that should guide design in this area, and set out our recommendation.

2.1 MPOC provisions

A code change can be proposed by any party to the MPOC (i.e. shippers, interconnected parties and the Transmission Services Provider (TSP)). A proposed amendment cannot be progressed unless proposers have first discussed their proposal with the TSP in good faith, with a view to finding a mutually satisfactory proposal.

2.2 VTC provisions

A code change can be proposed by any party to the VTC (i.e. shippers and the TSP). Proposers must publish a Change Request Notification summarising the change, why it is necessary and what its effect is likely to be.

2.3 Initiation of code change proposals – key design issues

We think the primary goal of the initiation phase should be to ensure that potentially worthwhile proposals can get onto the table. The most likely source for such proposals will be the persons affected by the code. At a minimum, the process should therefore provide for any ‘contractual party’¹ to propose code changes.

However, the transmission access code will also affect parties that do not have a current contractual relationship with a TSP that reference the GTAC. A range of parties fall into this category including:

- gas producers
- gas consumers – both those directly connected to the transmission system and others
- market operators
- service providers such as metering or data providers
- prospective shippers, gas consumers and producers

While these parties may not have a contractual relationship with the TSP, they may still be directly affected by code terms. For example, shippers may require their consumers to assume code obligations via back-to-back provisions in their gas supply agreements. Similarly, prospective shippers or interconnected parties will become bound by code terms if they enter the sector.

Each of these persons can claim a legitimate interest in the parts of the code that affect them. However, the strength of those claims will clearly depend on the circumstances. Some persons could be very heavily affected by code provisions, while impacts could be minor for others.

Widening the pool of persons with ability to propose code changes also has some drawbacks. In particular, it increases the likelihood of code changes being proposed that are manifestly ill-conceived, frivolous or

¹ By which we mean parties bound to the code via a transmission service contract.

vexatious in nature. Processing such proposals would consume time and resource, unless there was some filtering process at the outset to reject them.

As a possible source of guidance, we have considered the practices adopted in other broadly similar contexts. Two electricity codes that preceded current regulated arrangements both allowed for any persons directly bound by code provisions to propose amendments.² This included participant types and service provider functions specifically named in the codes. No provision was made for other persons to propose code amendments.

As we discuss in section 4.3, in Australia, Great Britain and the United States, gas transmission access terms for ‘covered’³ pipelines/services generally require the ultimate approval of an independent regulator. While these regimes typically allow any person to make submissions to regulatory bodies, such bodies presumably put more weight on submissions from persons directly affected by possible changes.

Overall, these examples do not provide strong guidance on where to draw the boundary on proposer rights. Instead, it is necessary to weigh up the risk of excluding persons with a reasonable interest, versus expanding coverage to persons who are more likely to impose transaction costs via manifestly ill-conceived, frivolous or vexatious change proposals.

From a practical perspective, we identify three broad options for conferring proposal rights:

1. parties directly bound by code terms via transmission service or interconnection agreements – including the TSP itself
2. those in (1) plus gas users and gas market operators
3. any person (i.e. the wider public).

For the reasons noted earlier, we believe Option 1 would be too narrow.

Option 2 would expand the right to propose changes to include gas users and gas market operators. Gas users have a prima facie case for proposal rights in our view, as they ultimately meet the costs imposed by the code. Having said that, it could be argued that some minimum size threshold should apply for proposal rights – given that smaller consumers (such as residential users) are arguably less directly affected by the code. However, even though an individual gas consumer may have small usage, it may represent a group with material usage in aggregate.

We also see a reasonable case for allowing gas market operators to propose changes. Such operators may be significantly affected by code provisions, via agreements they have with shippers and/or other parties, since the gas transmission system provides the physical underpinning for gas markets.⁴

² These codes were the ‘New Zealand Electricity Market Rules’ and the ‘Metering and Reconciliation Information Agreement’. There was a third code that dealt with common quality issues. We have been unable to determine whether persons other than those directly bound by the code had proposal rights.

³ We use this term to refer to pipelines subject to economic regulation in the form of price or revenue caps and quality measures (Australia, Great Britain), and/or open access arrangements (United States).

⁴ As noted earlier, they may also be contracting directly with the TSP.

A similar argument could be used to include other service providers, such as metering service providers and data aggregators. However, we are less inclined to specifically include these parties. If a concern were to arise about code metering standards etc., we think it likely that shippers or gas users would propose a code change.

Option 3 would allow any person to propose a code change. It therefore has the least risk of excluding a person with a legitimate interest from proposing a change. However, there is a possibility that it will encourage frivolous changes from persons with no genuine interest in the gas sector. Although we do not regard this as likely, if such proposals were lodged they would cause transaction costs to the industry and (ultimately) gas consumers.

On balance, we favour Option 2. It should ensure that any person genuinely affected by the code is able to propose a change (either directly or via (say) a gas user). We think the risk of creating undue transaction costs is relatively low. A key reason is that (as discussed in the next chapter), proposers would remain responsible for their proposals beyond the initiation stage. Among other matters, proposers would be responsible for evolving their proposals from initial summary form, identifying impacts on other persons, and submitting the detail of marked-up code changes for final decision-making. These requirements are likely to naturally filter out any persons that do not have a genuine interest in code improvement.

Finally, if final decision-making rights reside with an independent body (as recommended in Chapter 4), we believe that body should *not* be able to directly propose any code changes.

In our view, being able to both propose and approve changes would place too much power with one entity. The independent body could come to see itself as the code 'author', rather than having a more specific role that requires it to work in concert with stakeholders. There is also a risk that industry participants would see lobbying of the independent entity as the best means to obtain code changes, rather than engaging with other stakeholders in a consultative process.

2.4 Initiation of code change proposals – recommendation

We recommend that the following parties be permitted to propose changes to the code:

1. any person that is bound by code terms via transmission service or interconnection agreements including the TSP itself
2. gas users
3. gas market operators.

3 Consultation and refinement of code change proposals

This chapter discusses the process for consulting on, and refining, a proposed code change. We start by briefly describing the current MPOC and VTC provisions. We then consider the principles that should guide design in this area, and set out our recommendation.

3.1 MPOC provisions

The process for amending the MPOC is defined in the code itself, with further detail in a memorandum of understanding between First Gas (previously Maui Development Ltd) and Gas Industry Co.

A proposed MPOC amendment cannot be progressed unless proposers have first discussed their proposal with the TSP in good faith, with a view to finding a mutually satisfactory proposal. Proposers then submit Change Requests to Gas Industry Co using a standard form. This form requires the proposer to submit information on:

- precise and complete details of the proposed amendment (in effect marked-up changes)
- reasons for the amendment
- an assessment of the effects of the amendment on MPOC counterparties and the pipeline operation
- an assessment of how the amendment relates to various existing code provisions, government policy or other relevant objectives
- whether the change is supported by the TSP
- the costs and benefits to the TSP, other parties to the code and industry participants
- how the change complies with the Commerce Act and other legal requirements.

Within 15 business days of receiving the Change Request, Gas Industry Co will advise the proposer if any other information is required and what consultation process and timetable will be followed. In practice this has tended to occur within a few days of receiving the Change Request.

Gas Industry Co will then post the Change Request and details of the consultation process on its website and call for submissions from stakeholders. In practice, around three weeks is allowed for submissions. Depending on the content of the submissions, cross-submissions may also be called for, although this has only happened very occasionally.

Once Gas Industry Co has analysed the Change Request and the submissions, it will publish a Draft Recommendation and again call for submissions from stakeholders. Between two and six weeks will be allowed, depending on the complexity of the issues. Cross submissions may occur.

If Gas Industry Co considers that the final recommendation is fundamentally different to its draft recommendation, it shall invite further submissions and (if Gas Industry Co considers it necessary or appropriate) cross-submissions.

3.2 VTC provisions

The proposer of a change publishes a Change Request Notification summarising the change, why it is necessary and what its effect is likely to be.

Within 15 business days after publication of a proposed change, the TSP, shippers and other stakeholders (including Gas Industry Co) may publish responses stating whether or not they support in principle the proposed change.

Within a further 10 business days, the proposer can then issue a Draft Change Request including a version of the VTC showing the proposed change.

For 15 business days after publishing the proposed wording, the TSP and shippers consult on the variation. The TSP or a shipper may publish a response to the Draft Change Request stating whether it supports the proposed change in principle, any specific objections to it and any conditions to its support. Gas Industry Co or any other stakeholder may also publish a response setting out its views on the proposed changes.

Within five business days after the consultation period, the issuer of the Draft Change Request may issue a Final Change Request including a summary of the proposed change (including the reasons for, and effect of, the change), a response to any substantive specific objections raised on the Draft Change Request, and an amended version of the code showing the proposed change in track changes.

3.3 Consultation and refinement of code change proposals – key design issues

We think the consultation and refinement phase should be directed at the achieving the following:

- filtering initial proposals to ensure they are sufficiently clear
- providing stakeholders with an opportunity to have input into draft proposals, so they can be refined and improved prior to a formal decision
- providing stakeholders with an opportunity to consider final proposals, and communicate their views to decision makers prior to the formal determination on whether the code change will occur.

The existing codes address each of these issues, but in different ways and to varying degrees.

The MPOC process places strong emphasis on the front-end, with an expectation that proposals will be submitted in a fully formed state. This is reflected in the requirement for proposers to consult with the TSP, set out specific marked-up changes to the code, and provide detailed supporting material (assessments of effects, costs and benefits, legal implications etc.).

Consultation with other stakeholders is required in the MPOC process, but is directed at informing decision makers about whether a proposal should be implemented – rather than refining the form of any draft proposal. The MPOC process does not preclude engagement with stakeholders to refine a proposal, but that would need to occur before a proposal is initiated and is at the discretion of a proposer. Alternatively, a proposer might withdraw a change request following feedback from stakeholders, but any modification to the proposal would require a restart of the entire process.

The VTC process places less emphasis on the initial proposal. It requires that a proposer submit a summary of a proposed change, along with reasons and expected effects. This step triggers a process of stakeholder engagement and refinement, which can lead to a final request that includes the marked-up code change. The VTC process therefore explicitly provides for change proposals to evolve in light of stakeholder input before they are submitted for final decision.

We prefer the evolutionary approach for the following reasons:

- final change proposals are likely to be more robust with lower risk of unexpected consequences where they reflect input from multiple stakeholders
- allowing proposals to evolve post-initiation should increase the level of stakeholder buy-in for code changes. The alternative approach carries a greater likelihood of polarising stakeholder views, as outcomes must be binary in nature
- allowing proposers to submit change proposals in summary form should avoid creating an undue barrier for participation by less well-resourced parties
- an evolutionary approach reduces the scope for strategic behaviour by proposers, such as bundling a controversial measure with more popular but unrelated measures
- an evolutionary approach may provide a more streamlined overall process, with less likelihood of having to restart a process from the first step.

An important aspect of this process is that the proposer retains authorship of their proposal. We think this encourages those persons with genuine interest in a code amendment to sponsor a change. Equally importantly, it should act as a filter to deter any person with little real interest in developing up a proposal to the point where it can be lodged with the final decision-maker.

For completeness, we have considered whether the arrangements should provide for an entity (such as Gas Industry Co or the TSP) to filter out proposals at the start if they are judged to be manifestly ill-conceived, frivolous or vexatious. While the goal of this additional safeguard is reasonable, we think it has the risk of unduly centralising power over code changes, and that it should not be necessary if proposers are required to carry the sponsorship of their proposals to the point of final decision.

Overall, we favour a VTC-like process for consultation and refinement of code change proposals. That process should define the steps and timeframes that relevant parties need to follow. The timeframes should allow sufficient time for parties to provide and consider feedback on proposals, while also minimising the scope for undue delays.

Although we have not examined the VTC timeframes in detail, they appear reasonable in broad terms. In addition, as discussed in Chapter 5, we recommend that specific separate provision be made for urgent code changes.

3.4 Consultation and refinement of code change proposals – recommendation

We favour a VTC-like process that allows for code change proposals to evolve post-initiation. Key features include:

- proposals are initially submitted in high level form, summarising the proposal, why it is necessary and what its effect is likely to be
- other stakeholders can provide feedback on the high level proposal
- the proposer prepares a final proposal setting out the change in detail after receiving stakeholder feedback.

4 Decisions on code change proposals

This chapter discusses the process for deciding whether a proposed code change should take effect. We start by briefly describing the current MPOC and VTC provisions. We then consider the principles that should guide design in this area, and set out our recommendation.

4.1 MPOC provisions

Once Gas Industry Co has analysed a Change Request and submissions, it publishes a Draft Recommendation and calls for submissions. Cross submissions may also be requested. Gas Industry Co then makes a final decision on whether to support the Change Request.

The Change Request will become binding provided:

- Gas Industry Co supports the Change Request in its final decision, and
- the TSP gives written consent to the Change Request, noting such consent cannot be unreasonably withheld or delayed – for example, consent could be withheld if the TSP was required to incur costs that cannot be recovered.

4.2 VTC provisions

Within 15 business days after publication of a Final Change Request, the TSP and the shippers may publish their position and are deemed to consent if they don't do so.

The Final Change Request will become binding unless:

- 25% or more of the total number of shippers do not support the change (or at least two shippers if there are four or fewer shippers in total), and/or
- The TSP does not consent. TSP consent cannot be unreasonably withheld or delayed – for example, consent could be withheld if cost impacts cannot be recovered, or if the TSP reasonably believes any shipper has not acted in good faith in the change process.

4.3 Decisions on code change proposals – key design issues

The design objective should be to place authority with those who have the best information and incentives to make decisions that are in the wider interest (however that may be defined⁵). This should ensure that:

- code change proposals with expected net benefits will proceed
- code amendments with expected net costs will not proceed.

Arrangements should also seek to provide a predictable and consistent framework for decisions. This is important because many assets in the gas industry have relatively long lives. Predictability will help to avoid unnecessary risk. Finally, the decision-making process should avoid undue costs.

Against this backdrop, we consider vote-based approaches versus an independent decision maker.

⁵ In this context, the relevant benefits and costs of a proposal could be those accruing to the contractual parties to the code, or more broadly to New Zealand Inc.

Vote-based approach – strengths and weaknesses

In general, vote-based approaches will perform well where:

- individual stakeholders have broadly homogeneous interests and a clear common goal
- all persons with legitimate interests get to vote, and
- voting rights are allocated to stakeholders to reflect the size of their relative economic interests.

Under these conditions, vote-based approaches have the advantage of locating decision rights with the parties with the best access to information, and incentives to make robust decisions.

Common stock companies are an example where these conditions generally apply. Shareholders have a common goal of maximising a firm's value, and share in profits or losses in proportion to their stakes. Votes are allocated based on relative shareholdings. Accordingly, voting by shareholders, each pursuing their own self-interest, creates a decision-making structure that is typically well-aligned with the overall goal of maximising the firm's value. Furthermore, if voters have divergent views about how best to achieve the common goal, the view of those with the greatest economic stake will prevail.

The preconditions for robust vote-based approaches do not hold in the gas transmission code context. The first challenge involves the identification of the parties who should have votes. Clearly, existing shippers will be directly affected by most (if not all) code changes, and they have a clear interest in outcomes.

However, they are not the only type of person affected by the code. Other persons can also be significantly affected by a gas transmission code – even though they may not be bound by the majority of code provisions. These include:

- gas producers
- gas consumers – both those directly connected to the transmission system and others
- market operators
- service providers such as metering or data providers
- prospective shippers, gas consumers and producers.

As noted earlier, the terms of the access code may flow on to other parties via agreements with shippers etc. In making this observation, we are not downplaying the importance of shippers and the TSP as the participants most directly affected by code changes. However, we think it is vital to recognise that changes can affect others, and in some cases these impacts may be quite significant (such as for interconnected parties).

Allocating voting rights to any subset of affected parties will necessarily exclude other parties. Over time, that would increase the risk of code changes evolving to suit the interests of those selected parties that have voting rights at the expense of others. Conversely, some change proposals may only affect a subset of parties (such as shippers). Allowing all parties to vote on every proposal would also be less than ideal.

In principle, these issues might be addressed by creating a differentiated voting arrangement, where voting rights vary depending on the nature of a change proposal. This was the approach adopted in New

Zealand with electricity codes until 2003.⁶ However, those arrangements were relatively complex and attempts to unify and streamline them ultimately foundered, largely due to disagreements about how voting rights should be modified under a proposed unified code. We also think that the costs and complexity of such an arrangement would not be justified in a gas transmission context.

Even if it were possible to readily identify affected parties (and hence voters), it would be challenging to allocate voting power to each person in a robust manner. A single vote per person ignores the reality that economic stakes can vary greatly across parties. It increases the likelihood that code changes will unduly favour smaller parties (assuming they are more numerous). Conversely, if votes reflect some measure of participant size (such as share of gas transport volume or charges), there is increased risk that code changes will unduly favour larger parties over time.

Although these might seem like academic concerns, experience from other codes shows that tensions between larger and smaller participants do arise in areas such as prudential security provisions, balancing tolerances and operating standards. Use of a voting structure to determine such issues will necessarily lead to outcomes that are quite sensitive to the allocation of voting rights.

Another key issue is where to set the bar for a vote to carry. A requirement for a bare majority may allow changes to be adopted that have marginal or no expected benefits. On the other hand, a higher threshold makes it harder for beneficial changes to come into effect. More generally, some evidence suggests that vote-based approaches are likely to be biased against innovation, because most innovations put some established interest at risk. This makes it harder to assemble a majority in favour of change – particularly where a super-majority is required.⁷

Experience in the New Zealand electricity sector also tends to support this view. After the electricity codes were established in the mid-1990s, there was relatively little evolution until they were replaced in 2003 by regulatory arrangements. Of course, stability also has benefits, but the fact remains that the electricity codes had difficulty in evolving to reflect technological changes occurring at the time, such as the increasing uptake of wind generation.

Independent decision maker – strengths and weaknesses

Relative to a vote-based approach, an independent decision maker is likely to face some information disadvantages. This is because much of the information about the effects of a proposed change will be held by participants. The decision maker will therefore be reliant to some extent on the provision of information by participants. In some cases, participants will not be motivated to provide the necessary information, and may even have incentives to skew their information provision.

On the other hand, a vote-based approach does not necessarily provide assurance that decision makers will be well-informed. Parties may still withhold or skew information provision if they think that will produce a vote that better suits their interest.

⁶ For example, the code governing the wholesale trading arrangements had a different voting structure to that governing trading at the retail level.

⁷ Michaels Robert J., *The Governance of Transmission Operators*, Energy Law Journal 1999, vol 20:233

More generally, the information disadvantage faced by an independent decision maker can partially be addressed through the arrangements for consultation and refinement of proposals. For example, the publication of submissions, potential to call for cross-submissions, and ability to undertake its own analysis will all contribute to a stronger information base for decision making. For these reasons, we think the theoretical information disadvantage faced by an independent decision maker relative to vote-based approaches is unlikely to be a major difference in practice.

Turning to the issue of incentives, we think an independent decision maker with a clear set of criteria to apply will perform better over time than a vote-based approach. The key reason for this view is that decision making criteria can be explicitly defined with an independent decision maker. The decision maker's performance in applying the criteria can also be judged over time.

In contrast, the vote-based approach relies on there being sufficient alignment between the self-interest of voters and the wider objectives (whatever that may be). As discussed in the previous section, we think this would be challenging to achieve in practice.

International experience – vote based approaches and independent decision makers

We have briefly reviewed the decision-making arrangements adopted in other jurisdictions for transmission access terms (for both gas and electricity). Although these jurisdictions differ from New Zealand in their scale, the underlying issues remain similar. In particular, stakeholders can affect each other because of the characteristics of gas and electricity networks. Participants may seek to push the recovery of fixed costs onto other parties, and may through their actions affect the quality of service experienced by others. Defining access terms therefore involves some degree of balancing the interests of different stakeholders.

The information from the review of other jurisdictions is summarized in

Table 1.⁸

⁸ The comments in the table focus on ‘major’ pipelines and electricity transmission lines. As is the case in New Zealand, access terms for ‘subsidiary’ pipelines and transmission networks may be determined by bilateral agreement between providers and users. It is important to note that access code issues are frequently bundled into broader regulatory arrangements in other jurisdictions – such as revenue cap arrangements.

Table 1: International practice in relation to decision making on transmission code changes

Code	Decision making arrangement	Comment
Gas transmission - Australia	Independent decision maker	Australian Energy Regulator (AER) approves access terms for covered transmission pipelines. ⁹
Electricity transmission – Australia	Independent decision maker	AER defines access terms for covered transmission networks.
Gas transmission – United States	Independent decision maker	Federal Energy Regulatory Commission (FERC) approves access terms for major (interstate) pipelines. ¹⁰
Electricity transmission – United States	Independent decision maker/voting	Access terms for some transmission lines defined directly by regulators – and in other cases by Independent System Operators subject to voting processes by stakeholders. Interstate arrangements remain subject to FERC oversight.
Gas transmission – Great Britain	Independent decision maker	Ofgem approves access terms for main gas transmission system as part of licensing regime and economic regulation framework. ¹¹
Electricity transmission – Great Britain	Independent decision maker	Ofgem approves access terms for the main electricity transmission system as part of licensing regime and economic regulation framework.

While the circumstances and details vary for each regime, with one partial exception the transmission access terms are determined by independent decision makers. The partial exception is electricity transmission in the United States, where access terms are subject to voting arrangements managed by an Independent System Operators (ISO) in some regions.

⁹ The AER approves access terms for covered (i.e. fully regulated) pipelines. In addition to setting tariffs, access arrangements must (among other matters) specify the reference services and their terms and conditions, the form of capacity trading arrangements, and the extension and expansion requirements. See National Gas Rules, Part 8, Rule 48, version 33.

¹⁰ Interstate pipeline companies, which can serve only as transporters of natural gas, are regulated by the FERC in the rates they charge, the access they offer to their pipelines, and the siting and construction of new pipelines. See www.iclg.com/practice-areas/oil-and-gas-regulation/oil-and-gas-regulation-2017/usa

¹¹ Gas transporter licence terms are approved by Ofgem. Among other matters, condition 4E in the licence requires that the national gas transporter offers transportation arrangements that are in conformity with the Network Code (also approved by Ofgem). Condition 4F requires the licensee to offer access in conformity with relevant UK legislation and EU directive.

However, even in these cases, arrangements ultimately remain subject to oversight by an independent decision maker, as ISOs must typically file proposed changes to their access arrangements with the Federal Energy Regulatory Commission (FERC).

An example is PJM, which covers parts of the mid-west and the mid-Atlantic seaboard of the United States. Votes are allocated to five classes of participant: generation owners, transmission owners, distributors, consumers and others. Each class has 20% of the total vote, and votes are distributed equally among the participants in a class. A two thirds majority of the overall votes cast is required for a proposed change to be advanced.

ISO structures have generally been successful in facilitating engagement and dialogue among diverse types of participants. However, the effectiveness of the voting arrangements for decision making is questionable. A recent study of PJM noted that the voting arrangements make it hard to advance proposed reforms.¹² The study also specifically noted the potential for relatively narrow sets of interests to be pivotal in a voting context, allowing a small group to block change. Arguably, this research bears out an earlier prediction that “an ISO is a political institution being called upon to do an economic job”.¹³

Independent decision maker expected to be more robust than vote-based decision making

Our conclusion is that the independent decision-maker model is preferable based on the factors discussed in the preceding section.

If an independent decision maker were to be utilised, it could be the Gas Industry Co, the Commerce Commission, a new body or the TSP. In our view, Gas Industry Co would qualify as being independent because of the provisions of the Gas Act.¹⁴ The enabling legislation also allows Gas Industry Co to fulfil this type of role, and it has experience and expertise in this area.

The Commerce Commission would also qualify as being independent, but does not undertake this type of function for any other industry codes. Furthermore, we think that legislative change would probably be required for it to perform that role.¹⁵

A new body is a further possibility. However, it could be difficult to access and retain people with appropriate expertise for a role that requires infrequent and unpredictable levels of activity. This option is also likely to be more costly than using an existing body.

The TSP is another possibility. It should be a well-informed decision maker and it should prefer to see the code evolve in a way that promotes the interest of pipeline users. However, despite these factors, the

¹² Yoo, Kyungjin, *Voting Behavior in PJM Regional Transmission Organization*, Pennsylvania State University, June 2016.

¹³ Michaels Robert J., *The Governance of Transmission Operators*, Energy Law Journal 1999, vol 20:233

¹⁴ Section 43ZL(2)(b) states that before making a recommendation to the Governor General to approve an industry body, the Minister must be satisfied that the constitution of the industry body requires the board of that body to have a majority of independent members, including an independent chairperson.

¹⁵ We are not aware of any enabling provisions that allow the Commerce Commission to make determinations about code change proposals in industry codes. Of course, it may be called upon to review a code under competition law, but that is a broader issue.

TSP does not qualify as an independent body in our view. For example, there is a risk that it may place too much weight on operational factors which could hinder code evolution over time.

In light of these factors, our view is that Gas Industry Co would be the preferred body to adopt as the independent decision maker.

Putting the identity of the decision maker to one side, we believe it would be important to define the criteria against which change requests should be assessed. Neither of the existing codes explicitly set out criteria for decision making.

In our view, the criteria should be sufficiently detailed to provide guidance to the decision maker about desired outcomes, but not prescribe how those outcomes should be achieved.

Section 43ZN of the Gas Act sets out objectives to guide the Gas Industry Co on any recommendations it makes regarding regulations. We think these can also be applied in the context of assessing proposed access code changes. The objectives are:

- a. the principal objective is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner; and
- b. the other objectives are—
 - i. the facilitation and promotion of the ongoing supply of gas to meet New Zealand’s energy needs, by providing access to essential infrastructure and competitive market arrangements:
 - ii. barriers to competition in the gas industry are minimised:
 - iii. incentives for investment in gas processing facilities, transmission, and distribution are maintained or enhanced:
 - iv. delivered gas costs and prices are subject to sustained downward pressure:
 - v. risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties:
 - vi. consistency with the Government’s gas safety regime is maintained.

Assuming Gas Industry Co is the independent decision maker, adopting these objectives should remove the potential for conflict to arise between Gas Industry Co’s decisions as code decision-maker and its statutory functions.

As a separate issue, Gas Industry Co could consider whether there is merit in providing further guidance about its decision-making procedures. For example, it might issue guidance on when it would utilise quantitative cost benefit analysis, or how it would expect to interpret aspects of the Gas Act objectives. While provision of such guidance may have merit, it is probably better considered in the context of Gas Industry Co’s broader responsibilities, rather than any code decision maker role.

We have also considered whether any Government Policy Statement (GPSs) issued under the Gas Act should also be included within the decision-making criteria. On balance, we do not favour such inclusion. We think it is unnecessary as the Gas Act’s principal objective provides clear guidance about desired outcomes – with further elaboration in the “other objectives”. In addition, we think it is important for the decision-making criteria to be relatively stable over time, and use of the Gas Act objectives would better achieve this.

Finally, the governance arrangements should set out the timeframes for the decision maker to adopt. In the interests of efficiency, we recommend that the 'standard' timeframe should provide for draft decisions to be issued within 25 business days of final proposals being lodged. After consultation on a draft decision (and possible cross submissions), a final decision should be issued within 15 business days. The arrangements should also provide a discretion for the decision maker to extend these timeframes by notice where it considers that additional time is required.

4.4 Decisions on code change proposals – recommendation

Based on the practical difficulties in designing a robust voting arrangement, we recommend that decision making should be placed with an independent body. We believe Gas Industry Co is the most suitable candidate for this role.

We also recommend that the governance arrangements provide explicit criteria for Gas Industry Co to apply when making decisions. We believe that the objectives in section 43ZN of the Gas Act are suitable for this purpose.

5 Other matters

This chapter comments on some matters that fall outside of the three elements in the code amendment process discussed in the previous chapter.

5.1 Urgent change provisions

The preceding chapters focussed on the processes that should apply for ‘normal’ code change proposals. These processes will necessarily take some time to apply, given the requirements for consultation. Circumstances may arise in which there is a need to make an urgent code change – for example to address some sudden and unforeseen physical change to the gas system.

To allow for urgent code changes, we recommend that the arrangements provide for code changes to be implemented without consultation if necessary to meet the code change criteria. We also recommend that such changes should automatically lapse after a defined period, unless they are ratified via the ‘normal’ change process. This provides a process safeguard against abuse of the urgent change provision, and ensures that all interested stakeholders will ultimately have an opportunity to submit on change proposals.

5.2 Manifestly uncontroversial code changes

A need may arise to make code amendments that are manifestly uncontroversial, such as to correct typographical errors, or to update references to external sources that change, such as legislation or industry standards. We think it reasonable to provide for such changes to be made without consultation to minimise costs.

We therefore recommend provision be made to allow uncontroversial code changes to be made with notification rather than consultation. However, if any person objects during the notification period, the change would not take effect, but would instead need to be considered via the normal process.

5.3 Administration of code change processes

A core feature of our recommendations is that proposers would retain authorship of their proposals until the point of final decision. We see this as being very important, and note that it is one of the characteristics that distinguishes a code change process from rules and regulations.

Having said that, it would be unreasonable to expect each proposer to undertake all of the administrative arrangements associated with code consultation. This includes matters such as receiving and publishing proposals and submissions and maintaining records. Instead, we think it makes sense for a single entity to act as administrator (for want of a better term). In fulfilling these functions, the administrator should:

- promote inclusive, accessible and effective consultation
- adopt processes that are transparent and easily understood
- act in an impartial, objective and balanced manner
- be cost-effective.¹⁶

¹⁶ These are drawn from the United Kingdom Code of Practice for energy code administration. See www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-administration-code-practice-cacop

The main potential candidates for the role are the TSP and Gas Industry Co. Our view is that the role should be allocated to the Gas Industry Co. This is based on the following factors:

- it is a neutral body with no direct commercial interest in the design of access arrangements
- it has established mechanisms and infrastructure to engage with stakeholders across the gas industry, which should assist in minimising costs.

In addition, Gas Industry Co is likely to be better placed than the TSP to facilitate the establishment of industry technical groups or other similar initiatives, should they be required.

5.4 Limited veto for TSP

The TSP is subject to price-quality control under Part 4 of the Commerce Act. This means it faces a maximum revenue allowance and quality targets that are fixed within each regulatory control period.

We think it would be unreasonable for the TSP to face material costs or risks as a result of a code change, where these are inconsistent with a prevailing Part 4 regulatory determination. Accordingly, we recommend that a limited veto be provided to the TSP, along the lines of those included in the MPOC and VTC.

6 Recommendations

This chapter sets out our recommendations on the design of the three elements in the code amendment process:

1. Initiation – how does a potential code change get initiated?
2. Consultation and refinement – what process is applied to share information about a code change proposal and allow for its evolution to the point of final decision?
3. Decision – once a proposal has been crystallised into a final form, what is the process for deciding whether it will take effect?

6.1 Initiation of code change proposals

The following types of persons should be permitted to propose changes to the code:

- any person that is bound by code terms via transmission service or interconnection agreements including the TSP itself
- gas users
- gas market operators.

6.2 Consultation and refinement of code change proposals

We favour a VTC-like process that allows for code change proposals to evolve post-initiation. Key features would be:

- proposals are initially submitted in high level form, summarising the proposal, why it is necessary and what its effect is likely to be
- other stakeholders can provide feedback on the high level proposal
- the proposer prepares a final proposal setting out the change in detail after receiving stakeholder feedback.

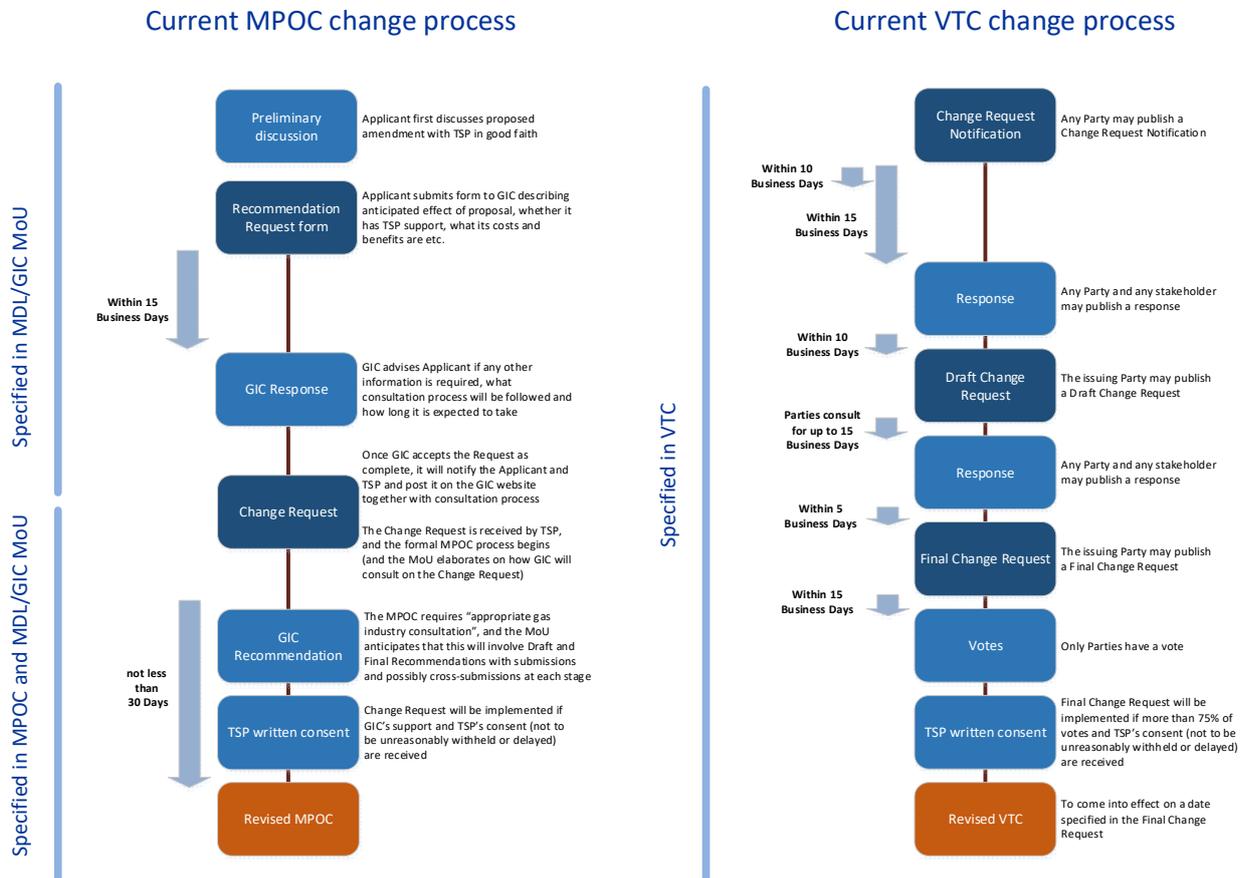
6.3 Decisions on code change proposals

Based on the practical difficulties in designing a robust voting arrangement, we recommend that the final decision making on proposals should be made by an independent body. We believe Gas Industry Co is the most suitable candidate for this role.

The governance arrangements should provide explicit criteria for Gas Industry Co to apply when making decisions, and we believe that the objectives in section 43ZN of the Gas Act are suitable for this purpose.

A limited veto over code changes (along MPOC and VTC lines) should be provided to the TSP, to protect it from code changes that are inconsistent with a prevailing regulatory determination issued under Part 4 of the Commerce Act.

Appendix A – Overview of current code change processes¹⁷



¹⁷ Provided by Gas Industry Co, based on the source document: www.gasindustry.co.nz/dmsdocument/5389