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31 July 2014

Ms. Victoria Chrisp
Policy Advisor
Energy Markets
Ministry of Business, Innovation & Employment

Dear Ms. Chrisp,

Please regard this letter as our submission on the "Gas Disruption Study" dated January 2014. We understand MBIE commissioned this as an independent study undertaken by a specialist team led by WorleyParsons Ltd. We appreciate your invitation to provide feedback and commentary on it. In this letter we will use the terms "MDL", "we", "us" or "our" to refer to the Gas Transmission Business (GTB) of Maui Development Limited.

1. Introduction

Our intent by making this submission is to highlight the areas important to MDL and its Maui Pipeline business as well as to make some general comments on the report. Our submission is structured under the following main headings:

- Incentive for investment
- Coordination of Regulatory Requirements
- Cost of regulatory compliance
- Other comments

2. Overview

Overall, we are impressed with the quality of the report from the study and the understanding shown of the incentives for investments and potential issues with the current arrangement.

To encourage investment in pipeline reliability, there needs to be greater certainty, before investment decisions are made, that investments will produce a timely return. The incentives to invest in pipeline reliability must be aligned to the economics of a pipeline business.

Required investments in gas transmission systems can be infrequent but large; lumpy, in other words. The Default Price-quality Path (DPP) regime established for GTBs, which is mostly derived from the regime for Electricity Distribution Businesses, does not allow for lumpy investments. We support development of a grid investment test that can be integrated into the regulatory regime to acknowledge the lumpy capital expenditure requirements of GTBs and allow for return on investment without having to rely on a Customised Price-quality Path (CPP).

We support the report's conclusion that there is currently a high degree of reliability and that existing industry operating standards and market structures pose no undue threat to security of supply but the potential for improvement remains.

The report outlines a number of recommendations for further analysis. We support the broad concepts, especially further analysis on *"how price/quality regulation might influence the approach to risk and the concomitant security standards that might apply, and the cost implications of adopting different security standards"*.

We do note that the first recommendation on *"Creating a standardised economic treatment of asymmetric risk (low probability high consequence events) to ensure the economics are more robust and comparative industry studies utilise a common methodology"* could be improved. It would seem preferable to sharpen the decision process around evaluation of cost/benefit of risk mitigation measures if the cost of those is to be challenged by price control regulation. Risk reduction decisions, along with the financial consequences of those in a price-controlled regime, need to be made at the same time to encourage risk reduction investment when efficient.

3. Incentives for Investment

The report correctly identifies in Section 9.2 that there is currently a potential mismatch between the regulatory allowance for a fair return on major capital expenditure and the need to maintain a safe and reliable asset network. The DPP regime for GTBs determined by the Commerce Commission potentially discourages significant reliability investments. This is because return on any significant new investments during a regulatory period cannot be obtained until the next regulatory price reset. This potentially leaves us in a situation where we could incur significant capital expenditure without being able to obtain any return on it for a period of up to 5 years.

The Commerce Commission's response to this concern has been to point GTBs to the option of applying for a CPP. Unfortunately, this is a complex, lengthy and expensive process that carries a high level of uncertainty for applicants while confronting them with an extraordinary amount of extra work. The recent example and outcome of Orion's CPP process has not inspired us with confidence. As covered in footnote 54 of the report, the CPP process reopens all of the building blocks for setting prices for an applicant. It is not limited to considering specific large projects.

An additional concern is that the CPP process remains limited to capital expenditures that can be foreseen in advance. If any unforeseen investment is required to ensure asset reliability after a CPP has been approved there is no opportunity to re-open the CPP and obtain a return for such investment prior to the next regulatory period. We believe the price control regime for GTBs should be designed in a manner to support prompt and efficient reliability investments, and provide confidence in obtaining a timely return for them, as and when the need arises.

We note that Gas Industry Company Limited (GIC) is currently considering an "investment test" for significant gas transmission infrastructure investments. We support the development of such an investment test and encourage the GIC to promote this work stream. Such a test should not only cover investments in new pipeline capacity but should also cover significant investments to maintain and protect the reliability of existing infrastructure.

4. Co-ordination of Regulatory Requirements

With respect to the investment test mentioned above, we encourage the Commerce Commission and the GIC to work together to incorporate such a test within the DPP framework. We expect this can be done as per the terms of the MoU between them. We hope such work can be concluded in time to at least include an investment test in the DPP regime for GTBs by the next regulatory period starting in 2017.

With respect to asset management we note that, as a Transmission System Owner, we are required by MBIE to operate in compliance with a number of accepted codes of practice and standards. These have been developed to ensure a suitable level of attention is given to asset reliability.

Since the start of the Information Disclosure regime determined by the Commerce Commission a substantial level of additional effort is required to ensure compliance with their requirements as well. To a large degree, however, those requirements have been adapted from those for Electricity Distribution Businesses. We consider that several of those requirements, in particular those relating to performance measures, are not suitable for GTBs.

We would like to see more suitable measures of asset performance developed for gas pipelines, taking into account the existing oversight of the pipeline certifier and MBIE. These should reduce duplication of effort for preparing and publishing information, and align with existing requirements to act as an RPO.

We also note that at the time of finalising the report a decision on Major Hazard Facilities had not been made. We support the draft decision that gas transmission pipelines are exempt from those requirements due to the thorough oversight already placed on the industry and robust codes of practice and standards the operators already adhere to.

5. Cost of Regulatory Compliance

We note that our cost of compliance with various regulatory requirements is substantial. Currently this represents over 10% of our GTB operating expenditure.

We believe there is potential to reduce these costs by coordinating and simplifying information requirements. This is especially relevant to the asset management, performance measures and risk management data where there are already thorough and suitable requirements placed on asset owners by AS2885. Ensuring further alignment between compliance requirements and the information already produced by an RPO will reduce the compliance cost. Streamlining compliance requirements between various regulatory bodies should improve the cost efficiency of the gas transmission industry.

6. General Comments

In response to Section 9.2.4 of the report regarding "Risk Transparency", we would caution against a requirement to publically disclose more information regarding analysis and treatment of risk. We note that, at a working level, risk management requires a wide and open consideration of all potential factors and circumstances that may contribute to operational risk. These considerations should acknowledge, but not be limited by, the fact that it is practically impossible to mitigate or eliminate all of those factors. The management of risks relies on often subjective assessments, after considering the consequences, in deciding whether each of many contributing factors should be treated, monitored or accepted. Publicly disclosing all of those considerations could lead to undue alarm on the one hand or undue caution on the other.

We support the recommendations made in the report with the following reservation. We believe the first recommendation for *"Creating a standardised economic treatment of asymmetric risk (low probability high consequence events) to ensure the economics are more robust and comparative industry studies utilise a common methodology"* could be improved. It would seem preferable to sharpen the decision process around evaluation of cost/benefit of risk mitigation measures if the cost of those is to be challenged by price control regulation. In a price-controlled regime the risk reduction options and their financial consequences need to be reviewed at the same time in order to encourage risk reduction investment when it is efficient to do so.

We support further work to carry out the recommendations and propose a priority is placed on *"how price/quality regulation might influence the approach to risk and the concomitant security standards that might apply, and the cost implications of adopting different security standards"*. Additionally more comprehensive modelling of the risk of an outage, as suggested in the third recommendation, could be of use to the wider industry and gas and electricity users in New Zealand.

Conclusion

We have appreciated the opportunity to provide this submission. For any additional questions or clarifications please do not hesitate to contact us.

Yours sincerely,

Matt Wilson
Commercial Operator, Maui Pipeline
for Maui Development Limited

The views expressed in this submission do not necessarily represent the individual views of the Petroleum Mining Companies.