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Bas Walker
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11 March 2009

Dear Bas,

Consultation on Exemption Application under the Gas (Switching Arrangements) Rules 2008:
Application SW08-11-T for the exemption of 'bypass' distribution systems and associated ICPs from rule 41 of the Switching Rules

1. On Gas Limited, Vector Gas Contracts Limited and Vector Gas Limited (together, Vector) welcome the opportunity to provide comments the Gas Industry Company (GIC) on Exemption Application SW08-11-T under the Gas (Switching Arrangements) Rules 2008 (the Rules).
2. Vector strongly opposes Nova Gas Limited's (Nova) exemption application to exempt consumers connected to the five gas gates from rule 41 and believes that steps need to be taken to ensure Nova complies with the Rules immediately. In support of this position, Vector notes:
 - that Nova is a distributor and registry participant;
 - the proper approach to granting of exemptions;
 - that the granting of the exemption will result in: (a) possible barriers to switching; (b) increased information asymmetries; and (c) will inhibit the fulfillment of the Gas (Switching Arrangements) Rules 2008;
 - that an exemption under the Gas (Downstream Reconciliation) Rules 2008 does not necessarily mean an exemption should be granted under a different regime such as the Gas (Switching Arrangements) Rules 2008; and
 - the risk of registry misuse through data trawling.

3. Further details are provided in the paragraphs that follow and in addition to the above; Vector provides comments to specific GIC questions in appendix A.

Nova is a distributor and a registry participant

4. Vector submits that it is unequivocal that Nova is a distributor. In support of this, Vector notes:
 - (1) Nova provides line function services as defined by the Gas Act 1992;
 - (2) Nova itself states that it “competes with the Powerco and Vector open access distribution networks.¹”
 - (3) the Commerce Commission identifies that Nova is an owner of distribution networks and is therefore a distributor²; and
 - (4) the GIC has already made a determination on this point in granting an exemption under the Gas (Downstream Reconciliation) Rules 2008 (Transitional exemption DR08-27-U).
5. Further, Vector submits that the GIC’s conclusion that bypass networks fall within the intent of the Rules and the purpose of the registry is correct. There is nothing in Part 4A of the Gas Act, the Government’s April 2008 Policy Statement on Gas Governance, or the text of the Rules to indicate that the two types of networks should necessarily be treated differently. As exemptions remain available, the only remaining question is whether Nova should be granted on this instance for a reason other than its suggestion that it is not a distributor.

General approach to exemptions

Simon Terry Associates Report

6. The report recently prepared for the GIC by Simon Terry Associates (STA) titled, “Application of Gas Governance Arrangements to Private Networks” is timely and useful in this context. Vector believes that granting this exemption would be premature without first considering the issues raised by STA. Vector considers that conclusions reached by STA are hard to ignore. In particular, given that both sets of rules were intentionally

¹ Nova Gas Limited, *Application SW08-11-T for the exemption of ‘bypass’ distribution systems and associated ICPs from rule 41 of the Switching Rules.*

² The Commerce Commission, *Gas Control Inquiry, Final Report: Generic Competition Issues*, paragraph 3.55.

designed to apply to “all industry participants” STA notes the significant amount of evidence that would be needed to justify an exemption.³

7. The report examines the grounds on which a private network could be exempted from a rule or regulation and provides some useful guidelines for the GIC to use when considering exemptions.

8. In particular, STA consider that:

“a case for an exemption of a private network could be potentially made if:

- *the exemption does not significantly limit the effectiveness of the regulatory and governance framework in achieving the objectives which the GIC is required to pursue as the co-regulator of the gas industry, while*
- *resulting in significant resource saving (from the viewpoint of society at large) and/or the protection of an element of substantial and desired competitive pressure in the downstream retail gas market.*⁴”

9. The STA report also notes the number of successful exemptions Nova has secured in the past and canvasses the grounds for each of these and questions whether the same grounds can be applied going forward. As a matter of general principle, STA considers that:

*“...[an] exemption for a private network should be allowed only when the absence of the particular information does not materially affect the integrity of the market oversight, allocation, reconciliation, or switching procedures which the regulator is required to establish and maintain on open access networks with which the private network is in competition of coexistence.”*⁵

Further, STA notes:

*“Differential treatment of private and open access systems opens the prospects that the regulatory arrangements themselves may be “gamed” for private advantage.”*⁶

10. The above general principles are relevant in the context of Nova’s application and should be applied by the GIC when making its final

³ Simon Terry Associates, “Application of Gas Governance Arrangements to Private Networks” p.2.

⁴ Simon Terry Associates, p.1.

⁵ Simon Terry Associates, p.35.

⁶ Simon Terry Associates, p.36.

determination on the Nova Bypass exemption. The more detailed guidelines of the STA report are also of considerable use. For example, the report considers that the following criteria should be examined: the purpose of the Rules when granting an exemption; the impact the exemption would have on competition; and whether the granting of exemptions in certain situations is justifiable.

11. Vector also believes that much thought needs to be given to any negative externalities, such as anti-competitive behavior that may result from exempting Nova bypass networks from industry arrangements, such as barriers to switching increased information asymmetry these are considered below.

Difficulties with granting the exemption

Possible Barriers to switching

12. One of the key reasons the switching and reconciliation arrangements exist is to facilitate benefits for consumers by both providing information on how to do so as well as a platform on which the switch is facilitated. Without information on Nova's installations competition in the gas distribution and retail markets will be impaired, limiting potential benefits to consumers. Consumers looking to switch away from Nova are also impaired as they are not provided with the same means to do so as other consumers on open access networks.
13. Vector notes that Nova acknowledged that distribution companies were likely to benefit from reduced costs and efficiencies that should result from upgraded switching arrangements in its submission of 8 November 2005. This view has obviously since changed. In its report to the GIC, STA accurately identifies barriers to switching would remain in place if Nova is:
a.) exempt from industry switching and registry arrangements; and b.) exempt from information disclosures. STA highlights the need to minimize information asymmetries through industry wide disclosure of information, in this instance through the registry, but other information disclosures are of equal importance. Vector discusses some important aspects of STA's discussion below.

Increased information asymmetry

14. Vector believes that information should readily be made available to assist consumers in making more informed choices. This is supported by STA's view that provisions in both the Gas Policy Statement of April 2008 and the Gas (Switching Arrangements) Rules 2008 exist to minimize information asymmetries and protect consumers from any anti-competitive behavior in

the gas market. They state that, “[the GPS] leaves no wriggle-room for exemption of private distribution networks of the gas sector⁷” as it has tasked the GIC with ensuring that “good information is publicly available on the performance and present state of the gas sector.⁸” Additionally, the purpose of the Rules upholds the importance of consumer choice by ensuring the switching and registry arrangements, enable customers to choose, and alternate, efficiently and satisfactorily between competing retailers. STA go further to consider that an “efficient, reliable and fair customer switching process” would require consumers are informed about both contract terms (including termination provisions) and competing offers available. While contract terms are slightly out of scope for the determination of the exemption, they are still important to consider. As STA cite, these information asymmetries are most readily identified when “suppliers with potential market power⁹” are required to disclose information on standard terms and conditions contained within their contracts. For example, STA consider that without proper disclosure of contract terms and conditions it remains unclear:

- whether there are competitive pressures on distribution prices;
- whether barriers to customer switching exist; and
- what information the network owner maintains and whether it would be readily available to a new retailer if a customer switched.

15. Given this, Vector considers that the inclusion of Nova installations on the registry is important to ensure competition in both retail and distribution is maintained and that the GIC ensure opportunity does not exist for Nova to secure unfair competitive advantages.

Inhibit fulfillment of purpose of the Rules and Gas Act

16. Vector considers that the GIC need to be confident that if the exemption is granted, that it would still fulfill the purpose of the Rules and the Gas Act for switching arrangements in the New Zealand gas market.

Rule 3 of the Gas (Switching Arrangements) Rules 2008 states:

“The purpose of these rules is to establish a set of gas switching and registry arrangements that will enable consumers to choose, alternate, efficiently and satisfactorily between competing retailers.”

⁷ Simon Terry Associates, pg.45.

⁸ Simon Terry Associates, pg.45

⁹ Simon Terry Associates, pg.43

17. This purpose can only be fulfilled with the disclosure of information by all industry participants.

18. Additionally, the Gas Act s43G(2) empowers the GIC to make other gas governance arrangements, providing for the ability of consumers to choose preferred gas retailer the purpose of which is to:

(c) "Provide for arrangements to enable consumers to switch gas retailers"

19. Thus the purpose of the registry and the Rules are to facilitate benefits for consumers. Nova argues that there is no reason for it to be apart of these arrangements as its consumers cannot 'switch' to alternative retailer, nor can retailers access consumers on Nova's networks as it is a private distribution network. However, Vector considers that consumers can make a 'switch' to a new retailer by disconnecting and reconnecting to a new network. This option provides a clear reason why Nova should not be granted the exemption as customers on the network should be able to make use of the switching arrangements that are granted to all other consumers and retailers. As noted above, if these installations are not included, competition in the gas distribution and retail markets will be impaired, limiting potential benefits to consumers. Additionally, Vector considers that difficulties would arise if Nova was not party to the registry and if one of its customers were to switch to a new retailer. For example, Nova may not keep historical metering information on its installations, as is required under the Rules.

20. Equally, the exemption, if granted, would be in direct conflict with the objectives found in s43(z)(n) of the Gas Act, in particular, it:

(a) would undermine economic efficiency by impairing competition in the retail and distribution markets;

(b) undermine competitive arrangements in the retail and distribution markets if the regime does not apply equally;

(c) create a barrier to competition in the market for distribution services; and

(d) create a disincentive to further investment in distribution networks if the regime does not apply equally.

Downstream Reconciliation and Switching are Separate Issues

21. Vector accepts that the GIC, as a 'public body', has a legal duty to act consistently in its decision-making so far as the merits of any individual circumstances will permit. However, Vector notes that there are clear differences as to the purposes of each set of Rules as well as the nature of the exemptions that would support the GIC not being bound to follow its previous decision DR09-27-U.
22. Therefore, Vector considers different purposes require different considerations. As seen in STA's report, the issues surrounding Bypass networks are markedly different for either set of rules and therefore the GIC should not be considering the two together.

Risk of Registry Misuse

23. Overtime, the Rules, through the registry determinations, have become watered down to allow for participants to simply enter one known parameter in the registry in order to receive an entire street worth of installation details. Vector has heavily submitted its views on the dangers of the registry being used as a marketing tool by participants.
24. Vector understands that the threat of bypass networks is believed to be limited to clusters of large scale commercial users. Despite the Commerce Commission's view that there is little prospect of further networks being developed, Vector believes that this could change with the addition of the central gas registry, which will contain information for all New Zealand gas consumers.
25. Given that Nova is a registered participant; Nova would still be able to trawl the website in search of such clusters. This would be clearly impairing competition given that this opportunity is not available to other retailers and distributors to look at the Nova network.
26. Vector considers that if Nova is granted an exemption for any amount of time, it should have its privileges to utilise the registry revoked as well.

Consistency of treatment

27. In the event that the GIC disagrees with Vector's opposition and grants Nova an exemption from the Rules, Vector requests that the GIC publish the criteria that apply to those installations that are exempt. If Nova is permitted to exclude installations on some basis, then Vector would potentially also seek exemption for installations in similar circumstances (e.g., in some level of proximity to Nova's pipelines, or within some

distance of transmission gates). It is important that rules and criteria are capable of being consistently applied in similar circumstances.

Concluding Remarks

28. To ensure the purpose of the Rules and Gas Act are fulfilled, the GIC should not grant Nova's exemption. Serious issues in terms of impaired competition in retail and distribution markets would result if Nova were to be granted an exemption.

29. As Nova's consumer information is not in the registry the impairment to competition is already in effect and will continue to be through any period of exemption. Therefore, Vector considers that Nova should be made to comply with the Rules immediately.

30. Thank you for considering this submission. If you have any queries, or require further information, please feel free to contact me.

Kind regards

A handwritten signature in black ink, appearing to read "Nathan Strong". The signature is written in a cursive style with a horizontal line at the end.

Nathan Strong

Manager Regulatory Affairs

Appendix A: Recommended Format for Submissions

To assist Gas Industry Co with the consideration of submissions, a suggested format for the preparation of submissions is set out below. This reflects the issues discussed in the main body of the paper. Submitters are free to provide any other material.

Submission from: Vector Limited

Question	Comment
<i>Q1: Do you agree or disagree that the consumer installations connected to Nova Gas' bypass networks should be included in the gas registry and subject to the Rules? Please give your reasons</i>	<p>Agree. Vector considers that if these installations are not included, competition in the gas distribution and retail markets will be impaired, limiting the potential benefits for these consumers. In addition to switching between retailers, Vector is aware that increasing numbers of consumers are looking to switch away from the Nova network.</p> <p>Vector also considers that given the Rules provide for switching between networks, it is clear that the intent was to promote consumer benefits through increased competition in both the retail and distribution markets.</p> <p>Furthermore, as the final design of the registry allows "trawling" by industry participants despite earlier assurances that it would not, the GIC needs to ensure it does not set up a regime which provides an advantage to one retailer and one distributor over the competitors in those markets.</p>
<i>Q2: Do you agree or disagree that a transitional exemption should be granted as sought? Please give your reasons.</i>	<p>Disagree. Vector considers that the Nova should not be treated any differently than other registry participants and should be made to comply immediately. The GIC has been planning the registry since 2005 and industry has been well informed of the project.</p>

Question	Comment
<p><i>Q3: Do you agree or disagree with Nova’s proposition that a transitional exemption should be granted mainly as a holding action until the issues in relation to bypass networks under both the Rules and the Gas (Downstream Reconciliation) Rules 2008 can be properly addressed? (The alternative is to address the underlying issues in the present application on their merits immediately, and deal separately with the downstream reconciliation issues at a later time.) Either way please give reasons.</i></p>	<p>Disagree. Vector believes that there should not be any exemption.</p> <p>The exemptions under either set of rules should be treated separately- the issues surrounding the treatment of bypass networks are different under each and the GIC should maintain that separation when dealing with the exemptions.</p> <p>Vector considers that the GIC should not delay an outcome for the treatment of Nova any longer and should address these issues immediately; the litigious nature of the gas industry poses a risk that this process is subject to undue delay there by frustrating competitive outcomes for consumers. Vector notes that bypass networks for the purpose of this exemption should be considered alongside the report “Application of Gas Governance Arrangements to Private Networks” as this allows the GIC and industry to address the wider issues surrounding regulating bypass networks.</p>
<p><i>Q4: If a transitional exemption is granted – and given the desirability as suggested by Nova Gas, of considering at the one time, the substantive issues in regard to the coverage of bypass networks by both the Rules and the Gas (Downstream Reconciliation) Rules 2008 – is there any merit in the exemption expiring other than on the same date (30 June 2009) as the existing downstream reconciliation exemption?</i></p>	<p>Disagree. The allocation and reconciliation rules are an entirely separate issue which simply deal with accounting for gas volumes. As noted above in Q3, The exemptions under either set of rules should be treated separately- the issues surrounding the treatment of bypass networks are different under each and the GIC should maintain that separation when dealing with the exemptions.</p>
<p><i>Q5: Given the additional information set out above, do you consider that there would be any adverse impact on other registry participants if the exemption as sought was granted? In particular would the ability of a move to occur from a customer installation on a bypass network to a new/recommissioned consumer installation on an open access network be impaired? If you think there would be adverse impacts, explain what they are and the reasons for those impacts occurring</i></p>	<p>Yes. Vector considers that there would be adverse impacts on other retailers and distributors as Nova would be given an unfair advantage allowing to ‘free-ride’ off industry arrangements.</p> <p>The Nova application states that it “competes with the Powerco and Vector open access distribution networks,” therefore, customer switching on these networks would be impaired if Nova were to be exempt from the registry.</p> <p>An additional adverse impact is borne out of the design of the registry which allows “trawling” for consumers along entire streets. As other participants have now populated the registry in compliance with the Rules, Nova can now aggressively target consumers on competing networks. This opportunity is not available to other retailers and distributors looking at the Nova network, clearly impairing competition.</p>

Question	Comment
<p><i>Q6: The possibility of adverse impacts on the ability to move to or from a bypass network under the Rules notwithstanding, do you have any information available which would indicate that these occurrences would be likely during the proposed term of the exemption?</i></p>	<p>As Nova’s consumer information is not in the registry the impairment to competition is in effect and will continue to be through any period of exemption. Now that the registry is operational, Nova is likely to target other retailers and distributors however this opportunity is not available in return, acting to impair competition.</p>
<p><i>Q7: The ability to make a switch aside, are there any wider reasons for not granting the exemption and ensuring that data for all Nova Gas’ bypass ICPs is entered into the registry? If yes, what are those wider reasons?</i></p>	<p>Yes, Vector has wider considers surrounding the Nova exemption.</p> <p>The purpose of the registry and the Rules are to facilitate benefits for consumers through switching. If these installations are not included, competition in the gas distribution and retail markets will be impaired, limiting the potential benefits for these consumers. As well as switching between retailers, Vector is aware that an increasing numbers of consumers are looking to switch away from the Nova network.</p> <p>Additionally, an exemption would be in direct conflict with the objectives in S43ZN of the Gas Act, in particular, it:</p> <ul style="list-style-type: none"> (a) would undermine economic efficiency by impairing competition in the retail and distribution markets; (b) undermine competitive arrangements in the retail and distribution markets if the regime does not apply equally; (c) create a barrier to competition in the market for distribution services; and (d) create a disincentive to further investment in distribution networks if the regime does not apply equally. <p>Furthermore, as the final design of the registry allows “trawling” by industry participants despite earlier assurances that it wouldn’t, the GIC needs to ensure it does not set up a regime which provides an advantage to one retailer and one distributor over the competitors in those markets. As other participants have now populated the registry in compliance with the rules, Nova can now aggressively target consumers on competing networks. This opportunity is not available to other retailers and distributors looking at the Nova network, clearly impairing competition.</p>

Question	Comment
<p><i>Q8: Do you think the condition suggested by Nova Gas, ie that all of the ICPs on each bypass network should be represented by a single notional ICP, is practicable or acceptable? Give the reasons for your view. If you disagree with this alternative arrangement, do you have any views on a more acceptable alternative condition?</i></p>	<p>Vector considers that the only acceptable outcome is for Nova to comply and that any other condition is not acceptable. The objective of the registry is that consumer installations are individually identifiable to facilitate competition and switching between retailers and distributors.</p> <p>Nova’s exemption application considers embedded networks and how they compare to bypass networks. In gas, the individual consumer on the embedded networks can not switch retailer and is captive to the choice made by the embedded network owner. Vector is aware that an affiliate of Nova is in control of a number of these arrangements on its network. Nova’s application notes the case of embedded networks within malls which supply multiple consumers. In electricity, these consumers have their own ICP and are able to switch retailer individually. This, however, is not what Nova has proposed. In some cases in electricity, Vector manages the registry functions, relating to the multiple ICPs on behalf of the embedded network owner for a fee. Vector would be happy to discuss such arrangements with Nova.</p>
<p><i>Q9: Do you consider that the nature of the exemption proposed by Nova Gas is such that Gas Industry Co has the jurisdiction to grant a transitional exemption under rule 90?</i></p>	<p>Refer to cover letter.</p>
<p><i>Q10: Do you have any views on the contention by Nova Gas that, in respect of its bypass networks, Nova Gas is not a ‘distributor’ under the Gas Act 1992 and the Rules?</i></p>	<p>Nova provides line function services as defined by the Gas Act 1992, in fact, the Nova application states that it “competes with the Powerco and Vector open access distribution networks.” Accordingly, as Vector provides “line function services” then by definition if Nova is competing in this market then it must also be providing that same service.</p>