30 October 2012

VTC CHANGE REQUEST

CHANGES TO BALANCING ARRANGEMENTS

Change Request

1. Pursuant to section 25 of the Vector Transmission Code posted on OATIS and effective as at 1 July 2012 (*VTC*), Vector Gas Limited (*Vector*) wishes to amend the VTC in accordance with this Change Request, for the reasons explained below.

2. A restated version of the VTC with the affected provisions marked up is appended to this Change Request.

Reasons for the amendments

3. The reason for the amendments to the VTC is to make the balancing arrangements in the VTC and the Maui Pipeline Operating Code (*MPOC*) compatible, following the Gas Industry Company's (*GIC*) recommendation supporting Maui Development Limited's (*MDL*) 13 October 2011 MPOC Change Request to implement a back to back (*B2B*) balancing framework.

4. During consultation for MDL's 13 October 2011 MPOC Change Request, Vector noted that, should that Change Request proceed, Vector would need to make corresponding amendments to the VTC. In making its draft recommendation, GIC considered that "Vector and the industry can work together to harmonise the balancing aspects of the MPOC and VTC so as to ensure the efficiency gains inherent in the change request will be fully achieved".[1]

5. In its final recommendation, GIC noted that MDL had agreed to delay implementing the MPOC changes until 1 June 2013, "allowing time for industry participants to negotiate and implement" the necessary changes to the VTC, among other things.[2]

6. Vector considers that the amendments to the VTC proposed in this Change Request:

   (a) are those that were envisaged by GIC and the industry to be necessary to make the balancing regimes in the VTC and MPOC compatible, and will

[1] GIC *Draft Recommendation on 13 October 2011 MPOC Change Request* (February 2012), p. 27.
[2] GIC *Final Recommendation on 13 October 2011 MPOC Change Request* (April 2012), Executive summary.

reinforce the causer pays objective that underpins the introduction of the B2B balancing framework;

(b) are those requested by Shippers during consultation on the first version of this VTC Change Request – Changes to Balancing Arrangements issued on 5 October 2012 that did not receive the necessary support from Shippers to be adopted;

(c) as such, are necessary to secure the efficiency gains GIC considered would result from MDL's 13 October 2011 MPOC Change Request; and

(d) will better achieve the objectives in s 43ZN of the Gas Act 1992 and Government Policy Statement on Gas Governance (*GPS*) than the existing provisions of the VTC.

7. In making this Change Request, Vector has been conscious of GIC's guidance that Change Requests should relate to a single function, and not seek multiple reforms at once. Consistent with that guidance, there are three changes necessary to make the balancing arrangements in the VTC and MPOC compatible:

   - removing the Imbalance Limit Overrun Notice (*ILON*) process, and replacing it with a B2B cash-out mechanism;
   - accommodating the new MPOC Peaking Charge in the VTC; and
   - limiting the scope for disputing invoices relating to balancing, to prevent the dilution of the price signals of the B2B balancing regime and ensure the causer pays objective is met.

   In addition to the above changes that are necessary to make the balancing arrangements in the VTC and MPOC compatible, at the request of Shippers, the VTC has been amended to include Vector in the allocation of peaking costs and to incorporate Vector's new methodology for allocating peaking costs into the VTC.

8. Schedule 1 to this Change Request provides a summary of each amendment.

Incorporating the B2B cash-out mechanism into the VTC

9. As can be seen in the marked up version of the VTC attached to this Change Request, there are in fact few amendments required to remove the ILON process and incorporate the B2B cash-out mechanism into the VTC. The key amendments are as follows:

   (a) the definition of "Cash-out" has been amended to extend the application of the cash-out procedure in clause 8.19 of the VTC to situations where MDL buys or sells to Vector a quantity of gas pursuant to sections 12.10, 12.11 and 12.13 of the MPOC; and

(b) provisions that relate to the Imbalance Limit Overrun Notice (*ILON*) process have been removed.

10. Given that these amendments are anticipated by GIC and the industry, Vector does not expect the substance of the changes to be contentious. They are targeted and reflect the minimum necessary to achieve harmonisation of the VTC and the MPOC in relation to balancing. Without the changes, the causer pays objective would be undermined as Vector would be unable to pass on certain balancing costs to the Shippers whose balancing actions or inactions cause the costs.

11. Vector has considered the amendments against the objectives in s 43ZN of the Gas Act 1992 and the GPS. Given the amendments are central to bringing the B2B balancing framework into the VTC, Vector is satisfied that GIC's analysis of MDL's 13 October 2011 MPOC Change Request against the objectives in its Draft and Final Recommendations is applicable to the amendments. The key conclusion of that assessment was as follows:[3]

> *… implementing the October 2011 Change Request will:*
>
> > ***Improve the efficiency of balancing arrangements.*** *Current arrangements involve a high degree of cost socialisation, poor price signalling, charges not directly related to underlying transaction costs, and poor accountability for costs and title. All of these matters are improved by the change request. While user risks are expected to increase, this is a natural consequence of greater cost accountability.*

Accommodating the new MPOC Peaking Charge in the VTC balancing arrangements

12. Again, there are relatively few amendments to the VTC required to accommodate the new Peaking Charge:

(a) Adding a new definition "Peaking Charge", which is defined by reference to the definition of Peaking Charge in the MPOC; and

(b) Adding the Peaking Charge to those payments that trigger the cost recovery procedure in clause 8.13(b) of the VTC (under which a payment to Vector is made from the BPP Account to cover Vector's payment to the Incentives Pool Trustee for a Peaking Charge).

13. These amendments are necessary due to the addition of the Peaking Charge to the MPOC and Vector does not expect the substance of these amendments to be contentious. Without these consequential amendments to the VTC, Vector would be unable to recover its costs associated with the Peaking Charge, even though it is Shippers – not Vector – who cause Peaking Charges.

[3] GIC *Draft Recommendation on 13 October 2011 MPOC Change Request* (February 2012), pp. 33-34.

14. In addition to the amendments required to accommodate the new MPOC Peaking Charge in the VTC balancing arrangements, at the request of Shippers, during consultation on the first version of this VTC Change Request – Changes to Balancing Arrangements issued by Vector on 5 October 2012, Vector has amended section 8.13(b):

   (a) to include Vector in the allocation of peaking costs and to clarify how much the allocation of peaking costs to Vector and Shippers is reduced when Vector has failed to act as a reasonable and prudent operator; and

   (b) to require Vector to apply a new methodology (recently implemented by Vector) incorporated as a new Schedule 9 to the VTC, when determining which of Vector, Shippers and Non-Code Shippers are to pay peaking costs and in the calculation of the amount of costs each must pay.

15. Vector has assessed the amendments against the objectives in s 43ZN of the Gas Act 1992 and GPS, and considers that the amendments will better achieve those objectives than current arrangements. In particular, the amendments will better promote:

   (a) ***productive efficiency***: Because the amendments will allocate balancing costs to Shippers whose actions or inactions cause the need for balancing, Shippers will have incentives to balance their position and reduce balancing costs;

   (b) ***allocative efficiency***: Without the amendments, Shippers would be able to avoid paying the cost of the Peaking Charge. Allocative efficiency will be improved if the allocation of cost is shifted from the person who did not cause it (i.e. Vector) to the persons who caused it (i.e. Shippers). Allocative efficiency will also be improved by the incorporation of the new methodology to allocate peaking costs, which we expect to provide for a more accurate allocation, including the allocation of costs to Vector to the extent that Vector has caused or contributed to peaking costs;

   (c) ***a reduction in user risks***: Shippers' user risks will be reduced by the incorporation of the new methodology to allocate peaking costs, as the methodology will more closely allocate costs to the persons who have caused it; and

   (d) ***stability***: The balancing arrangements will be fairer and more stable if costs are allocated to those who caused the costs.

Limited scope for disputing invoices relating to balancing

16. The overriding objective that underpins the introduction of the B2B balancing regime is the more accurate allocation of balancing costs to those whose balancing actions or inactions have caused the costs. To the extent that causers of bala costs – Shippers – are able to avoid or delay paying those costs, the causer pays objective will be undermined.

17. Accordingly, to avoid undermining the B2B balancing arrangements, Vector has made amendments to section 16.17 of the VTC to limit the scope for Shippers to dispute invoices relating to balancing. Shippers will be able to dispute invoices only where they are able to show that there is manifest error in the information used by Vector to calculate BPP Amounts. This will reduce the ability of Shippers to use the disputes regime to delay payment (as has been a feature of the current regime), which will prevent the dilution of the price signals of a causer pays/B2B balancing regime and result in more efficient transaction costs.

18. Vector has assessed the amendments against the objectives in s 43ZN of the Gas Act 1992 and GPS, and considers that the amendments will better achieve those objectives than the current arrangements. In particular, the amendments will:

(a) ***better promote productive efficiency***: The amendments will reduce the ability of Shippers to avoid or delay paying balancing costs that they caused. Because of the certainty this creates, Shippers will have greater incentives to balance their position and focus on reduce balancing costs. If the status quo remains, Shippers will have a greater incentive to concentrate their efforts on avoiding or delaying payments, rather than dedicating resource to reducing balancing costs.

(b) ***better promote allocative efficiency***: Without the amendments, Shippers are able to avoid or delay paying balancing costs. This causes Vector to bear some of the balancing costs (which it did not cause). This is inefficient as it dilutes and/or undermines the incentives created by a causer pays principle – the precise situation that shifting to B2B balancing is intended to resolve. Allocative efficiency will be improved if Shippers bear the costs that they have caused.

(c) ***establish a more appropriate sharing of user risk***: The amendments will reduce Vector’s exposure to financial risk and increase Shippers’ exposure. However, the outcome will be a more appropriate sharing of user risk. It is unreasonable for Vector to be exposed to the risk of balancing costs it did not cause and had no ability to manage. Vector is effectively in the position of a financial intermediary which collects payments from Shippers to pass on to MDL. So long as Vector calculates and allocates balancing costs in good faith and without manifest error, it should be able to recover such costs without undue delay and associated transaction costs.

The existing disputes regime creates an incentive for delay by Shippers and an opportunity for them to manage their cashflows, all to the disadvantage of Vector and MDL. While the amendments will increase user risk for Shippers, it is appropriate for Shippers to bear an increased risk as it is their actions that cause balancing costs and accordingly Shippers are best placed to manage the risk or face the consequences of failing to manage that risk. Nevertheless, Shippers still have scope to dispute invoices where they can show the invoice is the result of manifest error, and Shippers will have the opportunity to demonstrate to Vector before an invoice is issued that they did not cause peaking costs (see paragraph 22 below and Schedule 2).

Vector notes that GIC supported MDL's 13 October 2011 MPOC Change Request on the basis that Vector would make changes to ensure that those parties which caused balancing costs would bear those costs:[4]

> *While the proposal exposes the TPWP to greater risk of cash-out, <u>our analysis assumes that Vector, as TPWP, will likely arrange its own affairs to ensure that those costs are allocated to the parties responsible for those cash-outs</u>. (emphasis added)*

The amendments Vector proposes are therefore consistent with the expectation of GIC.

The new methodology to allocate peaking costs that is to be incorporated into the VTC is also relevant in considering user risk. Although since Vector implemented this methodology there has only been one relatively small peaking charge, Vector expects that the new methodology will allocate costs more accurately and therefore reduce Shippers' exposure to financial risk.

(d) ***not be costly to implement***: There will be little or no cost to implement the amendments.

(e) ***no reduction in transparency***: the amendments do not reduce the current level of transparency in relation to the allocation of balancing costs to Shippers.[5]

(f) ***improve the balance of the arrangements***: The current dispute arrangements are inefficient and undermine the causer pays principle in that Vector sometimes bears balancing costs even though it does not cause them. This is because Vector is effectively in the position of a financial intermediary which collects payments from Shippers in relation to balancing costs and passes those payments on to MDL. Where Shippers delay or avoid making those payments for balancing costs, Vector is left to bear the cost. In other words, Vector is often "caught between" MDL and Shippers. The misallocation of balancing costs was the key driver of the introduction by MDL of a B2B balancing regime. The amendments to limit the scope for dispute of invoices relating to balancing will rectify this issue and make the balancing arrangements more efficient.

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[4] GIC *Final Recommendation on 13 October 2011 MPOC Change Request* (April 2012), p. 25.

[5] Transparency can only improve if Shippers agree to sharing their mismatch and running mismatch positions, Receipt Quantities and Delivery Quantities (on an hourly and daily basis) at each Delivery Point.

(g) ***increase stability***: Because the disputes arrangements will be more efficient, the balancing arrangements will be more stable.

19. Overall, the amendments will promote the GPS outcome that gas governance arrangements are supported by appropriate compliance and dispute resolution processes.

20. Vector is conscious that on 31 July 2012, it lodged an appeal with the GIC on a proposed change to the prudential and dispute provisions of the VTC that did not receive the necessary support from Shippers to be adopted (the Prudential and Dispute Appeal). The Prudential and Dispute Appeal includes a change to the dispute resolution provisions in section 16.17 of the VTC, and accordingly the amendments proposed in this Change Request have been drafted for both versions of section 16.17 in the attached marked up version of the VTC.

21. A decision on the Prudential and Dispute Appeal is expected in November 2012, well before the proposed effective date for this Change Request (see paragraph 23 below). Accordingly, if the Prudential and Dispute Appeal:

(a) *is not* recommended by the GIC, this Change Request will apply to the current version of section 16.17 of the VTC;

(b) *is* recommended by the GIC, section 16.17 of the VTC will have been updated with effect from the first day of the month following the month in which it is recommended by the GIC, and this Change Request will apply to that updated version of 16.17.

22. If both Change Requests were to be implemented, the position would be as follows:

(a) For invoices issued under section 16.1 (for Transmission Charges):

- The scope for disputing such invoices would not be affected (i.e. in this respect, the status quo would remain); and

- A Shipper disputing the invoice would be required to pay not less than half of the disputed portion of the invoice.

(b) For invoices issued under sections 16.2 and 16.3 (for BPP Amounts):

- The scope for disputing such invoices would be limited to situations in which the Shipper is able to show that there is manifest error in the information used by Vector to calculate BPP Amounts; and

- As a result, there would be no requirement to pay not less than half of the disputed portion of the invoice (i.e. in this respect, the status quo would remain).

23. Finally, Vector is also conscious that Shippers currently have the ability under section 8.13(b) of the VTC to demonstrate to Vector's reasonable satisfaction

that they did not cause Vector to incur, or contribute to Vector incurring, peaking costs. To ensure that Shippers have the opportunity to demonstrate that they did not cause or contribute to peaking costs before an invoice is issued, Vector has developed a new process as set out in Schedule 2.

Nature, intended impact and effect of amendments

24. These amendments are consequential in nature – that is, they are necessary because of the proposed changes to the MPOC resulting from MDL's 13 October 2011 MPOC Change Request recommended to come in effect from 1 June 2013.

25. The intended impact is to make the balancing0 arrangements in the VTC and MPOC compatible, and to give effect to the causer pays objective that underpins the new B2B balancing arrangements.

26. The effects of this Change Request are:

    (a) Balancing costs will be more equitably allocated to those who caused them;
    (b) The causers of balancing costs will have greater incentives to manage their balancing position and reduce balancing costs;
    (c) The price signals of the B2B/causer pays balancing regime will not be diluted; and
    (d) A more appropriate sharing of user risks associated with exposure to balancing costs.

27. If this Change Request is approved, and Non-Code Shippers agree to similar amendments to their transmission services agreements with Vector, in each case prior to 1 June 2013, then Vector will be in a position to withdraw its Material Adverse Effect notice. This is because the amendments outlined above enable Vector to pass on the balancing costs it receives from MDL to the causers of those costs (ie Shippers) and significantly decrease Vector's exposure to balancing disputes, both of which mitigate the risks Vector faces in its current role as effectively a financial intermediary for balancing costs.

Effective date of change request

28. The Change Request will take effect on the same date as MDL's 13 October 2011 MPOC Change Request takes effect.

General

29. Unless the context requires otherwise, all capitalised terms in this Change Request shall have the same meaning given to them in the VTC.

30. By signing below, each person gives its consent to the amendment of the VTC, as outlined in paragraph 1 above. This document may be executed in counterparts, with all copies to be read and construed as one document.

Vector Gas Limited

Contact Energy Limited

Energy Direct New Zealand Limited

Genesis Power Limited

Greymouth Gas New Zealand Limited

Mighty River Power Limited

Nova Gas Limited

On Gas Limited

Vector Gas Contracts Limited

SCHEDULE 1: SUMMARY OF PROPOSED AMENDMENTS

Clause	Matter	Proposed amendment	Reasons for proposed amendment
1.1	New and amended definitions	New definitions: • "Peaking Charge" • "Peaking Allocation Methodology" • "Peaking Cost" Amended definitions: • "BPP Allocation Day" • "Cash-out" • "Shipper Allocation Formula" Removed definitions: • "ILON AEOI" • "ILON Compliance Period" • "Imbalance Limit Overrun Notice" • "Vector's Contribution"	The amendments to clause 1.1 are consequential upon the substantive changes to make the balancing arrangements in the VTC compatible with the balancing arrangements in the MPOC. The new definition "Peaking Charge" is defined by reference to the MPOC definition of "Peaking Charge". The definition of "Cash-out" has been amended to extend the application of the cash-out procedure in cls 8.19 of the VTC to situations where MDL buys or sells to Vector a quantity of gas pursuant to sections 12.10, 12.11 and 12.13 of the MPOC.
1.2(n) & (q)	Construction	These clauses hav been amended so that a reference to the MPOC includes a reference to the MPOC as amended or replaced from time to time. Before the amendment, any reference to a defined term in the MPOC meant a reference to the definition of that term as defined in the MPOC at 1	This amendment is necessary because the new definition of "Peaking Charge" refers to that term as it is defined in the current version of the MPOC.

		December 2007.	
8.2	Obligation to use reasonable endeavours to manage Running Mismatch	Each Shipper to use reasonable endeavours to manage its Running Mismatch.	This obligation was previously only triggered when an ILON was notified to Vector. Because the ILON process has been replaced, and cash-outs will occur without the issue of an ILON, an ongoing obligation is appropriate.
8.5	Procedure where Vector receives an ILON	Clause has been deleted.	The clause has been deleted as the ILON process has been replaced.
8.12	MPOC indemnity costs	Clause has been deleted.	The clause in the MPOC that required Vector to indemnify MDL has been removed due to the ILON process being replaced. As clause 8.12 concerned the procedure where Vector was required to make an indemnity payment, it has been removed.
8.13	Payments relating to Incentives Pool Debits and peaking	Clause 8.13(b) has been amended to: • include the situation of the payment of a Peaking Charge to MDL; • require Vector to apply the methodology to allocate peaking costs in new Schedule 9 when determining which Shippers are to pay peaking costs and in the calculation of the amount of costs each must pay; • include Vector in the allocation of peaking costs; and • clarify how much the allocation of peaking costs to Vector and Shippers is reduced when Vector has failed to act as a reasonable and prudent operator.	These amendments will: • ensure Vector is able to recover from Shippers any payment it makes for a Peaking Charge; and • provide Shippers with more certainty about how peaking costs will be allocated (including to Vector to the extent caused or contributed to by Vector).

8.24-8.25	Balancing and Peaking Pool and Payments from BPP Account	"MDL" has been added to the list of persons who may be paid out of the BPP Account.	The amendment is to reflect that the payment of the Peaking Charge is made direct to MDL.
16.17	Disputed Invoices	The clause has been amended to limit the scope for disputing invoices relating to balancing.	This amendment is necessary to avoid undermining the B2B balancing regime and to give effect to the causer pays objective that underpins the introduction of the B2B balancing framework.
Schedule 5, Table A	Information generally available on OATIS	Information types "Vector's Contribution to an Imbalance Limit Overrun Notice" and "Imbalance Limit Overrun Notices" removed from the Schedule.	These information types have been removed as the ILON process has been replaced.
New Schedule 9	Peaking Allocation Methodology	A new schedule containing the methodology to allocate peaking costs has been incorporated.	This is the methodology that Vector will be required to apply when determining which of Vector, Shippers and Non-Code Shippers are to pay peaking costs and in the calculation of the amount of costs each must pay.

SCHEDULE 2: PROCESS FOR SHIPPERS TO DEMONSTRATE PRIOR TO INVOICING THAT THEY DID NOT CAUSE OR CONTRIBUTE TO PEAKING COSTS

1. On or before the 2nd business day of a month (or as soon after as reasonably practicable) Vector notifies Shippers of the days and Welded Points in the previous month at which it expects (acting reasonably) to receive Peaking Charges/Peaking Costs from MDL.

2. On or before the 10th day of each month, Vector issues invoices to Shippers for Transmission Charges.

3. Vector receives an invoice from the Incentives Pool Trustee for Incentive Pool Debits (IPDs)

4. Vector receives an invoice from MDL for gas sold to or purchased from MDL to settle Accumulated Excess Operational Imbalance on the Maui Pipeline (cash outs).

5. As soon as possible, and in any event within 1 business day of receiving its invoice for Transmission Charges, a Shipper will provide Vector with information (if any) to demonstrate to Vector's reasonable satisfaction that it did not cause Vector to incur or contribute to Vector incurring the Peaking Charges or Peaking Costs.

6. Vector allocates the cash out costs, IPDs and Peaking Charges/Peaking Costs with respect to any previous Month to Shippers and itself.

7. On or before the 14th day of a month (or as soon thereafter as is reasonably practicable) Vector will issue to each Shipper an invoice for that Shipper's cash outs, IPDs and Peaking Charges/Peaking Costs with respect to any previous Month (which will include any adjustments for any Shipper that has demonstrated to Vector's reasonable satisfaction that it did not cause Vector to incur or contribute to Vector incurring the Peaking Charges or Peaking Costs allocated to it).