30 August 2013

Ian Wilson
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Gas Industry Company Limited
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Wellington 6143

Dear Ian,

Re: Submissions on the Gas Transmission Investment Programme, Status and Development- July 2013, and on the Advice from the PEA – July 2013

1. This submission is made on behalf of the Major Gas Users Group (MGUG):
    a. Ballance Agri-Nutrients Ltd
    b. Carter Holt Harvey Ltd
    c. Fonterra Co-operative Group Ltd
    d. New Zealand Steel Ltd
    e. New Zealand Sugar Ltd
    f. Refining NZ

2. The following comments relate to specific concerns we have with both the GIC paper and PEA report. While the views are expressed on behalf of the MGUG, we note that members may have views specific to their operation that they may choose to correspond directly with the GIC.

GIC Report General

3. We note that the GTIP (and related projects) was set up as a matter of some urgency in response to specific constraints on capacity. While this urgency appears to have reduced we note the PEA comments (Page 15) that in the context of the time scale for making changes and that some risks could emerge on shorter timeframes etc "suggests there are no grounds for delay". We agree.

4. We support GIC's view that the GTIP "remains the best framework for the work". However we have concerns with the way the GIC is now regarding what MGUG sees as a continuing project. MGUG strongly recommends that a project focus should be maintained.

5. The MGUG supports the evolutionary convergence approach but this is a pathway description, not an alternative outcome. We'd note that the various "alternatives" can in fact be complementary along an evolutionary pathway and should not be excluded as interim and final solutions for developing a more efficient gas transmission market.

A. Governance

6. To date MGUG has been fully supportive of the approach to the GTIP. Given the requirement for specific deliverables to be produced within a defined timeframe, the governance arrangements have recognised the need to apply a project focus. This has enabled the GTIP to engage all stakeholders (including consumers), and facilitated access to specialist expertise as required.

7. We do not see that that project focus has changed at this point of the programme. MGUG is therefore disappointed that GIC's way forward has not sought to ensure continuity as a project.

8. Instead the PEA has called on the signatories to the MPOC and VTC to adopt and operationalize the guiding principles by "…establishing governance arrangements to support delivery of the plan". Responsibility for outputs and timeframes has been devolved to participants; as a result a project focus and the broader industry participation that was a feature is at risk of being lost.

9. PEA has invited the GPBs and shippers to adopt and operationalize the guiding principles; in essence the parties who have <u>a vested interest in the outcomes of this process</u> are the holders of the pen. While the PEA has recommended regular reporting to GIC and consultation with wider industry these parties are nevertheless arms-length from the process.

10. GIC is proposing a parallel process whereby it determines the preferred option and undertakes design, ready to be put forward as a Statement of Proposal by mid 2014 (the expectation is that progress will be achieved within the expected timeframes). At the same time GIC expects there will be a cross fertilisation of ideas between the two processes although it is not clear how this would work in detail.

11. The MGUG considers that a parallel process may be excessive and unnecessary and may undermine the momentum which a continuing project focus would provide. GIC can still have resort to the regulatory process through active monitoring of well scoped deliverables using a gate process (go/no go) to test whether there is a need for the regulatory option.

12. As users we expect governance arrangements for a project of this nature to provide a good place for consumers, as well as the regulator and other stakeholders. We do not see why these arrangements cannot be structured in a project focussed way to ensure that, including involving the regulator and other stakeholders. We believe this is reinforced by the objectives of the Gas Act. Unless there is an independent presence within these industry-arranged deliberations it will be difficult to assess whether roadblocks are arising or whether an emerging consensus is efficient. It would be difficult for the regulatory backstop to operate in an efficient and timely manner if this information is not available.

B. Transparency

13. We note the PEA was detailed in the nature of the transparency expected for a well-functioning market, which for the sake of emphasis we repeat (page 18):

> "Transparency of information is a vital component of a well-functioning pipeline capacity access and pricing regime. By making information about pipeline capacity, usage, contract rights and prices widely available in a user friendly form, parties are better able to assess the likelihood of congestion, and to optimise their plans.

Transparency also promotes robust discovery regarding the price of capacity firmness. Absent transparency, some parties will be reluctant to participate in price-based allocation processes due to fears (whether well-founded or not) that they could be gamed by parties who enjoy privileged access to information, such as shippers who are affiliated with pipeline owners.

Finally, transparency promotes broader confidence in arrangements by politicians, industry, customers, and regulators. It allows problems to be identified and remedied at an earlier point, and the 'sunshine test' can act as an important check on the behaviour of market participants."

14. GIC has engaged further with Vector (letter from GIC to Vector dated 11 March 2013) to establish a level of transparency for the VTC that is consistent with that of the MPOC. We are unsure that setting a transparency benchmark at a level of the MPOC meets the PEA's statement on transparency.

15. Nevertheless we agree that transparency is a key characteristic of a sound access and pricing regime. At this stage the outcomes from this dialogue with Vector are uncertain and it is difficult for consumers to judge without the benefit of being involved in the process. We note that in its presentation to the 15 January workshop,[1] the GIC explicitly called for objections to the transparent disclosure of nominations, receipts and deliveries or flows, capacity reservations and contracts. To our knowledge, no such objections have been offered.

C. Project Approach

16. The MGUG believes that GTIP should still continue to operate a project approach to the way forward rather than relying on the parallel process as suggested. In principle this should include:

    a. Specific project management position

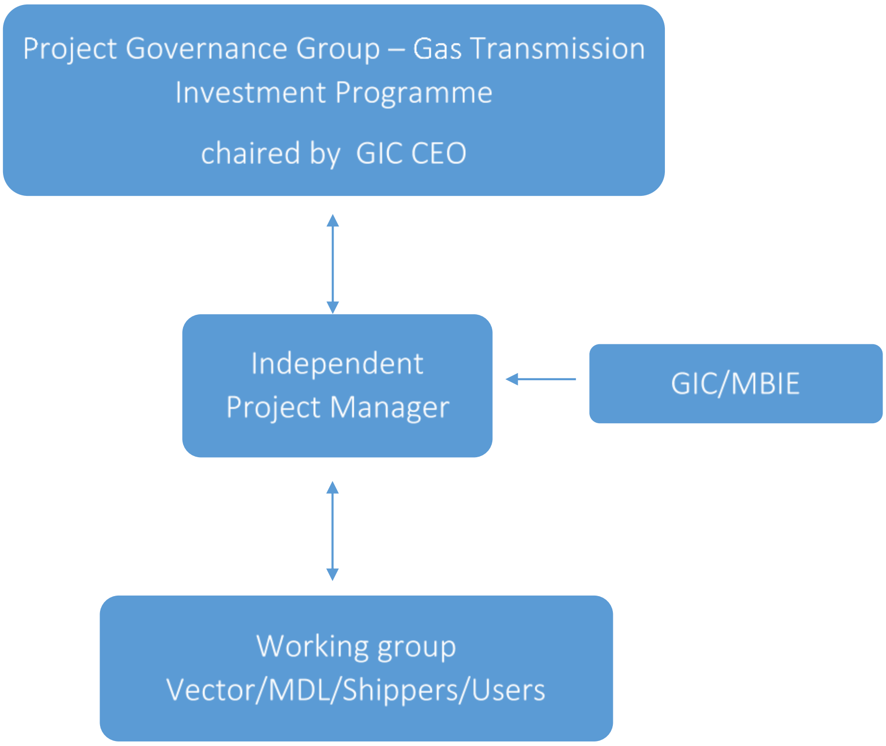
    b. Managed as a specific set of deliverables in a time bound manner

    c. Allowing for a wider range of stakeholders (including regulatory oversight)

    d. Supported by an overarching governance body broadly representing the industry (similar to that for the Panel of Strategic Advisors).

17. A suggested structure would be as follows:

[1] http://gasindustry.co.nz/sites/default/files/u254/demand_management_and_transparency_workshops_-_january_2013.pdf



18. It is difficult to comment on specific deliverables, given they are expressed as high level guiding principles. However they will need to be defined further and agreed if they are to be adopted and operationalized as the PEA suggests. These will then need to be incorporated as a specific set of milestones with the resulting plan indicating a logical progression for achieving.

19. The PEA indicated that change requests to implement governance should be formulated and proposed by November 2013. We are not sure what this means in practice but there should be a time bound project plan developed as part of this process.

20. A further concern with the proposed governance process is that it involves parties that are in competition with each other (e.g. shippers) in direct discussions over the terms and conditions of pipeline access, which terms will then have an impact on competition. This places it within the area of concern relevant to section 27 of the Commerce Act, the section dealing with agreements between competitors. We suggest that broader participation in the code-change process would help to mitigate the risks that (a) parties will fail to agree and (b) they might agree on measures that weaken rather than strengthen competition.

PEA General

21. The PEA report evaluates what it terms "alternative approaches to improve arrangements" before deciding that "Evolutionary Convergence" is the preferred approach. The MGUG is of the view that the approaches aren't alternatives, but rather that evolutionary convergence could include all of the approaches over time and in fact there are good reasons why all of the alternatives should still be considered within the evolutionary mechanism.

22. For example, "capacity follows the end user" has little relevance with capacity constraints/ capacity allocation/ or investment. It is simply a principle that addresses downstream competition issues. The principle may need to be modified on the basis that a shipper uses a

portfolio approach that isn't necessarily the sum of individual demand to transfer capacity. It is then up to the new shipper to determine whether the transferred capacity is sufficient and whether incremental capacity is bought or sold via, for example, a capacity auction.

23. Secondly the PEA doesn't deal with the investment barriers created by pipeline ownership very well. Vector particularly with its portfolio of investment opportunities, some in regulated businesses, some unregulated, will look for the highest return across its portfolio. An investment decision in pipeline capacity may be economic on a standalone basis but still not occur because return is less than say across Vector's fibre business. The risk of underinvestment in key national infrastructure suggests that it will be necessary to bring in a regulatory investment test for gas transmission.

24. The wording around "evolutionary convergence" – i.e. "timely manner based upon current and expected developments in the state of the gas market" risks a pedestrian approach to evolution. If the direction of change is beneficial then the industry should be heading down a more specific time bound path irrespective of what the current and expected state of the gas market is ameliorated only if the immediate cost of the change is demonstrated to be significant in relation to foreseeable benefits.

Yours sincerely

Hale & Twomey Ltd/Arete Consulting Ltd
For the Major Gas Users Group

Appendix 1: Submission template
GTIP, Status and Development - July 2013

QUESTION		COMMENT
Q1	Do you agree with our assessment of the GTIP thus far? If not, where does your assessment differ from ours?	We agree with GIC's general comment that the GTIP remains the best framework to achieve the programme but differ on particular aspects, namely: • Although Vector's Capacity Determination project is noted to have project objective "achieved" we would note that MGUG raised a number of points that have been acknowledged but disregarded by Vector. Matters that haven't received a satisfactory outcome include the RPO definition and basis for determining maximum contractual capacity. • While supporting evolutionary convergence this does not mean that alternatives considered should , by definition be excluded (e.g. 'capacity follows end user' could form part of a range of capacity services • We disagree with the process going forward – the success of the programme to date has been due to the project focus adopted for execution. We believe a project focus should continue with a defined governance arrangement supporting delivery of agreed milestones with an agreed project timeframe and, further, we suggest an independent professional project manager be appointed to manage the project
Q2	Are there any Projects you think should be given greater or lesser attention by Gas Industry Co? Are there any other projects you think should be considered as part of GTIP?	The GIC needs to consider the design for a Regulated Investment Test for gas transmission and gas distribution businesses. GIC should also becoming the repository for all statutory and other material information on the market that is currently difficult to locate e.g. non-standard agreements
Q3	Do you agree that the characteristics of a well-functioning transmission market, as described by the PEA, could be used as criteria for evaluating regulatory options?	Yes
Q4	Do you agree with the proposed way forward for the Information Projects?	Some elements of Information Projects are critical to Market Projects e.g. Transmission Market Disclosure Project and incomplete dialogue with Vector. It is not clear that both the Maui and Vector systems provide the level of transparency sought by the PEA (para 4.3 on page 18). It is difficult to see how this would not be part of the Market Projects. We disagree that it should be last of the GTIP.

QUESTION		COMMENT
Q5	Do you agree with the proposed way forward for the Market Projects?	No – see discussion in Q4
Q6	Do you agree with the proposed way forward for the Regulatory Projects?	Agree except GIC needs to be more proactive than waiting for significant investments to occur. At this stage it is not a given that investment will proceed even if justification is established, given the commercial nature of the participants. Further work on a Regulated Investment Test is absolutely necessary to test the regulatory framework where there is a need to force an investment, and also to understand the impact of pricing methodologies on investment decisions.

Advice from Panel of Expert Advisers – July 2013

(note that these questions are not embedded in the PEA's report, but the questions reference the relevant sections)

QUESTION		COMMENT
Q7	Do you agree with the Problem Definition? If not, please explain your reasons. (see PEA's Second Advice paper, Section 1.2)	Yes
Q8	Do you agree with the assessment of the current state of the market for transmission capacity? If not, please explain your reasons. (see PEA's Second Advice paper, Section 2.2)	In general yes. However the assessment for Vector's system is only made on basis of firm capacity. MGUG would note that interruptible capacity is not included in the assessment. We'd note that Refining NZ for example still struggles to get the gas that it wants on its interruptible supply and real physical capacity constraint has been a feature of the North pipeline lateral for some time. Furthermore the possibility of gas users limiting their demand because of potential congestion raises the need to undertake analysis of real or potential demand rather than e.g. relying on flows and committed capacity purchases.

QUESTION		COMMENT
Q9	Do you consider that the PEA has considered all the reasonable options for improvement? If not, what other options would you wish to have considered? (see PEA's Second Advice paper, Chapter 5, Broad approaches to moving forward)	It has considered reasonable options but it has failed to establish the case that they are competing alternatives before ruling out obvious short term evolutionary steps like capacity following the end user and capacity auctioning for example.
Q10	Do you agree that Evolutionary Convergence is the best approach to improving access arrangements? If not, what other option do you prefer? (see PEA's Second Advice paper, Chapter 5, Broad approaches to moving forward)	Evolutionary Convergence describes a pathway approach – it is not a solution to specific issues affecting access arrangements.
Q11	The PEA proposes a set of 'guiding principles'. Do you agree with these principles? If not, what alternatives would you propose? (see PEA's Second Advice paper, Chapter 6, Guiding principles for moving forward. Also summarised in bullet point format in of Gas Industry Co's Status and Development paper)	The guiding principles are secondary to overlying principles determined by the Gas Act Objectives and characteristics of a well-functioning market.
Q12	Do you agree with the PEA's overall conclusion, including its 'indicators of success'? (see PEA's Second Advice paper, Chapter 7, Conclusion)	The measures largely describe short term process steps being achieved. MGUG would also suggest that more specific outcomes as defined by the project team be included.

QUESTION	COMMENT
Q13 Do you agree with the PEA’s recommendation to Gas Industry Co? (see PEA’s Second Advice paper, Chapter 8, Recommendations)	MGUG considers the recommendations to be reasonable but not sufficient. In particular as noted in our covering letter: • The guiding principles in themselves are developed from higher guiding principles related to Gas Act Objectives and well-functioning market characteristics. These principles override the PEA’s recommended guiding principles. • MGUG’s recommendation is that a project governance structure and project management approach continues to the next phase of work and that includes engaging an independent professional project manager. • The need to include other stakeholders in the project including consumers and regulators. Leaving the GTBs and Shippers holding the pen raises conflicts of interest issues. • The addition of RIT as a regulatory option should be considered by the GIC as part of the GTIP.

Q14	Several boxes with dashed borders appear throughout the PEA's Second Advice paper. These boxes contain material that has been discussed by the PEA but not sufficiently closely examined to draw firm conclusions. Do you have any comments on this material? (see PEA's Second Advice paper: Section 6.1.6 box titled 'Possible initial components of a development path'; Section 6.2.2 box titled 'Rotowaro model'; Section 6.2.3 box titled 'Possible initial components of a development path'; Section 6.3.4 box titled 'Possible initial components of a development path'; Section 6.4.2 box title 'Possible initial components of a development path')	Re 6.1.6 this provides a level of definition of the development path and indicates what needs to be specified within the deliverables of a project plan. We note that further drilling down of details may be required including • Capacity Products – ○ well defined firm and non-firm services ○ the percentage split between them ○ more flexibility over time periods e.g. the start date for the gas year and provision for seasonal variation within years. • Transparent disclosure of nominations, receipts and deliveries or flows, capacity reservations and contracts. • The option for users to hold the right to capacity ○ It should be possible, as an optional extra service, for users to hold the assignment right to contracted capacity; ○ This would enable users to implement their own "capacity follows user" scheme should they wish to; ○ We appreciate that this could attract an extra payment to reflect the prospect of shippers losing some portfolio diversity; ○ Nevertheless, some users may want such a service and be willing to pay for it. We note also: • The discussion centres on firm vs. non-firm capacity as if these are the two alternative products. We aware that Vector is considering different classes of non-firm capacity with different commercial priorities. This seems to introduce unnecessary complexity to system changes that users haven't requested. • If the transparency on the Maui system is to be considered a benchmark it may still fall short of what transparency is available in other jurisdictions, such as the US. Secondly Maui transparency is not something that appears to be "widely" available so falls well short of how the PEA describes an ideal transparency standard (4.3) • For transition issues we think it is more appropriate to recast this more generally as "agreements giving rise to property rights would be phased out or bought out". Re 6.2.2 the Rotowaru model raises a number of uncertainties/ambiguities which are confusing because it is combining entitlement to gas with capacity and it is not clear to MGUG how this is intended to work (or indeed what it would mean for different market participants) – the model needs further scrutiny.