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Dear Steve

**Submission on the Draft Concept Report on Gas Supply
and Demand Scenarios, 2012 - 2027**

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make a submission on Concept Consulting's draft report, *Gas Supply and Demand Scenarios 2012 - 2027* ("the Concept Report"), released for consultation by the Gas Industry Company ("GIC") on 6 September 2012.
2. No part of this submission is confidential and Vector is happy for it to be made publicly available.
3. Vector's contact person for this submission is:

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4. Vector appreciates the GIC commissioning the Concept Report, following Vector's request in September 2010 that the GIC consider producing a "set of independent forecasts [that will] provide valuable information that can be used by all parts of the gas industry, and the wider community, to facilitate planning".¹ An obvious potential use is for gas transmission and distribution asset management planning and investment.
5. It is clear from Vector's initial review of the Concept Report that it contains useful material and fills a number of information gaps, including signalling the directions of various segments of the gas market in the next few years. This is information that has been extremely difficult for Vector to access because much of the information in the Concept Report has not been readily made available in the sector or in the public domain before. The Concept Report begins to establish a good basis for investment and planning purposes and determining future use of gas in New Zealand. As such, it has the potential to be an important reference for decision makers in the New Zealand gas sector.

¹ Letter from Daniel McCarthy (Group General Manager Commercial, Vector) to Rt. Hon J.B. Bolger (Chair, GIC), Industry Demand Forecasting, 6 September 2010.

6. To enhance the value of the Concept Report, Vector encourages the GIC to publish, to the extent possible, the data relied on for the analysis undertaken in the report. This would enhance transparency, credibility and usefulness of the Concept Report and its findings by enabling its users to undertake analysis of their own. This could include analysis of 1) aggregate allocated delivery quantities for TOU-metered consumers and all other consumers by Delivery Point, 2) the inputs into the "simple model" used to illustrate the relative economics of new build boilers for industrial process heat, in particular, key input data such as the capital cost of different types and scale of coal or biomass boilers and fuel handling equipment, and 3) the assumed required rate of return on capex and amortisation period.

Limited consultation period

7. The limited consultation period the GIC has allowed belittles the potential and importance of the Concept Report. The provision of 12 working days for submissions (and, critically, six working days for review of the underlying spreadsheets) is inadequate for reviewing the Concept Report and assessing the assumptions used, especially given that this is the first time in the gas sector that information of such importance has been drawn together into one document.
8. The standard practice of regulators is to provide four-six weeks for consultation, particularly on issues of primary importance to industry and consumers. The timeframe provided for this consultation is, in Vector's view, a mis-judgement of the importance of a supply and demand study to the sector and an unreasonable expectation in general. Vector is concerned that the setting of unreasonable consultation timeframes could set a poor precedent for future consultation processes.
9. Consistent with good regulatory practice, Vector **strongly recommends** that the GIC develop, with industry participants, a "consultation charter" or "consultation guideline" that would set out principles and standards for consultation.² This would provide certainty for industry participants and clearly set out agreed expectations, including what a reasonable consultation timeframe should be.

Preliminary observations

10. As indicated above, Vector has only been able to undertake a preliminary review of the Concept Report. As a consequence, this submission is limited to high level comments on two specific examples. Vector uses these examples to illustrate that the Concept Report will need careful and considered review.

² As a matter of principle, Vector strongly believes in the standards for consultation established by case law, particularly in relation to the setting of consultation timeframes. This is reflected in the Electricity Authority's Consultation Charter:

2. Process for consulting on Code amendment proposals General consultation principles

2.1. When the Authority undertakes consultation on Code amendment proposals, it will design its process to comply with the basic standards for consultation established by case law – specifically the principles of consultation specified by the Court of Appeal in 1993. The Authority interprets those principles as being as follows:

...(b) **consultation must be allowed sufficient time, and genuine effort must be made.**

...(g) the Authority **must approach the matter with an open mind, and must be prepared to change** or even start a process afresh.

[emphasis in (b) and (g) added].

11. Given the limited amount of time made available for this consultation, and depending on how the Concept Report is subsequently used, Vector reserves the right to make further submission on the report, in its draft or final form, at a later date.

Example 1: How to adopt the Concept Report's demand growth forecasts?

12. As a next step, all the key supply and demand forecast inputs that could be useful for asset management planning and investment purposes should be identified and matched against the content of the Concept Report to find any gaps that need to be filled.
13. It is not entirely clear how the GIC envisages aspects of the Concept Report would be used for asset management planning and investment purposes. Purely by way of example, it is unclear how the Concept Report scenarios are intended to be used for demand growth forecasts.
14. A standard modelling approach is to adopt a "most likely" scenario and treat other scenarios as sensitivity tests around the core scenario.
15. Another approach, which the Electricity Commission adopted in its Statement of Opportunities/Grid Investment Testing, is to take a weighted average of the scenarios.
16. The Concept Report appears to rule out use of its scenarios in either of these ways with the statement that "It is important to emphasise that these price scenarios are not forecasts. Rather, they represent alternative 'futures' that could unfold over the 2012-2027 period." In Vector's view, this limits the usefulness of the report. The Concept Report should ensure that its scenarios are robust enough to be relied on for planning purposes.
17. The Concept Report also does not take the useful additional step of providing informed guidance about which scenario, or combination of scenarios, may be more likely over the timeframe by, for example, providing a weighting of the scenarios. Vector **recommends** that the Concept Report takes a view on a likely scenario, or combination of scenarios, to help inform long-term investment decision making and asset management planning.

Example 2: Conclusions about the Northern Pipeline

18. Vector agrees with the Concept Report's statement that "The existing pipeline system is expected to have sufficient capacity to accommodate the projected scenarios with higher demands."
19. However, Vector does not consider the Concept Report's subsequent claim that Vector's Northern Pipeline system is a "significant exception" to be well-founded.
20. The Concept Report's scenarios for the Northern Pipeline indicate that capacity constraints may remain for limited periods (approximately one week a year) and that anticipated demand growth does not justify capacity expansion.
21. Clearly, where capacity constraints are limited to a peak period, investment in an additional pipeline would only be economic where the value of lost load (VOLL) during the system peak exceeds the cost of expanding the capacity of the pipe. For example, the Concept Report's comparison of electricity prices with pipeline capacity cost figures on page 97 implies that "it would not be economic to invest

in pipeline capacity to enable uninterrupted gas-fired electricity generation during the gas peak week – even to accommodate infrequent dry years”.

22. The Concept Report also alludes to the fact that there are several options for capacity allocation during system peaks that could improve efficiency, and several options for reducing system peaks, e.g. power generators shedding demand and adoption of capacity pricing arrangements. Vector agrees with these statements but cautions against the Concept Report delving into policy matters such as how to deal with allocation of capacity during times of peak period capacity constraint. These are only some options to be considered in decisions relating to efficient use of the pipe, which could include revised access arrangements, different capacity products, decisions not to use the pipe at peak times, or investment in additional capacity. The role of the Concept Report is to inform these decisions, not to presuppose them.
23. Vector also considers that the credibility of the Concept Report is undermined by assertions about the Northern Pipeline, for example, the assertion that “a number of industrial stakeholders suggested they had been prevented from connecting due to unavailable pipeline capacity”. Vector considers that this whole section could be removed, including the hypothetical and discussions on interruptibility, without detriment to the report.

Closing comments

24. Vector agrees with the Concept Report that “The existing pipeline system is expected to have sufficient capacity to accommodate the projected scenarios with higher demands”. This statement holds regardless of whether the Concept Report’s scenarios are used for actual forecasts of future demand growth (as reflected, for example, in Vector’s Asset Management Plans).
25. It can be concluded from the Concept Report that capacity constraints on the Northern Pipeline are projected to remain limited to peak periods (approximately one week each year), which brings into question whether investment in a second pipeline could be justified, regardless of the basis of the analysis.
26. Vector encourages the GIC to establish an ongoing process for the development of gas supply and demand forecasting that:
 - a. is fit for purpose;
 - b. can achieve broad industry buy-in; and
 - c. is able to be used for planning purposes.
27. The time provided for consultation on the Concept Report was inadequate for this purpose. Vector would welcome the opportunity to further engage with the GIC on this process.

Yours sincerely



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