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Peter Davies
Gas Industry Company Limited
PO Box 10 646
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13 March 2009

Dear Peter,

Amended FY2010 LEVY FOR GAS INDUSTRY CO

1. On Gas Limited and Vector Gas Contracts Limited (together, "Vector") welcomes the opportunity to submit views on the Amended FY2010 Levy for the Gas Industry Company ("GIC"). Vector commends the GIC for engaging further with industry participants on the FY2010 Levy.
2. Vector supports the proposed \$527k reduction in levy initially suggested for FY2010 as well as the reprioritization of work streams. Vector remains opposed to the method of allocating the one-off Downstream Reconciliation Establishment Fee: the GIC has not robustly established that TOU-customers who account for a large proportion of gas volumes drive the costs of reconciliation or receive a substantial proportion of the benefits.
3. The first part of Vector's submission provides comments on the Amended FY2010 Levy , these include:
 - general comments on the Amended FY2010 Levy;
 - comments on the one-off Downstream Reconciliation Establishment Fee; and
 - a discussion on Appendix B: Submissions Summary.
4. Vector then provides comments to specific questions in Appendix A.

General Comments on Amended FY2010 Levy

5. Vector commends the GIC for revisiting the initial levy proposal. Vector recognises the amount of effort that has gone into the GIC reconsidering the industry's priorities and being responsive to concerns that the costs of

regulation need to be proportionate to the size and nature of the industry and reflective of the current economic climate, where businesses and consumers are under pressure.

6. Vector supports the reduction in the general levies. Vector accepts that there is a need for the GIC to raise additional funds to carry out new market administration functions, but we had reservations about the extent of the policy development work and its potential to encroach on market activities. These have largely been addressed in the revised levy proposal, but we would like to see an improved process in future where the GIC collaborates with stakeholders earlier in the process to debate and establish priorities before determining a budget.
7. The indicative work programme highlights the number of important tasks that lay ahead of the industry in the coming years. The GIC, as the industry co-regulator will be faced with the challenge of engaging with industry to develop new arrangements and improve upon the ones currently in place.
8. The GIC was founded on the model of 'co-regulation.' Vector believes that responsibility is therefore shared between the GIC and stakeholders for establishing priorities. The important aspect of this model is the idea that communication with the co-regulator and its industry is dynamic - occurring continuously through an open and transparent process. Thus, through the spirit of the co-regulatory model the GIC is empowered to work alongside industry to develop comprehensive solutions to pan-industry issues that are difficult to resolve through multi-lateral negotiations.
9. Vector encourages the GIC to continue to utilise discussion papers to pose questions and to elicit new ideas. Working groups and industry forums are useful tools for facilitating dialogue in the industry and transferring knowledge. Vector stresses the importance of the GIC facilitating these meetings and forums so that all areas of the gas industry (and consumers whenever possible) can be brought together to engage on issues and initiatives. Vector suggests that another possible avenue for engagement would be with company regulatory managers. Vector notes that the Electricity Commission (EC) recently hosted a successful meeting that brought together regulatory managers to discuss regulatory issues and upcoming work programmes in an effort to develop more of a shared understanding of what the EC considers are high priorities and areas of market development where benefits can be achieved.

One-off Downstream Reconciliation Establishment Fee.

10. Vector is pleased to see the GIC recognise and agrees with industry views that it is less than optimal to recover the one-off fee in 'one hit.' However, Vector still considers that alternative options of recovering this cost have not been given the attention required by way of a thorough analysis of options presented by industry participants. The response provided by the GIC on the

one-off establishment fee does not, in Vector’s view, adequately analyse the arguments presented in Vector’s submission. Nor does it provide Vector with a firm sense that the GIC is confident in its decision of allocating the downstream fees on a volume basis.

11. It is also unclear from the GIC’s discussion on the one-off fee what will occur once Vector’s exemption application is considered. In particular, Vector considers the GIC need to be explicit in stating what will occur if the GIC find there is a more equitable cost allocation. Vector believes that the best solution would be for the costs incurred using the previous methodology to be re-allocated to participants. Effectively, this would need to occur through a ‘wash-up’ and redistribution of fees.
12. Vector looks forward to the publication of its exemption application and considers that the GIC will appropriately address all of these issues.

Appendix B: Submissions Summary

13. Vector has adopted the practice of providing a detailed covering letter when submitting to the GIC. We have found this has allowed us to provide the GIC with more information on the subject for consultation without being purely restricted to the questions presented by the GIC. Vector also provides answers to questions posed by the GIC but often references comments made in the covering letter to support our answers. Vector found the table in Appendix B of the amended FY2010 levy paper did not capture points all of Vector’s point made in its submission (i.e. in its covering letter). In the table below we have therefore reproduced some of the comments made above in answering the questions:

GIC question	Vector Response
<p>Q2: Do you agree with the proposal to recover the establishment costs of the Gas (Downstream Reconciliation) Rules 2008 by way of a one-off Special Purpose levy, calculated on the same basis used to allocate the ongoing operational costs?</p>	<p>Given that the entire cost is to be levied in a single year, which is inequitable from the point of view that future generations of consumers will also benefit from the arrangements, it is critical to recognise that an equitable cost allocation approach has not been determined.</p> <p>Vector does not support the methodology behind the cost allocation of the one off levy.</p> <p>Moreover, Vector considers that the allocation of the one-off fee does not comply with several of the GIC’s cost setting principles: 2 (Beneficiary/Causer Pays), 3 (Rationality) and 5 (Equity).</p>

	<p>Principle 2: Vector does not agree that the one-off levy allocated on a volume basis represents true causer pays principles, i.e. the cost does not fall on the mass market which drive the work-load of the reconciliation agent and who are principally responsible for UFG due to the relatively imprecise data on usage from such customers. Vector notes that the underlying cause and hence the need for a complex regime to allocate it is at sites with an abundance of non-TOU metering. The new regime, in effect, spreads UFG around meaning that retailers with TOU metering have to pay for UFG that is attributable to mass-market. Thus, there is no incentive for the main causers of UFG to change their behaviour. Therefore, based on this, Vector strongly believes that the formula for both ongoing fees and the one-off cost should be allocated on a per ICP basis. We note the comments of the GIC that the basis for allocating on the basis of volumes is based on assumptions and administrative considerations¹, and not a robust, principled basis.</p> <p>Principle 3: Vector does not believe there is a “strong and logical link” between the costs needed to be recovered and the participants that are levied. The rationale used by the GIC in order to allocate the one-off levy on a volume basis is that it is the same as the method for allocating ongoing fees. Vector notes that weak analysis was demonstrated by the GIC in their initial determination of this allocation. We also note that there seems to be conflicting views on which method should be used, amongst the GIC, previous allocation agent and participants. The GIC’s final determination for the formula was that “competition benefits are <i>expected</i> to be strongly correlated to volumes.” This, in Vector’s view is a difficult association to make</p>
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¹ Page 14 of the Amended FY2010 Levy Consultation Paper sets out reasons why it would be difficult to deviate from the current allocation methodology.

	<p>as the relationship between reconciliation and competition is difficult to draw.</p> <p>Principle 5: Vector notes that all other ongoing market fees and levies for retail activities are charged on a per-ICP basis not volume. Therefore to align with principle 5, equity, the GIC should consistently allocate costs associated with retail work streams until the GIC can accurately quantify which methodology provides the greatest net benefit with associated users of the regime.</p> <p>Vector considers that the ideal solution would be to allocate the fee on a per ICP basis, however, considers that the GIC need to undertake further analysis to show which method should be used before either is used. Therefore, <u>as a compromise</u>, Vector recommends that the GIC adopt and interim solution to calculate the ongoing market fees and the one-off development cost of the Downstream Reconciliation regime on a 50/50 basis between a volumes and per ICP, i.e. that there is an equal split between the two so that neither allocation methodology is favoured over the other. Vector expressed that this solution should only be in place until the GIC can undertake the necessary analysis to determine which method is actually the more fair method.</p> <p>Additionally, Vector provided the GIC with a completed transitional exemption form on 5 February 2009 requesting the allocation formula on a 50/50 basis be applied to the ongoing market fees. At the time of this submission, the exemption has yet to be published.</p>
<p>Q4: Do you consider there to be any other items in the external work programme which should be included in the Company's strategic priorities for FY2010?</p>	<p>Vector notes that it was displeased to see that the GIC did not undertake consultation with stakeholders when developing its Strategic Plan for '09-'11. Vector also thought the GIC should issue 12 month rolling work plans once a month to allow participants to see what is on the horizon and resource for</p>

	<p>those events accordingly.</p> <p>Vector provides detailed comments on the GIC measuring competition and improving consumer outcomes.</p> <p><i>Measuring competition:</i> Vector considers that before any work is undertaken by the GIC in this area, that there needs to be a comprehensive and realistic assessment of what competition really means in the NZ gas market and what an effective level of competition would look like. We note further that the Commerce Commission would be the body best resourced to undertake an assessment as such. Additionally, we question why the GIC considers it has a role in tracking or stimulating downward pressure on price, as this too would seem to fall under the ambit of the Commission.</p> <p>For the record, Vector is firm on its view that there is already very strong competition for customers in the industrial and commercial market whether it focuses sales activities.</p> <p><i>Improving Consumer Outcomes:</i> Vector notes the importance of improved consumer outcomes, however, remind the GIC that all reasonably practical options are identified prior to undertaking work in this area. For example, GANZ should be consulted on for their work on Direct use of Gas ('DUOG') and the EGCC Code should be considered as a possible alternative to GIC regulated contracts.</p>
<p>Q5: Do you have any comment on the levy funding requirement for FY2010?</p>	<p>In addition to what the GIC have identified, Vector notes that it is important the GIC relay costs to industry participants as soon as they become known.</p>
<p>Q6: Do you have any comment on the proposed levy for FY2010?</p>	<p>Vectors stresses the importance of the GIC maintaining an overall view of the New Zealand gas market and in doing so, ensure that costs driven by regulations are exceeded by the benefits and are proportionate to the market. The discretionary nature of gas, the</p>

	<p>thinness of the market and the dominance of the producers are factors that all need to be considered and accounted for.</p> <p>Vector also notes the importance of the GIC carefully managing projects to avoid any increases in costs which do not produce a justifiable or quantifiable consumer benefit.</p>
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Concluding Remarks

14. Vector anticipates working with the GIC in the coming years on developing new industry arrangements and improving upon the old. Overall, we would like to see the GIC work more closely with the industry in the spirit of co-regulation to develop solutions to the key multi-lateral issues confronting the sector. We appreciate the willingness of the GIC to reconsider the levy and to make, no doubt, difficult resourcing decisions. We would encourage the GIC to consider additional stakeholder engagement around establishing priorities in future to ensure the levy-setting process runs more smoothly.
15. Thank you for considering this submission. If you have any queries, or require further information, please feel free to contact me.

Kind regards



Nathan Strong
Manager Regulatory Affairs

Appendix A Recommended Format for Submissions

To assist Gas Industry Co in the orderly and efficient consideration of stakeholders' responses, a suggested format for submissions has been prepared. Respondents are also free to include other material in their responses.

Submission prepared by: On Gas Limited and Vector Gas Contracts Limited (together, "Vector"), Nathan Strong

Question	Comment
<p>Q1: Do you consider we have correctly identified the policy priorities for FY2010?</p>	<p>Balancing and Interconnection: Vector considers that the GIC has improved upon its identification of policy priorities for FY2010 by making Pipeline Balancing and interconnection higher priority.</p> <p>Consumer Issues: Vector suggests that the GIC approach Consumer Issues with caution as past attempts at exploring regulations in this area have proven contentious. Engagement with other industry bodies is important to ensure industry resources are used appropriately.</p> <p>GPS: Vector considers that it would be useful for the GIC keep industry informed on priorities identified by the new Government. If these priorities require changes to the current GPC, Vector encourages the GIC to consult with industry on these.</p>
<p>Q2: Do you agree that it is necessary for the FY2010 annual levy to fund the roles under the approved gas governance arrangements?</p>	<p>Yes, it is important that the GIC continue to fund these arrangements. Vector considers that the GIC has invested much time and resource into these approved gas governance arrangements and that the focus should be on ensuring the work stream is complete, operative and achieves its intended purpose.</p>
<p>Q3: Do you agree we need to review the effectiveness of rule changes and make changes to those rules where appropriate?</p>	<p>Vector questions how the GIC can review the effectiveness of rule changes when one has yet to take place. Perhaps, the GIC's focus should be firstly on identifying what rules are operating inefficiently or where operative rules could be improved and then progress these changes. The GIC should look at the overall effectiveness of the process only after the process has taken place.</p>
<p>Q4: Do you agree the industry facilitative roles are valuable and that it is appropriate to budget for, and use, levy funds in this manner?</p>	<p>Yes, Vector agrees that this role and its continuation is valuable.</p>
<p>Q5: Do you support the annual levy funding requirement for FY2010?</p>	<p>Vector has no issues with the funding requirement.</p>

Question	Comment
Q6: Do you support the proposed annual levy for FY2010?	Vector supports the reduction in the retail and wholesale levy amount borne out of the reprioritization of its work programme. Vector <u>does not</u> support the one-off fee for the Gas (Downstream Reconciliation) Rules 2008 establishment costs. Please refer to comments in our cover letter.