



RECOMMENDATION

Final Recommendation on the 14 July 2017 MPOC transition change request

31 October 2017

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1. Introduction and purpose

1.1 Purpose

This paper presents Gas Industry Co's final recommendation (Final Recommendation) in respect of the Maui Pipeline Operating Code (MPOC) change request submitted by First Gas Limited (First Gas) on 14 July 2017, the "transition change request" (Change Request).

1.2 The Change Request

First Gas's Change Request aims to facilitate transition to a new gas transmission access code (GTAC) when certain conditions have been met. The Change Request provides that transition from the MPOC to a new GTAC can only occur if certain conditions have been met no later than 40 business days before a published date (termed the "New Code Date"). The conditions include certain procedural conditions and a substantive condition that requires Gas Industry Co to determine that the new GTAC is materially better than the current terms and conditions of access to and use of gas transmission pipelines having regard to the objectives and outcomes in the Gas Act 1992 and Government Policy Statement on Gas Governance 2008 (GPS).

1.3 Process to date

In a letter dated 14 July 2017, First Gas submitted the Change Request to Gas Industry Co for consideration. First Gas's Change Request is available at <http://gasindustry.co.nz/work-programmes/mpoc-change-requests/14-july-2017-mpoc-transition-change-request-tcr/mpoc-change-request-14-july-2017/>.

On 17 July 2017, Gas Industry Co notified industry stakeholders of the Change Request. Submissions were received by 9 August 2017.

On 30 August 2017, First Gas proposed a revised draft of the Change Request to include an additional condition regarding publication of a functional specification and data interface for the IT system selected to implement a new GTAC. The revised drafting is available at <http://gasindustry.co.nz/work-programmes/mpoc-change-requests/14-july-2017-mpoc-transition-change-request-tcr/mpoc-change-request-14-july-2017-supplementary-documents/>. Gas Industry Co provided interested parties with an opportunity to make submissions on the revised drafting by 7 September 2017.

On 22 September 2017, Gas Industry Co issued a draft recommendation to support the Change Request (Draft Recommendation). The Draft Recommendation and submissions on the Draft Recommendation are available at <http://gasindustry.co.nz/work-programmes/mpoc-change-requests/14-july-2017-mpoc-transition-change-request-tcr/draft-recommendation-on-14-july-2017-mpoc-transition-change-request/>.

1.4 Overview of Draft Recommendation

The Draft Recommendation supported the Change Request for the following reasons:

1. The Change Request improves efficiency when compared to a GTAC implemented through industry agreement for the following reasons:

- (a) There is a reduced opportunity for one or more participants delaying the transition process in order to seek more favourable terms (“hold-out”).
 - (b) It reduces the risk of any one industry participant being able to exert a disproportionate level of influence on the form of a new GTAC through allocation of assessment of the GTAC to an independent third party (Gas Industry Co).
 - (c) It establishes a process that ensures the effect of a new GTAC on the wider gas industry (not just parties to a new GTAC) is given appropriate weight.
2. The Change Request promotes fairness for the following reasons:
- (a) A “materially better” standard is a more appropriate standard to apply to an assessment of a new GTAC (as opposed to simply “better” as would be applied if a new GTAC were to be implemented using the current MPOC code change process). The new GTAC may introduce substantial changes to the terms and conditions of access to, and use of, the gas transmission system. A higher standard of “materially better” provides assurance that there are material improvements for the industry as a whole arising from transition to a new GTAC. We consider that a material improvement is desirable given the level of resource that industry is committing to the development of a new GTAC.
 - (b) Unlike an industry negotiated GTAC, the Change Request avoids the risk of any one industry participant being able to exert a disproportionate level of influence on the form of a new GTAC by allocating the substantive assessment of the new GTAC to an independent decision maker that is required to assess the new GTAC against a set of objective principles.

The Draft Recommendation noted the concerns of submitters regarding implementation risks, but considered that possible implementation risks are outweighed by the clear benefits associated with the Change Request. The Draft Recommendation also proposed that Gas Industry Co undertake a role in monitoring implementation risks.

2. Submissions on Draft Recommendation

2.1 Summary of submitter views

Two submissions were received on the Draft Recommendation from Greymouth Gas New Zealand Limited (Greymouth) and First Gas. These can be found at <http://gasindustry.co.nz/work-programmes/mpoc-change-requests/14-july-2017-mpoc-transition-change-request-tcr/draft-recommendation-on-14-july-2017-mpoc-transition-change-request/>.

Greymouth's submission supports the underlying rationale for the Change Request, but considers that the Change Request has not been adequately consulted on and is poorly drafted. In particular, Greymouth's submission:

1. Expresses a concern in relation to First Gas's decision not to adopt (or explain its decision not to adopt) Greymouth's suggested drafting improvements in relation to the Change Request.
2. Considers that Gas Industry Co has a vested interest in approving the Change Request and a new GTAC given its support for a single gas transmission access code. That is reflected in Gas Industry Co's decision to overlook drafting errors.
3. Disagrees with Gas Industry Co's assessment of the status quo (the relevant counterfactual). Greymouth considers that the only counterfactual is that the MPOC does not have an expiry date. The question is whether the Change Request is better than having the MPOC with an indefinite expiry date.
4. Considers that Gas Industry Co's assessment of the substantive condition against section 29.4 of the MPOC is flawed as the substantive condition is not concerned with MPOC change requests.
5. Provides detailed criticism of Gas Industry Co's response to Greymouth's suggested drafting errors and suggests that the weight of those drafting errors should have led to Gas Industry Co not supporting the Change Request.

First Gas's submission supports Gas Industry Co's draft recommendation. In particular, First Gas's submission:

1. Agrees with Gas Industry Co's view that the Change Request enhances the efficiency and fairness objectives in the Gas Act and GPS.
2. Agrees to the minor amendments proposed by submitters that were supported by Gas Industry Co.
3. Acknowledges that transition to a new GTAC involves costs and risk to a range of parties, but proposed to address this through an open and collaborative process rather than adding prescription to the MPOC.

3. Discussion of issues raised

Gas Industry Co's determination to support the Change Request should be considered in the context of its role under section 29.4 of the MPOC and the Memorandum of Understanding:

1. Gas Industry Co's key consideration in determining whether to support a Change Request is attainment of the relevant objectives set out in the Gas Act and the GPS. That involves looking at the proposed Change Request and determining whether, as a whole, the Change Request better meets the objectives.
2. Gas Industry Co's role involves assessing potential solutions formulated by the applicant – it does not involve Gas Industry Co "taking the pen" to develop a perceived optimal solution.

We have considered the submissions received from Greymouth and First Gas on the Draft Recommendation.

First Gas's submission is supportive of Gas Industry Co's Draft Recommendation. First Gas has agreed to undertake the technical and minor amendments recommended by Gas Industry Co in its Draft Recommendation. We do not consider that First Gas's submission raises any matters that require further consideration.

We provide the following responses to the issues raised in Greymouth's submission:

Issue	GIC response
Gas Industry Co has a vested interest in approving the Change Request or the GTAC in the form in which they are presented to it.	<p>We disagree with Greymouth's suggestion that Gas Industry Co has a conflict of interest or has predetermined its assessment of the Change Request.</p> <p>While it is true that Gas Industry Co and many industry participants (including Greymouth) have expressed an interest in developing a single gas transmission code (previously termed 'code convergence'), Gas Industry Co will not support a new GTAC that does not meet the substantive condition in the Change Request. If the test is not met, we would anticipate the parties to reflect on Gas Industry Co's assessment; undertake further work; and submit an improved code to Gas Industry Co for assessment.</p> <p>The Change Request, as drafted, may not be Greymouth's preferred solution for transition to a new GTAC. However, as expressed in our Draft Recommendation, we consider that the Change Request does better achieve the objectives and outcomes in the Gas Act and GPS when compared to the status quo. That assessment is undertaken in accordance with Gas Industry Co's role under the MPOC change process. We note that the</p>

	<p>Change Request proposes an elevated threshold (that a new GTAC is “materially better” than the current terms and conditions) in relation to Gas Industry Co’s assessment of a new GTAC.</p>
<p>The status quo, in relation to terminating the MPOC, is that the MPOC does not have an expiry date. The question is whether the TCR is better than having a code with an indefinite expiry date.</p>	<p>Greymouth’s submission suggests that the objective of the Change Request is termination of the MPOC. In our view, that is a narrow assessment of the objective of the Change Request. The Change Request aims to establish a process to transition to a new set of terms and conditions that apply to shippers and welded parties (a new GTAC). The question is how that transition could occur under the current MPOC. While the MPOC does not have a provision that provides for the expiry of transmission services agreements (TSAs) and interconnection agreements (ICAs), it does have a process for changing the terms of the MPOC that are incorporated by reference into those agreements. There is also nothing to prevent all parties from agreeing to a new GTAC to replace the MPOC. In our view, a new GTAC implemented through either of those processes is the most likely alternative to the process proposed in the Change Request, and therefore the correct alternatives to compare the process to.</p>
<p>Gas Industry Co’s assessment of the substantive condition against section 29.4 of the current MPOC is flawed.</p>	<p>Gas Industry Co’s reference to section 29.4 of the MPOC (the current MPOC change process) was in response to comments that the substantive condition is inadequately defined. The point of Gas Industry Co’s reference to section 29.4 of the MPOC was that both the Change Request’s substantive condition and section 29.4 of the MPOC set conditions that must be met before the MPOC is to be changed. We were simply pointing out that the substantive condition in the Change Request is more rigorously specified than the condition in section 29.4 of the MPOC.</p>
<p>The correct legal wording of the Change Request is that 40 business days before the New Code Date, the VTC shall terminate on the New Code Date. Gas Industry Co has overlooked this and assumed that procurement of a future-dated termination date fulfils the condition, which technically it does not.</p>	<p>Our interpretation of the relevant drafting is that it requires a future termination date for the VTC and transmission services agreements under the VTC. The drafting uses the language “shall terminate” not “have terminated”.</p>
<p>The correct legal reading of the Change Request is that the executable contracts need not relate to the new GTAC. There is no commercial protection</p>	<p>Our Draft Recommendation noted that we thought that Greymouth’s interpretation did not have regard to the context provided by section 22.16(a). The New Code will provide for use of,</p>

<p>for industry that the ICAs need to relate to the new GTAC.</p>	<p>and connection to, the gas transmission system. We also note the following statement in First Gas’s application form:</p> <p>“The objective of this change request is to:</p> <p>...</p> <p>(b) provide for the termination of the TSAs and ICAs governed by the MPOC, and their replacement with <u>new shipper agreements that will be made under the GTAC, and bilateral interconnection agreements that will be offered by the Applicant</u>; and</p> <p>...”¹</p> <p>That statement is consistent with the development of the GTAC to date – the shipper contracts (transmission services agreements) are a schedule to the GTAC and incorporate the terms of the GTAC by reference (this is similar to the approach in the MPOC). The interconnection agreements sit outside the GTAC but incorporate certain provisions by reference.</p> <p>Whether certain interconnection terms should be included in the new GTAC (and incorporated into interconnection agreements by reference) is a matter for consideration as part of the design of the new GTAC and Gas Industry Co’s assessment of the GTAC rather than this Change Request.</p>
<p>The “New Code” definition does not properly define the new code.</p>	<p>We do not see why defining the “New Code” by reference to the document published by First Gas is improper.</p> <p>The TSAs and ICAs that relate to the “New Code” can only replace the current TSAs and ICAs under the MPOC once Gas Industry Co has determined that the “New Code” (being the document that First Gas will publish) is materially better than the current terms and conditions of access.</p>
<p>The use of “may” in clause 22.16 creates uncertainty and is of no benefit – all issues in the conditions should be sorted. If discretion is required, that proves that the conditions as a group are inadequate.</p>	<p>The Change Request provides that all conditions must be satisfied for transition to a new GTAC to occur (not that transition must occur once all conditions are satisfied). The Change Request is intended to ensure that certain processes, systems and documents are in place before a new GTAC comes into effect.</p> <p>We disagree that discretion proves that the conditions are inadequate. As indicated in our Draft Recommendation, we consider that</p>

¹ Application for Gas Industry Company’s Recommendation on Proposed Amendments to the Maui Pipeline Operating Code (“MPOC”) dated 14 July 2017 available at <http://gasindustry.co.nz/work-programmes/mpoc-change-requests/14-july-2017-mpoc-transition-change-request-tcr/mpoc-change-request-14-july-2017/>, .

	discretion may be of value in the event of an unforeseen issue arising.
<p>The use of “fit for purpose” in the context of the IT system does not mean that the IT system has to be fully compatible with the GTAC. It also has no regard for the user interface.</p>	<p>It is normal for commercial contracts to use terminology such as “fit for purpose”. In our view, it would be difficult to draft a provision that described a detailed standard that the IT system must meet. It would also be undesirable given the risk that one or more significant matters are not included in the detailed standard.</p> <p>Greymouth’s submission references First Gas’s statements on Trello. We note that any views expressed by First Gas may not be definitive in terms of the meaning of “fit for purpose”.</p> <p>As indicated in our Draft Recommendation, we have identified the potential for disagreement regarding the conditions of transition as a potential cost associated with this Change Request. We do not consider that the potential for disagreement is of sufficient magnitude to outweigh the benefits associated with this Change Request.</p>
<p>The 40 business day notice period pushes risks onto Gas Industry Co’s shareholders other than First Gas. First Gas should indemnify shippers if the dates slip, or shippers should have an adequate window to integrate systems after it is certain that the GTAC is going ahead.</p>	<p>Greymouth has previously made this comment in its earlier submission on the Change Request. Our response is contained in our Draft Recommendation – our view is that all parties will incur costs relating to the development and implementation of a new GTAC. Accordingly, any slippage results in risks to all parties.</p> <p>Additionally, Greymouth’s comments do not provide information to support its view that the timeframes provided in the Change Request are inadequate.</p>

We consider that many of the issues above relate to the finer detail of the Change Request rather than concerns with the outcome that the Change Request is intended to achieve. For example, the correct interpretation of certain terminology used in the Change Request or whether discretion is appropriate. Most of the concerns raised in Greymouth’s submission on the Draft Recommendation are a continuation of concerns raised in its submission in response to the initial consultation on the Change Request. Other new concerns are responded to above. The Draft Recommendation noted that a potential cost associated with the Change Request was the potential for future industry disagreement regarding the conditions for transition. That potential cost continues and has been factored into our decision to support the Change Request.

Gas Industry Co’s Draft Recommendation concluded that:

1. The Change Request improves efficiency when compared to a GTAC implemented through industry agreement for the following reasons:
 - (a) There is a reduced opportunity for one or more participants delaying the transition process in order to seek more favourable terms (“hold-out”).

- (b) It reduces the risk of any one industry participant being able to exert a disproportionate level of influence on the form of a new GTAC through allocation of assessment of the GTAC to an independent third party (Gas Industry Co).
 - (c) It establishes a process that ensures the effect of a new GTAC on the wider gas industry (not just parties to a new GTAC) is given appropriate weight.
2. The Change Request promotes fairness for the following reasons:
- (a) A “materially better” standard is a more appropriate standard to apply to an assessment of a new GTAC (as opposed to simply “better” as would be applied if a new GTAC were to be implemented using the current MPOC code change process). The new GTAC may introduce substantial changes to the terms and conditions of access to, and use of, the gas transmission system. A higher standard of “materially better” provides assurance that there are material improvements for the industry as a whole arising from transition to a new GTAC. We consider that a material improvement is desirable given the level of resource that industry is committing to the development of a new GTAC.
 - (b) Unlike an industry negotiated GTAC, the Change Request avoids the risk of any one industry participant being able to exert a disproportionate level of influence on the form of a new GTAC by allocating the substantive assessment of the new GTAC to an independent decision maker that is required to assess the new GTAC against a set of objective principles.

The submissions in response to Gas Industry Co’s Draft Recommendation do not raise any new issues that, either individually or as a whole, outweigh the benefits of the Change Request in terms of attaining the efficiency objective in the Gas Act as well as the fairness objective in the GPS. Accordingly, we do not consider that Gas Industry Co should reach a different view on its assessment of the Change Request against the objectives in the Gas Act and GPS from that contained in its Draft Recommendation.

4. Final Recommendation

On the basis of our Draft Recommendation, submissions on the Draft Recommendation, and with due regard to our role under the MPOC and Memorandum of Understanding with First Gas and the objectives in the Gas Act and the GPS, Gas Industry Co's final recommendation is to support the Change Request.

The Change Request is an important 'first step' that ensures that there is a clear process for establishing the form of a new GTAC. Whether transition to new GTAC can occur will depend on satisfaction of the conditions specified in the Change Request. As mentioned in the Draft Recommendation, we consider that transition to a new GTAC is dependent on First Gas and other industry participants working together constructively.

Following approval of the Change Request, industry will continue to focus on the development of a new GTAC. First Gas's timetable provides for further drafting of the document and submission to Gas Industry Co. Gas Industry Co's role is to assess the version of the new GTAC submitted to it against the test established by the Change Request.

Reflecting on some of the submissions on the Change Request regarding IT system development, we note that First Gas's development of a new GTAC will include a parallel process for implementation of a new IT platform. Gas Industry Co urges all participants to participate fully in those processes with the intention that the new GTAC and supporting systems come together. First Gas has given assurance to participants regarding notification of IT system changes. We acknowledge that there will be an impact on industry participants' systems and urge industry participants to work closely with First Gas to ensure a smooth transition to the new arrangements.

ABOUT GAS INDUSTRY CO

Gas Industry Co is the gas industry body and co-regulator under the Gas Act. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

ENQUIRIES:

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