Vector Limited
101 Carlton Gore Road
PO Box 99882, Newmarket,
Auckland, New Zealand
www.vector.co.nz

Corporate Telephone
+64-9-978 7788

Corporate Facsimile
+64-9-978 7799

28 January 2016

Keston Ruxton
Manager, IM Review
Regulation Branch
Commerce Commission
By email: im.review@comcom.govt.nz

Dear Keston

Input Methodologies Review – Gas Specific Issues

This is Vector Limited's (Vector) submission on gas specific issues for the Input Methodologies Review (IM Review), following on from the gas stakeholder forum held on 8 December 2015. Nothing in it is confidential. For further information, or to discuss anything in this submission, please contact:

Anna Casey
Principal Regulatory Advisor
Tel: 09 978 8138
Email: Anna.Casey@vector.co.nz

This submission is made in Vector's capacities as a gas transmission system owner and a gas distributor, and also on behalf of its gas trading business. However, it is made in the context of the pending sale of its transmission and non-Auckland gas distribution assets to Colonial First State Investments, which, if all approvals are obtained, is due to complete in early 2016.

The December forum was a constructive meeting

The December forum was a constructive opportunity for members across the gas industry to discuss the IM review and other matters with the Commerce Commission (Commission). The format promoted frank discussion and we believe it has assisted in identifying and developing the issues that need addressing.

Close co-ordination between regulators is needed

The Commission and the Gas Industry Company (GIC) are both undertaking significant review projects in 2016. The GIC's Transmission Access work programme will influence, and be influenced by, the IM Review. It is therefore critical that the two regulatory bodies co-ordinate closely as these projects progress. A collaborative approach across all industry stakeholders, including regulators and consumers, will likely deliver the best regulatory outcome for the industry as a whole.

Input Methodology changes should not impede Transmission Access changes

One topic of discussion at the December forum was transmission pricing. The Major Gas Users' Group (MGUG) suggested that the Commission should consider changing the form of control to avoid the sorts of price rises experienced on Vector's gas transmission network in the last few years. MGUG also suggested the Commission should look at developing a pricing methodology for gas transmission.

The GIC's Transmission Access work programme proposes to change the way in which capacity is accessed and priced on the Vector transmission system. It would not be appropriate to make changes to the form of control, or impose a pricing methodology, based on perceived shortcomings of the existing transmission pricing methodology before the outcome of that work programme is known.

A potential outcome of the Transmission Access work programme is the introduction of capacity auctions. The Maui Pipeline Operating Code (MPOC) already provides for an auction-type product in its Authorised Quantity arrangements, although these have not yet been utilised. The GIC has indicated its preferred outcome would be to see more "Maui-like" arrangements on the Vector transmission system, which would require significant changes to Vector's existing capacity access arrangements.

However, under the current form of control on the Vector transmission system, it will be problematic to make any significant changes to capacity access and pricing. Notional revenue is calculated by reference to historical quantities. If the basis on which quantities are allocated and calculated changes as a result of the GIC's work programme, it will be difficult for the transmission system owner to confidently calculate a notional revenue for the new methodology based on historical quantities under the previous methodology.

To support transition from one methodology to another, Vector submits that a pure revenue cap (with wash-ups) would be the more appropriate form of control.

Treatment of balancing gas costs and cash-outs should be clarified

The new market-based balancing regime (MBB) on the Maui pipeline does not fit easily into the current provisions for recoverable costs under the Input Methodologies. The Commission wrote to Vector and Maui Development Limited (MDL) on 12 May 2015 setting out its interpretation of the relevant provisions, and confirming that MBB cash-outs were recoverable costs for the purposes of the Input Methodologies.

Vector submits that the Input Methodologies should be amended so that it is clear on the face of them that MBB cash-outs are recoverable costs. Vector also submits that there should be a clear mechanism for the return to affected parties of any amount of MBB cash-outs in excess of the actual cost of pipeline balancing.

That is, MBB cash-outs are not linked to physical balancing which means that there could be a disparity between the amounts paid to MDL via cash-outs and the amounts actually incurred by MDL in keeping the pipeline balanced. Without some mechanism to require cash-outs to be netted off against actual costs, and any excess returned to industry, it is not clear that these cash-outs will not result in a wind-fall gain to MDL.

The potential scale of the problem is indicated by the net MBB cash-outs for December 2015, for which $742,000 was invoiced in respect of Vector welded points. This contrasts with total net cash-outs invoiced in respect of Vector welded points for the year to October 2015 of $1.3m under the MPOC's previous Imbalance Overrun Notice cash-out mechanism. Furthermore, in the year ending October 2014 net cash-outs were only $0.5m.

Other issues

We also have some brief observations on the following matters:

- *Quality and reliability measures* –the discussion around quality and reliability at the December forum indicated that there is still some work required before enforceable quality measures can be introduced. Vector submits that this issue does not need addressing in the current IM review. A working group to identify the issues and propose solutions would be helpful ahead of the next IM review.

- *Capex wash-up* – Vector submits that a capex wash-up should be included in recoverable costs for gas pipeline businesses, as is currently provided for electricity distribution businesses.

- *CPPs* – Vector considers that changes proposed to CPP provisions do not need any special consideration in the context of gas distribution businesses. As outlined earlier, Vector has sold its transmission business to Colonial First State, so any further consideration of CPP issues in the context of gas transmission businesses will fall to them.

Yours sincerely
For and on behalf of Vector

Richard Sharp
Head of Regulatory