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A RESPONSIBLE CARE® COMPANY

23 October 2018

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Dear Ian

Further response to GTAC Documents provided for Consultation

1. This submission is made in response to GICs request for feedback in respect to the GTAC drafting and elements of the proposed arrangements that it considers require particular attention in its assessment.

2. On 3 October 2018 Methanex made a submission to GIC regarding the proposed GTAC as drafted on 11 September 2018. That submission focussed on the material outstanding concerns Methanex had regarding the GTAC as a prospective replacement for the Maui Pipeline Operating Code ("MPOC"). We have not repeated those comments in this submission and we request that GIC considers the 3 October submission in conjunction with this submission.

3. This submission focuses on building upon the 3 October submission and summarising Methanex views to GIC ahead of its upcoming deliberations to determine whether the GTAC, as submitted to it by FGL, is materially better than the two codes it is proposed to replace.

4. This submission also addresses changes to the GTAC that have been proposed by FGL subsequent to the 3 October submissions, as set out in the document provided by FGL at the 16 October workshop, and which we understand will be incorporated in the draft of the GTAC that is ultimately submitted to GIC.[1]

5. The views and concerns we expressed in our 3 October 2018 submission for the most part remain. However, we wish to expand upon those issues and also reflect upon the further changes to GTAC proposed by FGL subsequent to that submission.

6. During the course of this year FGL has embarked on a process to attempt to close the gap between it and the various stakeholders on a range of issues highlighted by GIC in its previous assessment of the GTAC. Methanex acknowledges that significant improvements have been made to the GTAC and it is substantially better than the version previously submitted to GIC.

[1] https://gasindustry.co.nz/dmsdocument/6345 ("Proposed GTAC changes following industry submissions")

7. However, from Methanex' standpoint, that doesn't mean it considers that GTAC is now materially better than the codes it is intended to replace, and specifically MPOC. Methanex' concern remains that the substantive benefits of the GTAC are by comparison with the VTC. By comparison with MPOC, Methanex remains of the view that there are no significant net benefits but there are increased risks it will face as an exclusive user of the Maui Pipeline under GTAC. Methanex considers that it derives none of the advantages of the GTAC that may accrue to VTC users but is faced with the prospect of potentially detrimental outcomes as a consequence of being required to accept the terms of GTAC if it is approved as a replacement to the MPOC.

   (i) Loss of the clear and unambiguous demarcation of the roles and responsibilities of Shippers and Welded Parties provided in MPOC;

   (ii) Grandfathered VTC agreements, and agreements that may be negotiated under the terms of the VTC prior to the effective date of the GTAC, will be applied across both pipeline networks potentially affecting the rights and obligations of Maui Pipeline users including Methanex;

   (iii) The prospect that provision of system-wide flexibility under GTAC will increase socialised costs and the risk of curtailment on the Maui Pipeline;

   (iv) Loss of the ability for parties to seek redress for enforced curtailments by way of compensation via Incentive Pool claims as currently provided for in MPOC.

   (v) Loss of the provision of the back-to-back indemnity for non-specification gas to Interconnected Parties. We disagree with FGLs view that it is unable to provide the indemnity to both Shippers and Interconnected Parties.

   (vi) Coordination risks arising from removal of point-to-point nominations, and universal OBA rules on the Maui Pipeline.

8. To the extent that Methanex performs its obligations by taking gas in accordance with its nominations it should not be exposed to any increased costs associated with gas balancing, or greater risk of curtailment than is the case under MPOC. In large part the impact of the changes imposed upon Methanex by introduction of the GTAC will depend on how FGL applies its discretion in operating the pipeline, be it in the level of flexibility it provides to other users, the costs it imposes upon users for failing to manage their imbalances, the degree of socialisation of those costs and its commitment to pipeline management and balancing actions in order to prevent and minimise socialising those costs and risks.

Increased Curtailment Risk

9. In its 3 October submission Methanex sought to encapsulate its overriding concern of the increased risks it foresees under GTAC of its use of the pipeline being curtailed due to the actions of other users, or the decisions FGL makes in regard to allocating flexibility and managing Line Pack/TTP. In this regard we acknowledge that FGL has, subsequent to the GTAC draft of 11 September, made a further change by inserting additional wording into Section 8.6 in regard to its use of balancing gas to avoid curtailment.

10. The amendment proposed by FGL falls short of an explicit undertaking but does provide contemplation that pro-actively buying and selling of balancing gas is an element of FGLs duty as a Reasonable and Prudent Operator. We consider this a particularly important commitment in the context of minimising the prospect of FGL curtailing compliant Shippers and in determining how FGL manages Line Pack and TTP on a daily basis to prevent that occurring. However, without an explicit undertaking in GTAC, the actual outcomes will be entirely dependent upon how FGL chooses to apply its discretion in operating the pipeline.

11. Methanex remains of the view that the risk it faces of curtailment in circumstances where it has not contributed to the cause is increased under GTAC when compared with MPOC.

Incentive Fee Rebating/Incentive Fees Pool

12. Methanex wishes to add a further remark in regard to its opposition to the removal of incentive fee rebating that it set out in its 3 October submission. If the GTAC is approved and Incentive Fees form part of FGLs revenue calculation it will become of critical importance that the Gas Transmission Pricing Methodology ensures that parties that outperform FGLs forecasting assumptions on incentive payments are rewarded and those benefits are not instead redistributed for the benefit of others.

    We provide the following illustration of the challenge now created with the decision by FGL to abandon incentive fee rebating/revenue neutrality and instead incorporate those fees into its revenue recovery calculations:

    (a) FGL forecasts that Party A will contribute \$10m in tariff revenue and \$1m in incentive fees for total contribution of \$11m.
    (b) Party A manages to avoid incentive fees completely during the following year but otherwise takes the amount of gas it was forecast to take. As a consequence, FGL recovers \$10m from Party A, under-recovering forecast revenue by \$1m.
    (c) In order to not penalise Party A for its performance in avoiding excess imbalances/overruns, the under-recovery of \$1m would need to be apportioned to other users tariffs and not to Party A, in a manner that reflects each party's relative performance in avoiding or contributing to incentive fee revenue.
    (d) Methanex' concern is this increases the complexity of resetting tariffs to achieve an equitable outcome and FGL may instead elect to reallocate in a simpler and more arbitrary manner. There is the prospect that parties that outperform on imbalances/overruns will not be compensated at all and instead see their DNC fees increase as a consequence of the under-recovery and reforecasting of incentive fee revenue/tariff revenue that results.

13. Given that GIC assessed the original GTAC on the basis that incentive payments were quarantined, directly rebated and otherwise revenue neutral, it will now need to reassess the implications that removal of rebating and allocation of incentive payments via FGLs pricing model will have in terms of efficiency and fairness. We also consider the change in approach has important implications on the degree of scrutiny that will be required when considering FGLs Gas Transmission Pricing Methodology.

Excluded Agreements

14. The issue of certain interconnection arrangements being grandfathered while MPOC ICAs are unilaterally terminated remains an unresolved matter for Methanex and is an issue that is entirely the consequence of merging the two pipeline systems. It is not the prospect that these existing VTC agreements are required to continue that is at issue for Methanex, it is concern that the rights and obligations of parties to those arrangements will impact upon Methanex under GTAC where they would not have done so under MPOC. FGL has been unwilling to warrant to MPOC Shippers and Interconnected Parties that their existing rights will not be prejudiced by those arrangements as a consequence of code replacement.

Running Mismatch Tolerance

15. During the workshop held on 16 October, and in reference to Methanex proposal for a discrete cap of not more than 7.5 TJ for each of $LPT_{RECEIPTS}$ and $LPT_{DELIVERIES}$, FGL indicated that it would be looking to provide more Running Mismatch Tolerance ("RMT") flexibility including by operating the Mokau compressor.

    This is a concern to Methanex since that flexibility is not being provided out of 'free pipeline space' in any sense. If RMT is increased as the result of running the Mokau compressor, that increased tolerance will be provided at no direct cost to the Shippers making use of it with the cost of running the compressor socialised (given some Shippers may not make use the extra tolerance but will presumably pay a share of the cost of operating the compressor proportionate to their nominations).

    Methanex is opposed to potential use of the Mokau compressor to provide for increased free tolerances. If it is to be used to provide additional flexibility to Shippers then it should be appropriately priced such as by way of Park and Loan with the user paying for its incremental use of the compressor required to support that requested flexibility.

16. Methanex therefore reinforces its recommendation in the 3 October submission that RMT should be explicitly capped by adding a further stipulation that RMT should not be provided out of any additional Line Pack that is created by operation of the Mokau compressor.

Peaking Regime

17. On the peaking regime, Methanex has noted that it considers the proposed peaking regime to be an improvement over the previous mechanisms of AHP, Specific HDQ/DDQ and Hourly Overrun proposed in the first version of GTAC. However, the merits of the proposed regime will be entirely dependent upon how FGL applies its discretion:

    (i) In determining who qualifies as a Peaking Party;
    (ii) How it approaches approving intraday changes to AHP nominations;
    (iii) Whether the +/- 25% tolerance proves to be too generous and contributes to pipeline instability;
    (iv) Whether the peaking charge serves as an effective incentive for Peaking Parties to remain within their tolerance.

18. In regard to the last concern Methanex has suggested that basing the peaking charge on DNC and location is flawed. FGL has not accepted this view but we wish to reinforce our concern by way of an illustration of the constraints that basing peaking charges on DNC will place upon FGL and the potential for it to distort incentives:

Assume two Peaking Parties (A and B):

a) Party A operates in the Taranaki region and faces a peaking charge of 30c/GJ;
b) Party B is located in the northern part of FGL pipeline system and faces a peaking charge of $1.50/GJ;
c) Party A frequently breaches it tolerances and it materially affects the pipeline while Party B breaches it tolerance occasionally but generally does not materially affect the pipeline;
d) FGL consequently seeks to increase the incentive on Party A by increasing the multiplier M from 1.5 to 5.[2] This has the effect of increasing Party A's peaking charge to $1.00/GJ but also increases Party B's peaking charge to $5.00/GJ. Understandably, Party B will consider that increase to be an onerous outcome and will place pressure on FGL to moderate the multiplier;
e) FGL will be unable to appropriately incentivise Party A to remain within its tolerance and at same time avoid imposing an onerous charge on Party B;
f) This issue would be avoided if the peaking charge was not explicitly linked to DNC but instead was an event-driven incentive applied equally to all Peaking Parties.

Closing Remarks

19. Methanex has considered its position in light of the consultation process and the improvements it acknowledges FGL has made to the GTAC:

(i) Methanex accepts that the GTAC in its revised form is generally an improvement over the version of GTAC that was submitted for GIC assessment in 2017, except in terms of the removal of incentive fee rebating which Methanex considers to be a significant retrograde step.

(ii) There remain outstanding concerns Methanex has that are principally a consequence of the merging of operation of Maui and VTC pipeline systems and what it considers to be the distinctly different characteristics of those two systems and their users.

(iii) It has been of considerable concern to Methanex that both FGL and GIC have placed emphasis on how the GTAC compares against the VTC as the principal measure of 'materially better' which has had the effect of minimising the impacts GTAC has with comparison to MPOC.

(iv) We have outstanding concerns that FGL will apply the extensive discretions it has under GTAC in a manner that favours Shippers using both MPOC and VTC systems and which in doing so increases the costs and risks for parties that make exclusive use of the Maui Pipeline under MPOC. Despite the improvements that have been made, Methanex believes that the GTAC will leave it in a detrimental position compared with status quo.

[2] Under Section 11.5, the multiplier M can be increased but in doing so it applies universally to all Peaking Parties and may be considered for some of those parties to be a disproportionate response.

Yours sincerely

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