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Vector Limited

101 Carlton Gore Road
PO Box 99882, Newmarket
Auckland 1149, New Zealand
www.vector.co.nz

Corporate Telephone
+64-9-978 7788

Corporate Facsimile
+64-9-978 7799

Energy Markets
Ministry of Business, Innovation and Employment
33 Bowen Street
Wellington 6011

By email: energymarkets@mbie.govt.nz

Submission on Worley Parsons' Gas Disruption Study

Introduction

1. Vector Limited ("Vector") welcomes the opportunity to make this submission on a report by Worley Parsons, *Gas Disruption Study – Report on the Potential Impacts on the NZ Gas Market* ("the WP Report"), dated January 2014.
2. The WP Report, commissioned by the Ministry of Business, Innovation and Employment ("MBIE"), "examines the likely consequences of a major gas disruption event within the New Zealand gas market and the risk management approaches applicable to reducing the economic losses that might arise". Through a series of scenarios based on credible loss events, the WP Study "assesses the impacts on the industrial and electricity markets and considers response strategies".
3. We find the assumptions and findings of the WP Report generally reasonable, but are concerned that, as a gas transmission system owner ("TSO") and former Critical Contingency Operator ("CCO"), we have not been consulted earlier in the course of this study. Had we been consulted, we believe we could have provided useful input to inform the report. We would be happy to engage with WP or MBIE to help them update the report based on our information and expertise.
4. We provide comments on and propose changes to various parts of the report below, including on investment incentives.
5. No part of this submission is confidential and we are happy for it to be made publicly available.

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

Luz Rose
Senior Regulatory Analyst
Luz.Rose@vector.co.nz
(04) 803 9051

Updating the WP Report

7. Vector finds the assumptions used in the WP Report generally reasonable. We agree with the Report's conclusion that "the New Zealand gas supply system has a high degree of reliability and that existing industry operating standards and market structures pose no undue threat to security of supply".
8. We note that the WP Report is dated January 2014 but was only issued for consultation in June 2014. Parts of the WP Report do not reflect various developments in recent months, which in a broad sense, reinforce the above conclusion. These include, among others:
- a. the development of emsTradepoint (formerly emTrade) as a liquid spot gas market, which went live in November 2013;
 - b. implementation of the new/amended Gas Governance (Critical Contingency Management) Regulations ("CCM Regulations"). The amended CCM Regulations were adopted in November 2013 and went live on 1 March 2014;
 - c. the first exercise conducted by the CCO under the new CCM Regulations, held on 25 June 2014;
 - d. establishment of WorkSafe NZ in December 2013; and
 - e. establishment of the Gas Industry Transmission Access Working Group ("GITA Working Group"). We describe the Working Group's ongoing initiatives below.

Initiatives by the GITA Working Group

9. One of the significant developments since the WP Report was released in January 2014 is the establishment of the GITA Working Group. The Working Group is facilitated by Vector and Maui Development Limited ("MDL") and comprises representatives from TSOs and Shippers.
10. The Working Group is developing "a programme of work to evolve towards a compatible set of access and capacity pricing arrangements" across both the Vector and Maui pipeline systems. This is broadly in line with the recommendations of the Panel of Expert Advisers that advised the Gas Industry Company ("GIC") on its Gas Transmission Investment Programme.

11. A range of gas transmission issues being considered by the Working Group are also raised in the WP Report. These are outlined below.

a. Gas quality

The Working Group is considering this issue in conjunction with the GIC's work on gas quality. Following an investigation of gas quality issues and consultations with stakeholders, the GIC concluded in 2012 that it had:

...no reason to doubt that gas quality is being managed by parties in the physical supply chain in a rigorous and professional manner. However, [it] believe[s] that that small possibility that a gas quality incident could cause serious economic and reputational harm, coupled with 'common pool' features of gas pipelines, puts a particularly heavy onus on the industry to ensure a high degree of transparency. Also, the introduction of the Gas (Safety and Measurement) Regulations 2010 has clarified the responsibility gas wholesalers and retailers have for gas quality. Demonstrating compliance with this responsibility will also require greater transparency.¹

As part of the Working Group's scope of work, Vector and MDL are examining (with a view to updating if necessary) their gas quality arrangements to reflect recent regulatory changes and ensure technical obligations on pipeline users match the requirements of NZ5442. A separate Shippers' working group is considering the merits of a Gas Information Exchange Protocol initiated by gas retailers and how industry participants can best demonstrate their compliance with the relevant regulations.

b. Gas capacity

The Working Group is considering a new market design for capacity allocation to manage congestion on the transmission system. This could include a semi-interruptible product to enable gas to flow to its highest-value use during periods of physical and/or commercial scarcity.

c. Transparency

The Working Group's broad objective is to move from a presumption of confidentiality to a presumption of disclosure of information. With Shippers' agreement, additional information is already available on the Open Access Transmission Information System ("OATIS") and this is expected to be widened further by a draft change request to the Vector Transmission Code ("VTC") which is currently under consultation. In the long term, this could involve replacing OATIS itself for a more effective information and transaction management system.

¹ <http://gasindustry.co.nz/work-programme/gas-quality>

TSOs and gas distribution businesses subject to price-quality regulation under Part 4 of the Commerce Act 1986 are also subject to comprehensive information disclosure requirements, for example, through their Asset Management Plans.

12. While the Working Group is working on the above issues, the GIC is developing a regulatory counterfactual as a 'backstop' solution to GITA. Vector, and most of the Working Group members, have expressed preference for industry solutions over regulated arrangements.
13. We suggest that the WP Report be updated to reflect the above developments in relation to the GITA Working Group.

Market development

14. The WP Report suggests that "a gradual evolution towards a more liquid secondary gas market will help mitigate the economic impacts of gas supply interruptions by enabling limited supply to be allocated to parties who value it the most during a period of gas supply curtailment".
15. The existence of a dynamic secondary market implies that trading could be possible or could resume between specific parties during a critical contingency, particularly during long outages (for example, gas could flow into curtailment bands that require it, or require it more, during an event). A 'recalibration of the market', where parts of it could function and other parts cannot, could occur at that point in time.
16. This raises the issue of identifying the exact point(s) at which the CCM Regulations can 'exit' (or for trading parties to cease from being subject to the CCM Regulations) and for the 'spot market' to take over, at least in some areas. What is the role of the CCM Regulations where it is possible for pockets of trading to occur during a critical contingency event? Vector considers there are currently insufficient guidelines to determine when the CCO should terminate a critical contingency before supply is restored to pre-critical contingency levels.
17. Market development could also involve developing some investment tests, should new investment be contemplated.

Comments on investment incentives

18. The WP Report speculates on Vector's investment incentives and how they may be affected by the current regulatory regime, specifically Part 4 of the Commerce Act. Vector was not consulted by the authors of the WP Report; thus, the speculation should not be seen as reliable. We request the removal of references to Vector's investment levels and incentives from the WP Report for this reason. These include

the last two paragraphs on page 66, the first and fourth paragraphs on page 67, the last two sentences of the third paragraph on page 68, and any other similar references in the Report.

19. For the record, Vector can only make investment decisions when it has relative confidence that the decisions will produce a return on investment over the lifetime of the invested-in assets that both equity and debt investors in Vector would regard as satisfactory for a utility business.
20. At present, Vector has concerns that current regulatory settings pose risks to investors in long-life assets as recovery of investments is currently back-loaded, increasing the risk of stranding if supply contracts or technological changes reduce demand. These concerns have been exacerbated by the recent review of the cost of capital range, and the proposal to reduce the Weighted Average Cost of Capital used for price setting purposes from the 75th to 67th percentile. This has increased the risk of unexpected ad-hoc regulatory interventions and reduced confidence in the current regime – a situation that does not promote confidence for investors.

Comments on specific sections

21. We set out below our comments and proposed amendments in relation to specific sections of the WP Report.

Page / Section	Comment / Proposed Amendment
References to “commercial” and “small” customers throughout the WP Report	The terms “commercial” and “small” customers should be clearly defined in the Report.
Page 11, second paragraph	MPOC and VTC are <u>multilateral</u> , not bilateral, arrangements.
Page 27, fourth paragraph	<p>The entire paragraph below is true only for gas transmission pipelines. The gas distribution system is constricted to particular standards.</p> <p>Most pipelines have been certified or re-certified to AS 2885 – we are not aware of any pipelines that are managed to an alternative code. Part 3 of the code provides comprehensive mandatory requirements and guidance for the establishment and administration of the Integrity Management System. The code effectively describes and mandates a specialised form</p>

Page / Section	Comment / Proposed Amendment
	<p>of a quality management system (including quality assurance and continual improvement processes) for managing the pipeline. Adherence to the code must be certified by an independent inspection body – the certificate of fitness issued by the independent inspector must be current for the pipeline to continue to operate.</p>
<p>Page 71, second to the last paragraph</p>	<p>Vector complies with the Gas (Safety and Measurement) Regulations 2010 through our Pipeline Management System and Safety Management studies, among other regulatory compliance activities.</p>
<p>Page 73, last paragraph</p>	<p>This statement seems to imply that Vector has not done “geotechnical assessments”. We have investigated this aspect as part of our Safety Management studies.</p> <p>We suggest the removal of this paragraph from the WP Report.</p>
<p>Appendix</p>	<p>The Appendix appears to be a ‘wish list’ of processes that a pipeline owner should undertake.</p> <p>As stated above, Vector complies with its requirements under the Gas Safety and Measurement Regulations and other relevant regulations. We are an active participant in the GITA Working Group that is looking into gas quality issues, which has implications for gas safety. Further activities need to be supported by a clear business case that takes account of the regulatory environment. The items in the Appendix generally do not meet this standard.</p> <p>As stated above, Vector’s expenditure and investment decisions are subject to regulatory settings under Part 4 of the Commerce Act, which sets default price-quality paths for regulated gas transmission businesses (or customised price-quality path should a regulated business seek this option).</p>

Concluding comment

22. We are happy to discuss with MBIE officials any aspect of this submission, including providing an update on the GITA Working Group. The Working Group's quarterly reports can be found on <http://gasindustry.co.nz/work-programme/gas-transmission-investment-programme?tab=2136>.

Yours sincerely

A handwritten signature in blue ink that reads "B. Girdwood".

Bruce Girdwood
Group Manager Regulatory Affairs