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Ian Dempster
General Manager Operations
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Dear Ian

Submission on the GIC's Statement of Proposal:
Downstream Reconciliation Rules Review

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on the Gas Industry Company's ("GIC") *Statement of Proposal: Gas Governance Downstream Reconciliation Rules Review*, released on 26 July 2012. Responses to the GIC's questions are provided in the Appendix.

2. Vector also appreciates the GIC's engagement with industry participants on this matter at the Retail Gas Governance Forum on 26 June 2012.

3. No part of this submission is confidential and Vector is happy for it to be made publicly available.

4. Vector's contact person for this submission is:

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The proposed changes

5. Vector supports most of the GIC's proposed changes to the Gas (Downstream Reconciliation) Rules 2008 ("the Rules"). In particular, Vector supports the GIC's proposals:

a. not to impose obligations on meter owners in the Rules. Vector agrees with the GIC that meter owners' obligations are sufficiently provided for in commercial agreements. Vector does not believe that more prescriptive industry arrangements, such as guidelines for metering contract terms, are necessary. Given the advent of new technologies, such as smart meters, regulation or greater prescription in a fledgling market could impose further costs without additional benefit to consumers. This would also send the wrong signal to those who are taking or willing to take the risk of investing in smart technologies;

b. retaining the exemption process, which would provide flexibility for unanticipated situations in the future;

c. codifying the exemption for unmetered gas gates and oversized meters while providing the GIC the discretion to reclassify their status when conditions at those gas gates change. Vector recommends that should conditions also change at gas gates that are currently metered (and not exempted), the same considerations should apply;

d. dealing with estimated daily energy quantities for both consumption and gas gate injected quantities (subject to amendments to the drafting outlined in the Appendix), which would remove the word "actual" throughout the Rules and introduce a new definition for "daily metered energy quantities". This would effectively allow the use of estimation by retailers and transmission system owners; and

e. amending the Rules relating to trading notifications, which would provide greater flexibility to industry participants regarding the timing of trading notifications without material impact on other industry participants.

6. The above changes had been explored extensively in the GIC's consultation on *Downstream Reconciliation Options* in February this year and by the Downstream Reconciliation Advisory Group over the past few months. Vector notes they are widely agreed, in principle, within the industry.

Audits

7. Vector prefers that the GIC's proposals in respect of performance audits be considered more broadly under the Gas (Switching Arrangements) Rules 2008.

8. Vector does not have any issues with providing the auditor more discretion in allocating the costs of event audits, and the audit of major system changes, subject to clear definitions and guidelines being released for industry consultation.

9. As a matter of principle, Vector believes the main purpose of audits, consistent with the efficiency objective of the Rules, should be to incentivise parties to

implement changes to improve the accuracy/reliability of their information, making the downstream reconciliation system more efficient and reducing costs for system users and consumers. This will also give allocation participants assurance that the information they rely on for their "daily metered energy quantities" is accurate and reliable.

Ongoing fees

10. Vector, however, does not support the GIC's proposal to retain the allocation of ongoing fees based solely on volume. The larger benefits that will accrue to retailers with higher volume consumption in the form of reduced Unaccounted-for-Gas ("UFG"), arising from efficiency improvements in the downstream reconciliation system, is in the real sense, not an "additional" benefit. If there was no UFG (i.e. in a totally efficient system), those retailers would have the benefit of avoiding that cost anyway.

11. The benefits from reduced UFG diminish over time as a more efficient downstream reconciliation system becomes the "new normal"; the benefits are time-bound. Should the GIC decide to maintain the status quo in the allocation of ongoing fees, Vector recommends that the fee structure be re-assessed when the incremental benefits from reduced UFG 'plateau' or zero out, which is forecast in the SoP to occur sometime between 2014 and 2015.

12. While the GIC indicates that there is no compelling evidence to shift to a 50:50 allocation based on volume and number of ICPs, Vector considers there is similarly no compelling evidence why it should be based on volume alone. Vector notes that in efficient systems, the recovery of fixed costs, which the GIC indicates comprise the bulk of the ongoing fees, is still influenced by the 'intensity of use' by system users. The ongoing fees are the only fees set by the GIC that are exclusively based on gas volumes.

13. Alternatively, Vector recommends that the GIC defer its recommendation on the allocation of ongoing fees, and consider this matter further for inclusion in the next SoP on Downstream Reconciliation that it intends to release in June 2013. Such consideration could possibly include seeking independent advice on the fairest and most efficient allocation and a cost-benefit analysis supporting the GIC's recommendation.

Future development costs

14. Vector recommends that future development costs be allocated on a 50:50 volume:number of ICPs basis, when there are no incremental benefits to be had from reduced UFG. This would be a significant improvement on the current allocation, as outlined above.

Yours sincerely

Bruce Girdwood
Manager Regulatory Affairs

Appendix: Vector's responses to specific questions

Question	Vector's comment
Q1: Do you agree that commercial arrangements provide sufficient obligations on meter owners for the purpose of the Rules? With regard to the suggestion by the DRAG, do you consider there is an identifiable market failure that merits Gas Industry Co developing a workstream on the creation of guidelines and/or principles for metering contracts?	Vector agrees that commercial arrangements provide sufficient obligations on meter owners in relation to the purpose of the Rules. It does not therefore consider that there would be additional benefits for industry and consumers from the establishment of a work stream to develop guidelines for metering contracts. The gas metering market is evolving with the advent of smart meters. In the electricity sector, Vector and other smart meter providers have demonstrated that the efficient, mass deployment of smart meters can be delivered, and this success should not be constrained by regulatory intervention or more prescriptive arrangements. In an evolving market, such arrangements may impose further costs without additional benefits to consumers. Retailers and distributors have the resources and capability to negotiate on a level playing field with meter providers (and vice versa) in complying with their obligations under the Downstream Reconciliation Rules. Intervention, through regulatory or industry arrangements, would constrain contracting innovation, stunt the development of emerging services, and generally impede the development of this market. Vector notes that the Government's Energy Strategy highlights the Government's drive towards improving energy efficiency levels across the economy. Smart technologies, including smart meters, have a major potential for improving not only network efficiency but also network reliability and consumer experience.

Question	Vector's comment
	More prescriptive arrangements do not contribute to achieving the Government's policy objective. Importantly, they could send the wrong signals to parties willing to take the risk and make investments in smart technologies.
Q2: Given that the review will cover all of the long-standing exemptions do you agree that the exemptions process should be retained?	Vector agrees that the exemption process should be retained, noting that this proposal has the unanimous support of industry participants. As the SoP indicated, the flexibility provided by the exemption process would be "useful if and when unexpected situations arise". Neither the GIC nor any industry participant could possibly forecast all eventualities, and there may be circumstances where an exemption would enable industry participants to better meet the purpose of the Rules, e.g. new or alternative processes that produce more accurate information. Retaining flexibility, even just for exceptional circumstances, is particularly important, given the impact of recent technological developments (e.g. deployment of smart meters, as stated above) remains to be fully appreciated. Possible changes in other parts of the gas sector may also have implications for the downstream reconciliation system that are not anticipated by the current or revised Rules, for example, recommendations for changes in transmission capacity arrangements arising from the GIC's Gas Transmission Investment Programme.
Q3: Do you agree with the proposal to codify a rule for direct connect gas gates? Do you agree with the	Vector agrees with the proposal to codify a rule for direct connect gas gates.

Question	Vector’s comment
creation of a new rule enabling Gas Industry Co and the allocation agent to access direct connect injection data as requested?	Vector recommends that all references to “direct connect gas gates” be amended to “single use gas gates”, which is a more accurate description of these gas gates. Vector does not agree with the proposal to codify a new rule for the GIC and allocation agent to access direct connect gas gate injection data. Industry arrangements are already in place to allow the GIC to access this data. Further, the allocation agent does not require this information to perform its role under the Rules.
Q4: Do you agree with the proposed rule for G1M gas gates? Do you agree with establishing the deterministic criteria for G1M gas gates in an industry determination?	Vector agrees with this proposal and supports the release of the draft determination on the parameters for determining G1M gas gates for industry consultation.
Q5: Do you agree with the proposed rule change for unmetered and oversized metered gas gates?	Vector supports this proposal, with a further recommendation below. Vector disagrees with the GIC’s view that gas gates with existing meters cannot be exempted in the future and must be replaced at the end of their life. The fundamental reason behind the proposed exemption for unmetered and oversized meters is that it would be uneconomic to install/maintain meters at these gas gates and it would make commercial sense for the transmission system operator to decommission these gas gates rather than install a meter. There may be circumstances in the future where replacing a meter at a particular gas gate is uneconomic, for example, due to significantly reduced demand at that particular gas gate since it was commissioned. A prescriptive

Question	Vector’s comment
	arrangement requiring the replacement of meters at the end of their life, despite changed circumstances, on the basis that a gas gate is currently metered, does not reduce the risk of that gas gate being decommissioned. While the possible non-replacement of existing meters is likely to be rare, Vector believes the principle underlying the proposed exemption should be applied consistently across all gas gates, currently metered or not. Vector recommends that the GIC, as part of its ability to add or remove particular gas gates from the list of unmetered gates and gates with oversized meters, establish guidelines setting out the basis on which existing meters need not be replaced in the future.
Q6: Do you have any comment on Gas Industry Co’s recommendation not to change the method of apportioning the ongoing fees?	Vector does <u>not</u> support the GIC’s recommendation not to change the method of apportioning the ongoing fees. While Vector agrees that retailers with large volumes benefit more compared to other retailers from efficiency improvements in the downstream reconciliation system in the form of reduced UFG, there is a point in the future when the magnitude of these benefits diminish and a more efficient system becomes the “new normal”. The benefits are therefore time-bound, i.e. it would not be ‘ongoing’ as the incremental amounts of UFG reductions become negligible/immaterial. Moreover, if there was no UFG, retailers with larger volumes would have the benefit of avoiding that cost anyway, so in the real sense, the anticipated benefit in the form of reduced UFG is not an “additional” benefit.

Question	Vector’s comment
	Should the GIC decide to maintain the status quo in the allocation of ongoing fees, Vector recommends that the fee structure be re-assessed when the incremental benefits ‘plateau’ or zero out, which the graph on page 33 of the SoP forecasts to occur sometime between 2014 and 2015. Another factor considered by the GIC is that “a large proportion of its costs are fixed” and “there is little correlation between ongoing costs and numbers of allocations”. In this connection, Vector argues that an efficient recovery of fixed costs is one that is based on the ‘intensity of use’ of a system. For example, vehicles going through a toll road pay 1) a fixed component, for the operator to recover the sunk cost and maintain the infrastructure and 2) a variable component, which is determined by the length of the toll road particular vehicles travel, i.e. where they enter and exit. Despite the fixed component being the same for all vehicles, those that use the toll road more times per day/week would still end up paying more of the fixed cost than those who use it less frequently. In downstream reconciliation, the number of transactions that are linked to particular industry participants (i.e. frequency of use of the system to attend to transactions caused by those industry participants) relative to others should be taken into account. If the GIC’s argument is that there is little correlation between ongoing costs and the number of allocations, then even an equal allocation of those costs to all industry participants would be a fairer allocation than the current arrangement. Taking into account the ‘intensity of use’ by various industry participants would go further in making the system even fairer and more

Question	Vector's comment
	efficient. While the GIC points out that there is no compelling evidence to shift to a 50:50 allocation, Vector considers there is similarly no compelling evidence why it should be based on volume alone. The fact that there has been no consensus on this issue for years reflects that current arrangements have not fundamentally addressed this issue, and that they do not unambiguously better meet the fairness and efficiency objectives of the Rules. It distorts market incentives and penalises the customers of those bearing a disproportionate share of the ongoing costs. Vector further notes that the ongoing fees are the only levies/fees set by the GIC that are exclusively based on gas volumes. The switching and registry costs are allocated based on the number of ICPs held and the GIC levy is a hybrid, reflecting both gas volumes and number of ICPs. Vector recommends that the GIC defer making a recommendation on the allocation of ongoing fees and give it further consideration and/or seek independent advice, for inclusion in the second SoP on Downstream Reconciliation Rules that it intends to release in June 2013. Vector further recommends that future development costs be allocated on a 50:50 volume:ICP numbers basis, when there are no incremental benefits to be had from reduced UFG. This would be a significant improvement on the current allocation, as outlined above.
Q7: Do you agree with the proposed rule enabling the correction, where necessary, of an AUFG factor if it is	Vector agrees with this proposal and recommends that the GIC is required to

Question	Vector's comment
found to be incorrect?	consult allocation participants before determining whether an AUFG correction is required.
Q8: Do you agree with the proposal for dealing with estimated daily energy quantities?	Vector generally agrees with this proposal but proposes the following amendments to the definition of "daily metered energy quantities" (page 41 of the SoP): **daily metered energy quantities** are quantities from gas measurement systems with ~~a datalogger or corrector~~ equipment fitted that records daily information or other devices used for a similar purpose in the future,~~. If no~~, provided that if reliable data is not available at the relevant time, the relevant energy quantities will be ~~determined in accordance with~~ the responsible allocation participant's best estimate at the relevant time determined in a manner consistent with:— **(a)** Schedule 1 for [gas quantities submitted under rules 31.1, 32.1, 33.1 or 44.1 (as relevant)/**consumer installations** in **allocation groups** 1 and 2]; or **(b)** The relevant **transmission services agreement** for [gas quantities injected at an **allocated gas gate**/information submitted under rule 41 or 44.1 (as relevant)]."... Schedule 1 was written specifically to apply to meters for consumer installations in allocation groups 1 and 2. Vector considers that Schedule 1 is not comprehensive enough to adequately cover all of the situations that may

Question	Vector’s comment
	require a metering correction for a gas gate meter because metering at the gas gates is often of different design to consumer installation meters. Further, section 11.5 of the Vector Transmission Code (part B of Vector’s standard transmission services agreement) requires Vector to correct metered quantities in accordance with the Metering Requirements (as defined in the Code).
Q9: Do you agree with the proposal to amend the rules relating to trading notifications?	Vector agrees with this proposal, which provides greater flexibility to retailers regarding the timing of trading notifications. It commends the GIC for undertaking a quantitative cost-benefit analysis to support this recommendation.
Q10: Do you agree that a rule should be created enabling performance audits to cover the accuracy of data population in the registry? Do you think that audits should be limited to certain fields relevant to reconciliation or would you prefer broader audit arrangements contained within the Switching Rules?	Vector prefers that this proposal is more broadly considered under the Gas (Switching Arrangements) Rules 2008. As a matter of principle, Vector believes that the primary purpose of audits should be to incentivise industry participants to implement changes that would improve the accuracy of their information and the efficiency of their systems and processes. This will also give allocation participants assurance that the information they rely on for their “daily metered energy quantities” is accurate and reliable.
Q11: Do you agree that rule 75 should be amended to allow the auditor more discretion in determining who should be responsible for paying the costs of an event audit?	While Vector agrees that the auditor should be given more discretion in the allocation of event audit costs, the general parameters of how the costs would be allocated should be clearly defined.

Question	Vector's comment
	Vector recommends that the GIC publish for industry consultation draft principles or guidelines that would guide the auditor in allocating the costs of event audits.
Q12: Do you agree that a rule should be created to require audits of major system changes? If so, do you agree that a post go-live audit should also be required? Do you think the definition of "major" should be specified in the Rules or in an industry guideline?	Vector agrees with this proposal and prefers that clear definitions on what a "major system change" be specified in an industry guideline rather than the Rules. An industry guideline would provide greater implementation flexibility for this new rule, which is likely to be applied to one-off (i.e. not regular), changes. The industry guideline should be cognisant that industry participants do not use the same systems and processes; what is effective and efficient for one industry participant may not be for another. Importantly, it should provide guidance on how disputes on interpretation would be resolved. Two audits for a system change seem excessive. While a pre-system change audit is mandatory, a post-system change audit should be at the request of the GIC.
Q13: Do you agree that rule 42 is redundant and should be deleted from the Rules? Will your organisation be adversely affected by its removal? Should the obligations in rule 28.4 be extended to transmission system owners?	Vector agrees that rule 42 is redundant, as unvalidated day-end gas quantities are now available to Shippers on OATIS pursuant to Schedule 4 of the VTC. It should therefore be deleted. There is no need for obligations in rule 28.4 to be extended to transmission system owners. Vector believes current contractual arrangements are sufficiently clear regarding various parties' obligations around data integrity.

Question	Vector's comment
Q14: Do you support the proposal to allow allocation participants access to the GAR170 report? If not, would you support disclosure of submission information consistent with the SupSub report?	If the cost of allowing all industry participants access to the GAR170 report is zero or negligible, Vector has no objection to this proposal. Otherwise, Vector questions its wider benefit, given that some participants may not need or want to access or fully access this report. In such a case, the costs of providing this report and associated system changes should be borne only by interested industry participants (i.e. those who indicate that they require this report). This is akin to a subscription fee, which is consistent with the "user pays" principle.
Q15: Do you agree with the minor and technical amendments proposed in this section? Do you agree that the proposals meet the criteria in section 43N(3) of the Gas Act?	Vector agrees with the minor and technical amendments proposed.
Q16: Do you have any comments on the transitional issues discussed in this section?	Vector supports the extension of all current exemptions by a year to enable a smooth transition to any new/amended Rules. It would be helpful if clear implementation timelines of the new/amended Rules are announced with sufficient notice. As there may be requirements proposed in the SoP that are more appropriately complied with outside the Downstream Reconciliation Rules (e.g. under the Switching Rules or through a voluntary agreement), it should be made clear under which rules, regulations, or arrangements specific requirements are to be submitted. As indicated in our response to Q6, Vector agrees with the GIC that the costs

Question	Vector's comment
	of future developments, necessitated by the rule changes, be allocated based on a "beneficiary pays" (or "causer/user pays") principle. As a starting point, Vector considers a 50:50 allocation based on volume and number of ICPs would be an improvement on the current system of allocating costs based on volume alone. The likely role of DRAG going forward should also be signalled. Vector has no issues with other industry participants not represented on the DRAG attending parts of DRAG meetings that are relevant to them.