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Submission on the Concept Report on Long-Term Gas Supply and Demand Scenarios

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Concept Consulting report commissioned by the Gas Industry Company ("GIC"), *Long term gas supply and demand scenarios* ("the Concept Report"), dated June 2014.
2. Overall, we find the Concept Report to be very comprehensive. However, we consider there should be a longer period between updates to the Concept Report unless there is a development that has a significant impact on regulatory or market settings.
3. We provide comments in relation to the likely wholesale gas price scenario forecast in the Concept Report, and on specific sections of the Report. We also provide high level information on ongoing initiatives by industry participants to address access and capacity issues on the Vector and Maui transmission pipeline systems.
4. No part of this submission is confidential and we are happy for it to be made publicly available.
5. Vector's contact person for this submission is:

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Wholesale gas price scenarios

6. We generally agree with Concept that of the three market scenarios it developed (Tight, Moderate and Plentiful Supply), the Moderate Supply scenario "appears to be the most likely outcome over time".

7. However, there have been developments and signs emerging over the past 12-15 months indicating that the trend, at least for the short term, could be shifting towards the Plentiful Supply scenario. These include the following:
 - As noted on page 44 of the Concept Report, Methanex reached full production at its three plant operation in December 2013 and has announced that it has arrangements in place to underpin production at its three plant operation for years to come.
 - Gas reinjection volumes have significantly increased from 2012 to 2013, indicating that options for producers to sell the gas are limited.
 - Gas stored in Contact Energy's Ahuroa gas storage facility is at around its current maximum capacity of 17.6 PJ.
 - The latest *Energy in New Zealand* annual report, published by the Ministry of Business, Innovation and Employment, indicates an increase of approximately 621 PJ in Remaining Recoverable Reserves (P50). The increase approximates three years gas demand.¹
 - Competition in the industrial and commercial market has increased significantly since early 2013, resulting in significant downward pressure on price. As identified in the Concept Report, the downward pressure on price is starting to become observable in the movement of industrial gas prices and is likely to become more observable as older contracts that were pegged to historical wholesale contracts are rolled over.
8. The above depicts a scenario of full (or close to full) utilisation of reinjection and storage, and where available supply exceeds existing demand. We could therefore expect to see a fall in wholesale prices, i.e. it is a buyer's market.
9. When considering the wholesale gas price with Methanex as the marginal buyer, an alternative approach would be to discount back to today's value (using the producer's cost of capital) the Methanex price in the next year that Methanex has the capacity to buy further gas. This would represent the price that the producer would be prepared to receive now, rather than waiting to sell to Methanex in the future.
10. We suggest that Concept update its report, taking into consideration the above developments.

¹ Ministry of Business, Innovation and Employment 2014, *Energy in New Zealand*, 2013 Calendar Year Edition, Wellington, page 27

GITA Working Group

11. In finalising its Report, Concept could also refer to the ongoing work by the Gas Industry Transmission Access ("GITA") Working Group. The GITA Working Group is facilitated by Vector and Maui Development Limited and comprises representatives from transmission system owners and shippers.
12. The Working Group is developing "a programme of work to evolve towards a compatible set of access and capacity pricing arrangements" across the Vector and Maui pipeline systems. A range of gas transmission issues is being considered by the Working Group, including a new market design for capacity allocation to manage congestion on the transmission system. This could include a semi-interruptible product to enable gas to flow to its highest-value use during periods of physical or commercial scarcity.
13. The Working Group is also looking into promoting greater transparency by making more information available on OATIS. For the long term, it is considering replacing OATIS itself for a more effective information and transaction management system.
14. The GITA Working Group's quarterly reports can be found on <http://gasindustry.co.nz/work-programme/gas-transmission-investment-programme?tab=2136>.

Comments on specific sections

15. We set out below our comments and proposed amendments in relation to specific sections of the WP Report.

Page / Section	Comment / Proposed Amendment
Page 8, Executive Summary	We query why the Mokau compressor is mentioned in the Executive Summary without much discussion in the report.
Page 10, footnote 7 and page 26, footnote 17	The range of \$1-2/GJ provided for charges for transmission and distribution in footnote 7 is inconsistent with the figure in footnote 17, which is \$1-1.50/GJ. In our capacity as gas retailer to industrial customers through our OnGas business, we consider a \$1.50-2.00/GJ range to be more accurate on a volume weighted basis.
Page 46, Figure 25	We suggest that Concept clarify whether the capital costs include a return on asset or an implied margin.

Page / Section	Comment / Proposed Amendment
Page 104	<p>The Concept Report states that “[o]n balance, it would...appear that the North system will not face capacity constraints in the short to medium term”. Consistent with this observation, we note that at Otahuhu B, annual flow is declining from 2013 (actual maximum flow) to 2015 (predicted maximum flow).²</p>
Page 140	<p>Under the second bullet, we would like to add that because “some consumers’ value of demand is significantly lower than others”, some consumers therefore may elect to be interrupted. As stated above, the issue of interruptible demand is being considered by the GITA Working Group.</p> <p>We recommend that a fourth bullet be added to the list of reasons why “[i]nterrupting demand could potentially be a more cost-effective solution than network investment”, as follows:</p> <ul style="list-style-type: none"> • Regulatory settings do not incentivise investment. <p>Vector’s expenditure and investment decisions in relation to its transmission pipeline are subject to regulatory settings under Part 4 of the Commerce Act 1986. Part 4 sets default price-quality paths for regulated gas transmission businesses, or customised price-quality paths should a regulated business seek this option.</p> <p>For the record, Vector can only make network investment decisions when it has relative confidence that the decisions will produce a return on investment over the lifetime of the assets that both equity and debt investors in Vector would regard as satisfactory for a utility business.</p> <p>At present, Vector has concerns that current regulatory settings pose risks to investors in long-life assets as recovery of investment is currently back-</p>

² Vector 2014, *Gas Transmission Asset Management Plan Update*, Information Disclosure 2014, <http://vector.co.nz/documents/101943/102848/Gas+Transmission+AMP+Update+2014+FINAL.pdf/dd4a97f9-3cce-4a42-bdc6-a3ffc5cd8992>, Tables 1, 2, 3 and section 2.8

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	<p>loaded, increasing the risk of stranding if supply contracts or technological changes reduce demand, or regulations/rules change.</p> <p>These concerns have been exacerbated by the recent review by the Commerce Commission of the cost of capital range, and the proposal to reduce the Weighted Average Cost of Capital used for price-setting purposes from the 75th to 67th percentile. This has increased the risk of unexpected ad-hoc regulatory interventions and reduced confidence in the current regulatory regime – a situation that does not promote confidence for investors.</p>
Page 140, Figure 97	<p>The numbers on the graph appear to be inflated if they refer to the Vector North system. We suggest that Concept clarify whether these numbers refer to the Vector North system only or the entire Vector transmission system.</p>
Page 141	<p>The Concept Report’s statement about a “significant potential for interruption at times of peak to manage pipeline capacity issues, but that there was not currently a strong price signal for them to deliver such interruptible potential” could give a mistaken perception. We note that only portions of Otahuhu and Southdown capacity are interruptible.</p> <p>Vector Transmission’s modelling assumes a full load and flat load; our contracts are mostly for firm load. This has been the case in the last few years.</p>
Pages 146-147	<p>We would like to refer Concept to Vector’s Transmission AMP³ for more details and related information on pipeline capacity at peak times.</p> <p>We suggest that Concept engage with the GITA Working Group to obtain more up-to-date information</p>

³ Vector 2014, *Gas Transmission Asset Management Plan, 2013-2023*, <http://vector.co.nz/documents/101943/102848/Gas+Transmission+Asset+Management+Plan+2013-2023.pdf/dfd42010-37ca-4ffa-84ed-42961f8753e2>, section 5

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	<p>on industry's views on congestion management on the Vector and Maui transmission systems, including on selective interruption.</p> <p>In addition, and as stated above, Vector's investment decisions in relation to its gas transmission pipeline are subject to regulatory settings under Part 4 of the Commerce Act.</p>

Concluding comments

16. We note that the GIC has commissioned an update of the Concept Report less than two years after the first report was published. In our view, the marginal value of updating this report too soon is not significant for many industry participants.
17. Taking into account the costs involved in updating such an extensive report, which are borne by levy payers, we suggest that the report instead be updated every three to four years unless there is a significant event that has a material effect on gas supply, demand, prices and regulatory or market settings, e.g. there is a major gas find in New Zealand.
18. We are happy to discuss with the GIC or Concept any aspect of this submission.

Yours sincerely



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Group Manager Regulatory Affairs