



GAS INDUSTRY COMPANY LIMITED



1. Strategic Issues for Gas Industry
2. Retail Market Update
3. Approach to Co-regulation
4. Wholesale Market Update
5. Infrastructure Access Update



Strategic Issues for the Gas Industry

Christine Southey
Chief Executive

11 October 2007

Agenda

- Energy policy objectives
- Role of gas industry
- Gas Industry Co's mandate
- Current GPS
- Future priorities

Energy policy framework

Government expects the energy sector to:

- Deliver secure, clean energy at affordable prices to support economic development while being environmentally responsible
- Respond to climate change by tackling carbon emissions from our energy production and use

Goal of 90% renewables by 2025

Role of gas industry

In other countries, gas is seen as a low emissions alternative to coal fired power generation

In NZ, gas has a different profile

It is primarily seen as an important fuel to ***maintain security of supply ...***

as we transition to sustainable energy future

Gas sector policy

To fulfill this role of ***securing supply***, we need:

- diverse sources of gas
- new entrants

Likely to see continuation of

- upstream initiatives
- use by Minister of regulatory powers

Rules to promote competition, ensure access and protect consumers

2004 Gas Act amendments

Regulatory powers delegated to Minister

- are not unlimited
- must follow a particular process

Gas Industry Co's core role is to give advice to the Minister on the exercise of those powers

Today we will discuss co-regulatory processes and our approach

Our current mandate

- **Consumer outcomes** – access to disputes resolution, default contract terms
- **Retail and wholesale market development** – market structures and systems (registry, reconciliation, spot market, outage management)
- **Infrastructure access** (capacity information, access rules)

Today we will also address
work stream progress

Future priorities

- Continue the work to remove barriers to competition and develop market structures and systems
- Appoint service providers and monitor industry compliance with new arrangements
- Consider further intervention where competition is not delivering the right outcomes for consumers

Conclusions

- Government seeking low emissions future
- Gas industry will need to adapt
- Policy environment still based on markets
- Focus today on:
 - Work stream progress
 - Co regulatory processes and functions



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Retail Market Update

1. Switching and Registry
2. Downstream Reconciliation
3. Compliance Regime

Bas Walker
Senior Adviser — Strategic Issues and
Projects

11 October 2007

Retail markets - overview

- Work aimed at structural market issues – part of wider consumer issues programme.
- Switching of direct benefit to consumers –at implementation stage.
- Reconciliation of indirect benefit to consumers – at policy proposal stage.
- Backed up by common compliance regime.



Switching and Registry



Switching and Registry - context

- Objective - to develop arrangements for consumers to switch retailers in a seamless and efficient way.
- New arrangements will replace current voluntary regime.



- Compliments information for consumers on Gas Industry Co website about potential gas suppliers in their area.
- Invitation to add to this information.

Switching and Registry – summary of rules

- Based on two key elements:
 - central registry of information on ICPs; and
 - rules governing switching information requirements and time frames.
- Registry operator appointed by Gas Industry Co.
- Backed up by compliance and enforcement regime.

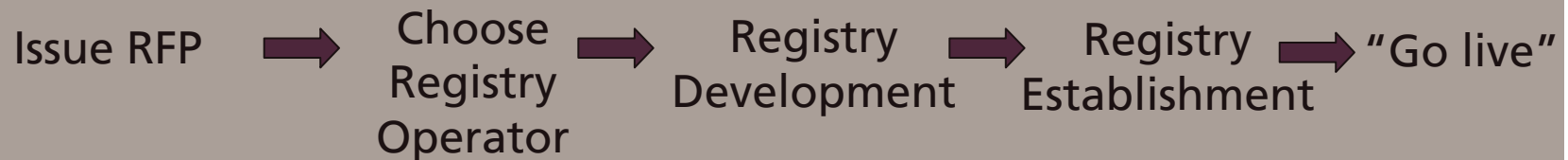
Switching and Registry - timeframes

- Rules for Registry come by February 2008.
- Rules for Switching on “Go Live” date set by Gas Industry Co.

Switching and Registry - paying the cost

- Rules provide for dedicated fees charged to Retailers.
- Development fee – one off charge to cover establishment.
- Ongoing fee – annual charge to cover operating costs.

Switching and Registry - implementation plan



By Nov 2007

By Feb/March
2008

By Sep 2008

By Nov 2008

Late
2008/Early
2009

Switching and Registry - industry involvement

- Overall co-ordination by Gas Industry Co
- ***Registry Establishment team***

↳ involvement of industry in stages through to selection of Registry Operator.

- ***Registry Implementation Team***

↳ mechanism for co-ordinating industry involvement in user acceptance testing and initial data entry.

Switching and registry - key strategic drivers

- Management of interconnections between:

Registry – Switching – Reconciliation – Compliance

- Achieving high quality and comprehensive data input.
- Ensuring industry is ready to go at “go live”.



Downstream Reconciliation



Reconciliation - context

- Provide process for assessing difference in gas quantities between gas gates and ICPs, and allocating residuals (UFG).
- Objectives are to:
 - Provide equitable/rigorous processes for assessing and allocating UFG; and
 - Assist industry process of identifying and rectifying causes of UFG.
- Will replace current voluntary regime.

Reconciliation - summary of current proposal

- Allocation agent appointed by Gas Industry Co.
- Allocation of UFG to retailers by global method.
- Allocation via UFG factor – initial, interim and final.
- Dedicated fees for ongoing costs paid by retailers.

Current status and future development

Submissions
due on
statement
of proposal



Possible
Recommendation
to Minister



Establishment
Stage



"Go live"

8 October
2007

Dec 2007

To mid 2008

Late
2008/Early
2009

Key strategic drivers

- Management of interconnections between Registry – Switching – Reconciliation – Compliance.
- Creation of more equitable regime for industry participants.
- Creating platform for addressing UFG.



Compliance Regime



Compliance Regime

- Proposed regulations recommended to Minister.
- Take effect 28 days after gazetting.
- Key elements:
 - Market administrator;
 - Investigation process; and
 - Rulings Panel.



Conclusions



Retail markets - conclusions

- Switching/reconciliation will address key structural issues in retail area.
- Full implementation by early 2009 at latest.
- Benefits to both consumers and industry participants.
- Will complement work on wider consumer issues.



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Mark Soper
Strategy and Corporate

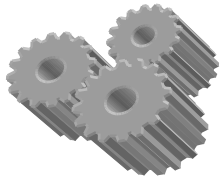
Nicole MacFarlane
General Counsel

Bas Walker
Senior Adviser

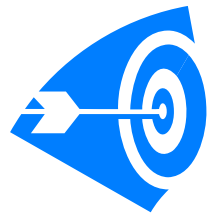
Approach to Co-Regulation

11 October 2007

Overview



Process Framework



Industry Agreements



Cost Allocation



Cost Benefit Analysis



Consultation Timeframes



Process framework



Context

- Gas Industry Co is a creature of statute
- Gas Act, GPS, Companies Act and company constitution provide the framework within which we are required to operate
- GPS sets out Government's priority areas for action



Good policy design necessitates focus on outcomes not outputs

Policy outcomes

- Gas Act amendments & GPS set out overall policy outcome:
 - To ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner

Policy outcomes (cont.)

- Other policy outcomes include:
 - Contribute to climate change objectives
 - Effective operation of markets
 - Promoting competition
 - Downward pressure on prices
 - Security of supply

Process requirements

- Before recommending rules or regulations we must:
 - “ ... seek to identify all reasonably practicable options...”
 - “ ... assess those options...and consider the benefits and costs of each ”
 - “ ... ensure that the objective ... is unlikely to be satisfactorily achieved by any reasonably practicable means other than the making of the regulation (for example, by education, information or voluntary compliance)”
 - “ consult with persons...that are representative of the interests of persons likely to be substantially affected...”

Policy approach

Problem Definition
and Issues Review



Clarify Policy
Objective



Identify "reasonably
practicable" options
that meet policy
objective



Assess those
"reasonably
practicable" options



Most Practicable
Option



Rules and Regulations

- *Statement of proposal*
- *Recommendation to Minister*



Industry Agreement

- *Recommendation to Minister*
- *Signed agreement*



Industry agreements



Overview

A range of policy instruments
available to be considered



voluntary
guidelines

codes of
practice

industry
agreements

rules/regulations

Gas Industry Co required to
determine which will best achieve
the regulatory objective



Industry often expresses
preference for non-regulatory
arrangements...



...but all require agreement from
participants...

Prefer industry agreements but....

Two recent examples

Standardising disconnection practices

- Gas Industry Co developed solution in December 2006
- Last chance for agreement by 31 October 2007

Gas processing information disclosure

- Unable to obtain agreement by extended deadline
- Regulated solution now proposed

Difficulties and barriers observed

- Commercial interest vs NZ Inc
- Risk of “hold-out”
- Corporate approval requirements
- Follow the leader
- Existing contractual constraints
- Natural monopolies vs competitive entities
- Commerce Act implications
- Perception of free-riding
- Ability to change and add new parties
- Asymmetry of information

Outcome

Experience to date suggests that industry arrangements are only suitable where:



- voluntary compliance is sufficient
- strong commitment across all parties
- existing contractual situation is simple
- scope is defined and contained

Gas Industry Co required to consider industry arrangements as one of the range of policy instruments available to it but.....

Conclusion

***Industry agreements need
you!***



Cost allocation



Cost Allocation

- Regulatory processes have costs external to industry participants – development/ongoing.
- Cost itself needs to be clear and justifiable.
- Cost to be allocated on basis of transparent, logical and comprehensive principles.

Gas Industry Co approach

General principles:

- Economic efficiency
- User/causer pays
- Rationality
- Simplicity
- Equity
- Revenue sufficiency

Approach

- Application on a case by case basis
- ↳ But end result must be robust against external scrutiny



Cost benefit analysis



Cost benefit analysis

Essential part of policy development process
For formal Rules/Regulations is required by
s43N(1)

A standard policy:

- 
- ensure comprehensive/consistent approach
 - provide platform for ongoing improvement.

CBA policy – costs and benefits

- Marginal not average values
- Use national economic perspective



Costs should cover:

- policy process
- development cost of chosen option
- operating and maintenance costs

Benefits should cover:

- competitive benefits
- reduced operating cost
- improved efficiency
- improved information.


CBA policy – risk and uncertainty

Distinguish between risk and uncertainty:

- scenario analysis (preferred);
- sensitivity analysis; or
- combination of both.

CBA policy – overall assessment

Data/information deficiencies a common problem

- 
- quantitative analysis if data sufficient
 - qualitative analysis, where data insufficient.

Quantitative

- Calculation of NPV at 6%, 10% and 12% discount rates.
- Analytical period up to 10 years reflecting economic life of solution.

Qualitative

- Rigour of analysis maintained but using words not \$.
- Use standard set of descriptors to characterise.

CBA policy - conclusions

- Critical importance of high quality CBA recognised by policy
- Will assist industry input of necessary information



Consultation timeframes



Consultation – case law

- Relevant information to be provided
- Sufficient time for submissions
- Party obliged to consult, while entitled to have a working plan already in mind, must keep its mind open
- You must take due notice of submissions (no early decisions)
- Although views can be modified during the consultation process, if a significant or fundamental change is proposed, there is an obligation to consult further with affected parties



The consultation must be a reality, not a charade

Consultation - approach

- The only formal “consultation” requirement under the Gas Act is to consult before making any recommendation to the Minister for approval of gas governance regulations or rules
- However, we are committed to ongoing engagement

 This has invariably meant the release of multiple discussion papers before the formal consultation document is released.

Consultation - timeframes

- The Board has adopted a policy of a **four-week** period for consultation
- This is in line with timeframes typically allowed by agencies such as the Electricity Commission, Commerce Commission and Ministry of Economic Development
- Internal planning has been done on this basis

Experience to date

- Longer consultation periods have been granted where the Board considers it warranted



- recent example is the statement of proposal on transmission access (7 weeks)
- Consultation periods have varied from 2 weeks to 8 weeks, but the median is 6 weeks
- The average number of submissions is 7
- The average proportion of late submissions is about 40%

Proposal for discussion today

- **4 week period for consultation on “discussion papers”**
- **6 week period for consultation on “statements of proposal”**
- **Extensions only in exceptional circumstances**



Questions? Comments?



The logo for GAS INDUSTRY COMPANY LIMITED features a stylized, three-dimensional flame icon in shades of blue and white above the company name. The word "GAS" is in a large, bold, serif font, while "INDUSTRY COMPANY LIMITED" is in a smaller, all-caps, sans-serif font.

GAS INDUSTRY COMPANY LIMITED



Wholesale Market Update

Ian Dempster
Senior Adviser — Wholesale Markets

11 October 2007



Gas contingency management



Scope of the problem

Security of supply covers a wide range:

- day to day supply/demand balance
- forecasting & planning for future needs:
 - energy supply
 - bulk transport
 - distribution

Largely, left to the “market” to provide

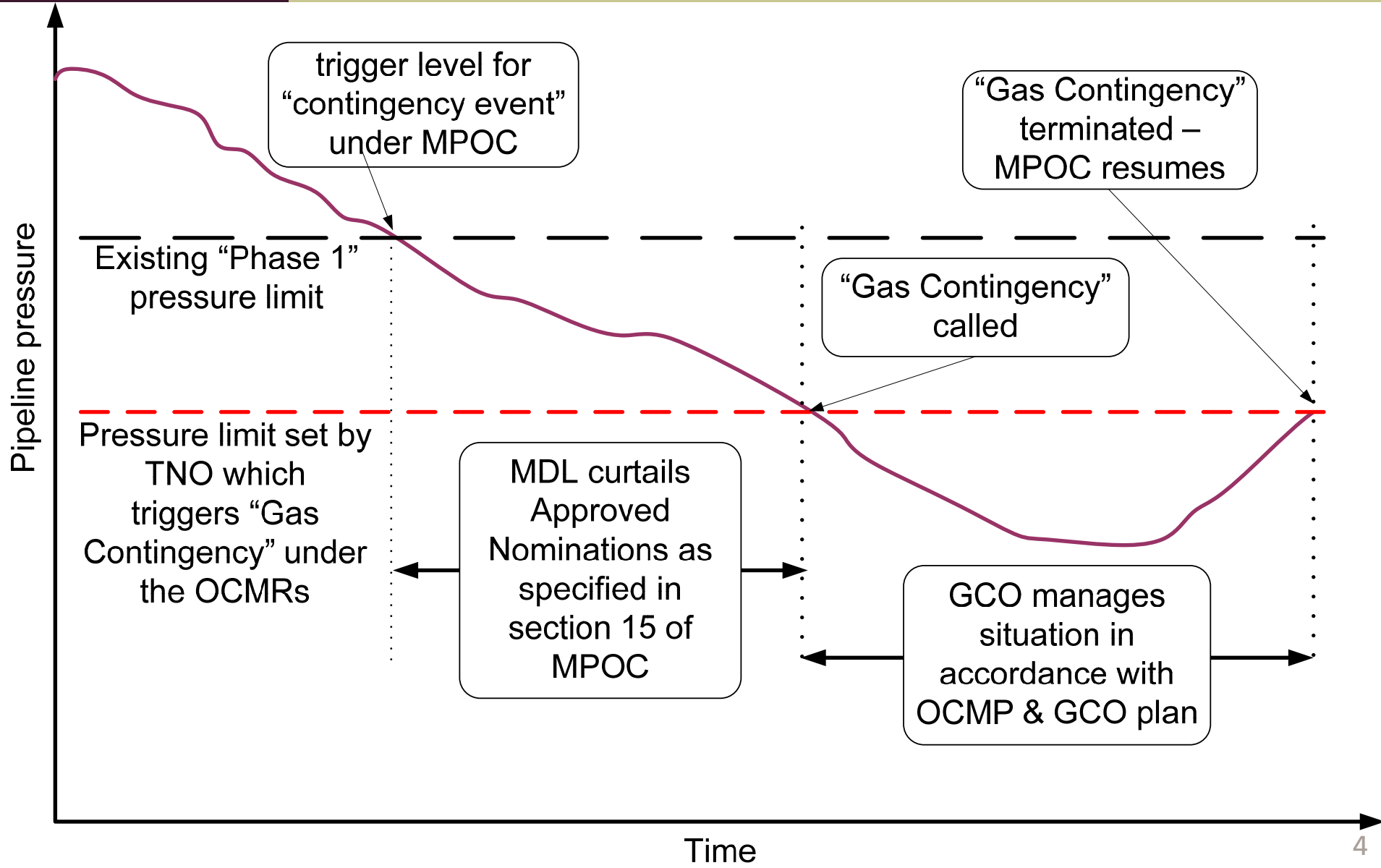
What happens when the wheels fall off?

Scope of the problem

Gas Industry Co asked to review NGOCP

- very narrow focus:
 - NGOCP (and its replacement) is the “ambulance at the bottom of the cliff”
- applies after commercial initiatives exhausted
- aims:
 - not to distort normal market behaviour
 - incentives to prepare for contingencies

Interface with commercial arrangements



Key changes

<i>Existing (NGOCP)</i>	<i>Replacement</i>
Voluntary arrangement	Mandatory with compliance and enforcement regime
No requirement to pay for gas taken from others	Gas taken must be paid for (at the Contingency Price)
No incentive for shippers or producers to supply gas	Contingency Price will incentivise parties to supply where possible
Uncertain outcomes – parties may not follow requests	Greater certainty – directions followed or fines levied

Status

Statement of proposal issued

Submissions received

- seeking clarification from a number of submitters
- some minor drafting issues – e.g. nomenclature
- report to Board this month

Revisions to draft regulations

Further consultation likely



Access to Gas Processing



Background

GPS requests:

Protocols that set reasonable terms and conditions for access to gas processing facilities

Prior consultation concluded:

- prescriptive access protocols not needed
- changes—new fields coming into production
- defer final recommendation
- maintain a watching brief
- limited information disclosure

Implementing information disclosure

Recommendation to Minister of Energy:

- pursue industry agreement
- regulation as backstop option

Minister's response:

- accepted recommendation
- if no agreement by mid-2007, expected a recommendation to regulate

Status

- Disclosure agreements not forthcoming
- Statement of proposal issued
- Analysing submissions
- Report to Board this month
- Expect a recommendation to the Minister shortly



Wholesale market design



Think of “Trademe”—for gas

Simple, low-cost, electronic trading platform

Begin with a trial market

- “live” trial, i.e. real deals
- requires market rules, participants, trading system

Gas Industry Co, with assistance from potential traders, sought proposals from platform providers.

M-co has been chosen as the preferred party to host the

New Zealand Gas Exchange

How does it work?

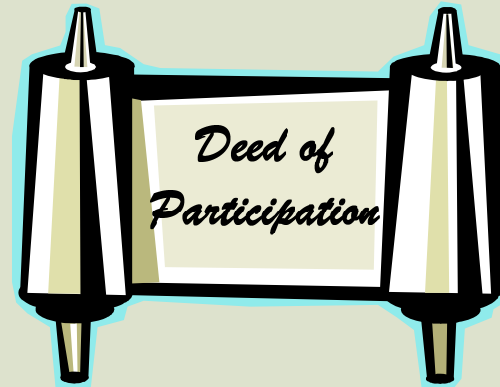
- Participation is voluntary
 - majority of gas sold on long-term contracts
 - short-term, private deals remain as an option
- Standard set of “products” on offer
- Formation of bilateral deals
- Performance of contract is outside of the formal market



Contract-based:

- Parties bind themselves to the rules

Apply to join the market

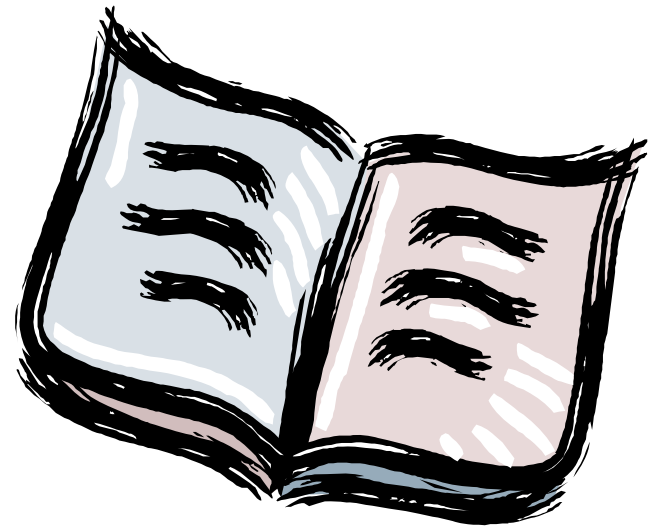


Undertake to be bound by the rules and honour obligations to:

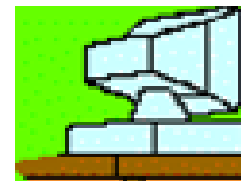
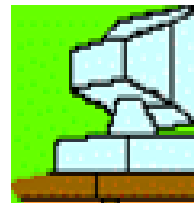
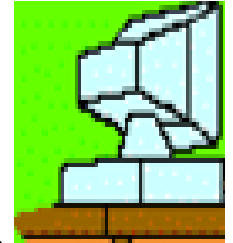
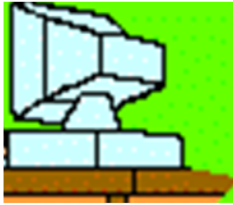
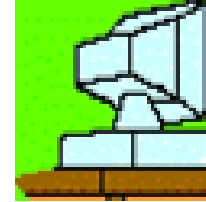
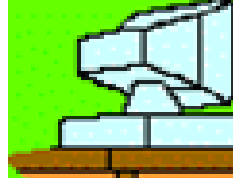
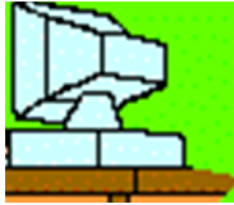
- **the body overseeing the market,**
- **other traders, and**
- **the trading system operator**

Contract-based:

- Parties bind themselves to the rules
- Rules govern:
 - entry to and exit from market
 - how offers are made and accepted
 - dispute resolution
 - rule changes, market hours, fees, conduct, etc



Doing deals



Process from here...

Finalising governance arrangements

Platform “tweaks” required

No firm “go live” date at this stage

In summary...

Increasing:

certainty

(contingency management)

information

(gas processing)

choice

(gas trading)



Infrastructure Access Update

11 October 2007

Ian Wilson
Senior Adviser
Pipelines

Agenda

- Transmission Access... update
- Distribution Access... what's in store



Transmission access

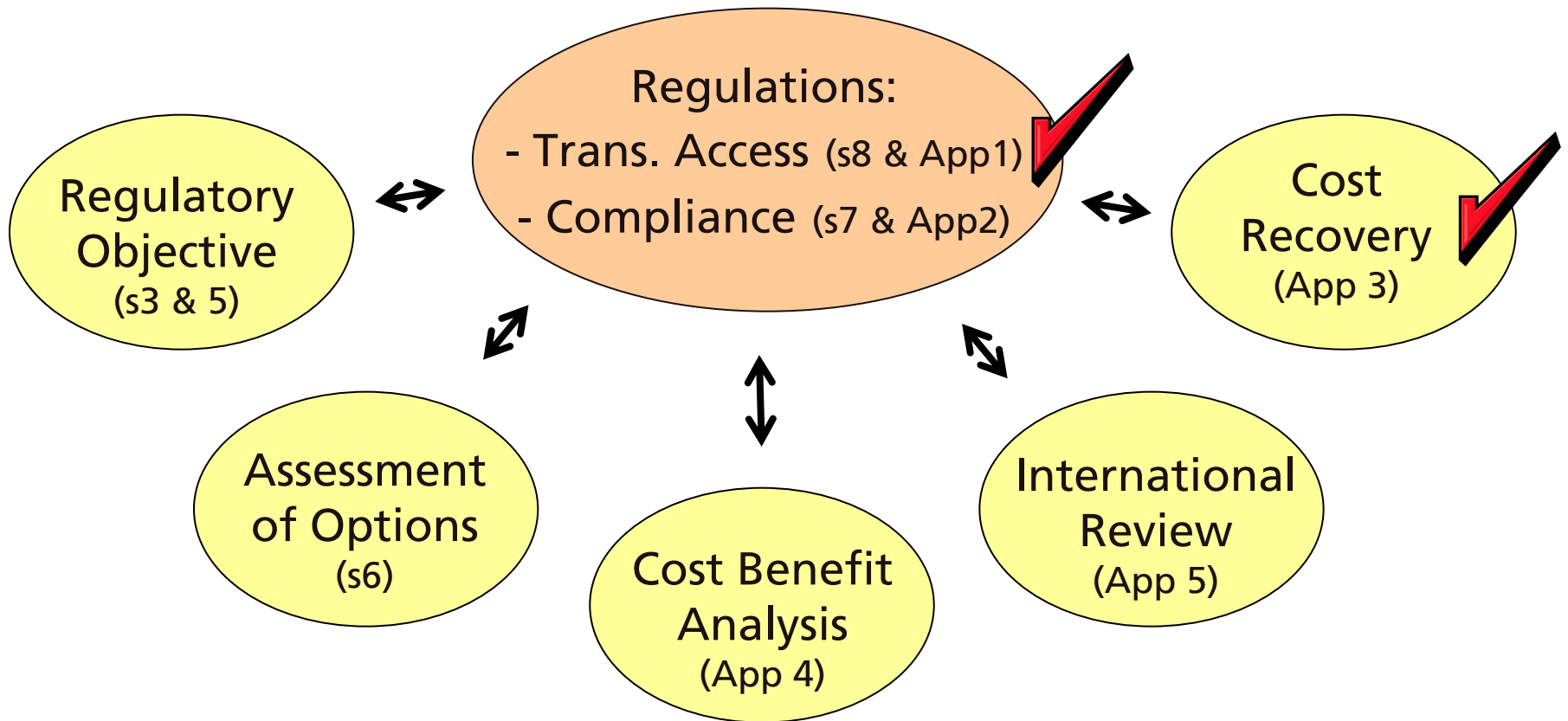


Purpose of framework

The access framework will address issues such as:

- new entrant access rights
- management of multilateral arrangements
- the management of conflicts of interest

Content of SoP



Overview – TSOs required to...

- Develop a Transmission System Code
- Offer standard services
 - Transportation, Interconnection & Balancing
- Develop policies
 - Ring fencing, code change, pricing, queuing, negotiations etc.

Balancing – TSOs required to...

- Offer a balancing service
- Provide information to users
- Conduct transparent process
- Disclose balancing gas transactions
- Minimise costs

Ring fencing – TSOs required to...

- Develop a ring fencing policy
- Treat affiliates on an arms length basis
- Physically separate from affiliated personnel
- Review and report on compliance annually
- Co-operate in compliance audit

Cost allocation

SoP paper:

- Considers who should meet costs
- Evaluates options against principles
- Concludes:
 - Where possible recover from causer
 - Otherwise recover from wholesale purchasers

Transmission Access Framework benefits

- Give users more certainty over:
 - Services on offer
 - Negotiability of service terms
 - How changes will be considered
 - How disputes will be dealt with
- Give TSOs confidence:
 - To write their own code
 - To engage with users within a known governance framework

Transmission Access Timetable

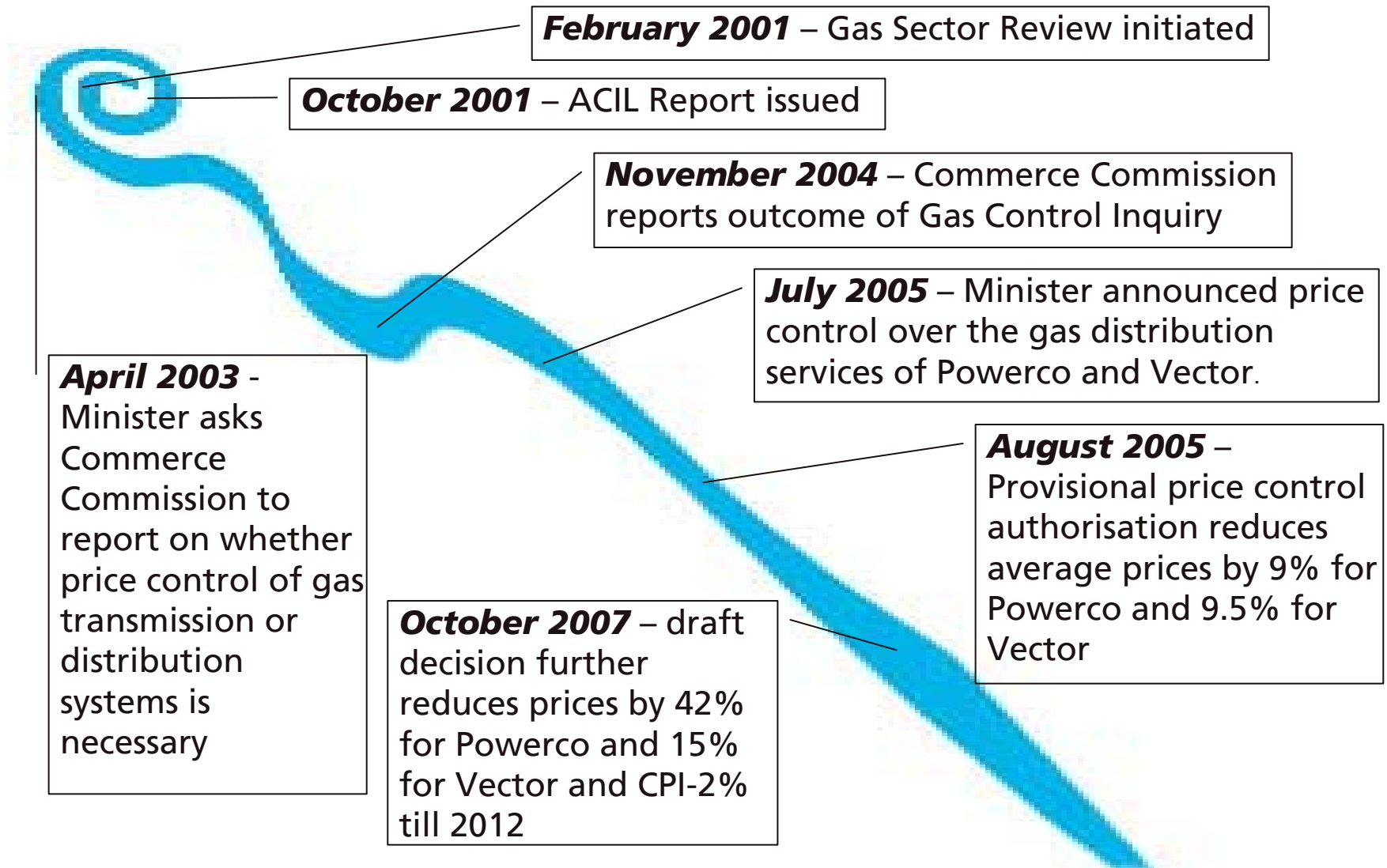
5 October 2007	SoP released for consultation
26 October 2007	SoP presented at industry seminar
23 November 2007	Final submission date
April 2008	Recommendation to Minister



Distribution access



Distribution events



Section 9 of GPS seeks:

- The establishment of consistent standards and protocols across distribution pipelines so that gas market participants can access distribution pipelines on reasonable terms and conditions.

Victorian Gas Distribution System Code

- Disconnections and Reconnections
- Distribution Metering
 - Principles, Installations, Standards, Testing, Data
- Operation of Distribution System
- Connections
- Access Arrangement Conditions
- Confidentiality, Curtailment, Dispute Resolution

Holistic view

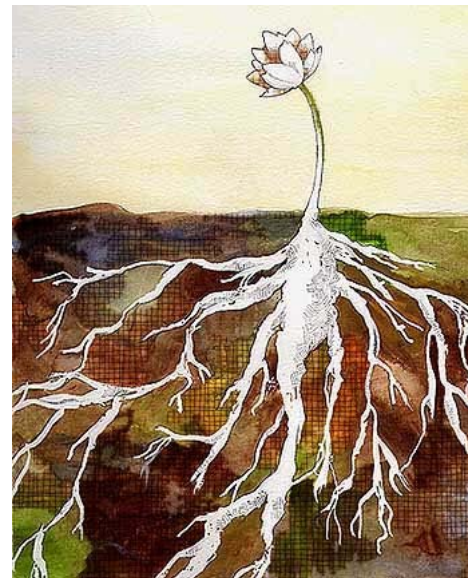
Objective: Efficient and fair outcomes for consumers

Competitive markets for:

- metering
- retailing

Regulatory oversight of:

- monopoly distributors
- service delivery systems
(metering, billing, switching)



**Consumer
Information**

**GANZ Safety
Protocols**

**EGCC
Scheme**

Distribution Access Timetable

February 2008	Review distribution contracts and follow up on previous interviews with affected parties
April 2008	Issue review discussion paper



Conclusion



Conclusion

Thanks for listening

Thanks for contributing

NOAM CHOMSKY:

“It's very common for the victims to understand a system better than the people who are holding the stick. ”

From CONVERSATIONS WITH NOAM CHOMSKY ON THE POST-9/11 WORLD

Interviews with David Barsimian