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Dear Ian

1. Methanex provides this submission in response to GIC's Preliminary Assessment of October 2018 Gas Transmission Access Code dated 5 December 2018 ("PAP").

   In the two submissions Methanex made to the GIC in October 2018[1] in respect to the proposed Gas Transmission Access Code ("GTAC") it acknowledged a number of improvements that had been made during 2018 to the previous version of the GTAC which GIC had determined was not materially better than the existing pipeline codes. Notwithstanding those improvements, Methanex also set out significant unresolved concerns regarding the revised GTAC particularly when compared against the existing arrangements Methanex has with FGL for pipeline access under the Maui Pipeline Operating Code ("MPOC"). The concerns we raised have not been lessened by GICs re-assessment.

The impact on Methanex of a single integrated code

2. Most of the benefits that have been attributed to GTAC by GIC in its assessments have been by comparison with the VTC. There is much less evidence of benefits being derived from the GTAC when compared with MPOC.

3. Methanex has submitted previously that the approach taken by GIC to compare the GTAC against a notional combined VTC/MPOC regime, rather than assessing the GTAC against each individual code, has been detrimental to fairly assessing the impacts upon Methanex' access rights. This aspect of GIC's approach to assessing the GTAC is particularly concerning to Methanex given it does not participate on the VTC-related network and so will see none of the benefits that GTAC may derive over the VTC, but, as exclusively a party to the MPOC, does see a deterioration generally in its terms of access and an increased uncertainty regarding its ability to reliably transport its nominated gas through the Maui Pipeline.

[1] Methanex provided submissions dated 3 October 2018 and 23 October 2018

Increased risks of socialised curtailment

4. In putting forward its argument that the risk of curtailments, and particularly socialised curtailments, would be increased under GTAC relative to MPOC, Methanex provided what it considers to be valid reasons for its position:[2]

   (i) More reliance placed on Shippers to physically balance gas flows to assure pipeline stability, where they may be unable to do so, or poorly placed when compared to FGL or Interconnected Parties.

   (ii) Less guidance is provided on FGLs commitments regarding buying/selling balancing gas to remedy imbalances.[3]

   (iii) The provision of increased and unpriced flexibility will increase line pack variability and more particularly increase unpredictability as Shippers take full advantage of that flexibility. Added to this is the prospect that the Mokau compressor may become increasingly devoted to providing support for that flexibility thus preventing its use as a stand-by reserve to address unpredicted swing.[4]

5. In arguing an opposite conclusion that socialised curtailments are likely to be reduced under GTAC, Methanex considers that GIC has not made compelling arguments to support that position:

   (i) The principal argument made by GIC regards the prospect of increased information flows under GTAC enabling curtailments to be more targeted when needed.[5] While there may be more nomination information in respect to gas offtakes on the VTC network, there appears to be no increase in the information available to FGL under GTAC in respect to gas injections generally, or offtakes from the Maui Pipeline, other than in respect to Peaking Parties nominations. It is also unclear to Methanex that the FGLs proposed Curtailment SOP, which GIC has made specific reference to[6], provides any greater level of FGL scrutiny than that already applied under MPOC.

   (ii) As far as the peaking regime is concerned, there will be increased information provided to FGL on hourly <u>forecast</u> gas flows by Peaking Parties. However, this does not address the increased curtailment risk of having wide tolerances that will allow for significant variation between actual and nominated gas flows combined with the ability for peaking parties to renominate intra-day, including abruptly changing their hourly profiles.

   (iii) The provision of increased information flows does not, as a matter of course, improve predictability and stability on the pipeline system. That also requires parties to flow accurately to their nominations. Failure to match nominations to actual gas flows is the inherent risk of providing increased flexibility that is of concern to Methanex and is not directly addressed by increased information flows.

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[2] Refer to Methanex 3 October 2018 submission, Items 4 and 7

[3] Section 3 of MPOC has no analogue in GTAC. There is also limited guidance provided in proposed Balancing and Curtailment SOPs on the measures FGL would take, or the circumstances under which it would buy/sell balancing gas to prevent curtailments.

[4] Use of the Mokau compressor to support free flexibility will, even if curtailments can be avoided by doing so, result in socialised costs associated with operating the compressor for that purpose.

[5] PAP, page 71

[6] PAP, page 71

6. More importantly, GIC has made no comment regarding the concern Methanex has that FGL may adopt a more 'hands off' approach to pipeline balancing[7], placing more onus upon Shippers to resolve physical imbalances. Placing reliance upon incentive charges as the predominant means of balancing the pipeline may well mean that large incentive charges are accumulated by FGL without achieving the desired outcome.

   Relying on incentives gives little regard to Shippers ability to actually address physical imbalances as they occur and before it becomes necessary for FGL to undertake direct curtailment action. In Methanex view, the prospects of excessive curtailments will depend mostly upon how FGL exercises its discretion regarding pro-active balancing, given that in Methanex' opinion it has less commitment to do so under the GTAC than is the case under MPOC.[8]

Incentive Pool/Fee Rebating

7. In the early stage of GTAC development FGL proposed incentive fee rebating and treating incentive fees generally as revenue neutral. At the same time FGL chose to discontinue the provision of an Incentive Pool as a repository for imbalance/peaking charges and which enables a party, that through no fault of its own has been unable to offtake its nomination, to claim liquidated damages in respect to gas it has not been able to offtake as a consequence of the actions of another party.[9]

8. Methanex considered that FGLs provision of incentive fee rebating was a reasonable compromise for FGL discontinuing the Incentive Pool as it would provide some mechanism to compensate parties who are more accurate with their nominations and who also face greater risk of being curtailed where they have not caused or contributed to the issue.

   FGLs subsequent decision to then drop the provision of incentive fee rebating and not at the same time reinstate the Incentive Pool as a claim mechanism now leaves parties with no remedy where they are curtailed due to another party's actions. This is of significant concern to Methanex and we consider that GIC has not sufficiently assessed this aspect of the GTAC.

9. The principal argument made by FGL in regard to justifying not having the Incentive Pool mechanism, and an argument that GIC seems to have accepted at face value, is that the claim mechanism has not been used under MPOC. [10] This is a poor argument, and is analogous to a party cancelling an insurance policy because it has had a history of making no claims.

   In recognition that parties are generally prohibited from making claims for damages against each other, MPOC provides both a back-to-back indemnity in the case of losses caused by the delivery of non-specification gas AND the Incentive Pool claim mechanism to compensate for losses caused by curtailments. Given that GTAC retains the general prohibition on parties' rights to claim damages from each other, it is inconsistent for it to retain the indemnity on non-specification gas and at the same time exclude the Incentives Pool regime.

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[7] Refer to Item 4(ii) in Methanex' 3 October 2018 submission
[8] Absence in GTAC of an analogue to Section 3 of the MPOC.
[9] Section 12.14, MPOC
[10] PAP, page 94 and again at page 98

10. Methanex considers that that there is a higher risk in GTAC when compared to MPOC in regard to 'forced' curtailments of compliant Shippers which may increase the prospect of losses being incurred. This warrants some form of compensation mechanism and makes the decision to abandon the Incentives Pool, without an alternative compensation mechanism, premature at the very least.

11. It is important for the GIC to explore the issue of the absence of the Incentives Pool under GTAC more thoroughly and give consideration to the extent to which changes under GTAC may increase the need for a liquidated damages mechanism.

Interconnection Arrangements

12. Methanex acknowledges that the revised GTAC has been improved compared with the previous version by having incorporated the essential terms and conditions for interconnection, at least in respect of those interconnected parties that will be bound by them.

    However, there remains significant negative implications of having a number of existing VTC interconnection agreements grandfathered into the GTAC (some of which are also undisclosed) which will not be subject to the terms of Schedules 5 and 6. This, together with the need for MPOC interconnected parties to negotiate new ICAs, makes interconnection arrangements under GTAC a deterioration for MPOC interconnected parties compared with the status quo.

13. Methanex believes that GIC has not considered this situation sufficiently in assessing the GTAC and the impact it will have on existing MPOC parties. In its assessment, GIC makes the point that *"GTAC interconnection arrangements are …. more comprehensive and transparent than those of the VTC"*[11] without at the same time reflecting on the fact that those same VTC interconnection agreements will continue under GTAC while being less comprehensive, less transparent and not covered by the common interconnection terms and conditions.

14. FGL has previously made the point that it can't unilaterally vary or terminate previously negotiated commercial arrangements, but the insertion of Section 22.16(b) into MPOC (with GICs assent) enables it to achieve essentially that result with regard to MPOC interconnection agreements.

    MPOC parties are now required to negotiate new ICAs in order to continue being able to access the Maui Pipeline. As a consequence of terminating the MPOC ICAs the imbalance in negotiating power now strongly favours FGL and Methanex faces the prospect that it will be presented with terms and conditions of access that are worse than status quo.

    Methanex considers that this issue should have formed an element of the GICs assessment of the relative benefits of GTAC, at least to those MPOC interconnected parties that now find themselves in a disadvantaged position relative to VTC interconnected parties who can count on their interconnection agreements continuing unchanged.

[11] PAP, page 26

Running Mismatch Tolerances

15. In respect to its earlier submissions Methanex wishes to highlight two issues regarding running mismatch which it considers GIC has not sufficiently considered:

    (i) Methanex is concerned that excessive free flexibility may be provided to Shippers, increasing the prospect of significant pipeline imbalances occurring and the potential for curtailments when combined with the prospect of a reduced willingness by FGL to pro-actively buy/sell balancing gas. In this regard it will be FGLs behaviour in managing the pipeline, including striking the appropriate balance between incentive charges to affect Shipper behaviour (and the balance between free and priced flexibility), and its own interventions to prevent undue curtailments, that will determine whether in practice GTAC proves to be materially better than the status quo in this regard.

    (ii) Concern that the Mokau compressor would be used routinely by FGL as a tool to provide for free tolerances (both as RMT and to enable Peaking Parties to take advantage of their peaking tolerances). If the Mokau compressor is to be used for providing flexibility to Shippers, the Shippers that utilise that flexibility should pay for the costs associated with running the compressor for that purpose.

    GIC has recognised that its earlier conclusion that, as a matter of course, code integration would yield operational savings in the use of the Mokau compressor was not justified (see PAP, page 29). However, we do not consider that GIC has given sufficient consideration regarding the allocative efficiency of the prospect that compressor use may be used to a greater extent to provide free flexibility and the implications that has on socialised costs.

Peaking

16. The peaking regime proposed by FGL in GTAC is one area where Methanex has previously indicated there may be the potential for an improved outcome compared to the regime in MPOC. However, Methanex also believes any gains could be undermined by two factors in the underlying design of the regime:

    (i) The size of the peaking tolerance, particularly when combined with the Peaking Parties ability to make intra-day renominations of <u>both</u> their daily amounts and their nominated hourly rate (shape/profile), may end up providing excessive flexibility and in doing so add to uncertainty for FGL in managing line pack.

    (ii) Methanex also remains of the view that basing the peaking charge on the location of receipt/delivery (ie DNC charge) creates an inherent bias, affording some Peaking Parties with a lower cost of exceeding its peaking tolerance compared with others. A scenario may arise where a Peaking Party with a relative low DNC charge may have a significant economic incentive to systematically exceed its peaking tolerances. Correspondingly, although the peaking charge regime allows FGL to increase the multiplier M to address such behaviour, it must impose the increased penalty on all Peaking Parties regardless of individual behaviour. This means that in order to give effect to an appropriate incentive on the misbehaving Peaking Parties, other Peaking Parties with higher DNC may face onerous charges as a result. As a consequence this may make FGL more reluctant to increase peaking charges than would otherwise be the case and more prone to criticism if it does.

17. In its assessment GIC did not give regard to Methanex concerns regarding the relative merits (and prospect of bias) of a peaking charge methodology, as proposed in GTAC, which is essentially determined according to geographical location rather than the particular impact of excessive peaking on the pipeline.

GIC set out the criteria as *"Peaking Charges will be efficient where they are targeted towards gas flows that are sufficiently peaky to cause system problems, and signal the likely magnitude of system costs resulting from peaking."* (PAP, page 40). But it is unclear to Methanex how GIC has applied these criteria, particularly the second part, to assess the GTAC peaking charge, or draw it conclusions regarding the charging basis (see PAP, page 44).

Gas Transmission Pricing Methodology ("GTPM")

18. Finally**,** while the gas pricing methodology has been excluded from the GTAC and has not been a significant part of GICs deliberations, it nevertheless remains a critical issue for industry participants.

19. Methanex chief concerns regarding pricing are:

- By excluding its GTPM from GTAC, FGL has also excluded a broader discussion which could have been had with industry on its approach to tariff setting and revenue recovery as part of the GTAC consultation process.
- It is not clear how and to what degree FGL will undertake consultation on its GTPM outside of GTAC, at the outset, and on an ongoing basis when addressing future revisions.
- Tariff Principles that are provided for in MPOC, being absent from the GTAC.

20. Regardless of the particular content of the Tariff Principles in MPOC, it is the fact that MPOC contemplates tariff design as being an integral part of the code that should be the critical factor in assessing its omission in the GTAC. We believe GIC has not considered this aspect in its assessment.[12]

Under MPOC any changes made to Tariff Principles (from which methodologies flow) need to go through the code change process. Under GTAC is not clear what, in any, consultation will be required when FGL considers making changes to the GTPM over time.

21. It is also a concern to Methanex that the current pricing regulation, in which the Commerce Commission focusses on the overall regulated revenue that FGL is entitled to recover, rather than specific pricing methodologies and principles, leaves a significant regulatory gap, including in terms of ensuring the Gas Act and GPS principles are adhered to.

This is especially the case in terms of how tariffs are set and apportioned among pipeline users efficiently and equitably if pricing principles and methodologies are not either:

[12] PAP, page 116.

(i) incorporated within the GTAC; or
(ii) specifically subject to GIC oversight.

22. In the absence of tariff principles being incorporated into GTAC it is essential that the GTPM is subject to adequate consultation within the framework of the Gas Act and objectives of the GPS.

Closing Remarks

23. Methanex remains of the view that the GTAC represents an outcome in terms of its pipeline access and transmission rights and obligations that, when compared with MPOC, is not materially better in any fundamental respect but does impose new and increased risks and uncertainties upon Methanex.

24. Methanex considers that the Final Assessment should place more emphasis on identifying and elaborating on those issues of outstanding concern to stakeholders that represent a risk of being a deterioration from the status quo.

25. In the event that GTAC is approved, the relative impact on Methanex, adverse, neutral, or positive, will in large part depend upon how FGL chooses to operate the pipeline and the discretions it has regarding balancing, tolerances and incentives, the integrity of the code change process, and GICs monitoring and oversight of the GTACs conformance to the Gas Act/GPS objectives. Methanex recommends that GIC establishes a formal review process to commence after the first year of GTAC operation. We also believe that in the interests of neutrality and objectivity it should be GIC and not FGL that administers any such review.

Yours sincerely

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