Vector Transmission Code 20 February 2009 Change Request Appeal: final recommendation

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GAS INDUSTRY COMPANY LIMITED

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About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

Its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy and Resources on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

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1 Introduction

Background

The purpose of this paper is to set out Gas Industry Co Limited's (Gas Industry Co) final recommendation on Vector Gas Limited's (Vector) 20 February 2009 change request appeal under the Vector Transmission Code (VTC).

Under the VTC, any party can request a variation or modification to, or waiver from, any provision of the VTC. Section 25 of the VTC sets out a process for considering such change requests, which includes compulsory consultation with all Shippers on Vector's transmission system. Under section 25.5(c)(i) of the VTC, 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

While performing its role in the appeal process in the VTC, 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 in the Government Policy Statement on Gas Governance (GPS) (together, the "objectives"). 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.

[1] VTC Section 25.7.

Gas Industry Co's final recommendation is binding on the parties to the VTC except to the extent that Vector has withheld its consent and the change would:

- require Vector to incur capital expenditure that it does not wish to incur or considers that expenditure to not be economically viable to incur; or

- require Vector to incur operating expenses or costs that it cannot reasonably expect to recover.

Even then, if another party is prepared to cover the cost, or Gas Industry Co regulates to recover the cost, then Vector is obliged to make the change[2].

Any recommendation made by Gas Industry Co shall be final and binding. Where Gas Industry Co is considering whether to support or not support a change that has already been made to the VTC, that change shall continue in full force and effect until otherwise notified by Gas Industry Co[3].

[2] See VTC sections 25.5(b)(i) and (ii), and section 25.8.
[3] VTC section 25.7.

2 The appeal

Introduction

On 21 January 2009, Vector initiated a change request titled 'VTC Change Request: BPP Trustee', which relates to the operation of the Balancing and Peak Pool Trustee Account. The BPP Trustee administers a mechanism included in the VTC that allocates the costs of balancing among Vector and its Shippers. Balancing costs include:

- payments made by Vector to Maui Development Limited (MDL) as a result of an imbalance limit overrun notice or incentives pool debit;
- payments made as a result of Vector taking its own balancing actions, such as purchasing balancing gas; and
- claims for non-delivery where a Shipper was unable to take gas to which it was entitled.

BPP costs are allocated proportionately among Vector and its Shippers according to a formula set out in sections 1 and 8 of the VTC. Gas Industry Co understands that Shippers with contracts that are not subject to the VTC (non-code Shippers) are allocated their share of BPP costs on the same basis as Shippers under the VTC.

Vector is the BPP Trustee.

The purpose of the change request is to grant the BPP Trustee the express power to borrow. This would allow the BPP Trustee Account to operate an overdraft.

Of the five Shippers who responded to the change request, three consented and two did not. Clause 25.5(c) of the VTC requires the consent of Vector and 75 percent of all Shippers who respond to a change request before the change can be made. The change request was therefore not successful and, on 20 February 2009, Gas Industry Co received an appeal from Vector (the appeal) to have the change allowed.

3 Process and submissions

On 10 March 2009, Gas Industry Co published the appeal on its website and notified relevant stakeholders. Submissions closed and were published on Gas Industry Co's website on 23 March 2009. Cross-submissions closed and were published on Gas Industry Co's website on 9 April 2009.

Submissions on appeal

Contact Energy Limited (Contact) did not support Vector's change request. Contact saw the main problem being that the VTC inadequately describes the operation of the BPP Trustee Account. It did not believe that those involved in negotiating the VTC had 'always contemplated' an overdraft facility, as Vector claimed. Contact believed that an overdraft facility on the BPP Trustee Account would result in 'innocent' Shippers covering cost created by 'guilty' Shippers. It suggested that allowing the BPP to operate in overdraft would make operation of the BPP unclear and mean that Shippers efficiently managing balancing would be exposed to the balancing costs created by other users of the pipeline. Contact considered this wrong and that socialisation of costs appeared contrary to the objectives under the Gas Act and GPS.

Contact submitted that it would be inappropriate for Gas Industry Co to support Vector's change request without addressing the underlying deficiencies in the BPP's operation.

Genesis Energy Limited (Genesis) submitted that it did not accept that it was necessary or desirable for the BPP Account to be able to go into overdraft. In its view, an overdraft facility would:

- reduce the incentive on the BPP Trustee to pursue slow payers;
- encourage VTC Shippers not to pay on the expectation that unpaid costs would eventually have to be socialised; and
- raise the issue of what should happen if the overdraft limit is reached.

Like Contact, Genesis Energy did not believe the ability to borrow was inadvertently omitted from the VTC, and cited various sections of the VTC to support its view. Genesis Energy also believed that it was feasible for the BPP Trustee to operate without an overdraft facility because 'all costs charged to the BPP are allocated to VTC Shippers'.

Nova Gas Limited (Nova) also submitted that it did not support Vector's appeal. Nova's opinion was that BPP payments should be limited to payments made into the BPP. This would give an incentive to the Trustee to pursue payments owing. It, too, was concerned about the possibility of socialised costs and innocent Shippers cross-subsidising those responsible for the owed amounts. Nova also agreed with Contact's concerns about the failure of the VTC to contain an express obligation on Vector to pursue non-code Shippers through the equivalent mechanism in their transmission services agreements. The lack of an enforceable obligation on Vector meant it would be possible for the BPP to build a large deficit.

Greymouth Gas Limited (Greymouth), On Gas Limited (On Gas), and Vector submitted in support of the appeal.

Greymouth Gas believed that the change request supports the principles of the balancing arrangements by allowing costs and benefits to flow to causers in a timely manner. It did not consider the cost of the overdraft to be an issue, because there are several ways in which it can be recovered.

On Gas suggested that it is not feasible to run the BPP Account without an overdraft function and it is more than likely that this was overlooked when the VTC was first drafted.

Draft recommendation

Following consideration of the six submissions and three cross submissions received on the appeal, Gas Industry Co prepared a draft recommendation. Gas Industry Co expected to release a draft recommendation on 29 April 2009, but decided that further specialist advice was required to conclude its analysis of certain aspects of the appeal. Publication of the draft recommendation was delayed until 9 June 2009.

In summary, Gas Industry Co's conclusions were as listed below.

Drafting errors

Gas Industry Co considered that it was required to analyse the change request whether it arose from a drafting error or not.

Liabilities for payments: current contractual arrangements

Gas Industry Co concluded that Vector's obligation in the VTC to pay balancing costs was the same whether balancing costs were charged to the BPP Trustee account or another Vector account.

Liabilities for payments: alternative contractual arrangements

Genesis proposed that Vector could behave in the same way as the electricity market clearing manager, who deals with non-payment or partial payment from purchasers by making pro-rata payments to generators. Gas Industry Co did not agree, but in any case, noted that its role in considering appeals is limited to determining if a change request should be adopted or not. It cannot determine that an alternative be adopted.

Behavioural assumptions: Vector paying balancing costs

Gas Industry Co noted that there appeared to be no legal or financial reason for Vector to behave differently depending on whether or not an overdraft facility existed. However, in section 1.9 of its 23 March 2009 submission Vector did posit that, in respect of making payments for balancing gas, its behaviour would be different if an overdraft facility existed. Gas Industry Co therefore tentatively concluded that suppliers of balancing services were more likely to be paid in a timely fashion if an overdraft facility existed.

Behavioural assumptions: pursuit of debts

Gas Industry Co concluded that Vector would be less likely to pursue debts if an overdraft facility existed. This was because, without the facility, if Vector was pursued by MDL (or any other balancing gas provider) to pay outstanding balancing costs, Vector would be more inclined to chase up payment from its Shippers.

Behavioural assumptions: behaviour of Shippers

Gas Industry Co believed that, if Shippers believed that Vector was less inclined to pursue payment, they would be less likely to pay balancing costs. This would apply if an overdraft facility existed.

Assessment against Gas Act and GPS Objectives

Gas Industry Co assessed its conclusions against the relevant Gas Act and GPS objectives. It considered that the relevant objectives were that:

- delivered gas costs and prices are subject to sustained downward pressure;
- risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties;
- the full costs of producing and transporting gas are signalled to consumers; and

- to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner.

In relation to these objectives, Gas Industry Co concluded that the provision of an overdraft facility would:

- put downward pressure on delivered gas costs;
- reduce operational and financial risks, and be neutral on efficiency risks;
- assist in ensuring that the full costs are signalled to consumers; and
- not necessarily lead to greater socialisation of costs.

Conclusion

Gas Industry Co supported the change request appeal, noting that this conclusion was consistent with its recommendation on Change Request 5 in the 9 October 2008 change request appeal[4].

Gas Industry Co acknowledged Shipper concerns that the risk of costs being socialised might be heightened by the absence of an express VTC obligation on Vector to pursue non-code Shippers to pay their share of any BPP costs owed. However, it suggested that this was best addressed by a VTC change request. Such a change could create an express obligation on Vector to pursue non-code Shippers and also address the concern about what would happen when the overdraft limit was reached.

Submissions on draft recommendation

Gas Industry Co only received one submission on the draft recommendation, from Vector.

In the submission, Vector agreed with the conclusions of Gas Industry Co's draft recommendation, but considered that it was necessary to restate its view on the intent of the change and comment on the assumptions Gas Industry Co had made about Vector's behaviour.

Vector provided further support for its view that the VTC was always intended to allow the BPP Trustee to borrow.

[4] See 9 October 2008 VTC Change Request Appeal on Gas Industry Co's website: http://www.gasindustry.co.nz/sites/default/files/u12/VTC_Appeal_9_Oct_08_-_final_rec_149334.1.pdf. Change Request 5 dealt with a proposal to ensure that BPP payments out of the pool did not exceed payments into the pool on the same gas day. Gas Industry Co did not support the appeal of Change Request 5 and determined that Vector's consent was validly withheld on that occasion.

Responding to Gas Industry Co's comment that '… it would have been helpful for Vector to have responded to submissions made to it on the original change request' (page 12), Vector noted that it had carefully considered such submissions. It concluded that only Contact had raised matters to which an answer would be necessary, and that such answers were effectively provided through the consideration of Contact's Change Request 5[5].

Responding to Gas Industry Co's comment that it would be helpful for appellants to be specific about which Gas Act or GPS objectives it believed to be relevant to the appeal, Vector noted that this was not part of the section 25 VTC Change Request process.

Vector agreed with Gas Industry Co's conclusion that there appeared to be no contractual reason to expect Vector to behave differently depending on whether there was an overdraft facility or not. Vector also noted that it did not believe that there was much choice of which route it could take to pursue debts; the VTC section 17 dispute mechanism was the only appropriate means of recovering unpaid amounts from Shippers.

Vector disagreed with Gas Industry Co's conclusion that Vector would be less likely to pursue debts if an overdraft facility existed. It considered that an overdraft facility would allow payments to be made to MDL on a timely basis, but would not be automatically resorted to. Vector had no obligation to pursue debts, and would do so at its discretion.

While Vector was unable to agree or disagree with Gas Industry Co's conclusion that Shippers would be less likely to pay BPP invoices if an overdraft facility existed, it noted that Shipper obligations under the VTC were the same whether there was an overdraft facility or not.

Overall Vector was equivocal about Gas Industry Co's conclusions, but commented that it endorsed '…any outcome that has the effect of reducing its operational and financial risk.'

Gas Industry Co analysis

Gas Industry Co notes that Vector's submission supported Gas Industry Co's draft recommendation. Nevertheless, for completeness, the matters discussed in the submission are briefly responded to below.

Gas Industry Co accepts that unless a VTC change request goes to appeal, Vector may not receive any substantive submissions on it. Common practice seems to be for a Shipper to submit only that it supports a change request or not, without providing reasons. However, where a Shipper does make a submission to Vector, Gas Industry Co believes that it is reasonable to expect that Vector should respond to it, even if that response is only to note that the matters raised have been previously responded to.

[5] See footnote 4.

In respect of the Gas Act and GPS objectives, Gas Industry Co accepts that these are not referred to in the section 25 VTC Change Request process. However, it should be clear from the MoU that Gas Industry Co will analyse an appeal with reference to these objectives. It would therefore be helpful for the appellant to be specific about which Gas Act or GPS objectives it believed to be relevant.

In the draft recommendation, Gas Industry Co reasoned that, if Vector was being pursued by MDL (or any other balancing gas provider) to pay outstanding balancing costs, Vector would be less likely to pursue its Shippers for allocated balancing costs if an overdraft facility existed. Vector disagreed with this conclusion. Gas Industry Co does not know which view is correct, but notes that if Vector is correct, the argument for allowing the overdraft facility becomes stronger, so Gas Industry Co's recommendation would become more robust.

4 Final recommendation

In accordance with section 25.7 of the VTC, and in respect of Vector's appeal of 20 February 2009 under the VTC, Gas Industry Co supports the change request appeal.

In accordance with section 25.5(c)(ii) of the VTC, the change must be made to the VTC with effect from the date specified in the change request: 1 January 2009. (Gas Industry Co notes that, although this retrospective date seems inappropriate for the current decision, the VTC does not allow for it to determine another date.)