



Final Recommendation on 27 November 2012 VTC Change Request Appeal (Balancing)

Date issued: 3 September 2013





About Gas Industry Co.

Gas Industry Co is the gas industry body and co-regulator under the Gas Act. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

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Executive summary

Vector Gas Limited (Vector) proposed a change to the Vector Transmission Code (VTC) on 30 October 2012 (Change Request) that did not receive the 75 percent support from Shippers necessary for it to be adopted. On 27 November 2012, Vector appealed to Gas Industry Co, in its VTC appeals body role, to have the Change Request allowed (pursuant to section 25.6 of the VTC).

The proposed change aims to align the VTC with pending changes to the Maui Pipeline Operating Code (MPOC) balancing arrangements arising from Gas Industry Co's support of the 13 October 2011 MPOC Change Request. These pending changes are to implement a back-to-back (B2B) allocation of balancing gas when the MDL Balancing Agent takes balancing actions, and the introduction of peaking charges.

Because the balancing arrangements on the Maui Pipeline, as governed by the MPOC, impact commercial arrangements on Vector's transmission pipelines, it is necessary for Vector to change the VTC to align the two codes when the MPOC changes are implemented.

Vector believes the proposed change is necessary to capture the efficiency benefits of MDL implementing B2B balancing arrangements.

Vector's proposed change comprises three parts. Two are to accommodate the introduction of B2B balancing and a Peaking Charge to the MPOC. The third is to limit the ability for Shippers to dispute balancing invoices Vector issues.

Draft Recommendation

Six submissions were received on the appeal. The overall tenor of the submissions was that the proposed VTC changes would accommodate the pending MPOC changes, and were reasonable. However, all submitters except Vector opposed the proposed removal of the right to dispute balancing invoices.

The Draft Recommendation, issued on 28 February 2013, concluded that the Change Request, taken as a whole, would be an improvement on the status quo and consistent with, or improve, relevant Gas Act and Government Policy Statement objectives.

Final Recommendation

Submissions on the Draft Recommendation largely mirrored submissions received on the appeal: generally supporting the Vector's accommodating of the MPOC changes, but against the proposed restriction to dispute balancing invoices.

These submissions were received by 25 March 2013. Normally Gas Industry Co would then have concluded its analysis and made a Final Recommendation. However, we were concerned about the situation with non-code transmission contracts. Because of the 'common pool' nature of pipeline balancing, equity and efficiency require all system users to subscribe to the same residual balancing

arrangements. Although Vector was in discussion with the Non-Code Shippers it was not clear that they would agree to amend their contracts to incorporate the same back to back balancing arrangements the proposed change would introduce. If Gas Industry Co's Final Recommendation supported the Change Request, the situation with Non-Code Shippers may have prevented the VTC change being implemented.

On 22 May 2013, we advised stakeholders that a Final Recommendation would not be issued until we were confident that all Vector shippers would be subject to consistent back to back balancing and peaking cost arrangements. However, to avoid uncertainty we noted that once we were assured on that matter, Gas Industry Co Management would recommend to Gas Industry Co's Independent Directors Committee that the Change Request be supported.

In the event, it has taken Vector some time to provide the assurance we were seeking. However, we have now been provided with that assurance, and can now issue this Final Recommendation.

In summary, we agree with submitters that Vector's proposed cost allocation alignments of the VTC with the MPOC are reasonable. We note Shippers' strong disagreement with the proposed changes limiting their ability to dispute related invoices from Vector. However, on balance we consider that the overall effect of the proposed changes will improve efficiency, and we note that Shippers are able to propose amendments to the VTC at any time, if they wish to alter the dispute arrangements.

In our capacity as 'industry body' under the Gas Act, Gas Industry Co will maintain a watching brief on back to back balancing as it is implemented, and could take action if we believe that the new arrangements are proving to be inefficient. In relation to that matter, please refer to the *Note to accompany Final Recommendation on the 27 November 2012 VTC Change Request Appeal*.

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Introduction

1.1 Purpose

This paper is Gas Industry Co's Final Recommendation on the Vector Transmission Code (VTC) Change Request Appeal submitted by Vector to Gas Industry Co on 27 November 2012 (the appeal).

The appeal and other relevant papers can be found at <http://gasindustry.co.nz/work-programme/vtc-change-request-appeal-27-november-2012-balancing>.

1.2 Background

Gas Industry Co's role under the VTC

Under the VTC, any Party may propose an amendment to the VTC. Section 25 of the VTC sets out a process for considering such Change Requests, including consultation with Shippers. Under section 25.5(c)(i), Vector and 75 percent of all shippers who respond must consent to a Change Request for the change to be made to the VTC. Once that process is complete, certain parties may appeal the outcome whether or not the Change Request was successful. For example, a party who voted against a Change Request that was successful may appeal that outcome and vice versa.

Gas Industry Co is tasked with independently reviewing and making a recommendation on Change Request appeals. Following consultation, Gas Industry Co must make a Final Recommendation 'supporting or not supporting the Change Request or finding that Vector has or has not validly withheld consent'¹.

In consultation with its shippers, Vector developed a process for considering Change Request appeals under the VTC. Gas Industry Co and Vector have incorporated that process into a Memorandum of Understanding (MoU). The MoU sets out in detail the process that Gas Industry Co follows when considering appeals. A copy of that MoU is available on Gas Industry Co's website: <http://www.gasindustry.co.nz/work-programme/vtc-change-request-appeal-20-february-2009?tab=1183>

When making its recommendation on an appeal, the MoU requires Gas Industry Co to have regard to the objectives specified in section 43ZN of the Gas Act 1992 (the Gas Act) and the objectives specified

¹ VTC Section 25.7.

in the Government Policy Statement on Gas Governance (GPS). The combined principal objectives for Gas Industry Co are to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner.

Gas Industry Co's Final Recommendation is binding on the parties to the VTC, except in limited circumstances in which Vector may withhold its consent if, for example, the change would result in Vector incurring unrecoverable capital expenditure or operating expenses. These circumstances are listed in section 25.5(b) of the VTC.

Current appeal

On 27 November 2012, Gas Industry Co received an appeal from Vector. The appeal relates to the Change Request initiated by Vector and notified to shippers on 30 October 2012. The 75 per cent threshold of shippers consenting to the Change Request was not met and Vector appealed to Gas Industry Co to seek its support to have the change allowed.

The Change Request aims to align the VTC with pending changes to the balancing arrangements in the Maui Pipeline Operating Code (MPOC). These MPOC changes were the basis of an October 2011 MPOC change request. Gas Industry Co supported that Change Request in a Final Recommendation issued in April 2012, but asked MDL to delay its implementation until June 2013. This was to allow consequential changes to be made, such as the proposed VTC changes now being considered.

The pending MPOC changes will alter balancing arrangements on the Maui Pipeline to improve the allocation of balancing costs and incentivise better balancing behaviour. They follow years of industry debate on how to improve balancing arrangement. That history is described in our Draft Recommendation on the MPOC Change Request.²

The essential features of the pending MPOC changes are described in Section 1.3.

1.3 October 2011 MPOC Change Request

The pending MPOC changes will introduce back to back balancing, and introduces peaking charges, on the Maui pipeline as outlined below.

Balancing Gas

Currently, each Welded Party must use reasonable endeavours to manage gas flow so that Running Operational Imbalance (ROI) tends towards zero over a reasonable period of time. If a Welded Party's ROI exceeds its ROI Limit at a Welded Point, MDL may give an Imbalance Limit Overrun Notice (ILON) to that Welded Party. An ILO gives the Welded Party a set amount of time to reduce its Accumulated Excess Operational Imbalance (AEOI) to zero. If the Welded Party has not complied with the ILO within the specified time period, MDL may settle the imbalance by buying gas from, or selling gas to,

² Available at <http://gasindustry.co.nz/work-programme/mpoc-change-request-13-october-2011?tab=2278>

the Welded Party at the positive or negative mismatch price irrespective of whether MDL makes a balancing gas transaction.

An Incentives Pool provides a system of liquidated damages. Each Welded Party that has an excess imbalance or exceeds its Peaking Limit³ pays into the Incentives Pool an amount equal to the Incentive Pool Debit (in GJs) multiplied by the Incentives Pool Debit Price.⁴ The Balancing Agent may make a claim on the Incentives Pool to meet the costs of buying any balancing gas. And a Welded Party may make a claim on the Incentives Pool if it is unable to off-take its Scheduled Quantity because another Welded Party has incurred an Incentives Pool Debit.

The pending MPOC changes will remove the ILON process. Parties with AEOI will be cashed out at the end of a day if the Balancing Agent has taken a balancing action(s). The ILON process is problematic because balancing costs are not necessarily attributed to those causing the need for them and, due to the 'grace period' nature of ILONs, balancing costs can be socialised amongst other pipeline users. Thus, the causer of a balancing action may avoid some or all of the costs associated with that balancing action under the ILON process. Replacing the ILON process with back to back arrangements allows better targeting of costs to the causers of a balancing transaction – a more efficient outcome.

Peaking

Current arrangements require each Welded Party to act as a reasonable and prudent operator to flow gas within its peaking limits, unless it has MDL consent to exceed these for operational reasons.

Peaking Limits apply to hourly deliveries at Large Stations⁵. A Peaking Limit is the maximum reasonably practicable and no less than the limits established according to Schedule 7 of the MPOC.

The pending MPOC changes will reduce the peaking limits at some Large Stations and introduce a Peaking Charge. The Peaking Charge will not apply if on the day: the Incentives Pool Trustee has invoiced the Welded Party for Incentives Pool Debits; or line pack is above the low line pack threshold; or no balancing actions were taken. The main difference from the status quo is that there will be an additional penalty charge on parties that exceed their peaking limits on days when balancing action(s) is/(are) taken.

Removal of TP Welded Party extra Balancing Gas scheduling rights

Current arrangements permit a TP Welded Party to use the Maui Pipeline for transmitting balancing gas. Such transmission has priority over other gas and cannot be displaced by other nominations.

³ Which is the greater of either (a) the hourly Scheduled Quantity times the Peaking Tolerance; or (b) the minimum peaking limit for that Welded Point.

⁴ Calculated in dollars as either (a) zero if there are no Incentive Pool Claims in respect of the relevant day; or (b) the sum of Incentives Pool Claims for that day divided by the sum of Incentives Pool Debits for that day

⁵ A Large Station is defined in the MPOC as a station not being a Small Station, where the definition of a Small Station is a station having a maximum design flow rate less than or equal to 5000 standard m³/h specified in Schedule 8 of the MPOC.

The pending MPOC changes will remove all TP Welded Party rights in relation to transmitting balancing gas.

1.4 Current VTC Change Request

Because the commercial arrangements on the Maui Pipeline, as governed by the MPOC, flow through to impact commercial arrangements on Vector's transmission pipelines, it is necessary for Vector to make changes to the VTC so as to align the two industry codes once the pending MPOC changes discussed above are implemented.

Vector therefore submitted the Change Request which it says will 'improve the efficiency of balancing arrangements' and particularly the promotion of productive efficiency.

The three changes to the VTC that Vector has identified as necessary to give effect to the pending MPOC changes are:

- removing the ILON process and replacing it with a back to back cash-out mechanism;
- accommodating the new MPOC Peaking Charge in the VTC; and
- limiting the scope for disputing invoices relating to balancing.

On 13 December 2012, Gas Industry Co notified industry participants of the Change Request appeal and invited submissions. Six submissions were received. Those submissions were considered in a Draft Recommendation issued on 28 February 2013, which supported the Change Request. Further submissions were called for on the Draft Recommendation.

1.5 Submissions received

Seven submissions were received on the Draft Recommendation, from:

- Contact Energy Limited (Contact);
- Genesis Power Limited (Genesis);
- Greymouth Gas New Zealand Limited (Greymouth);
- Mighty River Power Limited (MRP);
- New Zealand Steel Limited (NZ Steel);
- Nova Energy Limited (Nova); and
- Vector Limited (Vector).

These submissions are discussed in the following chapter.

1.6 Non-Code Shipper Agreements

When the Draft Recommendation was issued Gas Industry Co understood that Vector was renegotiating the Non-Code Shipper agreements to adopt the same balancing provisions as would apply to Code Shippers. We held off issuing a Final Recommendation until that was done.

In the event, the Non-Code Shipper agreements have not been re-negotiated, but Vector has now provided us with assurance that it is confident that the existing Non-Code Shipper contracts provide for the recovery of balancing and peaking costs from Non-Code Shippers in a manner consistent to that proposed in relation to Code Shippers, and that Vector intends to implement the relevant provision, and has no intention of amending those provisions in the future in a manner that would make them inconsistent with the provisions proposed in relation to Code Shippers.

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Evaluation of issues

In sections 2.1, 2.2 and 2.3 we discuss what submitters say about each of the three main aspects of the Change Request. Section 2.4 addresses miscellaneous other issues raised in submissions.

2.1 Proposed replacement of ILON process with back to back process

In their submissions, Contact and Genesis suggest that the allocation methodology proposed by Vector may not align with back to back principles. Gas Industry Co met with Contact to get a better understanding of this view. Contact observed that:

- MDL balances the Maui Pipeline as a whole and makes cash-outs only to the Welded Point(s) with AEOI that contributed to the need to take the balancing action on a day. However, at other Welded Points there may also be Vector Shippers who contributed to the need to take the balancing action (ie Shippers with 'contributing mismatch' on the Vector pipeline supplied from the Welded Point), but whose contributing mismatch positions are masked by opposing mismatches of other Shippers on the same pipeline. Since these Welded Points are not cashed out, shippers with contributing mismatch would not receive a share of balancing costs.
- In addition, if a Shipper anticipates that balancing action is about to occur, it could nominate strategically on the Maui pipeline in order to mask its contributing mismatch positions. This would involve the Shipper selecting a Vector pipeline that is unlikely to have a contributing mismatch in aggregate, and moving its own contributing mismatch to that pipeline (by adjusting its nominations on the Maui pipeline). In this way a causer could avoid an allocation of cost. The situation is really the same as in the previous example except that here the Shipper deliberately engineers the outcome.

Contact considers that it would be better, in terms of ensuring more accurate cost allocation to causers, if Vector took each Shipper's aggregate mismatch (across all BPP pools) into account when calculating the apportionment of balancing costs.

Genesis on balance supports this aspect of the Change Request but considers that additional changes will be required in order to achieve a causer pays outcome.

MRP also supports replacing the ILON process with the back to back process.

NZ Steel is in agreement with the general intent of the change but concerned about the lack of additional mechanisms provided to facilitate self-balancing. In particular it suggests an additional nomination cycle on the Maui pipeline (as it has previously advocated). If this is not possible, and Gas Industry Co supports the Change Request, NZ Steel requests a review step to check that compliance costs (direct and indirect) have not increased.

Nova accepts the need to align the VTC with pending changes to the MPOC.

Evaluation

As stated in our Draft Recommendation, allocating cash-outs by pipeline is consistent with current balancing arrangements so would not be changed by the Change Request. While it is possible that there could be better allocation methodologies than the one proposed by Vector, we cannot evaluate Change Requests against a counterfactual of how submitters would prefer the arrangements to be. We can only assess whether the proposed change is an improvement on the status quo. Shippers are entitled to make a Change Request which requires Vector to aggregate each Shipper's imbalance when calculating cost apportionment for balancing invoices if they believe it is superior.

The scope for Shippers to strategically manage their positions in order to avoid balancing invoices is a concern. However, we note that Shippers are required to use reasonable endeavours to ensure that their Receipt Quantities match their Delivery Quantities for each pipeline on the Vector system. Also, the extent that Shippers are able to manage their receipt quantities in a way that minimises their exposure to balancing costs, rather than matching their expectations of demand, will be no greater under the proposed arrangements than it is at present.

We do acknowledge that strategic shifting of mismatch between pipelines in order to avoid balancing costs could become more prevalent as costs are more closely targeted to causers. The introduction of back to back balancing will sharpen the incentives for Shippers to carefully manage their positions. Each Shipper will, presumably, consider the relative merits of using intra-day nominations to manage its position versus the risk of bearing the costs passed on by Vector when balancing actions are required. We acknowledge that there may also be some variances among Shippers in their ability to accurately manage their positions. However, we consider introducing back to back balancing will more accurately allocate balancing costs to welded points that have caused or contributed to the need for a balancing action.

Contact's and Genesis' concern about the potential for some parties to seek to avoid balancing costs by management of gas positions (or simply by correcting mismatch positions) by the end of a day in which a balancing action is taken, is noted. However, that option is open to Shippers now, and in future the existence of Peaking Limits may mitigate the extent to which Shippers can move their positions around. Also, a Shipper who takes strategic actions can never be confident that it is doing so alone; the peaking risk cannot be managed on an individual basis. So there is uncertainty to what extent the back to back arrangements might be frustrated by Shipper behaviour.

In summary, at a high level we remain convinced that back to back will be a clear improvement in terms of allocative efficiency over the ILON process, and it appears that submitters agree. However, the arrangements are not water tight and Shippers may seek to avoid costs in ways that are counterproductive, as pointed out by Contact. We accept this, but consider that there are good reasons to believe that such behaviour will be limited.

2.2 Proposed allocation of MPOC Peaking Charge

Vector's submission clarifies a point made in our Draft Recommendation. The Draft Recommendation said that 'The Peaking Allocation Methodology will apply when Vector has not acted as an RPO...'. Vector's submission states that:

- (a) Where Vector has not acted as an RPO, Vector is liable to bear peaking costs under 8.13(b) calculated in proportion to the extent to which Vector's failure to act as an RPO has contributed to the Peaking Cost. The remaining peaking costs are then allocated in accordance with Schedule Nine, which may also include an allocation to Vector.
- (b) Where Vector has acted as an RPO, Vector will be allocated a proportion of peaking costs in accordance with Schedule Nine.

Evaluation

We appreciate Vector's clarification on this, and confirm that we believe the allocation methodology to be fair. Nevertheless, we understand that some Shippers do believe there may be superior ways to allocate peaking charges, and are discussing these with other parties to the VTC. While we are interested to follow those discussions, they are outside the scope of this Final Recommendation.

2.3 Proposed limitation of the scope for disputing balancing invoices

In arguing against this aspect of the Change Request, Contact states that Gas Industry Co has failed to recognise the consensus views of the industry, which oppose this aspect of the Change Request.

Genesis' submission states that the proposed change will 'unfairly and unnecessarily restrict shippers' rights to raise legitimate disputes with Vector'.

Greymouth considers Vector is 'absolving itself of its entrenched TSO risks by passing these risks on to shippers'. Greymouth also says that support for this aspect of the Change Request is 'clearly opposite to the intent of legislation.'

MRP raises a number of objections to this aspect of the Change Request. In particular, it believes that:

- MDL may not consider a dispute raised by a party that did not ship gas on the Maui Pipeline;

- using final allocations would be a more accurate way of calculating balancing invoices but Vector has not indicated to Shippers how much it would cost to switch from using initial allocations to final allocations; and
- the proposed change is likely to increase TSO market power.

Nova does not support this aspect of the Change Request because having the right to appeal against invoice calculations does not necessarily result in costly dispute procedures, 'but it does stimulate responsible behaviour by the vendor, and encourages communications between the parties which can lead to improved procedures and understanding between the parties'.

Vector's submission agrees with the assessment in Gas Industry Co's Draft Recommendation, that appropriate dispute resolution processes will be in place if the change is implemented. In particular it sets out the following 'practical illustration':

10. If a Shipper receives a balancing invoice other than as a result of a Peaking Limit being exceeded that Shipper may take the following actions:

- (a) Pay the invoice in accordance with the VTC;
- (b) If the Shipper reasonably believes that there is a manifest error in the invoice, the Shipper may raise the issue with Vector. Vector will then check whether a manifest error has been made, including checking that any relevant information received from Maui Development Limited (MDL) is without manifest error;
- (c) If the Shipper reasonably believes that part or all of the amount of the invoice has been issued as a result of MDL not acting as a Reasonable and Prudent Operator (RPO) in relation to its balancing procedures, it may raise a dispute with MDL.

11. If a Shipper receives a balancing invoice as a result of a Peaking Limit being exceeded, the Shipper may take the following actions:

- (a) Prior to the invoice being issued, the Shipper may demonstrate to Vector that it did not cause or contribute to peaking costs;
- (b) Pay the invoice in accordance with the VTC;
- (c) If the Shipper reasonably believes that there is a manifest error in the invoice, the Shipper may raise the issue with Vector. Vector will then check whether a manifest error has been made, including checking that any relevant information received from Maui Development Limited (MDL) is without manifest error;
- (d) If the Shipper reasonably believes that part or all of the amount of the invoice has been issued as a result of MDL not acting as a Reasonable and Prudent Operator (RPO) in relation to its balancing procedures, it may raise a dispute with MDL.

Evaluation

Gas industry acknowledges the unanimous opposition of Shipper submissions to this aspect of the Change Request. And we appreciate this opposition does not only arise from a concern about being

unable to challenge incorrect invoices or inappropriate balancing actions, but also from a belief that rights to dispute are fundamental to commercial contracts, and are being reduced to an unacceptable extent.

However, it seems to us that there should be little or no need to dispute balancing invoices provided the balancing action giving rise to them was taken by MDL in accordance with the MPOC (ie where MDL has acted as a reasonable and prudent operator), and correctly ascribed balancing and peaking costs. Vector has set out a 'practical illustration' of the process (copied above) in its submission. Essentially, if Vector does make a manifest error in compiling an invoice, then that error would be corrected. Shipper submissions have not posited any other likely circumstances where incorrect invoices would be rendered, so we anticipate that the scope for this must be small.

Nevertheless, we think that Shipper's concerns have merit in some areas. In particular, Shippers are concerned about their more limited recourse if MDL's balancing charge is illegitimate. The fact that Vector Shippers may have created the need for a balancing action (by not maintaining a balanced position) does not alter the fact that Vector has the contractual relationship with MDL that permits MDL to charge Vector the resulting costs. Vector therefore has the right to question the validity of those costs, but the proposed change will mean that it never has to exercise that right on behalf of its Shippers.

Vector considers that, if its Shippers have issues with MDL's balancing actions, they are best to raise these with MDL directly. However, as MRP points out, not all Vector Shippers necessarily have a contractual relationship with MDL (although almost all do). In addition, MDL levies the charges on Welded Parties, not Maui shippers, so the grounds for Maui shippers to dispute the charges may be limited.

We also agree with Nova that the ability to dispute can be a means of stimulating responsible behaviour by a vendor, and encourage communications which can lead to improved procedures and understanding between the parties.

MRP's view is that limiting of Shippers' ability to dispute balancing invoices increases the market power of TSOs. Greymouth suggests that Vector is 'absolving itself of its entrenched TSO risks by passing these risks onto shippers'. We acknowledge that Shipper rights to dispute have reduced. However, we consider that the scope for such disputes is likely to be very limited. This is a matter we will continue to monitor in our capacity as industry body under the Gas Act.

2.4 Additional issues raised in submissions

Several additional points were made in submissions but were not directly related to any of the three changes above. We discuss those additional issues here.

Bundling of Change Requests

Several submitters commented that Vector's proposed change to the disputed invoices provision has been deliberately bundled, as a contentious matter, with other changes which are non-contentious. In a similar vein, some Shippers have claimed that Vector does not constructively engage with Shipper feedback provided during initial consultation between Vector and its Shippers on Change Requests.

We have discussed the 'strategic' bundling of Change Requests several times in the past. For instance, our Draft Recommendation and Final Recommendation on the 18 April 2011 MPOC Change Request⁶ both discuss this matter. In short, we observed that it is preferable that the scope of Change Requests is limited to individual issues. This ensures ease of processing by Gas Industry Co. However, we note that Vector, as author of this Change Request, considers that all the changes proposed do relate to the single issue of pipeline balancing.

We also note that Contact has made a VTC Change Request requiring that future VTC Change Requests only relate to a single issue, or related series of issues. Vector did not consent to that Change Request and on 31 May 2013 Contact appealed to Gas Industry Co. Gas Industry Co issued a Draft Recommendation on that Change Request on 2 August 2013. In essence, we concluded that Vector had validly withheld consent, believing that the proposed change would create ambiguity and may create inefficiencies. The Draft Recommendation and submissions on it are available at:

<http://gasindustry.co.nz/work-programme/vtc-change-request-appeal-31-may-2013-single-issue?tab=2751>

We have not previously discussed the initial consultation on Change Requests. However, we believe that constructive engagement at the time a Change Request is being designed is likely to lower the risk of it being rejected.

These are matters that are beyond the scope of considerations on the current Vector Change Request, but are discussed in a cover note accompanying this Final Recommendation.

Risk of precedent effect if passed

Some submitters claim that a precedent effect will be established if Gas Industry Co supports this appeal. These submitters imply that Gas Industry Co does not support the disputed invoice change and that approving the appeal could encourage parties to bundle Change Requests in such a way as to have a contentious issue approved with one or more non-contentious changes.

As the appeals body, Section 25.7 of the VTC requires that we '...shall make a written recommendation supporting or not supporting the Change Request...'. The VTC does not say that we may support some aspects of a Change Request and reject others, or that we should reject a Change Request if we do not support one aspect of it. The approach we have adopted in successive appeals over the years is therefore to make a single recommendation on the proposed change.

Process

⁶ The 'bundling' issue is equally applicable to MPOC and VTC Change Requests (appeals)

Greymouth says in its submission that the conflict of interest and process concerns it raised in its original submission on the appeal have not been dealt with. The relevant points were:

- a. given that balancing changes to the MPOC were expected to be introduced on 1 June 2013, Gas Industry Co's timetable established for completing an assessment of the VTC Change Request could sway us into approving the appeal, knowing that there would probably not be enough time for a party to propose a new Change Request if the present appeal was rejected; and
- b. Gas Industry Co's approval of the MPOC Change Request (for back to back balancing) predisposes our support for this Change Request appeal.

In regard to (a) it is clear that we have not allowed the 1 June 2013 date to drive our process since the process is still in train almost three months later.

In regard to (b) we do not agree that our support for the MPOC Change Request imposes a conflict of interest in supporting Vector's appeal. Each Change Request is assessed on its merits.

Unanimous opposition

Some submitters have noted that because of unanimous opposition of Shipper submissions to the Change Request, Gas Industry Co should not support it.

Gas Industry Co's assessment of appeals (or any policy decisions for that matter) must be made using the relevant objectives of the Gas Act and GPS. Submissions inform that assessment, but the predominance of one view cannot on its own determine the outcome.

We note that Shippers are able to pursue a change to the VTC at any time to set out different processes for management of disputed invoices. We encourage Shippers to liaise with Vector on this.

Self-balancing

NZ Steel's submission mentions that back to back balancing makes it more difficult to 'self-balance', particularly from 4pm to midnight when there is no intra-day nomination cycle.

This particular issue is more relevant for the MPOC. We cannot assess VTC Change Requests as parties wish they were. We note that parties to the MPOC are able to request that MDL introduces a fifth intra-day nomination cycle. Alternately, a party to the MPOC is able to suggest its own MPOC Change Request.

Review of compliance costs

NZ Steel suggests that if this appeal is approved then there ought to be a review to ensure compliance costs have not increased. Gas Industry Co thinks this is a reasonable idea. This is addressed in the proposal we make in our cover note.

3

Overall Evaluation

Regarding the proposed replacement of the ILON process with the back to back process, the Draft Recommendation discussed that the following Gas Act objective and GPS outcome were most relevant:

- the full costs of producing and transporting gas are signalled to end users; and
- an efficient market structure for the provision of gas metering, pipeline, and energy services.

Accommodating the back to back process in the VTC will improve the cost transparency of transporting gas as those parties that have contributed to the need for a balancing action are more likely to pay the costs of any balancing action. This is a more efficient outcome than the status quo.

Accommodating the back to back process in the VTC ensures that the efficiency benefits of back to back balancing in place of the ILON process will be realised, particularly as there will be reduced scope for balancing cost socialisation.

Submitters have pointed out that causers of a balancing action may be able to avoid costs if they are able to correct their positions by the end of the day in which a balancing action is taken. We acknowledge that this is possible. However:

- Shippers are able to do this already so this cannot be worse than the status quo;
- Peaking Limits and other operational constraints will limit the extent to which Shippers are able to engage in this opportunistic behaviour; and
- there will be less scope to avoid the costs of causing a balancing actions under the proposed changes than under the status quo. Cash-outs will occur daily for back to back balancing whereas the ILON process gives Shippers several days to avoid the costs of something they cause. This is an efficiency improvement.

In respect of proposed inclusion of the MPOC Peaking Charge, the Draft Recommendation discussed that the following Gas Act objective was most relevant:

- the full costs of producing and transporting gas are signalled to end users.

At present, where Vector makes a payment to the Incentives Pool as a result of deliveries at a Vector Welded Point exceeding the Peaking Limit, VTC arrangements provide for Vector to allocate such costs to causers if the causer can be identified. However, we understand that where Vector has attempted to identify causers the wording of the provisions allow ample scope for dispute. As a result Vector has generally socialised such costs. We consider that the more formulaic approach to allocating Peaking

Charges, as set out in the new Schedule Nine, will improve on this situation. Overall we consider that it will improve the signalling of peaking costs to system users.

In regard to the proposed limiting of the scope for disputing invoices relating to balancing, the Draft Recommendation discussed that the following GPS outcome was most relevant with respect to the proposed change:

- gas governance arrangements are supported by appropriate compliance and dispute resolution processes.

Our evaluation in the Draft Recommendation was:

‘...with the removal for Shippers to dispute balancing invoices from Vector, appropriate dispute resolution processes will still be in place. Shippers on the Maui pipeline will be able to raise a dispute if they believe MDL’s balancing procedures are sub-optimal. Vector will correct invoices that contain manifest errors. Shippers will also have the opportunity to demonstrate prior to an invoice being issued by Vector that they did not cause or contribute to peaking costs.

While we will not be able to assess the full impact of this change until after it occurs, we note that if Shippers experience considerable harm in not being able to dispute balancing invoices they are of course entitled to pursue their own VTC Change Request reversing this element of the current Change Request.

Our assessment is that this change is neither worse than nor better than the status quo.’

Shipper submissions all opposed this change. While our evaluation of these submissions in section 2.3 has led us to give more weight to Shipper views on the matter, we still believe that, except in a very limited set of circumstances, appropriate dispute resolution processes will be in place. So while the reduction in scope for disputes may be cause for concern, we cannot see that the consequences are material.

Overall, we conclude that implementing the Change Request will better achieve Gas Act and GPS objectives/outcomes, however some matters have been raised that are beyond the scope of our appeals body role and we have addressed these in a cover note.

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Final Recommendation

Our Final Recommendation is to support the Change Request.