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DEFAULT PRICE-QUALITY PATHS FOR GAS PIPELINE SERVICES

SUBMISSION BY METHANEX NEW ZEALAND LIMITED

Methanex New Zealand welcomes the opportunity to make a submission to the Commerce Commission on the policy paper *"Default price-quality paths for gas pipeline services from 1 October 2017"* published on 20 August 2016.

Methanex operates two methanol production facilities located at Waitara Valley and Motunui in the Taranaki region. We consume natural gas as a feedstock to produce methanol and as a fuel source to supply energy to our plant. We are the largest consumer of gas in New Zealand and when operating at capacity our gas demand exceeds 90 PJ per annum, or nearly half of all gas produced in New Zealand.

Methanex makes use of the Maui Pipeline to transport gas from producing fields to its plants. We do not make any use of gas distribution pipelines nor do we use the Vector gas transmission system. Consequently, the focus of our submission concerns the regulation of gas transmission businesses (GTBs) generally and specifically, the Maui Pipeline, owned by First Gas Limited.

FORECASTING EXPENDITURE

1. Methanex supports the Commission's proposal to use supplier forecasts combined with greater scrutiny. We believe this will strike a better balance between maintaining a low-cost approach and at the same time improving incentives for prudent and efficient expenditure in DPP regulation.

2. We also agree that materiality is key to ensuring scrutiny is aligned with the low cost approach and does not conflict with scenarios which should more appropriately be considered for a CPP.

3. We support in principle the Commission adopting a flexible approach for determinations on expenditures and that the Commission's scrutiny should be objective-driven rather than mechanistic. However, we consider the objective set out by the Commission in Section 3.78 to be too succinct and should be broadened to adequately reflect the objectives described more comprehensively in Section 3.77 (right investment, right time, right cost and right plan).

4. The Commission has recognised stakeholder concerns regarding transparency with its objective to publish much, if not all, information.[1] In particular, we support the approach of presuming information should be public unless a reasonable case has been made for non-disclosure.

5. We also consider that specific provision should be made for publishing information before determinations are made and providing opportunities for consumer feedback. We encourage the Commission to elaborate on its approach to enabling consumer participation in the process of assessing expenditures.

6. We also recommend that for any of its draft and final price reset decisions, the Commission publishes its approach to determining which expenditures are subject to scrutiny and which are not. It would be beneficial to allow consumers the opportunity to comment on the proposed approach in each case and feed that back into the Commission's decision making process.

BAU Variance Check[2]

7. While the mechanism described by the Commission to establish a materiality threshold is logical, the actual demarcation resulting from the BAU variance check is critical in determining, from a consumer perspective, whether sufficient scrutiny is being applied and in this regard we recommend that the Commission provides further guidance on how the demarcation will be made.

8. We are also mindful that in prescribing clearly that BAU expenditure will not be subject to any scrutiny the Commission may be signalling a gaming opportunity for suppliers.[3] We think a better approach would be not to specify a 'bright-line' on scrutiny/non-scrutiny but instead leave discretion to scrutinise all and any expenditure, but with the degree of scrutiny, if any, guided by the BAU variance check. This will allow some further tailoring to address specific issues on expenditures that may arise, including from consumer feedback.

9. In terms of the potential assessment measures for GTBs, we disagree with the view that ICPs are an important measure that ultimately contributes to the costs of gas delivery seen by

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[1] Sections 3.69-3.72

[2] Sections 3.96-3.101

[3] Section 3.99

consumers, particularly given that a substantial portion of gas transported on transmission pipelines is supplied directly to larger end users, such as Methanex.[4]

Excluded Expenditure

10. The Commission has described the basis for excluding expenditure due to deficiencies in Section 3.116 and has also described exclusions that are the result of size and complexity in Section 3.122. We think the Commission needs to go further in clarifying the different outcomes between the two criteria. Our interpretation is that the criteria in Section 3.122 and a CPP recommendation would only occur if an expenditure had (a) not already been excluded as deficient or imprudent but (b) due to size and complexity a CPP was considered by the Commission to be the appropriate mechanism.

11. Options for expenditures excluded as being deficient or insufficiently prudent (Sections 3.116-3.120)
In regard to fall-back options we suggest that with greater scrutiny and the other options available to extrapolate based on historic costs, or to exclude growth projects, the option to revert to the 2013 approach of applying a 120% cap in the DPP is no longer appropriate. The Commission has alluded to this as a consideration but has not appeared to have drawn a conclusion.[5]

12. Exclusions due to size and complexity and CPP recommendations (Sections 3.122-3.124)
While we conditionally support a flexible approach regarding the demarcation for scrutiny, subject to providing opportunities for consumer feedback, Methanex considers that a prescribed cap is necessary to establish the scale of expenditure increase that warrants a CPP recommendation. We are not sure how project complexity can be assessed as a determinant for excluding expenditure, but we suggest an objective monetary size-test is warranted. We are not wedded to a particular level, but consider that 120% of historic capital expenditure provides sufficient materiality to warrant exclusion and a CPP recommendation.

13. This is consistent with our previous submission that included a recommendation that, where large projects are contemplated by a supplier, then a CPP is the most suitable approach rather than a DPP re-opener.

SETTING QUALITY STANDARDS

14. We believe it has been appropriate for the Commission to reassess quality standards and establishing a new standard in respect to 'interruptions' has merit. However, we do have concerns regarding interpretation and application of the standard.

15. Interruptions, defined as a cessation of supply[6], is too limiting as a quality standard. The Commission has recognised this by suggesting a 'major interruption' definition is applied which we think in practice will difficult to adequately prescribe.[7]

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[4] *"Low cost review framework for gas pipeline expenditure"*, Strata Energy Consulting Limited, 29 August 2016, page 23

[5] Section 3.32

[6] Section 5.39, footnote

[7] Section 5.53

16. We suggest a better standard to apply is to focus on Critical Contingencies, as defined in the Critical Contingency Management regulations, which covers clearly defined events that generally have significant impacts on consumers and would pick up major interruptions as well as significant pressure excursions and other undesirable situations. We believe the appropriate threshold is to require mandatory reporting by GTBs for all Critical Contingency Events.

17. However, the key determinant to determining a breach by the supplier of the quality standard is the degree of control the supplier has to (a) minimise/mitigate the prospect of the event occurring and (b) once the event has occurred, to restore quality service as soon as practicable, both while acting reasonably, prudently and consistent with standard industry practices.

18. We are not convinced that "any interruption that exceeds the limit will be a breach of the quality standard and will be enforceable under section 87" is the correct approach.[8] Instead we think that provided there is a mandatory disclosure and reporting requirement where a Critical Contingency event occurs then the outcome of the report should be the determinant of whether a potential breach of the standard by the supplier has occurred and further investigation, enforcement action or sanctions are required.

19. We agree that GTBs responsibility (and consequences under Section 87) for those events should not extend to upstream events or third-party damage, except, in both instances, to the extent that the supplier has contributed to the occurrence, or exacerbated the impact of an event. In these situations, when determining whether a breach has occurred, the Commission should take into account the degree to which the supplier contributed to damages by a failure to act reasonably, prudently and in a manner consistent with standard industry practice, to avoid and mitigate the event. An obvious example of this would be, in respect to third-party damage, did the supplier have sufficient, well-maintained signage to avoid damage caused by unauthorised excavations.

20. In respect to Section 5.36, we do not consider the standard for GTBs should be measured against the simple metric of the number of customers affected. There is a clear hierarchy of customers established under Critical Contingency management processes, based on need and the cost impact arising from a critical contingency event.[9] There are also discrete customers, such as Methanex, that have a disproportionate level of value at risk compared with other customers. We recommend that a value at risk approach is used instead of reliance on raw customer numbers.

HIGH IMPACT LOW PROBABILITY EVENTS

21. A major interruption will have significant adverse impacts on consumers and the economy as a whole given the crucial role natural gas plays for a number of businesses and other consumers.

22. However, we do not think it appropriate to automatically set an excessive mitigation expectation on GTBs as this will potentially lead to over-investment. We think applying a reasonable and prudent operator/standard industry practice approach should establish the

[8] Section 5.33

[9] The Critical Contingency Management regulations applies Critical Care, Essential Services, Critical Processing and Electricity Supply designations to categorise gas consumers.

benchmark for assessing the appropriate level of investment made by supplier to reduce the risk of interruption. Beyond that we consider the most efficient means of addressing the consequences of HILP events is for consumers to make their own arrangements.

23. However, as alluded to by the Major Gas Users Group[10], the key to achieving an efficient outcome in terms of risk mitigation between supplier and consumers is to ensure that suppliers provide sufficient information on the nature of the risks and the mechanisms they have in place to mitigate those risks, in order to allow consumers to make their choices. We suggest the following steps are taken:

    A. Clear quality standards and objectives are set by the Commission regarding appropriate expenditure and management by suppliers to minimise risks of high impact, low probability events.

    B. Full information on risks and costs is made available by suppliers to consumers to allow for informed decisions by consumers to take their own risk mitigation measures.

    We believe the Commission has a role to play in assuring sufficient information sharing occurs by suppliers to consumers and this could be achieved through setting more comprehensive reporting requirements in information disclosure.

Yours sincerely

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[10] Section E17