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9 February 2012

Greig Hinds
Gas Industry Company
PO Box 10-646
Wellington

Dear Greig

Submission on Statement of Proposal on FY2013 Strategy, Work Programme & Levy

1. Vector welcomes the opportunity to make this submission on the Gas Industry Company's ("GIC") *Statement of Proposal on FY2013 Strategy, Work Programme, & Levy*, dated 21 December 2011. No part of this submission is confidential and we are happy for it to be made publicly available.

2. Vector appreciates the GIC's engagement with industry participants on this matter at the Co-Regulatory Forum on 10 November 2011.

Sharper focus on a smaller number of priorities

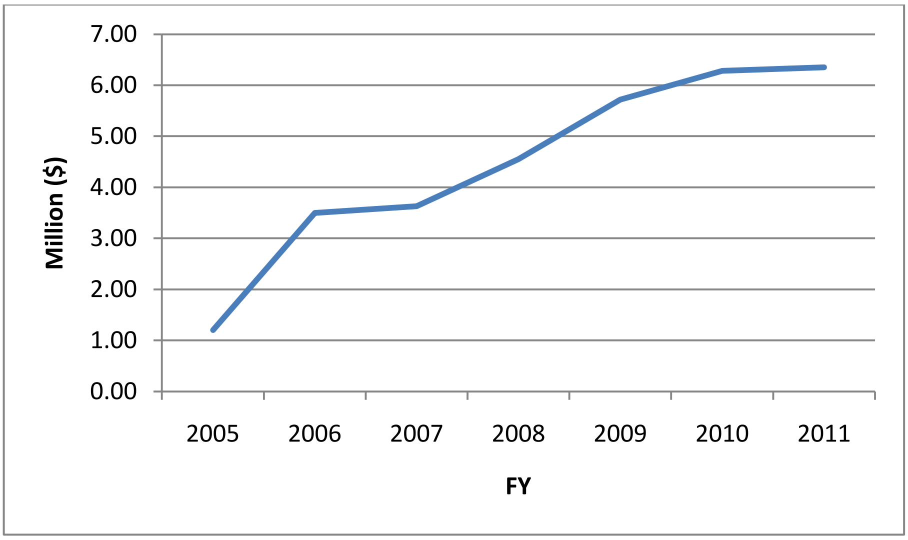
3. The GIC and industry participants have made significant progress in the past couple of years to ensure a smoother and more efficient levy development process. There is now widespread agreement on the principles underlying the development of the levy, though there will always be varying views on how they ought to be reflected in practice. While the levy development process and overall expenditure levels have stabilised, rising levy costs remain a concern.

4. Vector believes the GIC should focus on a smaller number of high priorities. If the GIC spreads itself too broadly, it risks making slow progress or regulatory inertia on important policy matters.

5. The GIC's proposed budget increase of approximately $268,000 in the GIC's proposed Work Programme for FY2013 is relatively modest. We are mindful, though, that this increase is preceded by substantial increases over the last six years.

6. The GIC should consider any future increases within the context of the substantial increases that have occurred since its establishment. The figure below indicates that the GIC's annual expenditure level has doubled from FY2006 (the amount indicated for FY2005 in the table is expenditure for only eight months).

Figure 1. GIC Annual Expenditure Levels, FY 2005-2011



Sources: GIC Annual Reports, 2005/2006 to 2010/2011. The figure for 2005 represents expenditure for only eight months.

FY2013 strategic priorities

7. The Government has made its fiscal objectives clear, which are: 1) clear priorities, 2) high quality services, and 3) reducing waste.[1] This would be an opportune time for refreshed thinking by the GIC on strategic priorities with the recent appointment of a new Minister for Energy and Resources.

8. The Government's Statement of Regulation[2] indicates a change in the approach the Government will take to regulation. It states that the Government will:

- Resist the temptation or pressure to take a regulatory decision until we have considered the evidence, advice and consultation feedback, and fully satisfied ourselves that:
  - the problem cannot be adequately addressed through private arrangements and a regulatory solution is required in the public interest;
  - all practical options for addressing the problem have been considered;

[1] http://gasindustry.co.nz/sites/default/files/consultations/254/statement_of_proposal_fy2013_levy_176004.1.pdf, page 25

[2] http://www.treasury.govt.nz/economy/regulation/statement

- the benefits of the preferred option not only exceed the costs (taking account of all relevant considerations) but will deliver the highest level of net benefit of the practical regulatory options available;
- the proposed obligations or entitlements are clear, easily understood and conform as far as possible to established legislative principles and best practice formulations; and
- implementation issues, costs and risks have been fully assessed and addressed;

• Require there to be a particularly strong case made for any regulatory proposals that are likely to:

- impose additional costs on business during the current economic recession;
- impair private property rights, market competition, or the incentives on businesses to innovate and invest…

9. This approach suggests that work should only be undertaken where a clear case of market failure is established that requires regulatory intervention. Otherwise, there would be a risk of potential encroachment on market activities.

10. While ticking off some 'low-hanging' fruit would be an attractive approach, the limited resources of industry participants, the demands from other regulators, and the current economic environment dictates a more holistic approach to developing governance and regulatory arrangements.

11. A more holistic approach involves a better appreciation of the linkages between the GIC's initiatives and those of other regulators. Table 1 identifies the work areas where synergies with other regulators could be achieved, and where close coordination is required to ensure consistency across regulatory regimes and avoid work overlaps and unnecessary compliance costs.

12. The table below outlines what Vector believes should be the GIC's top (Tier 1) priorities in the coming fiscal year and how other active work streams should be considered.

Table 1. Vector's proposed strategic priorities, FY2013

Policy initiative	Priority level	Comments
Gas Transmission Investment Programme ("GTIP")	Tier 1	Vector supports the GTIP, which sets a unified approach to addressing short-term transmission capacity issues and the long-term investment issue. As reflected in the feedback from industry participants prior to the Co-Regulatory Forum, the GTIP should be the GIC's highest priority in the medium to long term. Part of the certainty required is resolving the overlaps between the GIC and the Commerce Commission in relation to regulatory responsibilities for gas transmission investment and information disclosure. Overlaps create unnecessary compliance costs and increase regulatory

		uncertainty, as decisions considered by one regulator are less likely to be considered as precedents by the other.
Review of the Gas (Downstream Reconciliation) Rules 2008	Tier 1	Vector strongly supports the long-awaited review of the Gas (Downstream Reconciliation) Rules. While the review is expected to be a long and complex process, it is necessary to achieve more efficient outcomes for participants in the downstream reconciliation system and consumers who ultimately bear the cost of its operation. Vector expects this review to address the inefficient allocation of Unaccounted-for-Gas ("UFG") and ongoing costs of administering the Rules, remove unnecessary compliance costs, and codify exemptions that would better meet the purpose of the Rules. We urge the GIC to adhere to firm timeframes in relation to this review. Vector has made a separate and more detailed submission in response to the GIC's proposed options on downstream reconciliation. The submission will focus on the resolution of issues that would better achieve the purpose of the Rules.
Transmission Pipeline Balancing	Tier 1	Pipeline balancing is a long-standing issue that many, if not all, industry participants want to be resolved expeditiously. It is Vector's desire to avoid the exhaustive and costly balancing resolution processes industry participants experienced in recent years. Balancing should remain a high priority to ensure its completion. The SoP indicates that pipeline balancing is likely to become part of the GTIP. Vector supports efforts to identify linkages between work areas and merging them, or incorporating relevant ones to bigger projects. This would provide a more holistic consideration of issues and a more cost-effective way of progressing matters under consideration. The Commerce Commission is considering whether to include in its Default Price-Quality Path ("DPP") Determination for Gas Pipeline Services the recovery of balancing costs. We encourage the GIC to coordinate closely with the Commission on pipeline balancing to ensure consistency and workability between the DPP Determination and ongoing and future changes to the Maui Pipeline Operating Code and the Vector Transmission Code.
Critical contingency management	Tier 1	The Critical Contingency Regulations, developed by the GIC and industry, withstood its biggest challenge since the Regulations went live in January 2010 during the Maui Pipeline outage in October 2011. The Critical Contingency Operator ("CCO") Performance Report on

		the outage indicates that "[t]he Regulations and their application by those parties with obligations under the Regulations were effective."[3] The CCO Performance Report on the Maui Pipeline outage indicates that fine tuning rather than an overhaul of the Regulations is required. To further improve governance in relation to critical contingency and better achieve the purpose of the Regulations, the GIC should implement the CCO's recommendations in a timely manner. These are in relation to curtailment bands, regional designation of critical contingencies, the process for partial restoration, increasing knowledge and understanding of the critical contingency system, compliance incentives, and improvements to the review process. Vector further recommends a pan-industry consideration of how incidents that impact on both the electricity and gas sectors should best be managed, particularly where critical contingency management in one sector significantly impacts on the other.
Retailer insolvency	Tier 1	Vector strongly supports the development of permanent regulations to address retailer insolvencies. We note the overwhelming desire by industry for more certain arrangements. While industry participants almost always opt for contractual over regulated solutions (partly due to the unintended consequences of regulation), the fact that they are on the same side of this issue, which is rare, should provide a compelling reason to prioritise this matter. Permanent regulations would ensure the complete and timely transfer of an insolvent retailer's customers to other retailers, without which market participants face significant financial risks while the transfer is not completed. The inability to transfer customers efficiently is a case of market failure that requires regulatory intervention. The greater the success in promoting competition in the retail market, and as the current economic downturn continues, the greater is the likelihood of retailer insolvency. It is therefore important for insolvency regulations to be developed expeditiously, to ensure business and consumer confidence in the gas markets particularly during this uncertain period. The GIC should consider the cross-industry impact of insolvencies in the gas sector. We support the GIC aligning this work with that of the Electricity Authority, to

[3] www.oatis.co.nz

		the extent possible and reasonable.
All statutory obligations	Tier 2	Mandatory; low-level activity. [With no associated FTE, the $150,000 cost for design and printing appears to be high.]
Strategic Plan and Annual Report	Tier 2	Mandatory; low-level activity.
Retail Contracts Oversight Scheme	Tier 3	As retailers' contract terms become closely aligned with the retail contract benchmarks over time, the GIC sould monitor contracts, say every two years instead of annually.
Distribution principles	Tier 3	The small number of distributors should enable the GIC to monitor the alignment of their distribution contracts with the principles using in-house resources. It is expected that as contracts become transparent, distributors will learn from each other and adopt best practice. Over time, very little monitoring should be required.
NZ Gas Story	Tier 3	Should not require external resource. [With no associated FTE, the $150,000 cost for design and printing appears to be high.]
Gas quality	Tier 3	Discussion on retailers' proposed Safety Information Exchange Protocol is ongoing.
Interconnection	Tier 3	The successful interconnection of the Sidewinder Pipeline to the Vector transmission system in 2011 is a reflection that Vector's Interconnection Policy is working. Regulation in relation to interconnection is therefore unwarranted. The development of Vector's Interconnection Policy was informed by the GIC's *Transmission Pipeline Interconnection Guidelines*.
Access to gas processing facilities	Tier 3	The Gas (Processing Facilities Information Disclosure) Rules 2008 involves only low-level reporting and monitoring activities. Vector has started preliminary discussions with one party that requested access in early 2011 but has not received any response from that party since.
Code changes and appeals	As required	Code changes and appeals are anticipated to be mainly related to changes arising from the GTIP and pipeline balancing work.
Information Gathering Project	Regulatory option unneces-sary	Vector does not support general information disclosure powers for the GIC, which the GIC itself acknowledged it is not allowed to exercise under the Gas Act. The GIC's SoP on this issue has not fully identified a

		market failure that requires regulatory intervention or that cannot be addressed other than through the development of regulations. We note the recent success by the GIC in requesting demand information from industry participants as part of the Bridge Commitments, which was negotiated without the need for regulations. Vector considers the regulatory option to be a disproportionate response to a problem that has not been proven to be systemic, if it exists at all. Considering regulation could signal the GIC's adoption of an exceptionally low threshold for regulation. The GIC's proposal includes substantive overlaps with the Commerce Commission's proposed Information Disclosure Requirements for gas pipeline businesses under Part 4 of the Commerce Act, specifically gas transmission capacity and investment, terms and conditions for pipeline access, and gas quality. The GIC has not specified what information it would require to be disclosed, and is also unclear what specific concerns it has about compliance and enforcement of the Commission's Information Disclosure Requirements. We are not aware of any such problems. Vector recommends that the GIC liaise closely with the Commission to determine whether its needs can be accommodated within the Commission's Information Disclosure Requirements, avoiding duplication and overlaps. Vector will make a separate and more detailed submission in response to the SoP.

13. We note that Appendix C of the Statement of Proposal, "Cost of Operation", needs to be amended to tie in with the bulk of the document.

Projected demand

14. Methanex has made an announcement to the market that it is starting up its second train in July 2012.[4] This will have a significant impact on the overall PJs that are consumed.

15. Vector suggests that the GIC include the above and other foreseeable increases in demand in its projection, currently still at 150PJ per annum. Otherwise, there could be an over recovery in FY2013.

[4] http://www.stuff.co.nz/taranaki-daily-news/news/6279992/Methanex-Todd-sign-10-year-gas-plan

Longer levy regulation cycle

16. Vector believes a longer levy regulation cycle, say two years, would enable the GIC and industry to plan more strategically and for a longer term. This would be more consistent with the timeframe of key projects which span more than a year, eg GTIP. This would also avoid the costs of annual consultations.

17. A longer levy regulation cycle would provide further stability to the process (not having to seek Ministerial approval every year) and greater certainty for industry participants, while providing greater flexibility for the GIC to allocate funds to meet changing priorities or unforeseen circumstances, eg moving forward the review of the Critical Contingency Regulations following the Maui pipeline outage.

Closing comment

18. It is Vector's view that the GIC should focus on a smaller number of high priority initiatives that would have the most profound impact on the industry and deliver longer-lasting benefits to consumers. These include:

    - progressing the Gas Transmission Investment Programme with clear timelines, including resolution of overlaps in regulatory jurisdictions in relation to gas transmission investment and information disclosure;

    - reviewing the Downstream Reconciliation Rules which is long overdue to achieve more efficient outcomes and provide greater clarity on the interpretation of some of the Rules;

    - concluding the long-standing transmission pipeline balancing work stream in calendar year 2012;

    - implementing the recommendations of the CCO Performance Report following the Maui Pipeline outage; and

    - developing permanent retailer insolvency regulations.

19. In addition, the GIC may need to revise projected demand following Methanex's announcement of its second train coming to the market.

20. Finally, as part of a more holistic approach to developing governance and regulatory arrangements, Vector supports a longer levy regulation cycle to provide greater stability to the process and reasonable flexibility for the GIC to reallocate resources to meet changing priorities or unforeseen circumstances.

21. Attached is a completed submission form (Appendix A). If you have any questions, or require further information, please contact Luz Rose, Senior Regulatory Analyst, on 04 803 9051 or Luz.Rose@vector.co.nz.

Kind regards

Bruce Girdwood
Manager Regulatory Affairs

Appendix A: Specific Questions for Response

QUESTION	VECTOR'S COMMENT
Q1: Do you consider there to be other items that should be included in the Company's intended work programme for FY2013?	See the attached letter.
Q2: Do you consider there to be any items that should be excluded from the Company's intended work programme for FY2013?	See the attached letter.
Q3: Do you have any comment on the proposed levy for FY2013?	See the attached letter.
Q4: Do you have any comment on regulatory amendment described in section 4?	During the consultation on the FY2012 Levy, Vector supported the proposed regulatory amendment to enable the GIC to audit information provided with respect to levy payments. Vector continues to support this proposal provided that industry participants are advised of the reason(s) for any proposed audit and consulted on the reasonableness of such an audit.