11 March 2020

Gas Industry Company
Level 8, The Todd Building
95 Customhouse Quay
PO Box 10-646
Wellington 6143

Sent via email: info@gasindustry.co.nz

Information Disclosure Problem Assessment – Cross Submission Issues

1. In relation to the ongoing consultation on information disclosure requirements in the gas industry, Methanex thanks the Gas Industry Company for commissioning an independent report on the matter of The Impact of Methanex Plant Outages on the Gas Wholesale Market and providing an opportunity to make cross-submissions on elements of the Information Disclosure Problem Assessment that have proved contentious.

Question 1: Contract price and volume information

2. Methanex agrees with the GIC findings in the Problem Assessment in respect of the disclosure of gas contract information:

   (i) *"No significant problems associated with limited transparency of gas contracts have been identified."* Methanex considers that none of the submissions that have called for disclosure have adequately addressed this matter.

   (ii) GIC notes that practical issues reduce the value of structured gas contract information. In this cross-submission Methanex provides more detail on the factors we believe make the value of Methanex gas contract information virtually meaningless in determining underlying liquidity or in improving efficient price discovery in the wholesale gas market.

   (iii) GIC's characterisation of the adverse effects on parties being required to divulge commercial sensitive information. Methanex considers that the analysis and submissions:

   (a) have not established that there is a market failure in respect to efficient price formation in the wholesale gas market, and;

   (b) if a market failure were to be established, it has not been demonstrated that the disclosure of structured gas contract information would address the market failure or that any benefits of disclosure would exceed the costs incurred by the parties being required to disclose that information.

   (iv) The GIC's recognition of the importance of maintaining anonymity/aggregation and the limitations of being able to achieve that in context of the disclosure of structured gas contract

information. We believe it would be nearly impossible to maintain the anonymity of Methanex gas contract information if it were disclosed. In calling for disclosure of Methanex contract information, some submitters believe that gas contract information could be aggregated and anonymised prior to disclosure. Given the proportionate significance of Methanex gas contracts we have concerns that this could be achieved.[1]

3. Some submitters have called for the disclosure of gas contract information, despite also accepting that the information may not be meaningful or useful.[2] This reinforces our concern that the information will not be of any use in achieving a more efficient gas market[3] and that any potential benefits of information disclosure will not exceed the commercial costs of parties being required to make disclosures.

4. Methanex has pointed out previously that the highly and uniquely structured ("bespoke") nature of its gas contracts mean that price and volume information in those contracts have no relevance to price discovery in the wholesale gas market (or indeed in determining an efficient forward curve).

Methanex gas contracts generally share the following structural features:

(i) Gas prices are indexed to global methanol commodity prices, that is, the gas price Methanex pays varies in relation to the realised price of methanol.

This presents a fundamental problem in taking this information to establish a tradeable fixed gas price in New Zealand. A gas price referenced to realised global methanol prices will give no insights into prompt or forward gas pricing in New Zealand, particularly given the underlying uncertainty of methanol prices and that there is no forward methanol market.

(ii) Methanex contract volumes are invariably large, with stringent take or pay obligations. Methanex gas contracts contemplate flat load supply and provide little uplift flexibility for daily, weekday-weekend, or seasonal profiling.

Even if it were assumed that the commodity indexing issue could be resolved, the contract gas price also represents a delivery profile that would need to be radically repackaged into smaller parcels in volume and time as well as reprofiling (ie converting to a tradeable wholesale product). This presents changes to risk and expected value for the gas seller that it would need to reflect by adjusting prices offered to the market from the prices indicated in the Methanex contracts. So even if a fixed gas price could be derived from the commodity linked price, there would still be a dynamic and independently determined premium/discount adjustment associated with repackaging the volumes that would need to be factored in to extract a meaningful market price for standardised, tradeable products from the Methanex contract price.

(iii) There are numerous other non-price elements in Methanex gas contracts that are part of the overall value equation for the parties including:

(a) Firm vs contingent tranches of gas
(b) Priority/Interruption provisions

---

[1] *Mercury [p3], Meridian [p7], emsTradepoint [p2] all suggest information should be anonymised without explaining how this could be achieved. emsTradepoint makes the points that the information needs to be meaningful and maintain confidentiality but in its support of disclosure it has given no explanation as to how these two requirements would be satisfied.*

[2] *Electricity Authority [p4], Contact [p2]*

[3] *Electricity Authority [p4] – suggests that disclosure will yield information to accurately value the electricity forward curve, reduce transaction costs in gas trading and provide a reference point for writing risk management products. But the Electricity Authority provides no further explanation or supporting evidence as to how the disclosed information would be expected to achieve any of those particular criteria, given its earlier comment on the difficulty involved in extracting anything that could be meaningful from gas contracts.*

(c) Seller relief provisions
(d) Tailored arrangements to address carbon price exposure

(iv) Methanex secures gas to try and achieve constant methanol production and to all intents and purposes Methanex contracted gas is not tradeable gas.

Methanex' willingness to sell gas is essentially determined by its willingness to curtail methanol production. The wholesale gas price required to induce Methanex to curtail methanol production and enable gas from Methanex contracts to be offered into the market will bear no relation to the contract gas price.

In conclusion, Methanex considers that the provision of its contract price and volume information would be ineffective in trying to gain insights into pricing for the wholesale gas market. The information being sought is commercially confidential and we support GIC's conclusion that this information element should not be included in a Statement of Proposal on information disclosure.

Question 2: Forecasts of major users' gas consumption

5. Methanex agrees with GICs conclusion in the Problem Assessment that requiring forecasts of major users gas consumption should not be included in the Statement of Proposal. GIC also noted that it had not identified *"any significant problems that disclosure of these forecasts would address."*

Question 3: Major gas user facility outages

6. In the Problem Assessment, GIC notes that *"the concentrated nature of gas demand in New Zealand means that an outage in any of the largest major gas users could potentially have a significant effect on the volumes of gas available on the wholesale market"*. However, the evidence presented in the Contract Strategies Report shows there is not a strong correlation between Methanex outages and gas market responses.

7. Methanex agrees with the core finding of the independent report by Contract Strategies that Methanex plant outages have not resulted in material changes to the amount of gas available to the market or prevailing gas prices, or materially impacted the operation of the gas market.

8. In regard to Contract Strategies conclusion on the impact of disclosure on Methanex, we go further. Public disclosure <u>is very likely to</u> harm Methanex business and does represent an information asymmetry by revealing Methanex information to its competitors where they are not faced with the same requirements.

9. The report concludes that there is little correlation between Methanex outages and volumes of gas that Methanex, or gas producers, offer into the market and found that there was little impact on wholesale volumes traded or gas prices during Methanex outages.

10. We do however believe the recommendation of the report is inconsistent with the report's conclusions and will not improve gas market efficiency. The report recommends that:

"GIC consider putting in place an information disclosure regime requiring a party (producer or gas user) intending to make a material volume of gas available on the emsTradepoint wholesale gas market to publicly disclose, prior to the gas being made available on the market (but with sufficient contingency provided for an emergency gas release), the expected daily and total volumes of gas to be released onto the market and the timing of each intended gas release."

11. As Methanex understands it, the proposal essentially calls for a pre-offer notice of intention to offer gas to be made prior to an actual offer being made. This raises a number of concerns:

(i) Is the notice a guaranteed commitment or a "reasonable endeavours, good faith" estimate? If it is not an actual commitment to sell gas at X volume and Y price, the notice provides little instructive value. If it is a commitment then it is hard to see that such notice is functionally any different from the normal practice of a seller placing a live offer on the market.

(ii) Methanex considers that, if adopted, the proposal would encourage parties to undertake off-market transactions to avoid disclosure, or discourage spot trading activity altogether, and in so doing reduce wholesale market liquidity and efficient price discovery.

(iii) The disclosure rules create an information bias in favour of buyers since it is only sellers that would have the obligation to provide advance information of their intentions.

12. Methanex' view is that the recommendation, if implemented, would reduce wholesale gas market liquidity and efficiency.

13. In its submission, the Electricity Authority commented that Methanex *"has not explained clearly why disclosure of plant outages would affect its competitive position internationally, or quantity the costs this would incur".*[4] In response we wish to draw the GICs attention to Methanex' December 2019 submission where it described the challenge it faces with regard to assuring uninterrupted methanol supply to its customers during plant outages as well as an indication of potential costs of disclosure.

Public disclosure of Methanex outage information (particularly advanced notice of planned outage) will give a "leg up" to its competitors in global markets who are also not faced with similar disclosure requirements. As Methanex actively purchases third party methanol to ensure its customers remain supplied when its plants are out of service, rival suppliers who know the timing of those outages will also know when Methanex is seeking merchant methanol to keep its customers supplied, and how much it needs. This gives Methanex's competitors an information advantage (asymmetry) to extract higher prices from Methanex (or "short" Methanex in order to induce customer switching).

In its December 2019 submission Methanex noted that a 1% increase in methanol price paid by Methanex would increase costs by NZ$0.5 million. To put that into more real terms, it is not beyond the bounds of reasonable probability that a third party methanol supplier, with knowledge of an outage and knowing that Methanex at that moment is essentially a price taker, could extract a 10% price premium on a parcel of 100,000 tonnes of methanol (equivalent to lost production from a typical turnaround outage at Motunui). So at a prevailing methanol price of US$300/tonne, disclosure would represent an unrecoverable cost to Methanex of US$3m (~NZ$5m). If suppliers alternatively decided to "short" Methanex then the potential cost of losing customers would be far more consequential.

Yours sincerely

DEAN RICHARDSON
MANAGING DIRECTOR
METHANEX NEW ZEALAND LTD

Direct dial: +64 9 356 9293
Email: drichardson@methanex.com

[4] Electricity Authority [p2]