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Ian Dempster
General Manager Operations
Gas Industry Company Limited
PO Box 10 646
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Dear Ian

Vector Transmission Code (VTC): Appeal to Allow Balancing Arrangements Change Request

On 30 October 2012 Vector Gas Limited (*Vector*) submitted a VTC Change Request which we refer to as the Balancing Arrangements Change Request. A copy of the Balancing Arrangements Change Request is **attached** at Appendix 1.

More than 75% of responding Shippers did not consent to the Balancing Arrangements Change Request, and accordingly Vector wishes to lodge an appeal seeking to have the Balancing Arrangements Change Request allowed pursuant to section 25.6 of the VTC.

Reasons for the appeal

Under section 25.6 of the VTC and clause 2.2 of the Memorandum of Understanding dated 17 October 2008 between Gas Industry Company Limited (*GIC*) and Vector, Vector must provide full particulars as to its reasons for the appeal.

The Balancing Arrangements Change Request provides the full details of the proposed amendments to the VTC and the reasons for them. Vector's reasons for lodging this appeal are provided in greater detail below but, in short, Vector believes there is a sound rationale for each of the amendments, the reasons for the amendments are valid, and the amendments will as a whole be beneficial to Shippers and the industry.

The Change Request will better promote the objectives in the Gas Act and GPS than the status quo

The central reason Vector has lodged this appeal is that it believes the Balancing Arrangements Change Request will better promote the objectives in section 43ZN of the Gas Act and in the Government Policy Statement on Gas Governance (*GPS*) than the status quo. Most importantly, Vector believes that the amendments will improve the efficiency of balancing arrangements.

In support of this assessment, we attach at Appendix 2 a report (*NERA Report*) by James Mellsop, NERA. The NERA Report assesses each element of the Balancing Arrangement Change Request against the objectives in the Gas Act and GPS and concludes that, as a whole, the Change Request will better promote those objectives than the status quo. In particular, the NERA Report concludes that the Change Request as a whole will deliver efficiency gains relative to the status quo.

The key benefit of the Change Request is the promotion of productive efficiency

The GIC approved Maui Development Limited's (*MDL*) 13 October 2011 MPOC Change Request on the basis that it would deliver significant improvements in productive efficiency.[1] This was because the new back to back (*B2B*) balancing arrangements would better allocate balancing costs to those Shippers whose actions or inactions caused the costs. This would create greater incentives for Shippers to find the least cost options to balancing their positions, which would promote productive efficiency.

The amendments proposed in the Balancing Arrangements Change Request are consequential to MDL's 13 October 2011 Change Request. The amendments are primarily aimed at ensuring the full productive efficiency gains contemplated by the GIC when approving MDL's 13 October 2011 Change Request are captured. Vector believes the package of amendments in the Balancing Arrangements Change Request are necessary to achieve and maximise the efficiency gains.

In particular, the proposed amendments relating to balancing disputes will ensure that the causer pays pricing signals of the B2B balancing arrangements are not diluted. The history of balancing disputes in Appendix 3 shows that Shippers have been able to avoid or delay paying balancing costs by raising disputes and that a significant number of these disputes appear to be without a basis (having been resolved in Vector's favour). To the extent that Shippers are able to avoid or delay paying balancing costs, the sought-after gains in productive efficiency from implementing the B2B balancing arrangements will be undermined.

The new dispute arrangements will ensure that the efficiency gains that the GIC considers the B2B balancing arrangements will generate are captured in full, as Shippers receive the clear price signal delivered by the B2B arrangements.

Shippers' user risks may increase, but this is a more efficient outcome and is justifiable

While the new dispute arrangements may expose Shippers to increased user risk, this is justifiable and is more efficient that the current position because:

- This is a more appropriate allocation of user risk. The financial risk associated with balancing costs is caused by Shippers as they cause balancing costs. It is inefficient for a party whose actions do not cause balancing costs, nor the financial risk associated with those costs, to be exposed to that financial risk, but this is what is occurring under the status quo. Vector is required to pay the balancing costs to MDL in the first instance, and through Shippers regularly disputing balancing invoices, Vector has difficulty in recovering those costs (even though it did not cause those costs).

[1] GIC *Draft Recommendation on 13 October 2011 MPOC Change Request* (February 2012), p. 25.

- Shippers will face a greater incentive to reduce balancing costs, as the pricing signals of the B2B regime will not be diluted by the ability of Shippers to delay or avoid paying balancing invoices.

- Vector has taken significant steps to increase transparency and certainty for Shippers of balancing costs by incorporating a new peaking cost allocation methodology in the VTC. Vector expects that the new methodology will allocate costs more accurately and therefore improve the allocation of peaking costs to causers.

- In any event, Shippers still retain some scope to dispute balancing invoices where they can show the invoice is the result of manifest error, and Shippers will retain the opportunity to demonstrate to Vector before an invoice is issued that they did not cause peaking costs. Any possible increase to Shippers' user risks should therefore not be overstated.

- Furthermore, Vector currently checks all balancing invoices it receives from MDL for accuracy (in relation to price, volume etc). This practice will continue should the Balancing Arrangements Change Request be approved.

Vector acknowledges the suggestion in the NERA Report that the efficiency of balancing arrangements could be enhanced by amending the governance arrangements to permit Shippers to "step into" Vector's rights to dispute balancing invoices from MDL. Vector considers this could be achieved through an MPOC change request and has asked Shippers for input on this. We will continue to work with Shippers to evaluate options in this respect. Vector views the amendments to the disputes provisions as a significant first step in improving the overall balancing arrangements, of which allowing for step in rights may be the next step.

Summary

In short, the Balancing Arrangements Change Request will achieve significant gains in productive efficiency. The amendments may increase Shippers' user risks, but this is necessary to maximise the efficiency gains that can be achieved, and is a more appropriate allocation of user risk to those whose actions or inactions have generated balancing costs.

Feedback received from Shippers

Vector received feedback from some Shippers on the Balancing Arrangements Change Request relating to linepack management. It was suggested that, where the linepack in Vector's pipeline has increased, Vector should bear any balancing costs in relation to the linepack increase.

Vector disagrees. Any balancing costs as a result of an increase to the linepack should be borne by Shippers, as they caused the need for the linepack to be managed[2]. For example

[2] Excluding situations where Vector has not acted as an RPO in operating its compressors, in which case Vector would bear the relevant cost.

linepack generally increases to replenish gas that has been overtaken by Shippers' during a prior period, or as a result of Shippers' taking less gas than they nominate for.

Timing

Vector is conscious that MDL's 13 October 2011 MPOC Change Request will come into effect on 1 June 2013. The timing of the Balancing Arrangements Change Request was intended to ensure that, should an appeal to the GIC be required, there would be sufficient time for the GIC to assess the proposed amendments and make a recommendation.

While there is still some time to pass until 1 June 2013, Vector would appreciate it if the GIC would give this matter its early attention.

Please contact Katherine Shufflebotham if you require any further information to assist with your assessment of this appeal.

Yours sincerely

K-Shufflebotham

Katherine Shufflebotham

Commercial Manager – Networks

APPENDIX 1: BALANCING ARRANGEMENTS CHANGE REQUEST

APPENDIX 2: NERA REPORT

APPENDIX 3: INFORMATION ON BALANCING DISPUTES

Transmission Month	Disputed Amount $ (excl GST)	Days to resolve	Resolved in favour of
Dec-08	$28,618.81	1292	Vector
Feb-09	$5,708.52	1231	Vector
Feb-09	$84,820.22	524	Vector
Feb-09	$8,017.67	546	Vector
Feb-09	$340.15	84	Vector
Mar-09	$2,613.03	1205	Vector
Mar-09	$1,956.70	58	Vector
May-09	$102,921.26	1147	90% Vector/10% Shipper
May-09	$104,398.34	35	Vector
Jun-09	$53,598.01	1120	Vector
Dec-09	$2,688.71	223	Vector
Feb-10	$37,355.53	238	Vector
Jun-10	$11,961.80	64	Vector
Aug-10	$11,510.70	117	Shipper but full amount recovered from remaining Shippers
Aug-11	$9,277.26	35	Shipper but full amount recovered from remaining Shippers

Average days to resolve		**528**
Average months to resolve		**18**
Average disputed amount	**$31,052.45**	
Total disputed amount	**$465,786.71**	