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Dear Ian,

Submission on the Report: Application of Gas Governance Arrangements to Private Networks

1. Vector Limited (Vector) welcomes the opportunity to provide comments to the Gas Industry Company (GIC) on Simon Terry Associates Limited's (STA) Review of the Application of Gas Governance Arrangements to Private Networks (the Review).

2. Vector supports the GIC's decision to undertake a review of private networks in the New Zealand gas industry. The issue is contentious and too difficult to work out through industry consultation alone. The issues canvassed in this review are not only useful to the GIC and industry participants but also to a wider audience, including the Commerce Commission and Ministry of Economic Development.

Summary of Vector's Views

Application of gas governance arrangements to private networks

3. Supported by the findings of STA, Vector is strongly of the view that Nova gas should:

   - comply with the Gas (Information Disclosure) Regulations;
   - comply with the Gas (Downstream Reconciliation) Rules 2008; and
   - comply with the Gas (Switching Arrangements) Rules 2008.

4. Vector supports this compliance in order to ensure:

   - industry arrangements support and do not impede competition between pipelines and/or between gas retailers;

- all consumers that stand to benefit from industry arrangements are covered by gas governance arrangements; and

- accurate and transparent information for all participants of the gas industry is readily available.

5. The present arrangements provide an unfair competitive advantage to Nova as Nova does not have to share in the costs of open access but receives the information advantages derived from the open access arrangements. This enables Nova to cherry pick customers from Vector's open access network whereas Vector is disadvantaged by not having access to information on Nova's customers. In the event that Nova continues to obtain favorable regulatory terms, Vector should also receive an exemption for its customers in a similar situation.

Private vs Open Access

6. The report gives rise to a number of issues that surround the current regime operating with open access and private networks. STA note that application of the essential facilities doctrine, and Hilmer tests, to private networks implies only a time limited exemption of private networks from certain regulatory provisions. A long term exemption gives rise to several problems including:

   - the possibility that gas may not be transported on the lower-cost system;

   - the possibility of the private network gaining unfair advantages by free-riding off industry arrangements which spill over from the open access regime; and

   - the existence of stringent or unfair contract terms and conditions to ensure customer base is secured.

7. Vector agrees that there is justification to exempt new entrants from the requirements of open access for a period of time and that the case for a long term exemption is weak. Vector considers that the maturation of the Nova networks implies that they should now be subject to gas governance regulations. However, Vector is of the view that whether or not the Nova networks should be subjected to open access falls into a wider scope of regulation that does not need to be addressed at this time as effective competition can in most cases be achieved within the existing market structure where open access and private networks co-exist.

8. The remainder of Vector's submission discusses the views outlined above in relation to STA's review as well as general comments we consider are worth

noting on the handling of exemption under the GIC's industry arrangements.

The Application of Gas Governance Arrangements to Private Networks

9. Vector considers that the following issues need to be taken into account when giving consideration to whether particular gas pipelines must comply with particular aspects of the gas governance rules or regulations:

    - ensuring that the industry arrangements support and do not impede competition between pipelines and/or between gas retailers;
    - ensuring that all consumers that stand to benefit from industry arrangements are covered by gas governance arrangements; and
    - ensuring that accurate and transparent information for all participants of the gas industry is readily available.

10. In Vector's view consideration of these factors leads to the conclusion that Nova gas should be subject to the following gas governance rules and regulations:

    - the Gas (Information Disclosure) Regulations;
    - the Gas (Downstream Reconciliation) Rules 2008; and
    - the Gas (Switching Arrangements) Rules 2008.

Supporting competitive outcomes

11. Vector considers that it is important that the regulatory regime supports and does not impede competition between pipelines and/or between gas retailers. This factor is also stressed by STA where they state that the central issue addressed through this report is, "how to secure fair, efficient, sustainable and competitively-neutral outcomes" within the current dichotomy of the gas market. This is closely aligned with the Government's objective for the whole of the gas industry:

    "*to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable and environmentally sustainable manner.*"

12. Vector considers that subjecting the Nova Gas pipelines to the requirements of the gas governance rules and regulations set out in paragraph 9 would improve competition in the pipeline and retail markets for the reasons discussed in the paragraphs below.

13. First, requiring only open access pipelines to comply with the above requirements imposes costs on the open access pipeline which the private network does not have to bear. As pointed out by STA, the private bypass network is exempt from the "reporting requirements and cost sharing required to sustain open-access", creating a cost advantage. Imposing costs on some networks and not others will bias consumers to choose the relatively inefficient supplier. Hence Vector agrees with STA p20, that the costs of sustaining an open access regime should be considered as a joint regulatory obligation.

14. Second, subjecting only a subset of pipelines or retailers to certain information requirements also confers an unfair advantage on exempt players. In the instance of switching and the gas registry, Nova currently has full access to viewing installations on other distribution networks. Similarly, Nova has the advantage of viewing all other retailer's customers, whereas those on Nova's network are invisible to its retail competitors. Essentially Nova could trawl the registry in search of new customers.[1] However, other participants are unable to view Nova's information given Nova has refused to populate the registry with its customers. Additionally, Nova's exemption from information disclosures means that Nova is able to view information on the status of other networks but that privilege is not reciprocated.

15. Third, certain aspects of the rules are aimed at promoting competition. For example, by requiring the collection and disclosure of customer metering history switching arrangements promote competition by ensuring that consumers can switch pipelines and hence retailers in a timely, accurate and cost effective manner. Failure by Nova Gas to collect or disclose this information for its bypass networks would make customer switching more difficult. Failure to collect this information for Nova's monopoly pipelines would make a transition to open access more difficult in the future.

16. As STA note on page 40, the effective implementation of switching arrangements requires that industry participants also be subject to reconciliation rules. If a customer changed pipelines and retailers under the switching rules and was subject to the reconciliation rules under its new retailer, there will be no historic information on the customer's profile if the initial network were exempt. The review appropriately identifies that, "the more frequently switching takes place, the more potentially disruptive it becomes for the reconciliation/ allocation process" if certain players are exempt.

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[1] See Vectors Submission to the GIC, *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*. 11 March 2009.

Consumer Benefits

17. Of equal importance is the consultants' decision to adopt the consumers' lens when considering issues relevant to private networks. Vector considers that Nova's bypass networks should be subject to the requirements in paragraph 10 as these requirements provide consumer benefits through increased transparency, increased access to information and providing cost effective mechanisms for consumers to change suppliers. These measures provide another form of discipline on businesses to operate efficiently.

18. For example, reconciliation arrangements aim to track excessive amounts of UFG on networks and to allocate it to its causer. The arrangements provide a transparent view of where (at what sites) UFG exists. In theory, the allocation of UFG acts as an incentive for retailers to resolve large cases of UFG to ensure the end user, their customers, do not end up paying for that extra gas. Provisions in the rules also allow the GIC to investigate abnormal amounts of UFG that are more difficult to trace, providing a measure of consumer protection. Further, reconciliation and switching rules provide for consumer protection by providing a cost effective mechanism to enable consumer switching. This increases the pressure on firms to operate efficiently.

Accurate and Transparent Information

19. Information disclosure requirements enable consumers to make more effective choices and put further discipline on business performance by allowing consumers and regulators to compare the performance of different suppliers and to fully assess the terms of contracts.

20. Vector is pleased to see the report canvass the number of issues involved with the exclusion of Nova Gas distribution networks from industry wide information disclosures. The consultant's have correctly identified that the grounds originally identified in 1997 and 1999 for this exemption do not suffice in this new environment. Vector notes the number of changes that have occurred since the initial exemption was granted, such as the additional number of bypass networks that have been built on a different model (i.e. not landfill gas).

21. Given this, Vector has concerns regarding the latest exemption Nova has secured (Schedule 6 of the Commerce Act) from the new information disclosure regulations which the Commerce Commission will be shortly putting in place. Even if Nova is not subject to price regulation, there is a parallel with trust owned electricity distribution businesses, which remain subject to information disclosure despite being exempt from price regulation.

22. Vector is supportive of STA's conclusions on page 45 that there is "no wriggle-room for exemption of private distribution networks from mandatory information disclosure" in the April 2008 GPS. This further supports the need for Nova to be subject to gas industry arrangements.

Private vs Open Access

23. STA has opened up consideration of new issues in relation to private networks in the current gas market. Although an important issue, in Vector's view this question falls within a wider scope of regulation which Vector considers it would be within the Commerce Commission's mandate to address. Vector considers that the main issue to be addressed at this stage is whether under existing arrangements, where some pipelines are open access and other private networks, Nova should be required to comply with the gas governance rules and regulations. Vector sees this as the key issue to resolve in ensuring effective competition in the pipeline and retail business and in protecting consumer's interests.

24. Vector makes the following points in relation to the issues raised by the review.

Essential Facilities Doctrine

25. Vector notes the four criteria from the 1993 Hilmer report which should apply before a monopoly facility serving multiple customers is required to be open access. These criteria are:

    - Access to the facility is essential to permit effective competition in a downstream or upstream activity;
    - The making of a declaration of open access is in the public interest;
    - The legitimate interests of the owner of the facility must be protected;
    - The creation of such a right must have been recommended by an independent expert body.

26. These criteria have clear application in the case of a monopoly pipeline owned by a gas transporter. However, STA notes that the clarity of the Hilmer criterion 1 becomes problematic in the duopoly situation which occurs when there is a bypass network.

27. As STA discuss, consideration of open access in the case of new entrants requires the balancing of the following factors:

- A short run exemption from open access and related obligations is likely to be justified in order to encourage entry into the market. The exemption would be aimed at allowing time for the new entrant to recoup their fixed costs and earn some surplus from its competitive initiative;

- A long run exemption from open access and related obligations is not justified. In the long run the responsibility for open access should fall wherever it can be most efficiently performed as "the long-run interests of acquirers are best served by having gas transported on the lower-cost system, regardless of whether this is the original incumbent or the new entrant".

28. Vector agrees with the conclusion that new entrants should be allowed an exemption from the requirements of open access in the short term. In Vector's opinion it is important that the regulatory regime provides incentives for investment and innovation in order to encourage dynamic efficiency. A short run exemption encourages investment by giving greater certainty that a network owner can recover their costs. Innovation is also encouraged as new networks may find more efficient means to provide services.

29. Although Vector agrees that in theory there is no strong case to provide a permanent exemption for private networks from open access, Vector considers that efficient outcomes can be achieved in the New Zealand gas market without moving to requiring full open access on all Nova pipelines at this stage.

30. Nova Gas now operates an extensive network of pipelines. Nova's network includes bypass pipelines however in some areas, such as Flatbush, Nova is in effect a local monopoly. Although Nova Gas began by transporting landfill gas, it is Vectors understanding that the original landfill equipment was decommissioned. Vector considers that it would be useful for regulatory and policy discussions if Nova would confirm whether or not it still mixes landfill gas with gas supplied from the transmission system and, if that practice has ceased, the date on which that practice ceased.

31. STA notes the length of an exemption from certain regulatory requirements depends on the geographical extent of the network and time elapsed since entry. In Vector's opinion Nova has now provided an extensive network of pipelines for some time, particularly in the bypass market.

32. To Vector this implies that exemption of the Nova bypass pipelines from the gas governance rules and regulations is no longer justified to recover the fixed costs of set up. To continue with this exemption would provide Nova

with an unfair cost and information advantage. However, provided that the open access networks operate cost effectively and the gas governance regulations and rules are applied consistently, effective competition can exist even if Nova maintains its private status for some time as customers still have the ability to choose between retailers.

33. The length of time the Nova monopoly networks, such as at Flatbush, continue to enjoy private status needs careful consideration given the continued operation of such networks as private networks effectively eliminates retail competition. Subjecting these pipelines to the gas governance rules and regulations set out in paragraph 10 will allow a smooth transition to open access, if this is deemed desirable in the future, and will provide some degree of consumer protection before decisions are made on whether further regulation is needed.

34. In relation to the points made by STA we make the following points in relation to the Nova bypass networks.

- Economic efficiency: STA argue that a market which contains an open access and private network may result in retailers being forced to transport gas on the least efficient network. However, in Vector's opinion the key issue to resolve at this stage is whether regulation is biasing consumers towards choosing the least efficient network. Requiring only the open access network to comply with the gas governance rules gives the private network a cost advantage such that consumers may choose to use this network even if it is relatively inefficient.

- Free riding off industry arrangements: STA argue that exempt private networks are reaping the benefits of receiving information about competitors' networks without having to reciprocate the provision of information or contribute to the cost of regulations from which all distributors stand to benefit from. Vector agrees but considers that this argument has less to do with open access and more to do with all networks being subject to gas governance arrangements, such as reconciliation, switching and information disclosure;

- Unfair contract terms: STA notes that contract terms on Nova Bypass networks restrict the ability of customers to change retailers. Vector considers that information disclosure requirements are the best tool to remedy this situation, as information disclosure provides the customer with countervailing power in negotiations with gas suppliers.

Treatment of Exemptions

35. On a general note, Vector considers that many of the issues addressed through the exemption process have been complex and often need to be examined on a case-by-case basis. Vector agrees with STA that exemptions are not ideal. Experience to date with exemptions requests to the GIC's gas governance arrangements have been used to address a flaw in the rules or regulations in question. For, instance participants of the Gas (Downstream Reconciliation) Rules 2008 have had to apply for exemptions for directly connected consumers which are included under the definition of "gas gates" in the rules. However, as seen within the review, there is no need to reconcile these sites and therefore they should as a standard rule, be exempt from gas industry reconciliation rules.

36. Vector believes exemptions are helpful when no immediate resolution of the situation are present but should not be seen as permanent solutions. In these instances, rule changes are most appropriate.

37. Thank you for considering this submission. If you have any queries, or require further information, please feel free to contact me at nathan.strong@vector.co.nz or 04 803 9039.

Kind regards

Nathan Strong

Manager Regulatory Affairs