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18 October 2010

Ian Wilson  
Principal Adviser – Infrastructure Access  
Gas Industry Company  
PO Box 10-646  
Wellington

Dear Ian

**SUBMISSION ON GAS GOVERNANCE ISSUES IN DISTRIBUTION**

Vector Limited ("Vector") welcomes the opportunity to submit on the Gas Industry Company's ("GIC") consultation paper, *Gas Governance Issues in Distribution: Issues Paper*. Vector appreciates the discussions initiated by the GIC with stakeholders prior to the release of this paper.

Vector agrees with the GIC's conclusion, following its initial assessment of existing gas distribution arrangements, that there are no distribution issues that warrant the development of gas governance arrangements.

Furthermore, we strongly believe that it will not be a good use of the GIC's time to do further work on other aspects of gas distribution, for the following reasons:

- There is a dearth of significant complaints from retailers regarding access to distribution networks, or other complaints directly from consumers.
- All of Vector's gas distribution networks will be subject to comprehensive and consistent price (or revenue) and quality regulation and information disclosure from mid-2012, once recent amendments to the Commerce Act 1986 are implemented.
- Gas retailers are businesses of considerable size and are able to negotiate with distributors on a 'level playing field'. We consider that commercial parties are best suited to address commercial contracting issues.

Vector therefore cannot see any compelling reason for the further investigation or regulation of distribution networks. We believe that the cost of intervening into a contracting system that is working reasonably well will not outweigh any benefits.

Consistent with this view, Vector does not support the development of high level benchmarks for distribution contracts. Experience in the electricity market indicates that the development of model distribution agreements has been lengthy and costly, and needs further review. The GIC should instead be focusing on issues widely agreed by industry participants as priorities, which will provide the biggest gains for the gas sector, and ultimately, consumers.

Our responses to specific questions in the consultation paper are indicated in the attached submission form. Please note that Vector is making a separate submission on the GIC's companion paper, *Gas Governance Issues in Quality: Issues Paper*.

Thank you for considering this submission. We are happy to discuss any issues or questions you may have on certain aspects of this submission. Feel free to contact me at [John.Rampton@vector.co.nz](mailto:John.Rampton@vector.co.nz) or 04 803 9036.

Kind regards

A handwritten signature in blue ink that reads "John Rampton". The signature is written in a cursive style with a large initial 'J' and 'R'.

**John Rampton**

Manager Industry Governance and Policy

## Appendix A: Responses to specific questions

Submission from: Vector Limited

Contact: John Rampton, Industry Governance and Policy Manager, [John.Rampton@vector.co.nz](mailto:John.Rampton@vector.co.nz) or 04 803 9036

Question	Comment
<p><b>Question 1:</b> Do you agree with the proposed regulatory objective? If you disagree please explain why and/or provide an alternative.</p>	<p>The proposed regulatory objective encompasses high level principles (including safety, efficiency, reliability, access and clarity of roles) that Vector generally agrees with.</p> <p>Going forward, the GIC should also consider the objectives of the Government’s Draft Energy Strategy and Draft Energy Efficiency and Conservation Strategy. In particular, it should take into account both strategies’ overall drive towards improving efficiency levels across the energy sector, in order to maximise the sector’s contribution to the economy.</p> <p>Vector supports low-cost but effective regulation for the gas sector. This includes supporting initiatives to ensure that regulation is not overly prescriptive to impede the efficient operation of distribution networks and innovation in this sector.</p>
<p><b>Question 2:</b> Have we identified all relevant characteristics of distribution? If not, please suggest what other features you believe to be relevant, and explain why they are relevant.</p>	<p>The consultation paper misses a critical characteristic that have implications for the regulation of gas distribution networks—that interested parties need to be highly incentivised to undertake the risk associated with the investment and operation of such assets. It is important to ensure the correct policies are in place to incentivise and enable distribution operators to maintain and operate distribution assets efficiently and encourage innovation in this sector.</p> <p>A key relevant characteristic of gas distribution networks in New Zealand (as in many overseas jurisdictions) is that they are subject to extensive regulatory scrutiny and control:</p> <ul style="list-style-type: none"> <li>• Vector’s Auckland gas distribution network is subject to price and quality regulation under the Commerce Act (Vector Natural Gas Services) Authorisation 2008. Vector’s other gas distribution networks are effectively</li> </ul>

Question	Comment
	<p>prevented from increasing prices at a rate greater than changes to the Consumer Price Index ("CPI") by the "CPI criterion" that is set out in section 55F(2) of the Commerce Act 1986 (see discussion below for more details). All of Vector's gas businesses are also subject to information disclosure and other regulatory requirements under the Commerce Act 1986, the Gas (Safety and Measurement) Regulations 2010, and the Gas (Information Disclosure) Regulations 1997.</p> <ul style="list-style-type: none"> <li>• All of Vector's gas distribution networks will be subject to consistent and comprehensive price and quality regulation from mid-2012, following the Commerce Commission's implementation of price control of gas pipeline businesses under Part 4 of the Commerce Act.</li> </ul> <p>Given this impending comprehensive regulation and the paucity of significant complaints from retailers regarding gas distribution, it is Vector's strong view that further regulation of distribution networks (i.e. regulation of distribution contracts) by the GIC will not provide any benefits and could impede contracting innovation in this sector. We consider that commercial parties are best suited to address commercial contracting issues in distribution.</p>
<p><b>Question 3:</b> Have we identified all regulatory arrangements that are relevant to the analysis of gas distribution? If not, please suggest what other regulatory arrangements are relevant, and explain why they are relevant.</p>	<p>The consultation paper has identified the overarching regulatory arrangements that are relevant to the analysis of gas distribution governance. However, it has failed to emphasise key provisions of the Commerce Act that have significant implications for the regulation of gas distribution.</p> <p>As noted above, section 55F(2) of the Commerce Act provides that if suppliers of gas pipeline services increase their prices by more than the CPI over the period 1 January 2008 to the start of the new regulatory regime (mid-2012), the Commerce Commission can apply claw-back to compensate consumers for some or all of the over-recovery of revenues. This effectively acts as a CPI-0 price cap on the non-controlled gas transmission and distribution businesses up to 2012.</p> <p>Vector disagrees with the statement in the consultation paper that reliability and quality standards will just be reporting standards and not firm measurable targets under the</p>

Question	Comment
	<p>new Commerce Act regime. We note that the consultation paper also states that the Commerce Commission “does not commit to any particular set of standards but makes clear the regime will set in place objective quality standards with defined and measurable indicators”. It is unclear which of these statements the GIC believes to be correct. For the reasons outlined below, Vector considers that the new regulatory regime is likely to include measurable reliability and quality targets for gas quality.</p> <p>Section 53M(1)(b) of the Commerce Act states that a price-quality path must specify the quality standards that must be met by the regulated supplier. This implies some form of clear targets, which will be in place from 2012.</p> <p>We note also that the Commerce Commission has addressed this issue in the context of the Gas Authorisations (Vector and PowerCo) and is using those instruments to gain increasing knowledge and experience in respect of reliability and quality measures.</p> <p>The Commerce Commission has indicated a clear preference for measurable targets (although they note that these may be difficult to achieve due to data issues) and is explicitly considering the measures System Average Interruption Duration Index (“SAIDI”) and System Average Frequency Interruption Index (“SAIFI”) for this purpose. SAIDI and SAIFI are not ideal measures of the reliability of gas network supply but are definitely able to be expressed as measurable targets.<sup>1</sup></p>
<p><b>Question 4:</b> Have we identified all issues relevant to the analysis of gas distribution? If not, please suggest what other issues are relevant, and explain why they are relevant.</p>	<p>One of the issues raised by the GIC during its initial discussions with Vector on distribution issues concerns contracting arrangements for properties that have been vacated by customers.</p> <p>Distributors are entitled to charge retailers for ICPs that are available for use to cover fixed costs. Retailers need to inform distributors if they wish to disconnect the ICP and if there is zero consumption at the site. Vector’s view is that distributors should be able to continue to charge retailers in such circumstances to enable the recovery of significant fixed sunk costs.</p>

<sup>1</sup> Commerce Commission Issues Paper, *Initial Default Price-Quality Path for Gas Pipeline Businesses*, paragraphs 7.09-7.16, <http://www.comcom.govt.nz/assets/Gas/Gas-Default-Price-Quality-Path/Initial-Default-Price-Quality-Path-for-Gas-Pipeline-Businesses-Issues-Paper-12-April-2010.pdf>

Question	Comment
	<p>While there is a general understanding between industry participants of the various terms relating to the disconnection and reconnection processes, the absence of industry-agreed definitions of terms (e.g. "temporary disconnection", "transitional disconnection", "relocation", etc.) has led to some confusion or disagreement amongst industry participants.</p> <p>There is a protocol developed by the Gas Association of New Zealand ("GANZ") in relation to disconnection/reconnection, which by its nature, is not binding. In this regard, the GIC may consider facilitating a process for industry to develop a firm set of definitions. To start with, the GIC could assess whether the GANZ protocol is an appropriate basis for the development of a firmer industry agreement.</p>
<p><b>Question 5:</b> Do you agree Gas Industry Co should do no further work on the safety and reliability aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.</p>	<p>Please see Vector's separate submission on safety and reliability aspects of distribution services, in response to the GIC's companion consultation paper, <i>Gas Governance Issues in Quality: Issues Paper</i>.</p> <p>Vector considers that current contractual arrangements in relation to gas quality are adequate, well accepted, and understood by industry participants. The Vector Transmission Code, Vector's interconnection agreements, and the Maui Pipeline Operating Code are very clear as to relevant parties' obligations, responsibilities and liabilities regarding gas quality. More prescriptive regulatory arrangements are therefore unnecessary.</p> <p>We note that the consultation paper has not recognised the work that industry, through GANZ, is doing in relation to gas quality. GANZ has recently commissioned its first audits of Vector's transmission system in relation to gas supply pressure, odourisation, and quality. The outcome of the audits indicates a general acceptance by gas distributors and retailers that gas provided by Vector's transmission system met all three measures satisfactorily, with no party challenging the information/data provided.</p> <p>We strongly suggest that the GIC coordinate with GANZ in respect of the above audits and its intentions regarding distribution networks. We note that section 30(1)(a) of the Gas Safety and Measurement Regulations requires distributors to "implement and</p>

Question	Comment
	<p>maintain an audited safety management system...”.</p> <p>We understand the Ministry of Economic Development is also doing some work pursuant to the Gas Safety and Measurement Regulations. ‘Redundant’ investigation or regulation would not be consistent with the Government’s objective of streamlining regulation, and would not be a good use of the GIC and industry’ time.</p>
<p><b>Question 6:</b> Do you agree with the options identified for dealing with slow progress on updating standard distribution agreements? Which option do you think is most appropriate?</p>	<p>Vector believes it is unnecessary to consider options for dealing with the updating of standard distribution agreements.</p> <p>Vector’s distribution contracts have the right industry standards. We note that there have not been many new retailers seeking access, and the level of interest from existing retailers to actively renew their agreements has been low. We only had one request this year for a new gas retail contract. In any case, new retailers can easily seek access to Vector’s distribution networks.</p> <p>The extra burden of compliance will yield little benefit to end users, distributors and retailers. It is therefore not a good use of the GIC and industry’s time.</p> <p>Vector would like to stress that based on our experience with the electricity sector, we would harbour concerns with a regulatory initiative that sought to fully standardise distribution contracts. Flexibility could be lost, price shocks could occur, and there is likely to be little benefit. Regulating contracts would hamper contracting parties’ ability to negotiate terms that would suit their unique commercial needs, and would discourage contracting innovation. Furthermore, a diversity of contracting arrangements could be an indication of the existence of competitive pressures in the market.</p>
<p><b>Question 7:</b> Do you agree Gas Industry Co should do no further work on the other efficiency aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.</p>	<p>Vector agrees that the GIC should do no further work on the other ‘efficiency’ aspects of gas distribution services identified in the consultation paper (access, information and innovation). We believe these areas do not warrant further investigation or regulation, for the following reasons:</p> <ul style="list-style-type: none"> <li>• Access – Vector has not had significant complaints from retailers about access to</li> </ul>

Question	Comment
	<p>the distribution system. We also had a very low level of complaints directly from consumers through the Electricity and Gas Complaints Commission.</p> <ul style="list-style-type: none"> <li>• Information – All of Vector’s distribution network will be entirely subject to price (or revenue) and quality regulation and information disclosure, following the recent amendments to the Commerce Act 1986. The Commission intends to set in place standards with defined and measurable indicators in relation to quality and efficiencies that will be shared with consumers over time.</li> <li>• Innovation – The GIC has developed benchmarks for gas retail contracts with domestic consumers, for the protection of the latter. Unlike domestic consumers, however, gas retailers are businesses of considerable size and are able to negotiate contract terms with distributors on a ‘level playing field’. This allows both parties to negotiate for differentiated terms that better suit their commercial needs and enables innovation in contracting. As indicated above, diverse contracting arrangements could well be an indication of competitive pressures in the market.</li> </ul> <p>It is Vector’s view that the costs of intervening into a contracting system that is working reasonably well will outweigh any benefits. As evidenced by the paucity of significant complaints from retailers regarding gas distribution, we consider that commercial parties are best suited to address commercial issues.</p>
<p><b>Question 8:</b> Do you consider the high level benchmarks for distribution contracts proposed in Appendix A are appropriate? If not, please suggest what alternatives should be considered.</p>	<p>Vector does not support the development of high level benchmarks for distribution contracts. We do not see this as necessary for the reasons identified in our response to Question 7.</p> <p>In addition, experience in the electricity market indicates that the development of model distribution agreements has been lengthy and costly, and needs further review. The relevant parties struggled to find common ground on many issues and it remains unclear how effective the development of the model contracts could have been. Furthermore, if this degree of discretion is available to providers of electricity, which is an essential energy source, we cannot see any reason why a more restrictive arrangement should be imposed on providers of a discretionary fuel such as gas.</p>



Question	Comment
	<p>Focusing on gas distribution, which is already a regulated sector with a dearth of significant complaints, is not a good use of the GIC and industry's time and stretched resources. The GIC should focus on issues widely agreed by industry participants as priorities, which will provide the biggest gains for the sector, and ultimately, consumers.</p> <p>If the GIC decides to pursue the development of benchmarks for distribution contracts, Vector would like to be consulted and be able to provide further input.</p>