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Dear Sir

FONTERRA SUBMISSION ON "OPTIONS FOR VECTOR TRANSMISSION CAPACITY"

Thank you for this opportunity to make a submission on the options paper "Options for Vector Transmission Capacity", May 2010.

Fonterra makes this submission from the perspective of not only being one of New Zealand's major energy users but as a cooperative of dairy farmers who produce 75,000 tonnes of milk a day in the peak of the production season. This milk comes every day and unlike many other industrial processes there is no on/off valve. Further, the raw milk is highly perishable and cannot be stored for any period of time even if there was capacity to do so.

Security of energy supply is therefore of paramount importance to Fonterra

The cost of that secure supply of energy is also vitally important. Ninety-five percent of Fonterra's production is exported. These exports, in the main, compete with dairy products from other jurisdictions that enjoy various levels of subsidisation, something that has not been enjoyed by dairy exports from this country for some time.

The cost of energy has, in the past, been a competitive advantage enjoyed by energy intensive New Zealand exporters. That competitive advantage has now been totally eroded away with gas prices now less, for example, in the US than here in New Zealand. The price impact of the NZETS has increased further the cost of energy and further dented the competitiveness of New Zealand's dairy exports.

The capacity issues and thus security of supply with the North Pipeline are of serious concern to Fonterra as 6,000 tonnes per day of milk is processed in that region over the peak months. That milk processing is totally reliant on the North Gas Pipeline. If it could be transported and processed in the Waikato region its transport to that region would require one truck and trailer getting through the Auckland road network every 6minutes 24 hrs per day.

The Company's Takanini plant is also reliant on the North Pipeline and that facility supplies over half of the milk to the New Zealand white milk market.

We are aware from the 9th June meeting in Auckland that Vector has views on the various options for transmission capacity. At that meeting Vector advised that they would try and make those views public before the closing date for submissions to your Options Paper. That has not come to pass so this submission has been drafted without the benefit of having that information from Vector.

We would be happy to elaborate on the submission but feel we will be better informed if any discussion between us was after we have the benefit of Vector's views

Yours sincerely

Doug Watson
Energy Manager

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FONTERRA SUBMISSION ON "OPTIONS FOR VECTOR TRANSMISSION CAPACITY"
Issued May 2010

General

1. Fonterra is a large exporter of dairy products with markets in over 140 different countries. Fonterra earns more than 20% of New Zealand's export income and has milk processing facilities from Kauri in the north to Edendale in the south.
2. In total there are 23 milk processing sites responsible for processing 75,000 tonnes of milk each day in the peak of the dairy season. Unlike many other industrial processes there is no on/off valve; that volume of milk comes each and every day. Further complicating this is the fact that the raw milk cannot be stored for extended periods (measured in hours not days) and besides there is just not the silo space to store 75 million litres of milk
3. Fonterra's North Island processing sites are predominantly gas fired, many solely reliant on that gas
4. Transmission to the majority of those sites is reliant in some way on the Vector gas transmission network. Many sites have no alternative to gas as a fuel and are thus totally at the mercy of the Vector transmission network. Of particular note, in relation to this Options Paper are the northern sites at Kauri and Maungaturoto between them responsible for processing the bulk of the milk north of Auckland, at peak some 6,000 tonnes per day. Even if there was capacity to process this quantity of milk south of Auckland in the peak imagine the logistics of getting it through the grid locked roading system that is Auckland – a truck and trailer load every six minutes
5. The Company also has processing facilities within greater Auckland that are also totally reliant on the vector gas transmission system; facilities that New Zealand consumers are also totally reliant on for their daily food nutrition. This comment particularly applies to the milk processing site at Takanini which supplies liquid milk to more than half of the total New Zealand white milk market]. In addition to the Takanini processing plant the Tip Top ice cream factory at Mt. Wellington is dependent on this transmission line ,
6. Fonterra's peak loading is non coincidental as it follows the dairy season with its early summer peaks and mid-winter troughs

Fonterra's Key Concerns

7. Critical to Fonterra is security of supply. Any change to the existing management/operation of the transmission Vector Transmission system must not negatively the impact the systems short, medium and long term reliability
8. Further to the security supply point in 7. above there cannot and must not be management systems introduced that have the potential to restrict the supply of gas to processing facilities such as milk processing unless under extremely abnormal conditions.
9. Total energy costs have increased at alarming rates over the past five years, in Fonterra's case this increase has been 49% For an export company (95% of the Company's New Zealand production is exported) that increase is intolerable and if it were to continue NZ will lose its competitiveness in a very difficult market place and against often heavily subsidized competitors.

Fonterra sees the cost of transmission as an integral part of the energy supply chain and unfortunately a contributor to the large increases being incurred.

10. Fonterra's believes that any new gas transmission management system should allow companies like itself with non coincidental peak profile to get considerably better commercial reward than it does under the current system.
11. Fonterra believes that Vector should be required to communicate its investment schedule/ plans (much like other utilities do in NZ) and thus users of its transmission assets would be better warned of impending capacity restrictions

Comments with respect to various questions in the Options Paper

Q1 - Do you agree the objectives identified in section 5 are appropriate criteria for evaluating transmission capacity options?

Generally agree with the evaluation criteria as established. However the criteria assume equal weighting is given to each objective.
Disagree that minimizing *transition costs* (short term issue) is an important objective. It would be more appropriate to decide preferred regime on the basis of other objectives first and then once selected work on how to best minimize any transition costs.

Q2 - Do you agree with the current capacity arrangements?

It is difficult to understand how *investment efficiency* can be rated as *moderate* when the report itself is critical of the *current capacity arrangements* as measured against the *three impediments to efficient investment*. Our reading of the current situation would be *"poor".* For example the NZ gas market is largely predictable within the timeframe of investment decisions. Maximum demands are well understood and significant incremental increase in demand can easily be signalled if Vector were to make more of an investment in obtaining this necessary information.

A good score on price stability is also debatable in the context of throughput fees that have been climbing at a compound rate of 12% pa since 2003.

Q3 - Do you agree with the evaluation of the contract carriage option?

It is difficult from our position to see big distinctions between *contract carriage* and the *current arrangements* we also have difficulty rating this option as many of the "scores" would change significantly were there a secondary market

Q4 - Do you agree with the evaluation of the common carriage option?

Fonterra does have concerns with the *common carriage* option from the perspective of *supply security* and *price stability* as noted in the first sections of this submission the dairy sector in New Zealand competes in a subsidized global market and any deterioration in either of these criteria cannot be tolerated. We note that in your summary to section 9 *Common Carriage Option* you state *"Common carriage eliminates the problems associated with contract carriage* ***without secondary markets"*** We would like to understand this more and to be assured by you that the *common carriage* option is not reducing security of supply levels and if it isn't it is not intending to maintain security of supply levels at inefficiently high costs.

Q5 - Do you agree with the evaluation of the current hybrid option?

There is the risk that this option has the potential to default to a contract carriage option because there is no limit on how much reserved capacity can be bought that might crowd out opportunities for

common users. Refinement of this *hybrid* option should though mitigate this risk. Fonterra's sees this option as having to mitigate its concerns with the *common carriage* option

Q6 - *Do you agree with the evaluation of the MDL carriage option?*

We agree with the evaluation

Q7 - *Do you agree with the evaluation of the incremental change option?*

Perhaps aspects of this option have merit in the short term ie until the Commerce Commission settles on its decision in 2012. We suggest, following advice, that the incremental changes could include:

- More comprehensive disclosure – i.e. daily on historical physical throughput for each of the systems and off-takes – or alternatively a report on spare physical capacity at each point on each day to avoid commercially sensitive information from being disclosed. This information could be available on weekly or monthly basis rather than disclosed annually.
- Requiring reserved capacity to be held in the name of the end user, so that if the end user changes supplier, the supplier automatically has reserved capacity transferred to it.
- That a spare physical capacity (even if there is no commercial capacity) be made available on common carriage and interruptible basis and that proceeds be rebated to contracted users on a pro-rata basis for physical capacity that they made available – e.g. if a user has 20TJ of reserved capacity but only uses 16TJ physically, the "spare 4TJ" is made available to a pool. If someone who also has 20 TJ of reserved capacity but requires 24TJ they automatically take the 24 TJ and pay for the additional 4 TJ to the pool.

Q8 – Are there other options that you think should be considered and evaluated?

We believe that the selection of options has covered the spectrum sufficiently.

Q9 – Do you agree that only the hybrid and incremental change options should be considered further?

Yes we agree and suggest that given the timing of the Commerce Commission work, that incremental change is a practical intermediate step for improvement.

Q10 – Do you agree with the proposed next steps?

Yes we do on the proviso that our views above are considered