

Gas Industry Co
Industry Conference 2009
“Making Gas Markets Work”

Intercontinental Hotel
Wellington, New Zealand
Wednesday 11 August 2009

Industry Quest for Gas Utopia



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Introduction

Agenda – The Vision

In preparation for today's presentation, I asked an industry participant what they would like me to talk about.

The answer first surprised me, and then I thought it was a useful challenge. It was along the following lines:

"I want to hear about your vision for the future. We are all working very hard for you at the moment – as well as doing our day jobs – and I want to know where this is all going, I will feel better about doing this work if I know what it looks like."

I thought this was a question that would resonate with many of you.

We often get caught up in our 'day jobs' and lose sight of what the destination is, and how far we are along the road.

Industry on Quest

Essentially, the answer is that this industry is on a quest, and the quest is to improve the efficiency of the gas sector whilst ensuring the benefits of this efficiency flow down to all gas consumers.



But, like it or not, we are all on the same journey, and we can each help or hinder the quest.

The Destination for the Quest

The destination is an efficient gas industry:

An efficient gas industry is one where there is a competition between producers, wholesalers and retailers:

- New supplies are progressively introduced as reserves are depleted (Producers are happy to find gas when they go looking for oil as they are readily able to get that gas to market);
- Wholesale and retail customers (the electricity generators, petrochemical plants, industrial, commercial and residential users of gas) all have good information about their supply choices and are able to contract for supply on terms which meet their different business needs;
- If long term contracts are entered into there are no barriers to on-selling the gas to third parties (so resources can be efficiently allocated along the supply chain); and
- There are also no barriers to competition at the retail level - customers are readily able to switch suppliers and there are efficient arrangements for reconciliation of gas quantities transported through common networks.

An efficient gas industry is also one where gas transportation services are available between production or storage sites, and end users or distribution networks, so gas can be freely traded.

This requires that:

- Pipeline companies have incentives to invest in new infrastructure;
- New and existing users have a clear understanding of the interconnection and access arrangements that apply to them. (In other words you should not need 30 years in the industry and an affinity for anagrams to understand how to get your gas from point A to point B on a relatively simple linear pipeline network);
- Access terms should be fair and reasonable, so that pipeline companies and shippers have confidence that access rules strike a reasonable balance between the interests of different parties, and are able to be changed to meet changing circumstances;
- Legal remedies are available in a timely and economic manner to address any breaches of the agreed rules;

- There is confidence that competition is occurring on fair terms i.e. that the ownership structures do not create opportunities for cross-subsidisation or unfair access arrangements; and
- The rules to ensure a secure and safe supply are clearly defined in a way which creates the least possible impact on market trading.

The destination also involves a fair gas industry.

A fair gas industry is one where back-stop arrangements are in place to protect those with the least market power – domestic and small business consumers.

Nature of the Quest

Is the quest real?

I have described a gas Utopia – an efficient gas sector delivering fair outcomes to its consumers.

As you all know Utopia is the name of an ideal community or society taken from the title of a book written by Sir Thomas Moore, back in 1516, describing a fictional island in the Atlantic Ocean which possessed a seemingly perfect social, political and legal system.



So, is our Utopia just as fictional?

I don't believe so. New Zealand can have an efficient and fair gas industry if it continues to encourage indigenous production, improve access to the key infrastructure, enhance the market discovery process and provide safeguards for the consumers of relatively small quantities of gas.

What is the route?

How do we get there?

Well, old sages have gazed into the future and mapped out a route. The old sages are a succession of consultants and policy advisers starting with the ACIL Consulting Group in 2001. The industry has also had a say along the way in a variety of consultation processes, led by the Ministry of Economic Development.

The current map for the industry is laid out in the April 2008 Government Policy Statement on Gas Governance, affectionately known to us all as “the GPS”.

The GPS sets out 16 different outcomes for the industry to pursue. For convenience these can be grouped into five different priority subject areas. In our ‘quest’ these can be thought of as ‘challenges’ each of which must be mastered. Each challenge we master will bring us closer to our Utopian goal.

The ‘challenges’ are:

1. Infrastructure Access
2. Wholesale Markets
3. Retail Markets
4. Consumer Arrangements
5. Advice on Strategic Issues



Who is in charge?

Gas Industry Co has clearly been given a leadership role by government and by the industry. However, we see this quest as a partnership. We need the support of all stakeholders – industry, government and consumers to design and implement new gas governance arrangements to master these challenges.

In some instances, it makes sense to leave industry arrangements as they are, if they will take us closer to our Gas Utopia. In others we will:

- Adjust the arrangements, if they are only slightly off target; or
- Rewrite the arrangements, if they are taking us in totally in the wrong direction; or
- Where no arrangements exist, write new arrangements.

So how are we making out on our challenges?

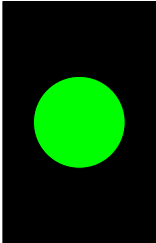
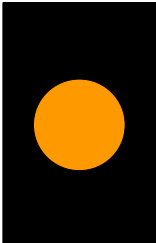
In the next section of my presentation, I will give you a quick progress report in the form of a 'traffic light score card'. I realise it may be a risk to give you a score card in the form of red, orange and green lights so I should start with a comment on the milestones on which the scores are based.

The milestones in this report come from our Strategic Plan and were set as stretch targets – designed to motivate the industry on its quest – not soft targets that we knew you would be able to meet even before we started the trip.

So the message is: do not get disheartened by the red or orange circles – we will get there!

Infrastructure Access challenge

The first challenge is infrastructure access. The challenge is to ensure that new and existing users can access essential infrastructure on reasonable terms.

	Access to gas processing <ul style="list-style-type: none">● The Gas (Processing Facilities Information Disclosure) Rules 2008 came into effect Jun 08● Ongoing role to manage/analyse disclosures● Report to Minister on whether further regulation is required by Apr 2013
	Transmission open access <ul style="list-style-type: none">● Minister has accepted recommendation from GIC that work be progressed by way of targeted focus on particular issues● Some milestones not met● Recommendation on balancing this year, other issues to address

Later on this morning, Ian Wilson is going to talk about what this involves so I will simply report that we have made good progress on the Gas (Processing Facilities Information Disclosure) Rules which came into effect in June 2008 but have had a setback on transmission access as we have had to reposition this work stream around targeted

intervention rather than a framework approach as we described to you at last year's Industry Conference.

Wholesale market challenge

The basic challenge is to ensure that wholesale markets function well. This means there are no barriers to trading and the market discovery process is as efficient as possible. The GPS maps out two immediate tasks.

	<p>Wholesale market trial</p> <ul style="list-style-type: none">● Original milestone for go-live was Jun 08 but deferred to address new issues● Implementation of trial depends on progress with MPOC and OATIS
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Wholesale Market

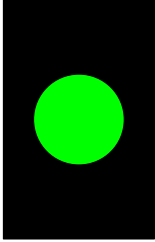
One involves the development of a formalised secondary market for the trading of gas. This is seen as important for fostering flexibility, transparency and competition. One of the challenges with developing a formal trading platform has been the need to keep implementation costs low and as part of that, to tailor the design to fit within existing transmission arrangements.

These factors have meant for us the design issues have been significant. Although we were able to quickly reach agreement with the industry on the concept of a trading hub, industry participants were uncomfortable with the costs of our first design so we have had to develop another and this meant we missed the original date for go-live.

We are now proposing a model which has Gas Industry Co taking responsibility for balancing the trading hub on an interim basis for the purposes of a trial with MDL cashing out any remaining imbalance at the end of each day. We are discussing with MDL the changes which might be required to implement this design. Once this step is complete we will need to follow the industry code change process and, subject to the outcomes of that process, should be in a position to start the trial.

Contingency management

The other task in the wholesale market challenge has been the development of new arrangements for the management of gas shortfalls in the event of a critical contingency occurring.



Contingency Management Regulations

- Commencement date of regulations in Dec 08
- Go-live delayed as plans not yet approved by experts
- Go-live date depends on TSOs delivering compliant plans
- Thereafter ongoing oversight role

The Gas Governance Contingency Management Regulations commenced on 4 December 2008, but do not go live until critical contingency management plans prepared by the pipeline companies have been approved.




Three cycles of proposed plans have been submitted, reviewed by the Expert Adviser, and subsequently rejected. The key sticking point has been the resolution of the critical contingency imbalance methodology. However, I believe we are edging closer to approval.

So we are in reasonable shape on this challenge and I think we have all learned a good deal from the obstacles encountered on the way.

Retail market challenge

The retail market challenge is to put in place the building blocks for increased retail competition.

Since the last conference, new rules have come into effect for the reconciliation of gas quantities in the downstream markets and for switching customers. We also have regulations to ensure compliance with the new rules.

	<p>Downstream reconciliation</p>
	<ul style="list-style-type: none"> ● Go-live was Oct 08 ● Involved development of allocation system and appointment of allocation agent ● Ongoing market operations ● Policy review planned for next year
	<p>Customer switching</p>
	<ul style="list-style-type: none"> ● Go-live was Mar 09 ● Included development of registry platform and appointment of registry operator ● Ongoing market operations
	<p>Compliance and enforcement</p>
	<ul style="list-style-type: none"> ● Regulations come into force Sept 08 ● 1st Rulings Panel hearings are expected in Q1 FY2010 ● Ongoing market operations

Since the last conference, new rules have come into effect for the reconciliation of gas quantities in the downstream markets and for switching customers. We also have regulations to ensure compliance with the new rules.

Implementing the new rules and regulations has been a huge focus for Gas Industry Co and the industry.

It has involved:

- Appointing service providers, investigators, industry experts and the Rulings Panel;
- Development and implementation of two complex IT systems;
- Establishment of new processes for tasks we have not done before like deciding whether to do a special allocation or event audit; and
- Consideration of 53 exemption applications.

In some ways, it is like we have gone through a second establishment phase – such has been the scale of the new work.

From my perspective, the new systems are now functioning effectively and the transition to a rules based central service provider model and tailor-made compliance regime has been achieved smoothly.

I suspect there are others in GIC and the industry who are probably just feeling exhausted and have yet not realized how much they have achieved on this challenge.

Consumer outcomes challenge

Another important part of the journey to Gas Utopia relates to the need to ensure there are back stop arrangements to protect consumers particularly because of their inferior bargaining power.

Attendants at last year's Industry Conference may recall that the Minister of Energy, observed that:

'A major challenge for the gas industry is to meet consumer expectations in the light of ever increasing energy costs. Many of the objectives in the GPS aim to ensure consumers get a fair deal.'

The Associate Minister of Energy and Resources told us this morning that:

'Another major challenge for the industry is to accept that in the contemporary society, consumer rights and satisfaction is paramount. Any industry that aspires to grow needs to take into consideration consumers' feedback and complaints.'

The GPS includes requirements that:

- Consumers have effective access to a complaints resolution scheme; and
- Contractual arrangements adequately protect the long term interests of domestic and small business consumers.

Unfortunately, it feels like we have not got past level one in our quest to deliver these tasks. This is partly because of an early decision we made to work within existing industry arrangements.

Consumer complaints



Consumer complaints

- Deferred to enable industry to further develop its industry scheme
- Depends on agreement between government, industry & regulatory agencies on scheme design

The EGCC scheme was originally recommended to the Minister in March 2005 but the Minister deferred approving it until it was extended to cover land complaints. This extension was done and the scheme again recommended for approval in May 2007.

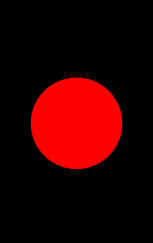
The Minister then made a second deferral decision, this time to enable a parallel recommendation to be made in respect of electricity complaints. This was sensible as the small size of the gas industry does not justify a stand alone scheme.

We are currently in a joint project to finalise a suitable provider with the Electricity Commission. After a contestable tender last year, the EGCC emerged as a front runner, but, this ranking was conditional on scheme members making changes to their constitution. Unfortunately, this did not occur at the first vote as there were some other matters in the scheme the members wanted to address.

We have now given the industry additional time to amend their scheme and I have a high level of confidence that we will get there. However, we have taken longer than we originally forecast when mapping out our activities for this year's Strategic Plan.

Retail contracts

The challenges in addressing consumer complaints scheme have had a flow on impact on the work on retail contracts. Originally, the two projects were connected as the Model Contracts Working Group recommended that the EGCC code of practice could be evolved into an industry benchmark retail code.



- Recommendation to Minister due in Dec 09
- Work delayed due to spill-over effect from EGCC scheme
- Options paper released before the end of the year

Following consultation, we have now decided that retail contract benchmarks should be addressed separately from the code of conduct.

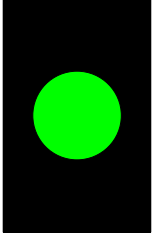

We are currently preparing an options paper on retail contracts. It is expected the options to be consulted will include:

- Publication of recommended minimum terms and conditions (with voluntary disclosure on the extent of adoption); and
- Regulation for mandatory minimum terms.

We are very aware that any regulatory solution needs to be carefully designed so as not to impose undue costs on participants and the consumer. For this reason we do not favor full regulation of contracts. We think the costs would be prohibitive.

Strategic advice challenges

The final set of challenges in the GPS relates to assessing the state of the sector and the effect of existing policies and new arrangements.

	<p>Review performance and present state of gas sector</p> <ul style="list-style-type: none">• The Allen Report, prepared in 06• Reviewed the state & performance of industry• Plan is to complete review in FY2011
	<p>Advice on the direct use of gas</p> <ul style="list-style-type: none">• Work is underway

This challenge can be seen as our reward for overcoming the first set of challenges. The purpose of the Strategic Advice Challenge is to ensure that there are no unidentified barriers to progressing to an efficient gas sector!

As part of this challenge, we have been asked to advise whether its in New Zealand's interests to promote the "direct" use of gas. A project is under way on this.

Work is also underway on other GPS matters but you will probably not see anything in the public arena until 2011 as there is a lot to consider.

Resources for the Quest

The Quest is a joint effort and we consider that the teams within your organisations are going to have to be well equipped to provide ample input along the way.

This is a challenge for Gas Industry Co as well. Since our last conference we have undertaken an organisational restructure to assist us to grow our in-house capability to meet your requirements and to clarify roles and accountabilities. The resulting structure is set out in the next slide. Gas Industry Co now has about 16 staff.

Infrastructure Access Group 2FTEs	Market Operations Group 4FTEs	Corporate Services Group 7FTEs	Office of the Chief Executive 3FTEs
<ul style="list-style-type: none"> • Gas Processing • Interconnection • Balancing • Industry facilitation roles, including MPOC and VTC change requests • Distribution 	<ul style="list-style-type: none"> • Wholesale Market • Contingency Management • Downstream Reconciliation • Switching • Compliance and Enforcement • Market Design 	<ul style="list-style-type: none"> • Levy • Statutory Accounting • Stakeholder Communication • Business Planning and Reporting 	<ul style="list-style-type: none"> • General oversight of all workstreams • Industry Performance • Direct Use of Gas • Consumer Issues • Strategic Issues • Government relations

You will note that in order to keep costs down in the current year, a rather large number of GPS tasks have been parked with me. Let me reassure you this is a transitional responsibility.

Concluding Remarks

In conclusion, I think the amendments to the Gas Act which were made in 2004, have effectively asked the industry to go on a quest: a quest for a Gas Utopia.

This is a place where the industry delivers economically efficient and fair outcomes to its consumers.

Gas Industry Co has been appointed to guide the quest, but we will need the support of all our stakeholders to get to a final destination.

As with all quests, we expect a number of challenges and obstacles on the journey and as I have described to you we have already faced a few significant ones. However, we have also overcome other challenges and the good news about this quest is just like the quests in the myths of old: the benefits of the journey accrue on the way.

This is already starting to happen as our other Gas Industry Co speakers will share with you.

Christine Southey
11 August 2009