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Steve Bielby  
GTIP Project Sponsor  
Gas Industry Company  
PO Box 10-646  
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Dear Steve

**Submission on  
Gas Transmission Investment Programme, Status and Development**

1. Vector Limited ("Vector") welcomes the opportunity to make a submission on the Gas Industry Company's ("GIC") consultation paper on *Gas Transmission Investment Programme, Status and Development - July 2013*, dated 19 July 2013, and the accompanying Panel of Expert Advisers ("PEA") paper *Advice from Panel of Expert Advisers, Report to Gas Industry Company*, July 2013. We refer to these two documents as the GIC paper and the PEA paper respectively.
2. This submission is not confidential and we are happy for it to be made publicly available.
3. Vector's contact person for this submission is:

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**Support for the evolutionary convergence approach**

4. We support the overall approach that the PEA and GIC are suggesting, of evolutionary convergence through bringing the VTC and MPOC closer into line through the use of a joint governance approach, led by Vector and Maui Development Limited ("MDL") with industry involvement and GIC support. This approach is preferable to any of the alternatives.

5. By providing general support to such an approach Vector does not in any way agree to the delegation of any of its rights under the VTC to any party.

### **Guiding principles**

6. The guiding principles could usefully support the evolutionary convergence approach through providing common criteria for all parties involved in the process (Vector, MDL, shippers and the GIC) in support of the objective of a harmonised set of access and capacity pricing arrangements. We thus support the adoption of guiding principles, but only if:
  - a. they are used, along with the objectives of the Gas Act 1992 ("Gas Act") and the Government Policy Statement ("GPS"), as criteria by all parties; and
  - b. they are deemed consistent with the Gas Act and the GPS.
7. With the exception of the issue of cost recovery described below, Vector supports the discussion and analysis around guiding principles in Section 6 of the PEA paper. However, the text of Section 6 of the PEA paper is too discursive to serve the purpose of being the guiding principles, which need to be clear and concise. We believe that the more concise description of the guiding principles presented in Appendix A to the GIC paper provides a better foundation, and we recommend in Appendix B below some refinements to that text to bring them closer to the PEA's Section 6 descriptions.

### **Code change process**

8. The evolutionary convergence approach relies on amendments to the Vector Transmission Code ("VTC") and the Maui Pipeline Operating Code ("MPOC") being made in an efficient, coordinated and timely manner.
9. Vector has previously raised concerns over the current VTC code change process, which is not functioning in a way that might be expected in a self-negotiating/ multi-party contract context, and re-iterates them here:

*There is no incentive on any party to engage on drafting points, or even to consider the change request, until the last moment. Problems with the operation of the contract, and proposed solutions, are not worked through in advance of a party activating the formal change process. Once submitted, and parties focus on the problem definition and potential solutions, there is no ability to amend a change request. There are also real issues regarding how to deal with overlapping change requests from different parties, often conflicting. As a measure of the poor process, all recent change requests have either been abandoned or appealed. There is also lack of clarity in the appeal structure.<sup>1</sup>*

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<sup>1</sup> Vector's Transmission Code Change Request to the GIC of 31 May 2013.

10. Furthermore, the VTC and the MPOC differ in their change and appeal processes. Vector agrees with the PEA's assessment that:

*It may be possible to efficiently progress some operational convergence issues via existing code change provisions within the MPOC and VTC. However, the establishment of common code development processes for capacity access and pricing issues should be a priority matter, as this would facilitate overall progress and help to ensure that change processes are disciplined and coordinated.<sup>2</sup>*

11. Vector believes that the code change process for both the VTC and MPOC need to be improved, as noted in paragraph 9 above, in order to be fit for the purpose of coordinated change to access and capacity pricing arrangements in the VTC and MPOC.
12. The rationale that underlies the evolutionary convergence approach can be achieved in a range of ways. This could be as low touch as working together to ensure that any proposed changes are not inconsistent with the other code through to the adoption of common code changes. Both of these approaches rely on the agreement of parties to co-ordinate their approach to managing changes to the VTC and the MPOC by Vector and MDL, and by the GIC, who is appointed by Vector and MDL in an arbiter or approval role. It would be particularly useful if all changes were measured against common criteria by all these parties. As the GIC will, in its arbiter or approval role, need to adopt the same criteria, it would need to endorse the guiding principles as reflecting the objectives of the Gas Act and the GPS.
13. Further, to carry out its arbiter and approval role effectively, the GIC should consider whether it is appropriate for it to develop a design of its preferred option as is suggested in the GIC paper (under Market Projects, section 5.3). To do so would put it into conflict with assessing code change proposals against the same criteria as used by Vector and MDL and the wider industry, which would undermine the evolutionary convergence approach. As an alternative, should the GIC wish to develop a design of its preferred option, it may be more appropriate for MDL and Vector to appoint an alternate arbiter under the change process to remove any conflict of interest from the GIC's dual roles.

### **Joint development process**

14. Vector supports a joint development process and is willing to work with MDL and other interested parties to agree such a process if there is support for a joint approach. The evolutionary convergence approach should adopt the code change processes for the VTC and MPOC, improved for the reasons described above.
15. We call the process by which Vector and MDL could develop code changes, to support the evolutionary convergence approach, the 'joint development process'.

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<sup>2</sup> Section 6.4.1 of the PEA paper.

The approach we propose for establishing the joint development process – consistent with and building on the PEA’s recommendations – is as follows:

- a. Vector and MDL could:
    - i. Agree a memoranda of understanding (“MOU”) between themselves that sets out the extent of Vector and MDL co-ordination;
    - ii. Determine the initial scope of the evolutionary convergence approach (which broadly will be those access and capacity pricing arrangements discussed in the PEA paper); and/or
    - iii. Establish an industry advisory group;
  - b. Vector, MDL and the GIC should improve the code change process as described above, taking into account any advice from the industry advisory group. This may involve changes not only to the VTC and MPOC, but also to the GIC’s MOUs with Vector and MDL;
  - c. Vector and MDL should work with the industry advisory group in:
    - i. Developing the work plan; and
    - ii. Developing code change proposals; and
  - d. The GIC arbitrates/or approves (or not) code change proposals in accordance with the improved code change processes.
16. This industry advisory group would consist of Vector, MDL and shippers, with economist support.
  17. Vector and/or MDL would then consider this advice in formulating a VTC and/or MPOC (respectively) code change proposal for approval.
  18. Vector believes that the role of the PEA can finish once the guiding principles are confirmed. Access and capacity pricing arrangements should be left to Vector and MDL to develop further with the industry advisory group and the counterparties to the VTC and MPOC, consistently with the guiding principles, objectives of the Gas Act and the GPS.
  19. We see no point in for example the PEA fine-tuning the text of issues discussed to date (such as the boxes with dashed borders that are the subject of question 14), as they will be re-evaluated, and other options considered, by Vector and MDL and the counterparties to the VTC and MPOC as part of the evolutionary convergence process. Indeed, further analysis by the PEA would be counter-productive to the evolutionary convergence process, for the same reasons that the GIC should consider not developing a design of its ‘preferred option for improvement’, discussed in paragraph 13 above.

## **Cost recovery**

20. The evolutionary convergence approach is likely to add administrative costs to the industry, albeit with every expectation that market benefits will outweigh them. There may be code changes at a rate beyond historical business as usual, which may incur both additional administrative costs and additional implementation costs, and there will be additional operating costs, for example of running the industry advisory group and its economist support.
21. The GIC and PEA papers do not adequately address the critical issue of cost recovery: in those papers the only discussion of the recovery of additional costs is in the context of the costs of providing information (PEA paper, section 6.3.3). The GIC has expressed this in its draft guiding principles as "the costs of making information transparent should be recovered from a broad base" (GIC paper, Appendix A).
22. Vector is of the view that the changes to access and capacity pricing arrangements that will result from the evolutionary convergence approach will benefit all market participants and, as a principle, is a cost that should be borne by those parties.

## **Timing**

23. We agree with the PEA's findings, coupled with the findings in the Supply and Demand Report by Concept Consulting, that recent events have alleviated near term concerns about capacity availability on the Vector North system, and provided 'breathing space' to improve capacity access and pricing arrangements at a more fundamental level. We agree also with the PEA's assessment that given the long time scale for making changes, and that some risks could emerge on shorter time frames, we should not delay moving towards evolutionary convergence.
24. However, that breathing space suggests also that there is no ground for undue haste. We should proceed with the implementation of the evolutionary convergence approach without delay, but at a measured pace in a progressive and logical manner.
25. The GIC is currently scheduling publication of its analysis of submissions and full response to the PEA paper in late September 2013. Assuming that the evolutionary convergence approach prevails, Vector looks forward to working with MDL, the GIC and the industry to implement it from October 2013.
26. The first action will be agreement between MDL and Vector of an MOU. The timelines of this will depend on, amongst other things, the schedule of Vector and MDL Board meetings. Once the MOU is agreed, then MDL and Vector can start work on the scope and governance arrangements (see paragraph 15), as the PEA recommends. It is too early to tell how long this will take, but we expect it to be at least several months.
27. The PEA suggests as an indicator of success that change requests to implement governance be formulated and proposed by November 2013. The action is

appropriate but the timing is unrealistic. There may need to be parallel actions of refining the MOUs between GIC and Vector, and between GIC and MDL. The GIC's endorsement of the guiding principles as reflecting the objectives of the Gas Act and the GPS will need to be part of the timeline. It is neither necessary nor appropriate to fix dates before work has even started on the implementation plan. Noting that there are no other dates in the PEA paper's indicators of success, we recommend replacing "by November 2013" by "in a timely manner", which are the words used elsewhere in the PEA's conclusion.

## **Recommendations**

28. Vector supports an approach where MDL, Vector, shippers and consumers work together to adopt the evolutionary convergence approach, and recommends that, to make it work:
  - a. The GIC adopts the PEA's recommendations, but with concise guiding principles based on the text in Appendix A of the GIC paper, modified as per Appendix B below, and endorsed by the GIC as being consistent with the objectives of the Gas Act and the GPS;
  - b. The GIC adopts the PEA's indicators of success, but replacing "by November 2013" by "in a timely manner";
  - c. The GIC works with Vector and MDL to overhaul the code change process to ensure certainty, consistency and efficiency, and avoid duplication of effort. This may include changes to the GIC's MOUs with Vector and MDL;
  - d. Vector works with MDL and the industry to establish an approach that leads to a joint development process, including an industry advisory group, consistent with and building on the PEA's recommendations;
  - e. The GIC, in its role as arbiter and approver of code change proposals, should use the same criteria as Vector, MDL and the wider industry. This means:
    - i. The GIC should endorse the guiding principles as reflecting the objectives of the Gas Act and the GPS;
    - ii. The GIC should consider not developing a design of its preferred option; and
    - iii. The GIC should wind-up the PEA once the guiding principles are confirmed and the industry advisory group is established;
  - f. The costs of the changes to access and capacity pricing arrangements resulting from the evolutionary convergence approach should be borne by all market participants; and

- g. The GIC should not proceed with the 'testing investment options project' or other non-urgent matters, so that the GIC and industry can focus on establishing the evolutionary convergence approach.

Yours sincerely



Bruce Girdwood  
**Manager Regulatory Affairs**

## Appendix A Response to the consultation questions

### GTIP, Status and Development - July 2013

Question	Vector response
Q1 Do you agree with our assessment of the GTIP thus far? If not, where does your assessment differ from ours?	Vector does not believe that consideration of a regulatory investment test is warranted (see also our response to questions 2 and 6). Otherwise, yes.
Q2 Are there any Projects you think should be given greater or lesser attention by Gas Industry Co? Are there any other projects you think should be considered as part of GTIP?	The testing investment options project is not a priority, and would best be left so that the GIC and industry can focus on establishing the evolutionary convergence approach (see also our response to question 6).
Q3 Do you agree that the characteristics of a well-functioning transmission market, as described by the PEA, could be used as criteria for evaluating regulatory options?	Yes.
Q4 Do you agree with the proposed way forward for the Information Projects?	Given the GIC's explanation that the way forward is that the Markets Disclosures Project will be the final GTIP project, and will be a 'catch-all' used after all other GTIP projects are complete, then yes.
Q5 Do you agree with the proposed way forward for the Market Projects?	No. The GIC should not develop a design of its preferred option for improvement. To do so would put it into conflict with assessing code change proposals against the same criteria as used by Vector, MDL and the wider industry, which would undermine the evolutionary convergence approach.  The way forward for the Market Projects should be focused on supporting the evolutionary convergence approach.  As an alternative, should the GIC wish to develop a design of its preferred option for improvement, it should step aside from its arbitration role and Vector and MDL would then be free to appoint an alternative, independent arbiter.

<b>Question</b>	<b>Vector response</b>
<p>Q6 Do you agree with the proposed way forward for the Regulatory Projects?</p>	<p>No. The testing investment options project is not a priority at the moment, and would best be left so that the GIC and industry can focus on establishing the evolutionary convergence approach.</p>

**Advice from Panel of Expert Advisers – July 2013**

<b>Question</b>	<b>Vector response</b>
<p>Q7 Do you agree with the Problem Definition? If not, please explain your reasons. (see PEA’s Second Advice paper, Section 1.2)</p>	<p>Yes.</p>
<p>Q8 Do you agree with the assessment of the current state of the market for transmission capacity? If not, please explain your reasons. (see PEA’s Second Advice paper, Section 2.2)</p>	<p>Yes, but we note that that breathing space suggests also that there is no ground for undue haste. We should proceed with the implementation of the evolutionary convergence approach without delay, but at a measured pace in a progressive and logical manner.</p>
<p>Q9 Do you consider that the PEA has considered all the reasonable options for improvement? If not, what other options would you wish to have considered? (see PEA’s Second Advice paper, Chapter 5, Broad approaches to moving forward)</p>	<p>Yes.</p>
<p>Q10 Do you agree that Evolutionary Convergence is the best approach to improving access arrangements? If not, what other option do you prefer? (see PEA’s Second Advice paper, Chapter 5, Broad approaches to moving forward)</p>	<p>Yes.</p>

<b>Question</b>	<b>Vector response</b>
<p>Q11 The PEA proposes a set of 'guiding principles'. Do you agree with these principles? If not, what alternatives would you propose?</p> <p>(see PEA's Second Advice paper, Chapter 6, Guiding principles for moving forward. Also summarised in bullet point format in Appendix A of GIC paper)</p>	<p>We agree with the need for guiding principles. However, Chapter 6 of the PEA's paper is too discursive. For guiding principles to be useful, they need to be clearly and concisely expressed. The GIC has provided a good foundation for this in Appendix A to its consultation paper, but a few important points within the PEA's Chapter 6 have not been adequately captured. We therefore recommend a number of changes, in Appendix B below.</p> <p>Further, while there is a guiding principle related to the recovery of costs of information provision, there should be one for recovery of the wider costs of implementing the evolutionary convergence approach costs more generally.</p> <p>The changes to access and capacity pricing arrangements that will result from the evolutionary convergence approach will benefit all market participants. We therefore recommend that a guiding principle be added that the costs of the changes to access and capacity pricing arrangements resulting from the evolutionary convergence approach should be borne by all market participants.</p> <p>The GIC should endorse the guiding principles as reflecting the objectives of the Gas Act and the GPS.</p>
<p>Q12 Do you agree with the PEA's overall conclusion, including its 'indicators of success'?</p> <p>(see PEA's Second Advice paper, Chapter 7, Conclusion)</p>	<p>The date for change requests to implement governance to have been formulated and proposed is likely to be too optimistic. Whether or not this is so will only become clear once Vector and MDL have drafted the implementation plan.</p> <p>Noting that there are no other dates in the indicators of success, we recommend replacing "by November 2013" by "in a timely manner", which are the words used elsewhere in the PEA's conclusion.</p> <p>Otherwise, yes.</p>

<b>Question</b>	<b>Vector response</b>
<p>Q13 Do you agree with the PEA's recommendation to Gas Industry Co? (see PEA's Second Advice paper, Chapter 8, Recommendations)</p>	<p>Yes.</p>
<p>Q14 Several boxes with dashed borders appear throughout the PEA's Second Advice paper. These boxes contain material that has been discussed by the PEA but not sufficiently closely examined to draw firm conclusions. Do you have any comments on this material?</p>	<p>This material will prove useful to Vector, MDL and the industry advisory group as a discussion of options, when those parties consider the issues.</p> <p>We see no point in fine-tuning the text of them now, as they will be re-evaluated, and other options considered, as part of the evolutionary convergence process.</p> <p>Indeed, fine-tuning them other than through the joint development process would be counter-productive, for the same reasons that the GIC should not develop a design of its preferred option for improvement: to do so would put it into conflict with assessing code change proposals against the same criteria as used by Vector, MDL and the wider industry, which would undermine the evolutionary convergence approach (see also our response to question 5).</p>

## **Appendix B Detailed comments on the Guiding Principles (Q11)**

We agree with the need for guiding principles. However, Chapter 6 of the PEA's paper is too discursive. For guiding principles to be useful, they need to be clearly and concisely expressed. The GIC has provided a useful foundation for this in Appendix A to its consultation paper, but a few important points within the PEA's Chapter 6 have not been adequately captured in that draft. We therefore recommend the following changes.

Further, while there is a guiding principle related to the recovery of costs of information provision, there should be one for recovery of the wider costs of implementing the evolutionary convergence approach costs more generally, including both changes and ongoing operation. We have recommended inclusion of this below.

### **Offer mix of transmission services across both pipeline systems**

- TSOs should offer firm services for a range of terms (i.e. durations) and allocate these according to willingness to pay;
- once allocated, firm service rights should be tradable;
- TSOs should also offer non-firm services; and
- services should be harmonised to facilitate shipping across both pipelines.

### **Determination of physical transmission capacity**

- TSOs should publish the physical capacity determinations of their systems (by location or zone, as appropriate) and the underlying methodology applied, including the security of supply standard; and
- capacity determination methodologies should be transparent and stable over time.

### **Proportion of physical capacity available as firm**

- a process allowing input from shippers, users and TSOs should be used to determine what proportion of physical capacity will be offered as firm.

### **Term structure and release profile for services**

- it is desirable for transport services to be offered for a range of terms;
- generally, a progressive release of capacity for a particular future year is preferred, but exceptions are possible; and
- a relatively simple term structure and release profile should be adopted at the outset, to arrangements should evolve over time in response to the needs of contracting parties.

### **Nominations regime to allow for scaling when capacity scarcity arises**

- nominations should apply for all services contracts (at least for those zones where congestion is possible); and
- there should be incentives for parties to give accurate nominations (such as nominations forming the basis of transmission charges).

### **Transition away from grandfathering and supplementary agreements**

- arrangements giving preferential renewal rights to incumbent users should be phased out without misappropriation of property right;

- Supplementary agreements-arrangements be should be phased out and replaced by generic ones ~~and subject to codes~~; and
- transparent and efficient discounting or capital recovery arrangements should not be precluded.

#### **'Bolt on' arrangements for capacity pricing when scarcity occurs**

- at the time capacity rights are initially allocated: allocate capacity on a willingness to pay basis (at least where congestion is possible during the term of the offered contracts). A simple auction should be adequate; and
- at the time of a constraint: consider how price signals might be generated. This could involve capacity trading, with more sophistication possibly being introduced over time.

#### **Treatment of congestion rents**

- any congestion rents should be allocated in a way that minimises distortions to long-term bidding for firm capacity and short-term incentives.

#### **Transparency of information**

- all pipeline information relevant to the formation of prices for capacity rights should be made widely available;
- the costs of making information transparent should be recovered from a broad base; and
- the information provision functions could be externalised in the longer term.

#### **Cost recovery**

- the costs of the changes to access and capacity pricing arrangements resulting from the evolutionary convergence approach should be borne by all market participants.

#### **Governance for pipeline capacity access and pricing**

- the establishment of common code development processes for capacity access and pricing issues should be a priority; ~~and~~
- the establishment of common code dispute resolution procedures should be considered; and
- evolving toward common governance does not mean that a full merger of the MPOC and VTC codes is required.