

Keston Ruxton
Manager, IM Review
Regulation Branch
Commerce Commission
PO Box 2351
Wellington
(via email to im.review@comcom.govt.nz)

28 January 2016

Dear Keston

RE: IM Review -Gas Stakeholder Meeting 8 December 2015

1. On behalf of the Major Gas Users Group (MGUG), I would like to thank the Commission for organising and facilitating the Gas Stakeholder Meeting on 8 December 2015 which continued engagement with the gas pipeline sector on the IM review and identifying issues for the DPP reset.
2. MGUG was established in 2010 to promote the interests of a number of industrials who are major consumers of natural gas. Members of the group make up a significant proportion of New Zealand's productive sector (as exporters or in import substitution) and consume large quantities of natural gas for energy (including co-generation), process heat and as a feedstock.
3. Membership of the MGUG includes:
 - Ballance Agri-Nutrients Ltd
 - Goodman Fielder New Zealand Limited
 - Fonterra Co-operative Group
 - New Zealand Steel Ltd
 - New Zealand Sugar Company Ltd
 - Oji Fibre Solutions (NZ) Ltd
 - Refining NZ
4. These industries are a significant part of New Zealand's economy, including in the primary industry export sector, in provision of energy security, and through import substitution benefiting New Zealand's balance of payments. Their manufacturing base in New Zealand relies on a secure energy supply, which for natural gas includes secure and reliable gas transport (transmission and distribution). Collectively the group has invested significant long term capital in manufacturing facilities that consume about 30 Petajoules per annum of natural gas or about 15% of the gas supplied to the market in New Zealand.
5. To date most of MGUG's focus relating to gas pipelines has been on gas transmission issues rather than distribution as this reflects the dominance and importance of this form of gas

transport infrastructure supplying MGUG sites but we believe that the broader points apply equally to regulation of gas distribution businesses.

6. The purpose of this submission is to expand on the views of MGUG raised in the workshop and to identify issues that may be relevant in the review process.

Engagement with Stakeholders

7. MGUG supports the idea that different regulators in the sector (GIC, Commerce Commission, MBIE) continue to coordinate with each other to ensure coherent and aligned outcomes in the IM and DPP process that don't conflict with intended outcomes of other gas sector work-streams or broader national interest.
8. Current alignment issues include security and reliability standards for gas transmission (DPP and TSO responsibilities under Pipeline Codes), and the impact of the Commission's decision on form of control on GIC's ability (potentially) to regulate for efficient transmission pricing. In addition competition regulation should also have regard to impacts on wider public benefits of national infrastructure, including gas transmission networks.
9. MGUG has a particular interest in having input into defining relevant transmission quality parameters under the DPP through a separate stakeholder working group. MGUG considers that the current parameter (RTE) does not adequately define the minimum level of service expected from a transmission system but that security and reliability does. We note that the GIC is also preparing an issues paper on this topic that potentially links in with GPBs Asset Management Plans and the review conducted by MWH identifying opportunities for improvement¹.
10. Given that the Commission intends to publish an issues paper in April/ May 2016 and a draft decision by September 2016 it would seem to MGUG that there is some urgency in coordinating a review on the quality (security and reliability) parameters.

Transmission Ownership Change

11. MGUG considers that the recently announced ownership changes that are yet to be approved by the OIO adds some uncertainty to the IM review and DPP reset process. MGUG's view is that the different experiences of the MDL and Vector owned transmission infrastructure in the first regulatory period might require different adjustments for the next period, particularly around WACC, Form of Control, and management of pricing methodologies. Under a common ownership structure we are assuming that any distinctions and opportunity for differentiation will be lost in a requirement to provide for a single regime. MGUG accepts this may be inevitable but suggests nevertheless that the Commission should not ignore the different outcomes experienced from the first regulatory period when setting the parameters for the next regulatory period.

¹ MGUG is submitting separately on this report

12. MGUG will review the initial reasons paper for comment on use of domestic rather than international parameters for WACC, but we believe that the increased overseas ownership structure of GPBs should also influence new WACC settings.

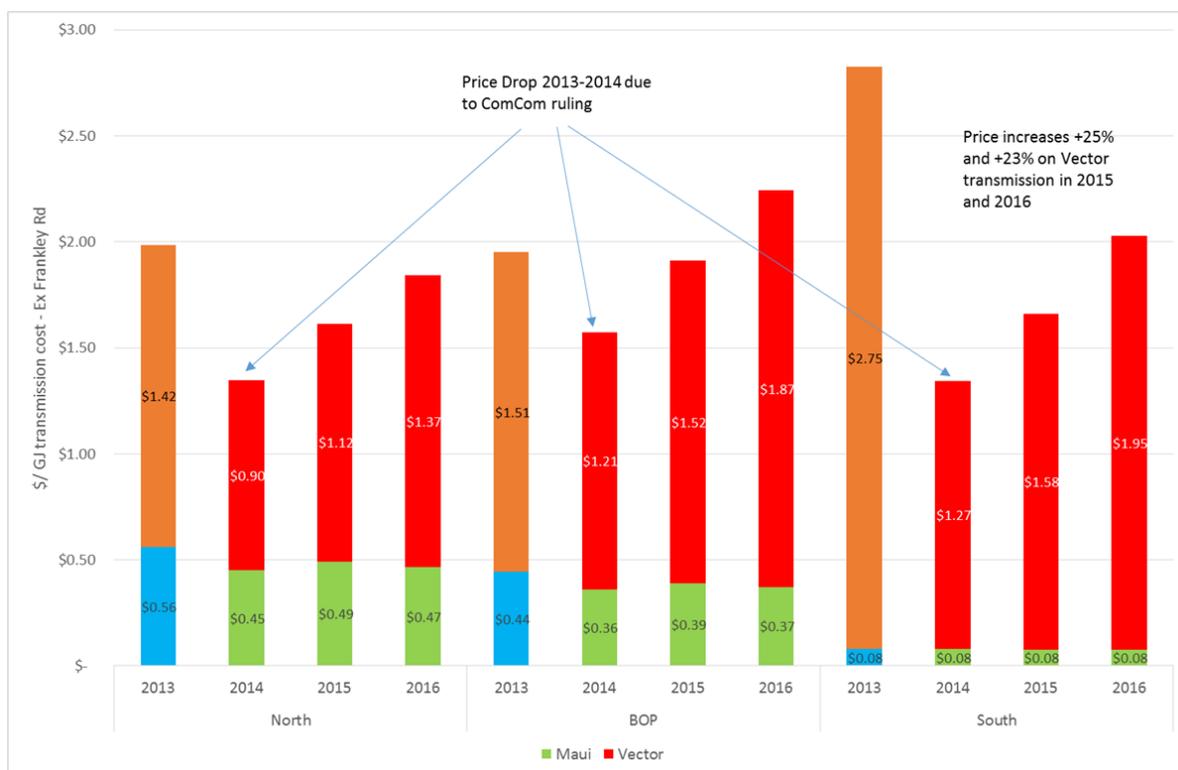
Pricing Methodology

13. MGUG is concerned that form of control is incentivising perverse and inefficient pricing outcomes on gas transport pricing, particularly on the Vector transmission system, but potentially also on distribution systems.
14. Bespoke nonstandard products cover more than 72% of the Vector transmission system volume transported, yet produce only 40% of the revenue². Discriminatory pricing in MGUG's view does not meet the objectives of the Gas Policy Statement on Gas Governance, and is at odds with accepted economic regulation principles being applied in other jurisdictions, such as the EU³.
15. It is unclear to MGUG which agency, Commerce Commission or GIC, has the powers to regulate on pricing methodology but our assumption is that if it is the GIC under transmission access arrangements then the Commission's regulatory settings should not inadvertently undermine the GIC's ability to act on this matter.
16. MGUG experience in the first regulatory period with transmission pricing from MDL and Vector bears out that pricing methodology may be an area overlooked by the Commission. Pricing methodology is an area over which the Commission has remarkably little to say other than inviting (but not requiring) adherence to quite broad pricing principles under an assumption that pricing is a zero sum game under the Form of Control.
17. MGUG considers that experience during the first regulatory period in relation to Part 4 of the Commerce Act Purpose statement (52A) has demonstrated that the Vector Pricing Methodology in particular has not produced outcomes that are consistent in competitive markets (Figure 1).

² Gas Transmission Services Default Price-Quality Path Determination – Compliance Statement 10 December 2015. Weighted average transmission price of nonstandard products are 30% of standard agreements.

³ market EU Directive 73/2009/EC (further specified in Regulation 715/2009) requires third party access arrangement regime to be based on published and pre-approved tariffs that are applied in transparent and non-discriminatory way

Figure 1: - Vector Posted Price Increases



18. MGUG would therefore submit that Form of Control and Pricing Methodology are related, not separate issues when determining how revenue or pricing parameters are set in the DPP.
19. MGUG are making a separate submission to the GIC in the context of their 2017 SOI and Levy paper for the GIC to include pricing methodology in their work programme.

Part 4 interaction with wider economy

20. S26(1) of the Act requires the Commission to have regard to economic policies of Government.
21. Gas infrastructure is one component of a broader investment in energy in the New Zealand economy. A competitive market should ensure appropriate efficient investment signals for optimal long run allocation between different energy substitutes.
22. The nature of regulation that allows gas transport revenue to rise regardless of actual demand for services seems to artificially distort the relative efficiency of delivered gas as a substitute primary energy source within the broader New Zealand economy. Whereas the current New Zealand gas supply situation is indicating abundance, and real wholesale gas prices appear to be falling along with other fuels (petrol, diesel, fuel oil),⁴ the relative

⁴ With reference to MBIE publication Energy in New Zealand 2015

competitiveness of gas investment is being undermined by continual and rapid increases in transport charges.

23. MGUG considers that the Commission should demonstrate in its reasoning the broader economic impacts of its determination.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Hale', with a large, stylized initial 'R'.

Richard Hale
Hale & Twomey Ltd
Secretariat for the Major Gas Users Group