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Peter Davies
General Manager – Corporate Services
Gas Industry Company
Level 8, The Todd Building
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Dear Peter

SUBMISSION ON THE PROPOSED GIC LEVY FOR FY2011

Vector Limited ("Vector") welcomes the opportunity to submit on the Gas Industry Company's ("GIC") proposed industry levy for FY2011. We appreciate the GIC's proactive engagements with industry participants, through workshops and discussions with individual stakeholders, during the development of the proposed levy.

Since the GIC's inception, Vector has been consistent in calling for an effective and low-cost regulatory regime for the gas sector. We support actions that lead to simpler, more transparent, and more cost-effective regulatory processes.

Lower regulatory costs benefit not only industry participants but also gas consumers.

FY2011 work programme

The GIC proposes a very full work programme for FY2011. We note the Government's wish to progress all of the objectives in the Government Policy Statement on Gas Governance 2008 ("GPS") expeditiously. In order for the GIC to achieve this, the levy has to go up.

The proposed 28% increases on the previous year's wholesale and retail levies are significant by any budgetary standards. We acknowledge that, on the main, the levy has not been increased due to rising costs but to cover reserves being run down.

The proposed work programme requires a substantial amount of work to be undertaken in a short period of time. In addition to the direct costs of regulation, as reflected by the levy, implementing the proposed initiatives will impose additional costs on industry participants. These include costs associated with providing inputs into GIC processes.

At the GIC workshop on the levy in October 2009, industry participants generally agreed that there is little room for substantial cuts in the levy if the proposed work programme is to be implemented in full. The only way to reduce or at least maintain rate levels is to limit the number of priorities and focus on those that will deliver the most effective regulatory outcomes. It is our view that initiatives, particularly new ones, can only be justifiably undertaken if the benefits to industry and consumers significantly outweigh the costs.

It should be recognised that most of the initiatives in the proposed work programme are interrelated. The sequence and timing of their implementation need to be carefully considered vis-à-vis other initiatives in order to achieve more effective and least-cost arrangements (for example, the establishment of notional trading hubs for the wholesale market will resolve some issues that the upstream reconciliation project is aimed to address).

Vector's priorities

The recent reforms in the electricity sector have imposed a heavy regulatory burden on electricity companies, many of which also operate in the gas sector. The proposed initiatives for the gas sector will certainly test the capacity and willingness of industry participants to absorb additional regulatory costs.

The GIC should focus its resources on issues that will have the most profound impact on industry and provide longer-lasting benefits to consumers. These issues include transmission pipeline balancing and the review of the Gas (Downstream Reconciliation) Rules 2008.

Vector strongly supports the GIC indicating the above issues as priorities for FY2011, and would like to see the GIC succeed in facilitating effective arrangements to address these issues. More specifically, establishing an effective unified pipeline balancing regime that reflects the 'causer-pays' principle will have substantial positive flow-on effects to the rest of the industry.

Through this submission, Vector urges the Government to enable the regulator to focus on the above priorities.

Corporate costs

Vector echoes other industry participants' concern about the level of corporate costs for FY2011.

Vector supports the reduction of the GIC Board meetings to nine per year. This will reduce the cost of holding Board meetings and the demand on management's time in preparing Board papers, but will not unduly slow down the decision-making process. We would not support a reduction of Board meetings to less than nine per year as we believe appropriate Board oversight and involvement is required in these busy times.

We wish to see the GIC carefully manage projects to constrain cost increases. In particular, it should take into account public sensitivities and the pay levels of comparable organisations in making recommendations to the GIC Board regarding pay increases for its staff. Vector does, however, appreciate the efforts to constrain these costs, given the current economic climate, and urges vigilance for the future.

Levy regulation cycle

Vector supports a move to a two-year levy regulation cycle, which is estimated to generate savings of approximately $100,000 per year. This will reduce compliance costs and allow industry participants to look at sector issues more strategically and consequently, assist them in planning for a longer term.

Any changes to the levy regulation cycle should provide the GIC reasonable flexibility to reallocate funds, to enable it to effectively respond to changing priorities or meet 'emergency' costs (e.g. if an extreme critical contingency happens). We recognise that some cost adjustments may need to be made as the year progresses. We propose that cost changes that are significant be relayed to market participants as soon as they are known.

The GIC should ensure that the level of workload, and therefore costs, are relatively stable from one cycle to another. Doing so will provide greater regulatory certainty to levy payers and the market, in general.

New GPS

Vector would like to be able to provide input into the development of any new GPS. We encourage the GIC to influence the Government to provide market participants with an opportunity to have a say in the development of this important document which will provide the regulatory framework for the gas sector.

We support a more holistic interpretation of GPS objectives, which considers how various objectives impact on each other. Initiatives to meet GPS objectives should be implemented in a pragmatic manner, taking into account commercial realities, particularly the impact of the current economic climate on the gas market, and the capacity of industry participants to absorb additional regulatory costs.

It should be noted that New Zealand's open access gas market is still immature compared to other markets such as electricity. The new GPS should ensure that industry participants are able to effectively cope with the pace of change associated with some regulatory measures.

In line with the recent reforms in the electricity sector, we anticipate seeing a more streamlined GPS that is focused on key issues such as market efficiency and security of supply.

Closing comment

Vector appreciates the open and frank discussions initiated by the GIC regarding its proposed work programme and the levy. While there is now a general acceptance of current levy-setting arrangements, which need fine-tuning more than wholesale changes, the level of regulatory workload year-on-year needs to become more 'stable'. We recognise that determining the level of workload and compliance costs that would be considered appropriate by the wider sector will require the support of the Government, the co-regulators and market participants.

We would like to engage with the GIC in future discussions on its strategic priorities and work programme.

Thank you for considering this submission. Our responses to specific questions in the consultation paper are indicated in the attached submission form. If you have any queries, or require further information, please feel free to contact me at John.Rampton@vector.co.nz or 04 803 9036.

Kind regards

John Rampton
Manager Industry Governance and Policy

Appendix A Proposed Format for Submissions

Company contact: John Rampton, Manager Industry Governance and Policy, Vector Limited
(John.Rampton@vector.co.nz; 04 803 9036)

QUESTION	**COMMENT**
Q1: Do you consider there to be any other items that should be included in the Company's intended work programme for FY2011?	It is Vector's strong view that no further items should be included in the proposed work programme for FY2011, which is a considerable expansion over last year's workload. Implementing this programme in full over a year could only lead to higher levies and higher costs to industry. The only way to reduce the levy is to limit the scope of the proposed programme. The GIC should focus on priority items that are intended to resolve many long-standing industry issues and will have the most significant impact on market participants. Initiatives, particularly new ones, should only be undertaken if the benefits to industry and consumers significantly outweigh the costs. The issues in the GIC work programme that are the highest priority for Vector are transmission pipeline balancing and the review of the Gas (Downstream Reconciliation) Rules 2008. We support the GIC indicating these issues as priorities for FY2011.

Q2: Do you consider there to be any items that should be excluded from the Company's intended work programme for FY2011?	Vector proposes that the GIC focus its resources on the high priority issues identified in our response to Q1. We believe these issues will have the most profound impact on industry and provide longer-lasting benefits to consumers. We would like to see the GIC succeed in facilitating effective regulatory arrangements upstream, particularly the establishment of a unified pipeline balancing regime. This is an area where the GIC has dedicated a considerable amount of resources. It is important that it remains a high priority to ensure its completion. Aside from transmission pipeline balancing and the review of the Gas (Downstream Reconciliation) Rules 2008, we consider all other initiatives as second-order priorities.
Q3: Do you have any questions on the calculation of the levy funding requirement for FY2011?	Vector supports a move to a two-year levy regulation/calculation cycle, which is estimated to generate savings of approximately $100,000 per year. This will reduce compliance costs and allow industry participants to look at sector issues more strategically. Any changes to the levy regulation cycle should provide the GIC reasonable flexibility to reallocate funds, to enable it to effectively respond to changing priorities or meet 'emergency' costs (e.g. if an extreme critical contingency happens). With respect to GIC staff salaries, we agree with the advice that the GIC has received that they must only be recovered from the levy and not from market fees. As we see it, the purpose of the levy is to primarily meet the operation costs of the GIC under s43ZZC of the Gas Act. While the authority to charge market fees under s54 of the Gas Act appears relatively wide, it cannot cover any matter already included in the levy provision.

Q4: Do you have any comment on the proposed levy for FY2011?	Vector considers the proposed 28% increases over the previous year's wholesale and retail levies as high by any budgetary standards. The proposed work programme requires a substantial amount of work to be undertaken in a short period of time. In addition, this imposes additional costs on industry participants associated with providing inputs into GIC processes. At the GIC workshop on the levy in October 2009, industry representatives generally agreed that there is little room for substantial cuts in the levy if the proposed work programme is to be implemented in full. Therefore, the only way to reduce or at least maintain rate levels is to limit the number of priorities and focus on those that will deliver the most effective regulatory outcomes. We have identified these priorities in our response to Q1. Vector supports the reduction of the GIC Board meetings to nine per year. This will reduce the demand on management's time in preparing Board papers and the cost of holding meetings, but will not unduly slow down the decision-making process. We would not support a reduction of Board meetings to less than nine per year as we believe appropriate Board oversight and involvement is required in these busy times. We wish to see the GIC carefully manage projects to constrain cost increases. In particular, it should take into account public sensitivities and the pay levels of comparable organisations in making recommendations to the GIC Board regarding pay increases for its staff.

Q5: Do you have any comment on regulatory amendments describe in section 8?	Vector has no issues in relation to the proposed changes pertaining to: • the FY2011 levy regulations providing clarity on issues relating to gas storage facilities; • the recovery of levies on the remaining recoverable gas at Tariki/Ahuroa; • the removal of a section on Maui gas from the FY2011 levy regulations, as a result of the expiry of contracts between the Crown and the Maui Mining Companies in FY2010; and • the establishment of compliance arrangements under the levy regulations to ensure the timely supply of certain information requested by the GIC.
Q6: Do you consider that GIC should alter its current method of defining direct costs and allocate more of its indirect costs to work streams?	Vector supports cost calculations that provide greater transparency. The GIC states that the current method of defining direct and indirect costs (especially absorbing salary costs into work streams) is more transparent. Therefore, it would seem inconsistent to adopt a different method just to achieve the appearance of a lower direct/indirect cost ratio.
Q7: Do you support the inclusion of a portion of Gas Industry Co's indirect costs in market fees for FY2012, as opposed to their inclusion in the FY2011 levy?	See our response to Q3.
Q8: Do you agree that Gas Industry Co should recover its costs associated with MPOC/VTC outside the levy regulations?	Vector does not support recovering costs associated with the MPOC/VTC outside the levy regulations. As a statutory body established under Part 4A of the Gas Act, the GIC may currently not have to authority to do so (i.e. fees have to be authorised by regulations).

Q9: If you agree with Q8, do you agree that Gas industry Co should recover its costs associated with MPOC/VTC rule changes from applicants or MDL and Vector?	Vector does not support this proposal for reasons stated in our response to Q8.
Q10: Do you agree that Gas Industry Co should seek to recover its full internal costs associated with the compliance regime through orders for costs in relation to hearings?	While the authority for the recovery of compliance costs needs to be carefully considered, Vector's major concern with respect to the compliance regime, however, is the need for current arrangements to be altered to reduce compliance costs. No more than 10% of breaches reported under current reconciliation arrangements are determined to be material. This suggests that the rules are not expressed effectively, resulting in unnecessary compliance costs. At the GIC Retail Governance Forum held in November 2009, Vector raised the above concern and the impracticality of producing multiple reports for the same breach. There was a general agreement among industry representatives that such transactions are a waste of the Market Administrator's time and industry resources. The upcoming review of the Gas (Downstream Reconciliation) Rules 2008 should include provision(s) to minimise compliance costs by only targeting serious breaches of the Rules. In addition, we expect the review to clarify the intent of some allocation Rules, noting that there are varying interpretations of how these Rules should be applied.