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31 March 2017

Tricia Jennings
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Commerce Commission
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Dear Tricia

Gas DPP Reset 2017 – cross-submission due 31 March 2017

Methanex has taken the opportunity to review the Commission's Draft Reasons Paper[1]. We have also reviewed the submissions provided by interested parties in response, and in particular the submission made by First Gas which has taken issue with the Commission's draft determinations in a number of respects.

Methanex is a user of the gas transmission system owned by First Gas, specifically the Maui Pipeline. We make no use of gas distribution pipelines so we have restricted our comments to Gas Transmission Business (GTB) related matters arising from First Gas' submission on the Draft Reasons Paper (published 13 March 2017) together with the updated draft decision relating to Gilbert Stream (published 23 March 2017).

By way of background, as a major gas consumer on the Maui Pipeline, there are two key issues of importance to Methanex in respect to the DPP reset and other determinations in respect of GTBs:

- that there is an appropriate level of scrutiny of First Gas expenditure to confirm that expenditure is prudent, reasonable and efficient; and

- whilst we support expenditure to maintain the general baseline integrity of the pipeline network, we want to ensure that Methanex does not bear socialised costs associated with expenditures on parts of the network it does not use.

[1] "Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022 Draft Reasons Paper", Commerce Commission, 10 February 2017 (**"Draft Reasons Paper"**)

In summary, the points made in this submission are:

- First Gas has proposed significant increases to expenditure that have not been sufficiently supported. Such increases should be the subject of a CPP application, as opposed to its inclusion in a DPP reset;
- We disagree with First Gas' proposal that interruptions to users in Band 2 (which includes Methanex) be excluded from the scope of a major interruption; and
- We support the Commerce Commission's draft decision to cap the annual wash-up recovery at 10%.

Starting prices and allowed expenditures

1. First Gas has proposed GTB expenditures that represent a significant step change from Business-as-Usual. Increased expenditure may indeed be necessary to address issues affecting the gas transmission network which have emerged in recent years or which may not have been sufficiently addressed by previous owners of the gas transmission network in the past. However, it is critical in the context of a monopoly business that the level of costs and timings are sufficiently supported. We agree with the Commission's conclusions that this has not been the case with respect to the Asset Renewal and Replacement (ARR) capex and Routine Corrective Maintenance and Inspection (RCMI) opex categories, within the constraints of the DPP reset process and the level of supporting information supplied by First Gas.[2]

2. Our view is the DPP reset is not well-suited to address significant step-changes in monopoly expenditures from Business-As-Usual.[3] Consequently we consider that a CPP is the appropriate path for First Gas to follow to get its proposed expenditures accepted. This would provide for greater consumer consultation, verification and auditing of those expenditures than is contemplated in the DPP reset process.

3. We understand that the Commission has decided to include $9 million of forecast capex for the Gilbert Stream project.[4] In this matter, we defer to the Commission's judgement and it does appear that this specific project is necessary and well-defined. However, we are concerned that this decision may be precedent setting in regard to consideration by the Commission of other significant ARR expenditure that First Gas has requested to be added back. In aggregate First Gas is requesting $38 million of additional capital expenditure[5] for which we are not convinced that sufficient evidence has been provided that these are prudent, reasonable or efficient expenditures.

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[2] Draft Reasons Paper, X20

[3] Draft Reasons Paper, X16, X18 and 4.42

[4] "Gas DPP 2017 reset: First Gas Transmission, Gilbert Stream – updated draft decision", Commerce Commission, 23 March 2017

[5] First Gas Submission, page 5, proposes ARR capex of $94.6m, excluding White Cliffs, representing an increase of $38m or 67% over the fall-back amount determined by the Commission. Of this amount it appears that $26m (Appendix B) is allocated to geohazard and in-line inspections which we are not clear has been sufficiently supported. We also note that it appears that First Gas's forecast ARR expenditure sets aside $6.5m for Gilbert Stream and not the $9m described in the Commission's findings on allowable expenditures. In our view the various figures provided in First Gas' submission adds further confusion as to what should be the appropriate level of supportable expenditures in First Gas' forecast.

4. As a CPP application to incorporate the White Cliffs project appears inevitable[6] our recommendation is, having accepted Gilbert Stream expenditure, for other non-BAU expenditures that have not been accepted under the draft determination to remain excluded. First Gas then has the opportunity to propose those expenditures as part of a forthcoming CPP application which will provide for a more appropriate level of scrutiny than has been the case under the DPP reset process.

5. This view also holds for the increased RCMI expenditure that has not been accepted.[7] We accept the point made by First Gas that additional near-term work is necessary to identify and remediate known geo-hazards. However, we also accept Strata's view that First Gas has not sufficiently made the case for sustaining those elevated costs over the entire regulatory period.[8] Based on information supplied in First Gas' submission, and even accounting for the reclassification of some opex historically allocated elsewhere by Maui Development Limited, First Gas is proposing an additional $3 million of average annual RCMI expenditure above Business-As-Usual.[9]

6. A CPP application may allow First Gas the opportunity to support its case for the level of ongoing RCMI expenditures it has proposed. Alternatively, a DPP/CPP re-opener might be justified if for example the need for significant unfunded geohazard work emerges. In the meantime the DPP reset proposed by the Commission will not prevent First Gas undertaking the near-term work it has proposed by reprioritising expenditures.

7. In response to the Commission's draft determination First Gas has proposed a fall-back amount based on step-and-trend. Whilst Methanex is not in a position to assess the methodology First Gas has used in its proposal to restore RCMI opex[10], we don't believe the Commission should accept the adoption of a fallback methodology that would have the result of restoring expenditures that have been rejected by the Commission as being insufficiently supported.

Quality Standard – Limiting the major interruption definition

8. We do not accept the reasons First Gas has given in proposing that, in defining the scope of a major interruption, the Commission changes the cut-off from Band 1 to Band 2.[11] The purpose of the definition is to capture, as far as practicable, events that have a major impact on consumers. The only reason for not including all Bands, including Band 1, is that Band 1 consumers, uniquely, have the ability to switch fuel sources to mitigate the impacts of gas supply interruptions. Without qualification, Methanex, as a Band 2 gas user, would be significantly adversely impacted by an interruption of gas supply. Consequently we recommend that the Commission retains the definition it has proposed.

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[6] First Gas mentions the prospect of a CPP to accommodate White Cliffs frequently in its submission.

[7] Draft Reasons Paper, X20

[8] "Report on First Gas transmission supplier evidence assessment responses", Strata Energy Consulting, 28 November 2016, page 2-3

[9] First Gas Submission, reference to Table 1, adding average $0.9m for reclassified MDL opex to the historic average of $13.1m per annum yields a total of $14.0m. This amount is consistent with the Commission's fall-back amount but significantly lower than the $17.0m average per annum which First Gas is seeking to restore.

[10] First gas submission section 2.5 and Table 1, page 22-23

[11] see page 42-43 of the First Gas submission.

Wash-up mechanism for under/over recovery

9. We consider that the Commission's draft decision to set the wash-up cap at 10% is appropriate as a mechanism to reduce price volatility. It is also consistent with the IM's and previous decisions by the Commission to set a limit on annual wash-up recovery.[12]

10. First Gas has advised the Commission that its proposed pricing methodology will not fit with placing a cap on annual adjustments. We consider that the example table provided by First Gas on page 47 did not provide actual evidence of how the capped adjustment creates an issue.[13]

Yours sincerely

Kevin Maloney
Managing Director
Methanex New Zealand Limited

[12] Draft Reasons Paper, F22-F26

[13] First Gas submission, page 12 and Section 5.2-5.3.