

FIRST GAS INFORMATION PAPER

TO: Transmission Pipeline Stakeholders

FROM: First Gas

DATE: 15 June 2017

RE: **Preliminary Draft Code Changes to Transition from VTC and MPOC to GTAC**

Introduction and Summary

The terms of access to First Gas' gas transmission pipelines are currently governed by two separate codes—the VTC and the MPOC. First Gas proposes to replace these codes with a single access code, the Gas Transmission Access Code (GTAC), that will specify the standard terms of access to gas transmission in New Zealand. The transition from VTC/MPOC to GTAC is currently scheduled to occur on 1 October 2018.

The transition to the GTAC needs to be managed seamlessly. This requires the expiry date of the VTC and its associated agreements to be extended to 30 September 2018 (the VTC currently expires on 30 September 2017). A change to the MPOC is also required to insert a termination provision, since the MPOC does not currently have a provision for its expiry or replacement by another code. We propose that (subject to specified conditions being fulfilled) MPOC termination will occur on the same date as the VTC terminates, with the GTAC coming into force at that point. The conditions for MPOC termination that we propose are discussed in detail below.

We have attached preliminary drafts of VTC and MPOC code changes to this paper. We invite comments on these preliminary drafts by 30 June 2017, before they are formally submitted into the change processes (which differ under the VTC and MPOC). The timing for continuing consultation on the substance and implementation of the GTAC and for completing the required code change processes is set out below.

Objectives for the transition process

We are seeking to design a transition process with the following three characteristics:

- **A seamless transfer.** The transition from the VTC/MPOC to the GTAC needs to be instantaneous, with no gaps or exceptions in coverage and no overlap between competing requirements from different codes.
- **Certainty.** The transition should provide reasonable certainty for all parties, well ahead of the actual transition date:
 - For First Gas, this should allow sufficient time to procure and implement a new transaction management IT system, and to prepare the documentation needed to support operation under the GTAC (contracts, the pricing methodology, and any required operating policies and procedures).
 - For shippers, this should allow sufficient time for training on use of the new First Gas IT system, integration of their systems in advance of go live, and to confirm their ability to access gas transmission services up to and beyond the transition to the GTAC.
 - For all transmission stakeholders (Shippers, interconnected parties, and gas users), to confirm their ability to access the benefits of using the gas transmission system.

- **Ability to influence, without creating the risk of hold-out.** Parties should be assured that their comments on the GTAC are taken seriously and addressed. However, this should not provide the ability for any single party (including First Gas) to hold the process to ransom. Substantial resources are being put into GTAC development across the industry, and it is important to ensure that this effort is not wasted or delayed to protect narrow interests or respond to concerns that are not well supported or explained.

Opportunities for parties to influence GTAC design and implementation

One of our core objectives in co-leading the GTAC process with the GIC has been to ensure that the industry is closely involved in the development process, consulted at every step of the process, and broadly supports the proposed provisions in the GTAC and the path for its introduction. This has required us to release discussion papers and exposure drafts of GTAC sections, facilitate regular workshops, and engage in one-on-one meetings with industry members. The feedback we have received on the process to date has been overwhelmingly positive, and we thank gas industry stakeholders for engaging in the process openly and in good faith.

We also acknowledge that a continued focus on following a good process and our active engagement with stakeholders is essential for the successful transition to the GTAC. We will reflect on the submissions made on our Emerging Views paper before releasing a full draft of the GTAC in August 2017. We then propose a further round of consultation and negotiation on the draft code (including welcoming suggested mark-ups by contract counterparties) before finalising the GTAC.

We see the transition process from VTC/MPOC to GTAC providing a further avenue for any remaining concerns about the GTAC to be addressed. We think that this can be best achieved by specifying two sets of pre-conditions to be fulfilled before the GTAC is implemented:

- **Substantive conditions** that provide comfort that the final form of the GTAC is better than the status quo. As described further below, we think this involves a process of assessing that the GTAC better meets the requirements of the Gas Act and the Government Policy Statement on Gas better than the VTC/MPOC. We note that the GIC entrusts code change decision to its independent directors and as the industry body, is best placed to establish the parameters for an assessment and to undertake this assessment.
- **Procedural conditions** that ensure that the date of transition to the GTAC has been published well in advance, that the final form of the GTAC has been resolved, that the GTAC allows existing pipeline users to continue using the transmission system on reasonable terms, and that contracts allowing them to operate under the GTAC are available for execution.

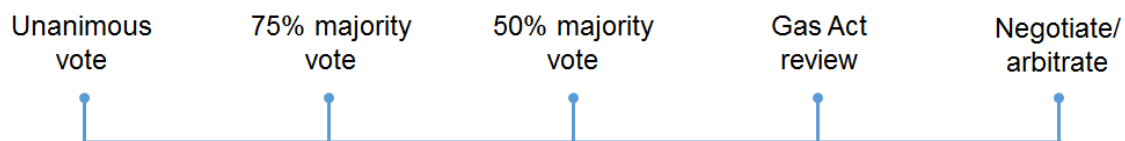
We consider that having two avenues for influencing the provisions of the GTAC—direct engagement on the draft code with First Gas *and* fulfilment of the substantive and procedural conditions outlined above (with GIC involvement)—should provide a reasonable level of comfort to the gas industry participants that their interests are recognised.

Options for deciding whether substantive conditions have been fulfilled

To provide reasonable certainty about the transition, it needs to be demonstrated that the substantive and procedural conditions have been met. This should be relatively straightforward for the procedural conditions, which should simply specify timeframes that First Gas should meet for having systems and documentation available.

The process for determining whether the substantive conditions have been fulfilled is more difficult to define. We see the options as lying on a spectrum from a “democratic” process of acceptance by all parties at one end, to a direct negotiation of the GTAC with arbitration as a fall-back at the other end. This spectrum is illustrated below.

Figure 1: Options for determining fulfilment of substantive conditions



We do not consider that the options at either extreme of this spectrum should be considered further. We do not support the option of a unanimous vote because it leaves the process open to the risk of hold-out by a single party by effectively giving all parties the ability to veto a move to the new code. The discussions we have had with industry stakeholders to date suggest that there is little support for such an approach. We also think that the option at the other end of the spectrum (a negotiate/arbitrate approach) is unlikely to work well. Under this option, a review of the final form of the code would only be required if terms cannot be satisfactorily negotiated. While this is reasonably conventional in regulated networks,¹ we consider that the process should give parties a higher level of assurance that the GTAC is taking available opportunities to improve overall access arrangements.

We have carefully considered the merits of options involving a vote of interested parties and requiring majority approval (either a simple majority of 50% or a 75% super majority as per the code change provisions of the VTC). The strengths and limitations of calling for a vote are set out in the table below. These have been canvassed in greater detail in the recent Concept Consulting paper on code governance.²

Table 1: Pros and cons of voting to fulfil substantive conditions

Pros	Cons
<ul style="list-style-type: none"> • Adds legitimacy to the process through democracy • Provides a clear demonstration of support or lack thereof 	<ul style="list-style-type: none"> • Need to define who gets a vote, creating the risk that some parties are disenfranchised • Creates the need to decide whether a 50% or 75% majority is sufficient, which creates the risk of holding the process to ransom • More open to the risk of status quo bias where parties are unwilling to vote in favour despite new arrangements being better overall

On balance, we consider that the disadvantages to establishing a voting process outweigh the benefits and we have therefore not incorporated a voting mechanism into the preliminary draft change requests.

¹ For example, Subpart 5 of Part 4 of the Commerce Act (sections 53G – 53J) provides a framework for a negotiate/arbitrate approach to setting prices and service quality levels. Electricity Distribution Businesses and Gas Distribution Businesses also have a type of negotiate/arbitrate for Use of System Agreements, which are proposed by networks but subject to regulatory oversight (with the regulator effectively playing the role of an arbitrator).

² <http://gasindustry.co.nz/dmsdocument/5500>

The Gas Act review option shown on the spectrum in Figure 1 does not involve a vote, and therefore avoids the limitations set out above. However, although we currently prefer this option for GTAC implementation, we recognise that there are arguments for and against relying solely on consultation processes and determination from an independent decision-making body (such as the GIC). We also note that the scope of the independent review can vary—in this case either having a sole focus on Gas Act objectives, or to include other requirements such as the support of cost benefit analysis or appropriate response to comments raised by parties.

Table 2: Pros and cons of independent assessment to fulfil substantive conditions

Pros	Cons
<ul style="list-style-type: none"> • Provides certainty • Less likely to be subject to risk of status quo bias • Provides confidence that consultation process has been effective • Examines overall market efficiency in deciding whether to adopt GTAC 	<ul style="list-style-type: none"> • Leaves the process subject to the determination of the decision maker • Places emphasis on regulatory and legislative objectives

Overall, we consider that the advantages of using the Gas Act review option outweighs the limitations. This is particularly the case if a mechanism can be designed to provide adequate comfort to stakeholders in the process that the Gas Act review reasonably safeguards their interests.

Proposed substantive conditions for transition

The substantive conditions proposed in the preliminary draft MPOC change request require the GIC to issue a determination before the implementation process for the GTAC can proceed. The proposed requirement for the GIC determination is:

- That following appropriate consultation, the GIC determines that the GTAC is materially better than the current terms and conditions for access to and use of gas transmission pipelines, having regard to the objectives in section 43ZN of the Gas Act 1992 and any objectives and outcomes the Minister has set in accordance with section 43ZO of the Gas Act 1992. The intention of this assessment is to provide comfort to parties that GTAC improves overall outcomes in the gas industry.

We have carefully considered other conditions that might be included in the GIC review to give additional comfort to parties that the GTAC adequately responds to their particular concerns. These options included a determination that all material outstanding concerns have been appropriately addressed by First Gas, that the process has been robust, and that code development process had been conducted in good faith, Our discussions with the GIC on these possibilities indicate that they would be new areas for the GIC to assess and that they would not be comfortable undertaking this type of evaluation. For our part, we have no intention of progressing the transition to the GTAC if the industry has major areas of concern.

We also note that the GTAC will be able to evolve after it is adopted and implemented. We acknowledge that the GTAC will not be perfect upon adoption, and we welcome future enhancements over time through code changes.

Proposed procedural conditions for transition

The procedural conditions proposed in the MPOC change request require the GTAC to be ready for implementation. This involves specifying timeframes by which certain systems and documents will be ready ahead of the transition date. We have proposed:

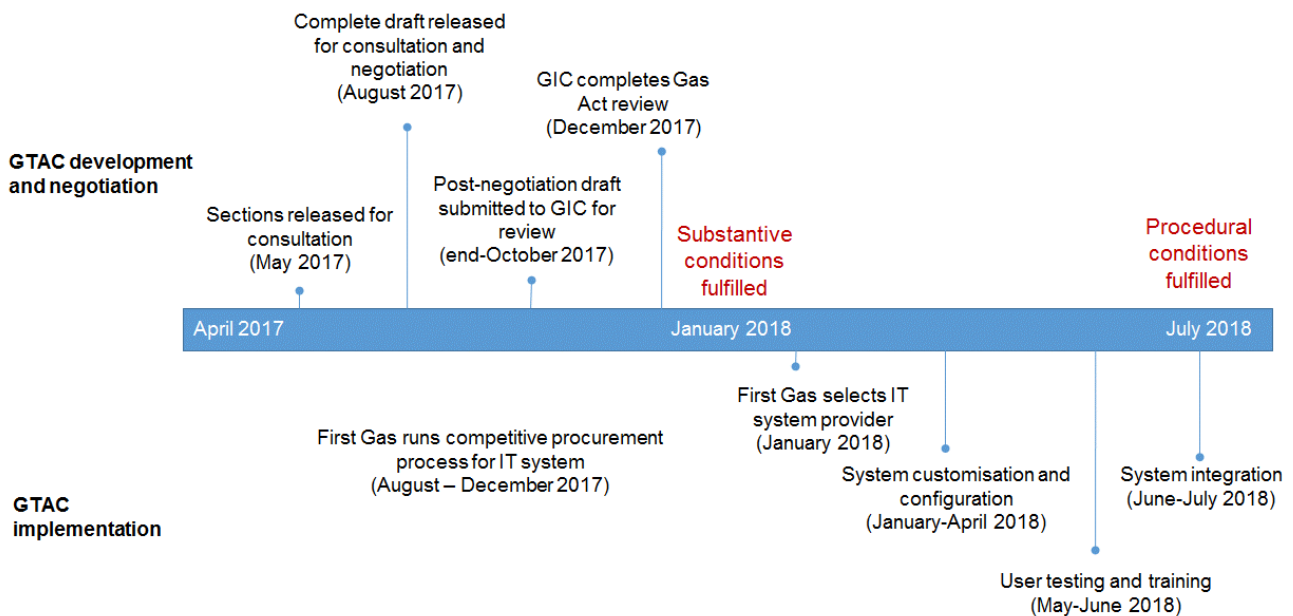
- By 2 months before the proposed transition date:
 - The GTAC has been published;
 - Formal notice of the transition date has been provided;
 - The GTAC makes provision for all Shippers to continue to transport gas and for current interconnected parties to continue to connect to the pipeline;
 - Executable contracts needed for operations under the GTAC have been provided to all parties requiring them;
 - The MPOC and the VTC are set to terminate at the time the GTAC comes into force.

Proposed timeline for completing conditions

While work on the final form of the GTAC is being finalised, First Gas will be running a procurement process for the IT system that will manage processes and transactions under the GTAC. The implementation of this system will require both capital and operating expenditure and First Gas will want the assurance of having the substantive condition fulfilled before finally committing to the new IT system. We expect that all parties will want assurance that the new IT system will be operational in time for the transition date before approval for the transition to the GTAC is given.

An overview of the timeline for fulfilling the proposed substantive and procedural conditions for MPOC termination is shown in Figure 2.

Figure 2: Proposed timeline for fulfilling substantive and procedural conditions



Mechanism for transition

Based on the objectives and proposals above, the transition process requires changes to both existing codes:

- A change to the VTC to extend its expiry date to 30 September 2018. This is accompanied by a commitment from First Gas to further extend the VTC if the substantive and procedural conditions for terminating the MPOC have not been fulfilled (see preliminary VTC change request, paragraph 4).
- A change to the MPOC, to allow its termination and replacement by the GTAC if the conditions outlined above are met.

Preliminary drafts of the MPOC and VTC change requests required to implement these changes are attached. These will be separately advised to the relevant parties as required by the VTC and MPOC.

Timeline for completing code change requests

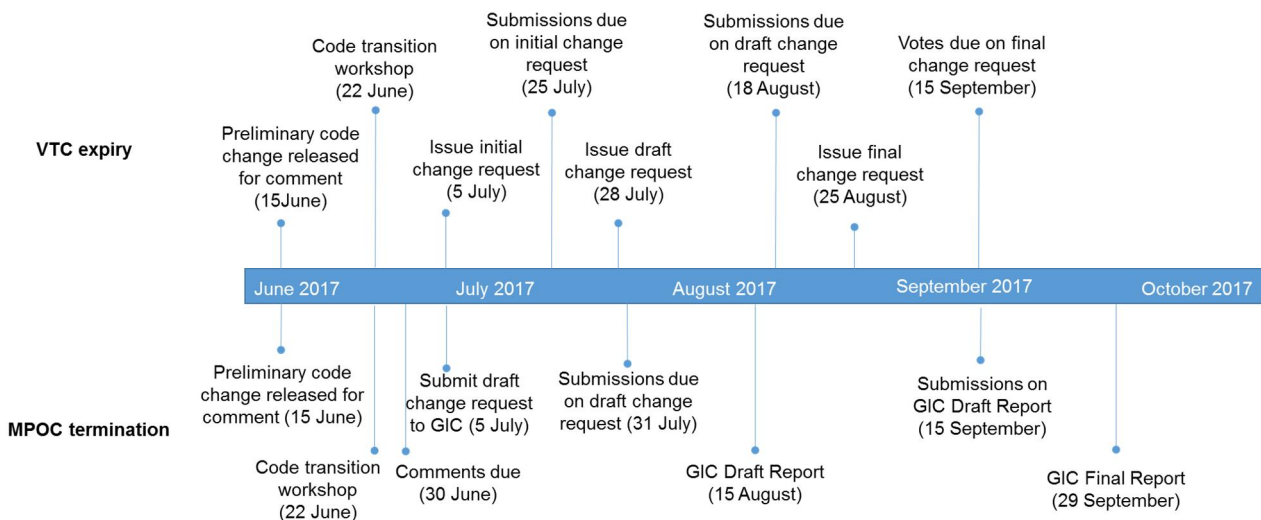
Following the release of this paper and accompanying preliminary change requests, we propose to hold a 2-hour workshop on 22 June 2017 to discuss the material and will receive submissions until 30 June 2017. We then propose to issue the Initial Change Request document for the VTC on 5 July 2017. On the same date, First Gas will send a draft MPOC change request to the GIC for publication. We expect that the GIC will promptly call for submissions on the draft change request.

Once the Change Request has been submitted the periods allowed for consultation and the preparation of reports will be determined by the GIC. However, we estimate that initial submissions on the Change Request will be due by 31 July 2017 and the final step in the MPOC change process is expected to be completed once the GIC issues its Final Report in late September.

The remaining steps under the standard VTC change request process will be completed by 15 September 2017, ahead of the current expiry date for the VTC. In the meantime, First Gas proposes to release a complete GTAC draft in August 2017, with the intention to submit it to the GIC for the review required by the MPOC change request by the end of October 2017.

The proposed timelines for the completing required change processes under both codes are set out in Figure 3.

Figure 3: Overview of timeline for completing code change requests



Feedback on proposed approach and preliminary draft change requests

We welcome feedback on the material presented in this paper and the preliminary draft code changes attached. We are conscious that parties are also currently preparing comments on the substance of the new code (due 23 June 2017), and do not want to unnecessarily distract from that important task.

However, it is clear from the timetable for making the necessary changes to the VTC and MPOC set out above that we need to engage now.

We invite comments on this paper by 30 June 2017. They can be uploaded to the GIC website at www.gasindustry.co.nz or sent to info@gasindustry.co.nz. All submissions will be posted on the GIC website (unless any party requests confidentiality over any the material provided).