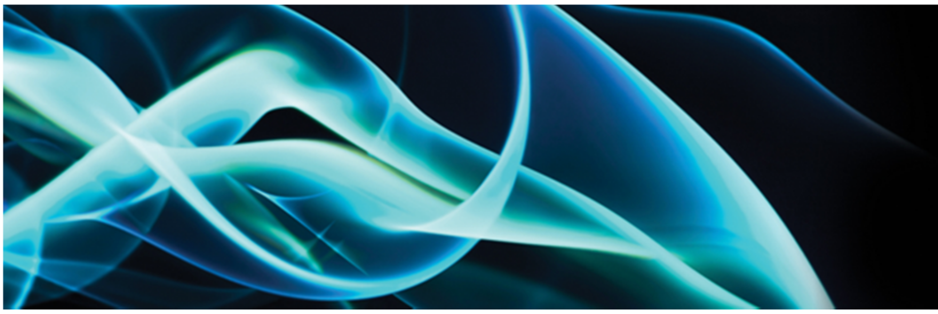

Gas Industry Co

QUARTERLY REPORT

Quarter ended 31 December 2013

FROM THE CHIEF EXECUTIVE

Gas Industry Co has refreshed its assessment of the state and performance of the New Zealand gas industry with the release just before Christmas of the second edition of *The New Zealand Gas Story.*

Our overall conclusion is that the industry remains in good shape, is tracking well against Government policy objectives for the sector and is proactively addressing the issues of importance to consumers, participants and policymakers.

There have been a number of important developments in the gas market since we first published the *Gas Story* in February 2013 and, with gas remaining of vital importance to New Zealand's energy supply, the outlook is encouraging:

- a very active exploration programme is under way, that will see the drilling of around 100 wells. This programme represents for New Zealand unprecedented investment in upstream petroleum exploration and development aimed at fulfilling objectives to replace and grow gas reserves.
- gas consumption has grown substantially, with total market demand heading back over the 200PJ market for the first time in a decade.
- at the same time, significant changes in consumption patterns are occurring. Methanex has substantially lifted its gas uptake following its return to full methanol production, while gas for thermal electricity generation has declined with the move towards a more efficient peaking role reducing the traditional baseload generation role.
- it is pleasing to see that wholesale trading is under way on the emTrade market with over 100 trades representing a cumulative volume of 130 terajoules (TJ), and a total value of $725,000 – or an average price of $5.5359 cents/gigajoule (GJ). We look forward to further developments in the wholesale market.
- and in the regulatory arena, the industry has been adjusting to a range of new governance arrangements, notably from the commencement of the Commerce Commission's new price-quality and information disclosure regimes, Crown Minerals Act changes, and the consolidation of workplace safety under the umbrella of a single new Crown entity, WorkSafe New Zealand.

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All reports, submissions and other documents referred to in this Quarterly Report are available on our website at www.gasindustry.co.nz

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In addition to fulfilling a key aspect of Gas Industry Co's statutory role, the *Gas Story* is also an important element in our strategic response to industry requests to us to foster a wider awareness and understanding of the contribution that gas makes to New Zealand and the economy. Our intention is for it to be a comprehensive and useful reference resource, while also pointing to other available material for readers seeking more detailed information on aspects of the industry.

We will continue to pursue other initiatives to tell the gas story through public presentations and tapping authoritative sources to focus on particular aspects of it. In this regard, as we head into 2014, we intend to offer the *Gas Story* in seminar format and to update the gas supply and demand picture that was painted in detail in the report *Gas Supply and Demand Scenarios 2012-2027* commissioned from Concept Consulting in 2012/13. It is hoped that, by keeping this sort of information current, we can provide useful assistance to industry participants and gas users in their energy investment decisions.

Steve Bielby
Chief Executive

Industry performance highlights

- Trustpower has entered the gas retail market and had about 720 customers as at 1 January 2014.
- With Trustpower's entry, there are now a number of gas gates where nine retailers actively trade. About 97 percent of gas customers are connected to a gate where at least six retailers trade, demonstrating that gas retailers generally are competitive throughout the North Island.
- Gas customer switches are averaging 3,800 per month; some 17 percent of gas consumers change retailers over the course of the year.
- The average switching time is about six business days, in contrast to the weeks or months that switching used to take prior to the inception of the switching registry.
- Unaccounted for gas (UFG) volumes have been negative overall in the past three months, reflecting mass market retailers' tendency to over-estimate their customers' consumption during summer. These negative volumes are expected to be corrected at the interim allocation stage. Average annual UFG now stands at about 1.2 percent.
- The Herfindahl–Hirschman Index (HHI) in all regions of the North Island has decreased in the past four years, as new retailers have entered the market and smaller retailers have increased their market share.
- Nova and OnGas are the largest retailers by volume. Both have a particular focus on the industrial and commercial sectors of the gas market, although Nova also has a presence in the mass market.

Transmission access improvement work progresses on twin fronts

Key recommendations from the Second Advice Report from the Panel of Expert Advisers (PEA) under the Gas Transmission Investment Programme (GTIP) on gas transmission access arrangements are being progressed on two fronts by Gas Industry Co and industry participants.

The PEA's Second Advice Report proposed ways that the transmission access codes – the Maui Pipeline Operating Code (MPOC) and Vector Transmission Code (VTC) – could be more closely harmonised through a process of 'evolutionary convergence' to meet the characteristics of a well-functioning transmission market. In particular, the PEA recommended that:

- signatories to the MPOC and VTC be invited to adopt and operationalise the guiding principles developed by the PEA and outlined in its Second Report.
- Gas Industry Co should consider development of a counterfactual regulatory solution in the event that industry-led code changes either do not eventuate, or prove insufficient.
  [Having considered industry submissions on those matters in July 2013, Gas Industry Co supported the PEA's recommendations]

Vector/MDL agree MoU on process to progress code changes

In October 2013, Gas Industry Co invited Vector and MDL to lead industry's discussions, and in December the two TSOs advised (Vector letter, MDL letter) they had agreed a Memorandum of Understanding (MoU) to work together to co-ordinate an industry response to the PEA's proposals relating to the pipeline systems.

That advice, in turn, followed meetings between Vector/MDL with Shippers to discuss governance matters, and to agree a strategy and work programme for considering, evaluating and, if appropriate, implementing the PEA's recommendations.

Vector, MDL and Shippers have established a working group that will meet regularly. An implementation plan has been developed and is available on the Gas Industry Co website. The working group acknowledges that some issues will be able to be resolved in the shorter-term, while others will take longer.

Gas Industry Co Options Paper on counterfactual design

In the first step in its development of a counterfactual regulatory solution, Gas Industry Co has issued *Transmission Access: Options for Improvement*, which identifies options for addressing the problems described by the PEA. Gas Industry Co is concerned to ensure the full range of options is considered before narrowing the choices to those that are most feasible and effective.

At this stage of the process, the options are pitched at a relatively high level to gain feedback on whether there are further options that should be considered, and if the evaluation of the options properly captures their relative merits.

The Paper sets out a number of initial changes that are common to all of the options and which could be readily applied to the existing pipeline codes. These are information transparency, fully defining an annual Authorised Quantity (AQ) product based on that in the MPOC, and clarification of Vector's as-available service arrangements. It then proposes five options for improvement to build on the initial changes and provides Gas Industry Co's qualitative assessment of them. These options are:

- Use it or lose it
- Firm future rights
- Capacity follows end-user
- Flow on nominations
- Daily capacity auction

Gas Industry Co is holding a workshop on the Options Paper on 12 February 2014, and submissions on the document close on 24 February 2014.

Bridge Commitments update

The Bridge Commitments are a series of commitments made by the majority of shippers and aimed at addressing concerns about competition on the North Pipeline in the shorter-term, while longer-term solutions are developed. They have been in place since August 2011.

No capacity offers were listed on the Gas Transmission Exchange (GTX) during the quarter, and Gas Industry Co understands that capacity availability did not pose a constraint to retailers responding to competitive tenders. Gas Industry Co also understands that firm capacity on the North pipeline has not been fully allocated for the gas year commencing 1 October 2013.

Together, these factors suggest there is no current shortage of capacity on the North pipeline and that capacity issues are not impeding customer switching and competition.

CCO role transitioning as CCM changes about to take effect

New Plymouth-based Core Group has been appointed as the new Critical Contingency Operator (CCO) and will take over the role from Vector Gas on 1 March 2014 when the amended Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations) take effect.

Industry stakeholders were introduced to Core Group at a Gas Industry Co workshop on 12 December 2013. At the same time, they were given an update on the progress of the CCM Regulation changes, and a rundown of the CCO transition arrangements. Key elements of the new CCM Regulations are:

- Changes to deferred curtailment designations and the designation criteria and approval process.
- Changes to curtailment bands.
- Obligations relating to the preparation and maintenance of plans the supply of information.
- Introduction of a new offence provision for gas users who do not cease using gas when directed.

During the transition period, Core Group is establishing a new website, and making general preparations including a review of CCO processes and information, developing communications

Core Group

Core Group is an integrated engineering, project management, and field services company, providing asset integrity management services to the oil, gas and pipeline industries. Incorporated in 2008, it employs 36 people across its main disciplines of pipeline integrity management, pipeline and plant maintenance, project management and supervision, engineering design, and GIS services. Its team includes chartered and professional engineers, professional project managers, supervisors and qualified technicians. It is a corporate member of the Australian Pipeline Industry Association (APIA) and the Australian Corrosion Association (ACA).
The principals at Core Group are familiar with the CCO role, having previously helped to provide the CCO function for Vector Gas and its predecessors, and having direct hands-on critical contingency management experience prior to the inception of the CCM Regulations.

plans and communications systems with Transmission System Operators (TSOs) and stakeholders, and preparing an information guide for stakeholders. Communications systems will be tested prior to the formal handover, with full communications tests planned immediately following the handover.

Core Group has requested consumer information from retailers and large users by 25 April as required by the amended CCM Regulations and in mid-January commenced consultation on the Information Guide.

Gas Industry Co records its appreciation to Vector for its years of service as CCO and, in particular, thanks Steve Ilkovics who did an excellent job of setting up the role.

Energy Market Services appointed Allocation Agent

Energy Market Services (EMS), a subsidiary of Transpower New Zealand Limited, has been appointed as Allocation Agent under the Gas (Downstream Reconciliation) Rules 2008 (Reconciliation Rules).

Following a competitive tender process on completion of the initial five-year term of the service provider agreement, Gas Industry Co reached an agreement in October 2013 for EMS to take over the appointment as Allocation Agent from NZX Limited (NZX). NZX continued as Allocation Agent until the end of 2013 to assist an orderly transition until EMS assumed the role from 1 January 2014.

A central feature of the role is the reconciliation of gas volumes leaving the transmission system with the volumes consumed by end users, appropriately attributing volumes to relevant retailers, and calculating and attributing volume differences in the form of unaccounted-for gas. The Allocation Agent also hosts, operates and maintains the allocation system and the allocation website.

Gas Industry Co considered it appropriate to seek competitive tenders after the bedding in of the Reconciliation Rules and allocation system over the past five years and that decision was vindicated by a reduction in the cost of the Allocation Agent services in excess of 20%.

Changes proposed to Retail Gas Contracts Oversight Scheme

A move from annual to three-yearly assessments and the introduction of a set of Reasonable Consumer Expectations (RCEs) are among proposals emerging from Gas Industry Co's review of the Retail Gas Contracts Scheme (Retail Scheme).

In the last three years, retailers' alignment with the Retail Scheme contract benchmarks has improved from 'Moderate' to 'Substantial'. The Retail Scheme, endorsed by the Minister in 2010, is designed to meet the Government Policy Statement on Gas Governance 2008 (GPS) objective that contractual arrangements between gas retailers and small consumers adequately protect the long-term interests of small consumers.

Gas Industry Co has released a Statement of Proposal which concludes that the original reasons for implementing the Retail Scheme remain valid. Gas Industry Co confirms its support for the continuation of the Retail Scheme in broadly the same form, but with changes that reflect the improvements to contracts in the past three years, industry participant feedback, and the activities of other relevant industry oversight schemes. The document also proposes:

- ongoing use of an external assessor
- flexibility around how assessment reports are structured, provided they are transparent and consistent.
- annual confirmation from retailers as to whether they have amended their standard published contracts.
- general monitoring of market changes.

Submissions are due by 17 February 2014 and Gas Industry Co expects to provide advice to the Minister of Energy and Resources on the future direction of the Retail Scheme by the end of February.

Questions over Gas Quality Protocol

Further industry feedback from Gas Quality workshops on a gas retailer-developed proposal for a gas quality compliance protocol has questioned whether a protocol is the best option, at least as currently drafted.

The protocol has been developed by a Steering Group of gas retailers to assist retailers to comply with the Gas (Safety and Measurement) Regulations 2010 (Gas Safety Regulations), and the Gas (Downstream Reconciliation) Rules 208 (Reconciliation Rules), and any other parties seeking assurance that statutory requirements are being complied with.

Initial post-workshop observations of the Steering Group discussions were that more work needs to be done to refine the scope of the Protocol and how it can become a 'living document', with an 'owner' and associated governance arrangements.

Gas Industry Co invited further comment from the industry before deciding the next steps in conjunction with the Retailer Steering Group. Three further submissions were received.

Submitters called for further discussions with wider industry groups to determine what sort of document would be most effective, what it should contain and how it should operate. Calls were also made for an assessment of whether information listed in the draft Protocol is already available in the public domain or disclosed to other regulators, and for requirements to be streamlined to minimise compliance costs. There has been no consensus about who should own the Protocol, although there was some support for it to be held by a party, such as Gas Industry Co, that is independent of industry participants.

Gas Industry Co continues to see gas quality arrangements as an industry-based initiative, but will maintain its work with the Steering Group.

In its Gas Governance Issues in Quality: Investigation Update paper in August 2012, Gas Industry Co reported that the Company's investigations gave 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 also noted that a gas quality incident has the potential to cause serious economic and reputational harm and, coupled with the 'common pool' features of gas pipelines, this puts a particularly heavy onus on the industry to ensure a high degree of transparency.

Transmission Code Changes

Final Recommendation: 31 May 2013 VTC Appeal – Contact Energy

In its Final Recommendation, Gas Industry Co has confirmed its Draft Recommendation conclusion that Vector validly withheld consent for a VTC Change Request proposed by Contact Energy. Contact proposed that Change Requests must relate to a single issue, or related series of issues. Vector did not consent to the change, and Contact appealed to Gas Industry Co, as the appeals body under the VTC, to have its Change Request allowed.

The appeal cites two grounds – section 25.6(a) of the VTC which provides for appeal by a Shipper who considers that Vector has invalidly withheld consent; and section 25.6(c) which provides for appeal by a Shipper who did consent, where the relevant change was not made. Gas Industry Co decided that it would assess the first ground of appeal before determining whether to address the second.

In its Draft Recommendation, Gas Industry Co questioned whether the VTC allowed it to consider the second ground of appeal, where it had already found the appeal under the first ground had failed. Gas Industry Co considered it had no jurisdiction to make a contract interpretation on this matter, as this could exceed its scope at an appeals body, and suggested the VTC parties agree among themselves, or use the VTC dispute resolution processes to reach a decision as to Gas Industry Co's jurisdiction.

Submitters on the Draft Recommendation held different views about whether Gas Industry Co can or must consider the second ground of appeal if it found that Vector reasonably withheld consent. Having considered the four submissions, Gas Industry Co concluded there remains doubt as to whether it does have jurisdiction and that, in any event, it is desirable for the parties to reach agreement between themselves, or via the VTC dispute resolution processes.

Industry Consultation on Levy Funding for FY2015

Gas Industry Co has set out its proposed strategy, work programme and levy requirement for the year ended 30 June 2015 (FY2015) in a Statement of Proposal (SoP) issued on 11 December 2013. Submissions close on 7 February 2014.

The SoP takes into account feedback received on the corporate strategy and draft work programme presented by Gas Industry Co to the annual Co-Regulatory Forum on 28 November 2013. The work programme continues to be a mix of activity designed to meet statutory requirements, such as the administration of existing gas governance regulations, and to address Government and industry priorities for gas sector governance arrangements. It continues existing multi-year workstreams, including the GTIP, but does not propose significant new workstreams.

The work and associated costs reflect Gas Industry Co's approach to prioritising its work and achieving value-for-money delivery of the work programme. The estimated work programme costs for FY2015 of $5.6 million are lower than the $6.1 million forecast for FY2014. Both the estimated retail levy of $5.84 per ICP and wholesale levy of 1.33 cents per GJ of gas are below the FY2014 rates of $5.90/ICP and 1.63c/GJ respectively.

At the completion of the consultation process, a formal recommendation for levy regulations will be made to the Minister of Energy and Resources. The work programme, and an indication of further activities in the two following financial years, will be formally set out in Gas Industry Co's 2015-2017 Statement of Intent, which will be published before the start of the next financial year.

Nigel Barbour joins Gas Industry Co Board

At Gas Industry Co's 2013 Annual Meeting on 21 November, shareholders elected Powerco Limited Chief Executive Nigel Barbour (left) as an Industry-Associated Director. Andrew Brown, who retired under the director rotation provisions of the Company's Constitution, was re-elected as an Independent Director.

Mr Barbour replaces Albert Brantley, Chief Executive of Genesis Energy, who retired from the Board at the Annual Meeting and did not wish to stand for re-election.

Mr Barbour joined Powerco as General Counsel in 2002 and held a number of senior operational and commercial roles, including periods as Acting CEO, until his appointment as CEO in October 2011. Prior to joining Powerco, he served as a solicitor with Transpower, the Bank of New Zealand, and in private practice.

Gas Industry Co Chairman Rt Hon Jim Bolger welcomed three new Shareholders - New Zealand Oil & Gas, Methanex and Nova Energy – to their first annual meeting.

Mr Bolger commented that Gas Industry Co appreciates the direct interest of shareholders in the Company, including through service on its Board of Directors. He noted that the 2012/13 year was very productive and Gas Industry Co continues to make pleasing headway with priority industry issues.

Coming up….

February	March
Second assessment under Gas Distribution Contracts Oversight Scheme 7th submissions deadline, FY2015 Strategy, Work programme and Levy 12th Gas Industry Co workshop on *Transmission Access - Options for Improvement* paper 17th submissions deadline, Retail Gas Contracts Oversight Scheme Review 24th submissions deadline, *Transmission Access – Options for Improvement*	1st Amended CCM Regulations take effect Core Group commences as new CCO Amended Compliance Regulations take effect

Performance Measures Quarterly Report for the period ending 31 December 2013

1 Summary

This Report provides an update on the performance measures that Gas Industry Co monitors on a regular basis. The purpose of these measures is to track the performance of the Gas (Switching Arrangements) Rules 2008 (the Switching Rules), the Gas (Downstream Reconciliation) Rules 2009 (the Reconciliation Rules), and the Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations), both in terms of activity related to these statutes and the competitive outcomes that they foster. The Report also tracks transmission balancing actions, as a means of informing Gas Industry Co's work on this issue.

In the past quarter, the ICPs on the Nova bypass networks have been added to the gas registry alongside the ICPs on the open access networks, and consumption data has been supplied for the allocation process. This means, for the charts in this report, that figures include Nova bypass ICPs and customer volumes from October 2013.

Highlights of the Report:

- Trustpower has entered the gas retail market and has begun attracting customers. As of 1 January, Trustpower had about 720 active gas consumers.
- On average, there are about 3,800 switches per month; about 17% of gas consumers change retailers over the course of the year.
- The average switching time is about six business days, in contrast to the weeks or months that switching used to take prior to the inception of the switching registry. In general, switches either take about 1 day (in the case of move switches, where a property is switched at the request of an incoming tenant or homeowner); or about seven days (for standard switches, where a gas customer simply decides to switch the retailer that supplies their existing location).
- Unaccounted for gas (UFG) volumes have been negative overall in the past three months, which reflects mass market retailers' tendency to over-estimate their customers' consumption over summer. These negative volumes are expected to correct at the interim allocation stage.
- Average annual UFG now stands at about 1.2%.
- The Herfindahl–Hirschman Index (HHI) is a way of measuring market concentration by using size and number of competing firms. In all regions of the North Island, HHI has decreased in

the past four years, reflecting the activities of new retailers entering the market and smaller retailers increasing their market share.

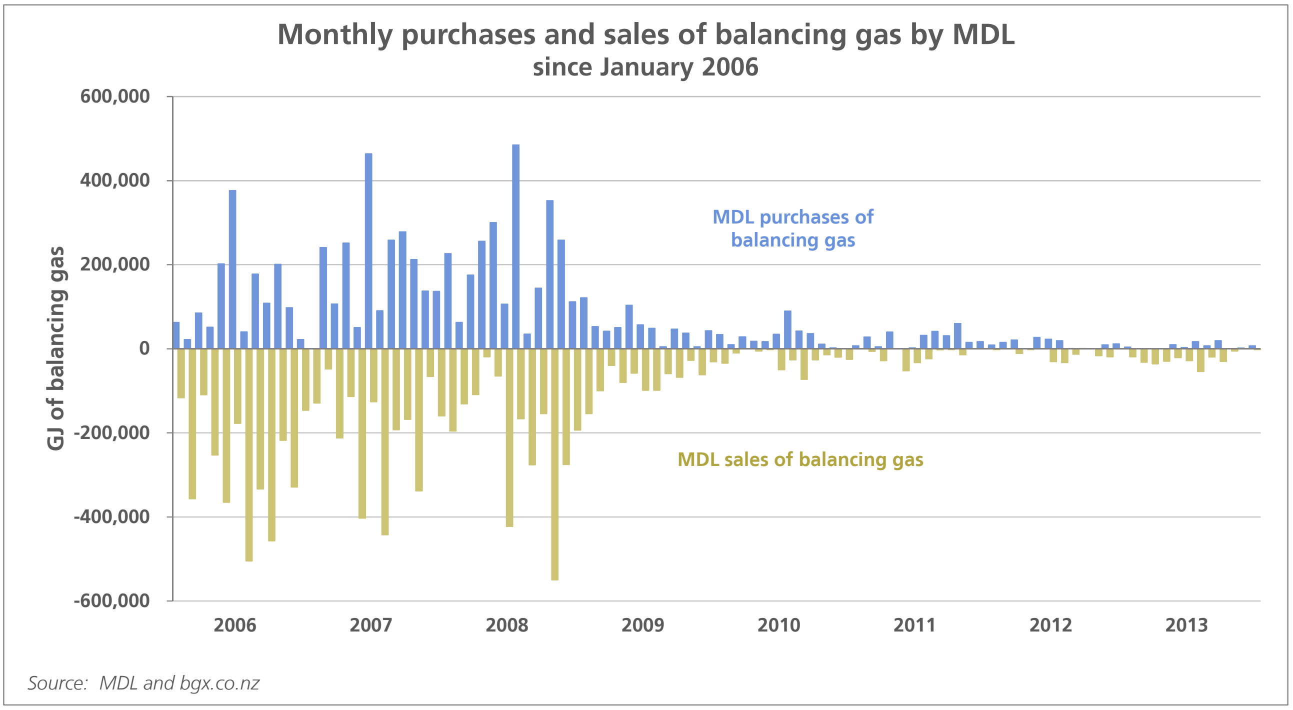
- In terms of market share by gas volumes, Nova and OnGas are the largest retailers, reflecting their focus on the industrial and commercial sectors of the gas market (although Nova also has a presence in the mass market segment).

- Due to the entry of Trustpower, there are now a number of gas gates where nine retailers actively trade. About 97% of gas customers are connected to a gate where least six retailers trade, demonstrating that gas retailers generally are competitive throughout the North Island.

2 Balancing gas volumes

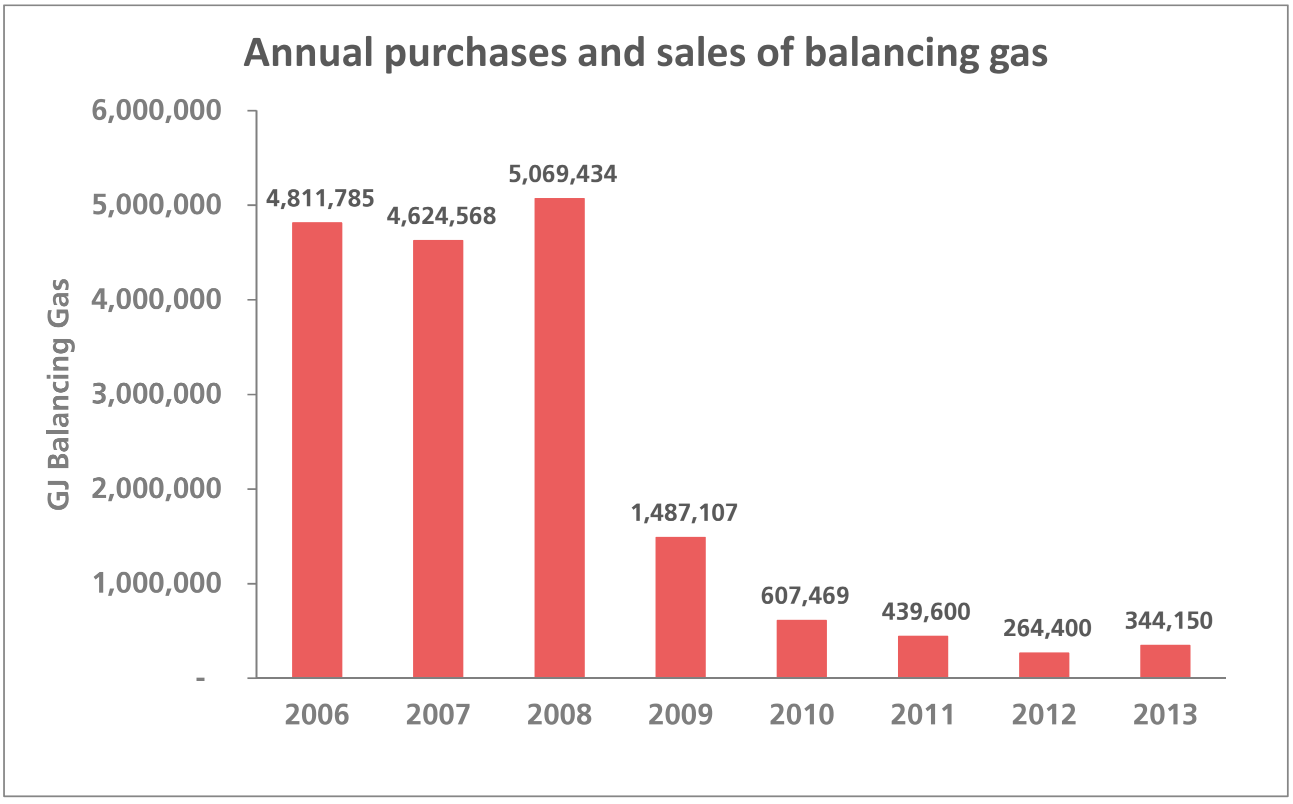
The volume of gas in a pipeline relates to the gas pressure in the pipeline and needs to be maintained below the safe operating pressure limit for the pipeline and above the minimum required to maintain the supply of gas to consumers. On the Maui pipeline, pressures will rise or fall as parties who inject gas into the pipeline over- or under-inject and as parties who receive gas from the pipeline under- or over-take relative to their respective scheduled volumes. When a transmission owner, or operator, manages the gas inventory in a pipeline, it is referred to as *secondary* or *residual balancing*. MDL buys and sells balancing gas in order to manage gas volumes and thus maintain gas pressure within safety and operational limits.

Prior to 2008, secondary balancing services were essentially free to holders of legacy Maui gas contracts, but changes implemented at the end of 2008 to the Maui Pipeline Operating Code, together with the arrangements in the Vector Transmission Code, mean that the costs associated with secondary balancing are generally recovered from pipeline users. In 2009, MDL instituted the Balancing Gas Exchange, an online platform that displays pipeline balance conditions and enables parties physically interconnected to the Maui pipeline to post offers to buy and sell balancing gas. These two changes appear to have provided gas transmission customers with an incentive to self-balance and greater information on which to base their balancing decisions.



The outcome is the significantly reduced volumes of gas needed to be purchased or sold by MDL to balance the Maui pipeline, as can be seen in the chart above.

The chart below summarises balancing gas transactions (both purchases and sales) by calendar year.

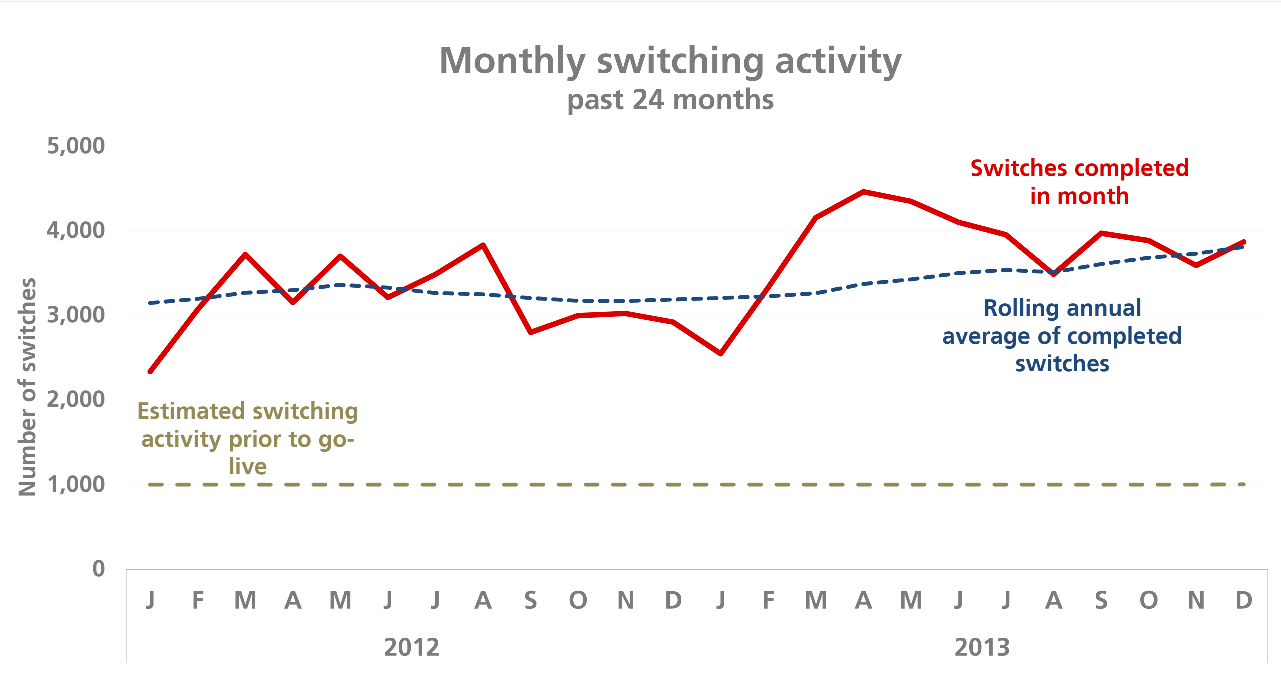


3 Switching performance measures

Monthly switching activity

There was an average of about 3,800 switches per month in 2013, compared with a 2012 monthly average of about 3,200. The churn rate (defined as the number of switches in the last 12 months divided by the total number of gas consumers) is over 17% as at the end of December. As a comparison, the annual churn rate for electricity is over 19%.

Prior to the gas registry going live in March 2009, approximately 1,000 switches were processed on a monthly basis, and the annual churn rate was approximately 4.8%.



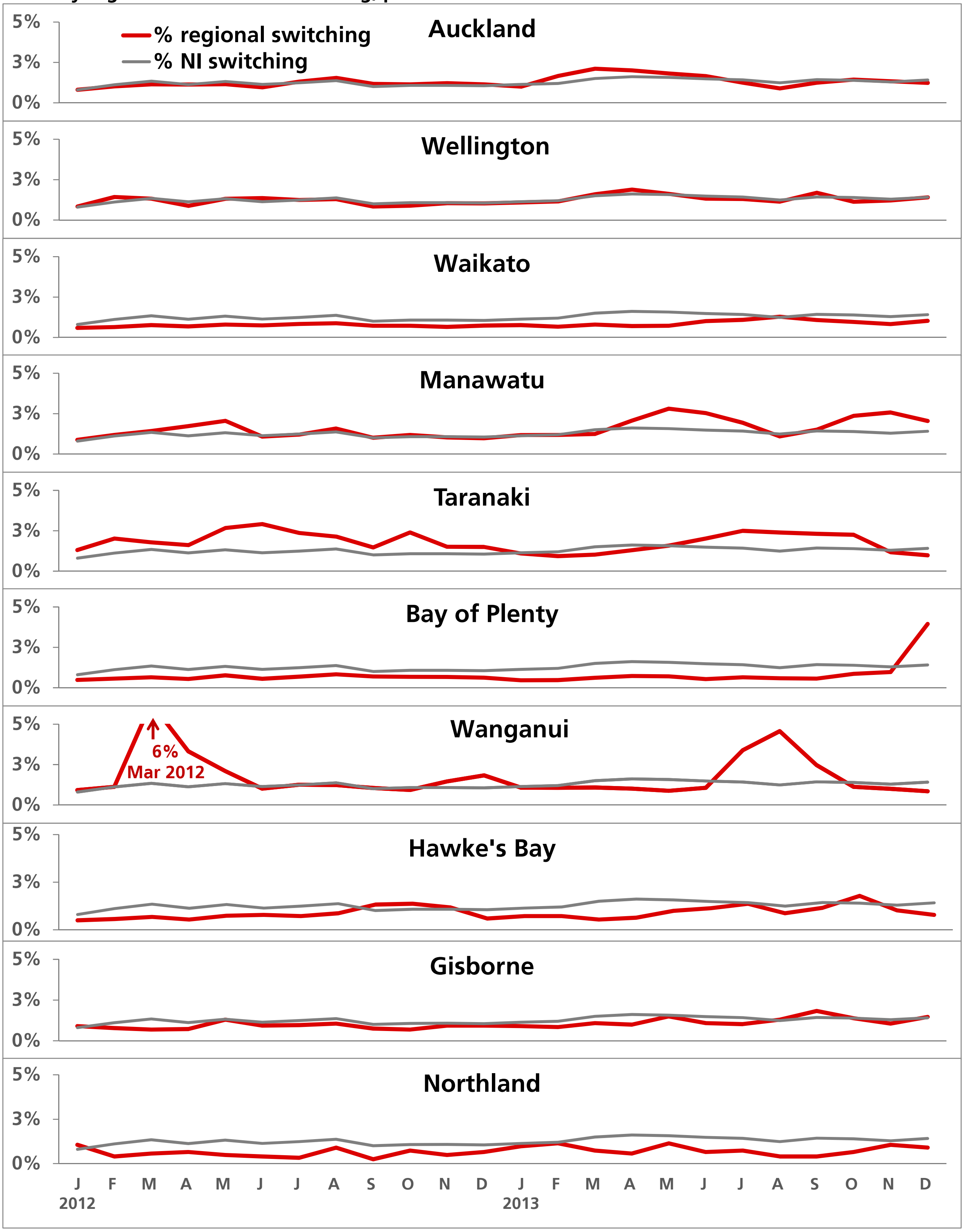
Regional switching activity

The charts below compare regional switching rates with total switching rates. The grey line is the same in all the charts below and shows number of switches (both move switches and standard switches) in a month as a percentage of active-contracted and active-vacant ICPS across all North Island gas consumers. As that line shows, monthly switching varies between about 0.7% and 1.6% per month.

The red line in each chart shows the number of switches in that region as a percentage of ICPs in that region. As might be expected, Auckland and Wellington switching rates tend to be similar to the North Island rates. Differences emerge in the smaller regions, though: in the past 24 months, for example, switching in Taranaki has generally tended to be higher than the average, while switching in Bay of Plenty, Hawke's Bay, and Northland has tended to be lower. The short-term spikes in switching rates in Wanganui – as well as the recent spike in switching in Bay of Plenty – appear to be due to targeted retailer marketing campaigns.

Note that the figures in the chart below do not include transfers of Auckland Gas and Bay of Plenty Energy customers to Nova.

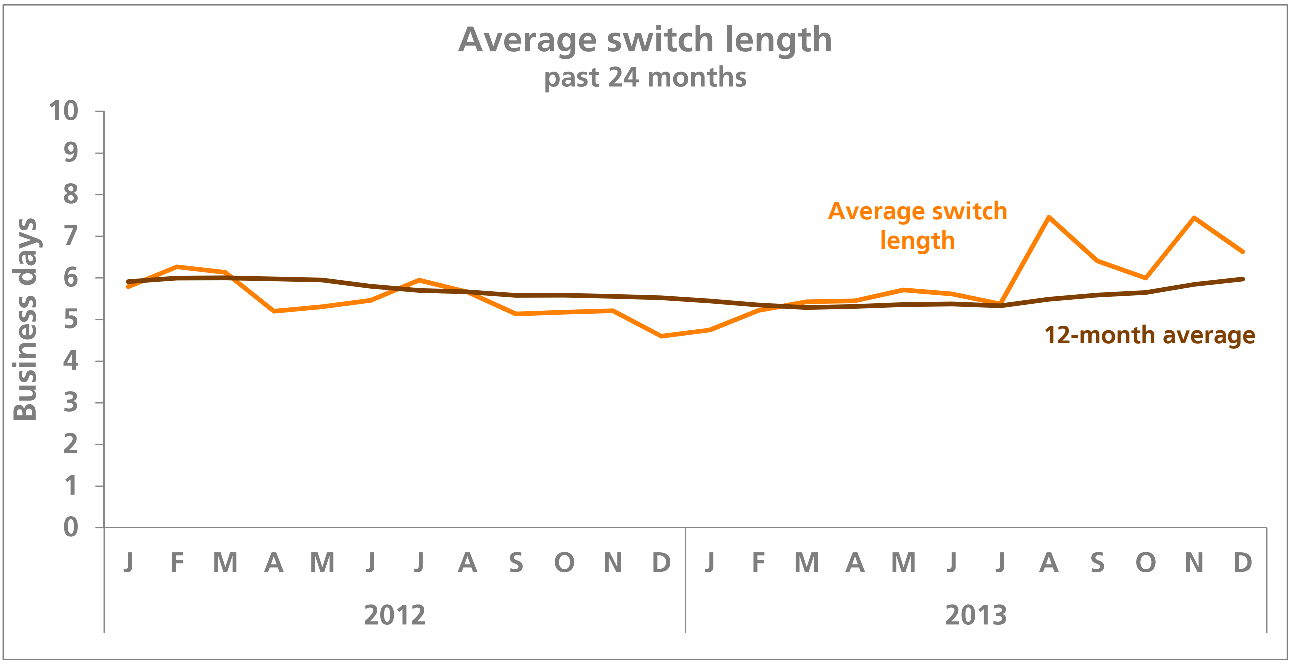
Monthly regional and overall switching, past 24 months



Time to process switches

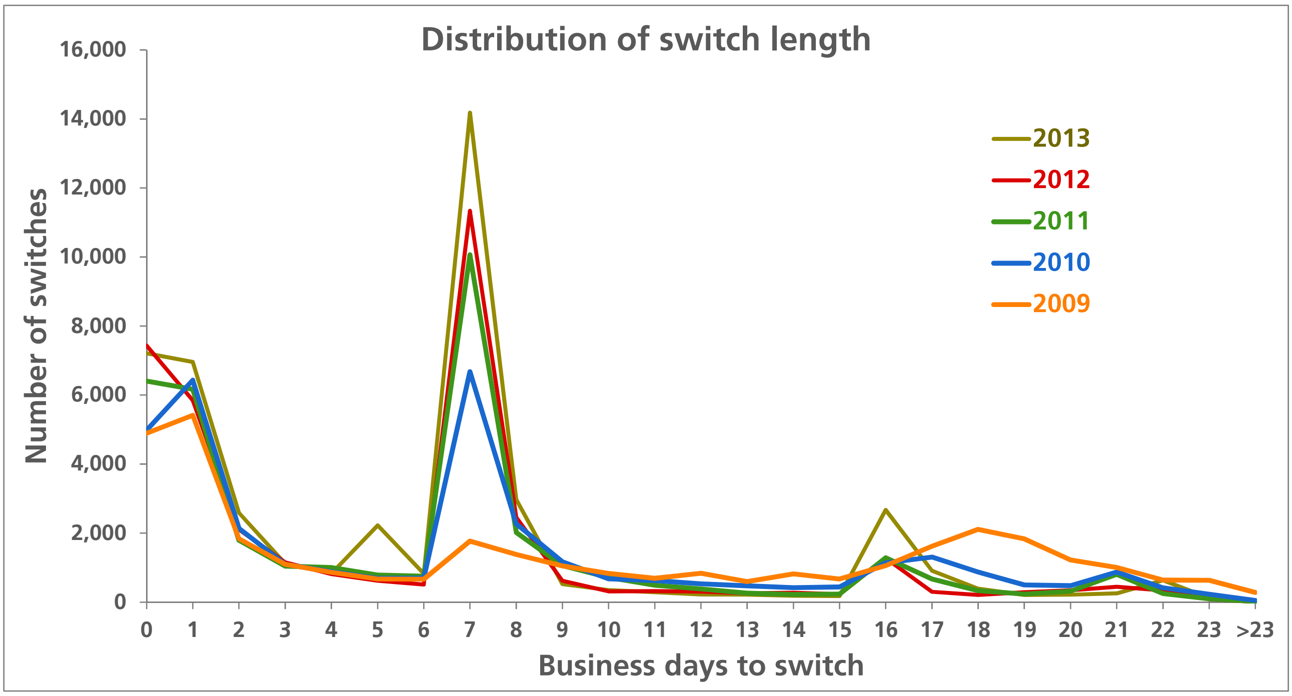
The chart below shows the average length of time it has taken to process the switch requests that have been received in a month. The twelve-month rolling average switching time now stands at under six business days, in contrast to the weeks or months that switching used to take prior to the inception of the switching registry.

The spike in switching time shown in August appears to be related to the implementation of Part 10 of the Electricity Industry Participation Code, which required changes to electricity participants' systems and entailed a suspension of the electricity registry. It is likely that the resulting delay in processing electricity switches had a follow-on effect in processing gas switches for dual fuel retailers in that month.



Distribution of switching length

The chart below shows the distribution of switching length since the start of the gas registry by calendar year. Switches taking zero to two business days generally are move switches (where a property is switched at the request of an incoming tenant or homeowner), while the majority of switches taking seven business days are standard switches (where a gas customer simply decides to switch the retailer that supplies their existing location). The Switching Rules stipulate that, for a standard switch, the new retailer can request a switch date that is not less than seven business days after the inception of the switch, and in most cases this request must be honoured by the existing retailer. These provisions seem to be the cause of the large proportion of switches being completed in seven business days.

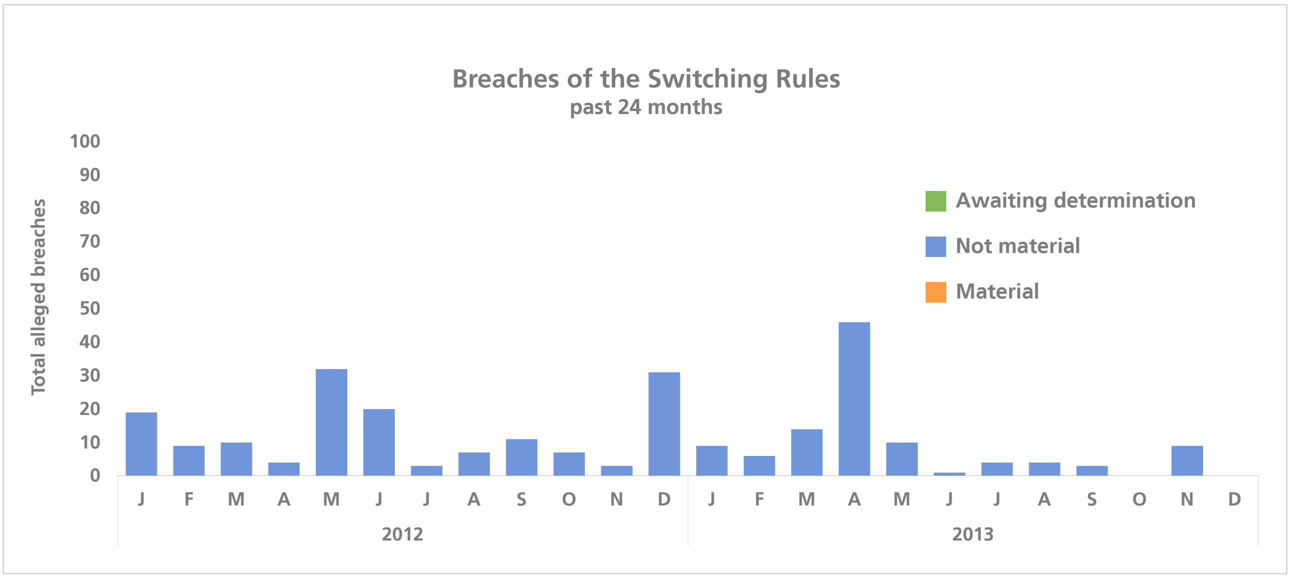


Note that the chart above excludes the transfers from E-Gas, Auckland Gas, and Bay of Plenty Energy to Nova.

Further, note that all of the switching charts in this section include only switches that occurred on open-access distribution networks; switches from open-access to bypass networks (or vice versa) would not be recorded as a switch in the Gas Registry.

Number and severity of breaches of the Switching Rules

In the first year after the inception of the Switching Rules, there were about 450 switching breaches alleged per month. In the past quarter, there have been a total of 13 breaches alleged. None of the switching breaches alleged in the past two years have been determined to be material by the market administrator.



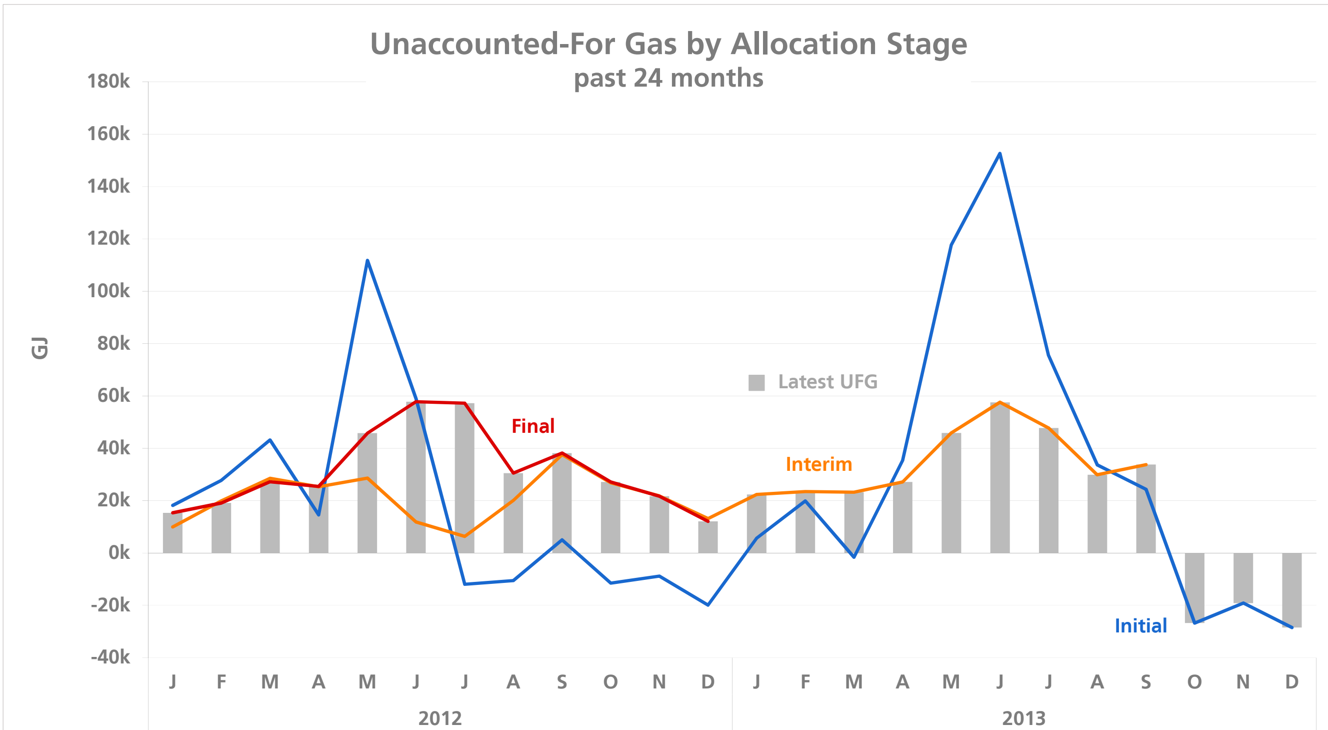
4 Allocation and reconciliation performance measures

Volumes of Unaccounted-for Gas

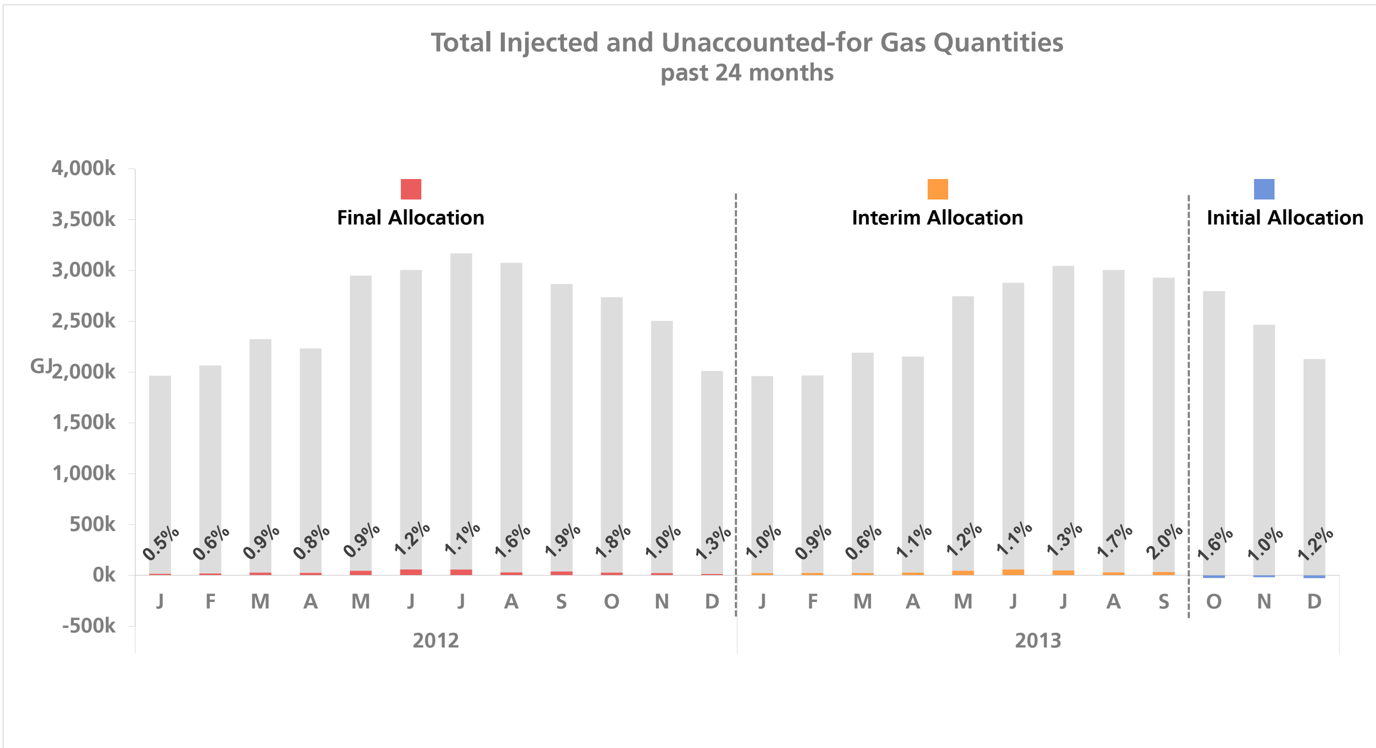
Under the Reconciliation Rules, the amounts of gas that retailers estimate their customers have used are subtracted from the amounts of gas leaving the transmission system. The difference is UFG, which arises from technical losses on the system, metering inaccuracies, and retailer estimation errors. UFG imposes a cost on the market: it is gas that retailers are allocated and must pay for, but cannot sell. Tracking UFG is a way of monitoring these costs and the efficiency of the retail market. This transparency should assist the industry to take steps to reduce UFG where it is efficient to do so.

The chart below compares total UFG quantities by consumption month and allocation stage (initial, interim or final). The grey bars show UFG based on the most recent data available.

Changes in UFG from one allocation stage to another are largely due to mass market retailers' consumption submissions becoming more accurate at later allocation stages. UFG tends to be most extreme at the initial allocation stage: in summer, UFG tends to be negative due to retailers' overestimations of customer consumption; and in winter, UFG tends to be positive due to retailers underestimating consumption. Generally, UFG volumes diminish considerably from the initial to the interim allocation stages. The final allocation stage reflects further minor adjustments to retailers' data, which can result in slightly more or less UFG, as shown by the orange and red lines in the chart below.

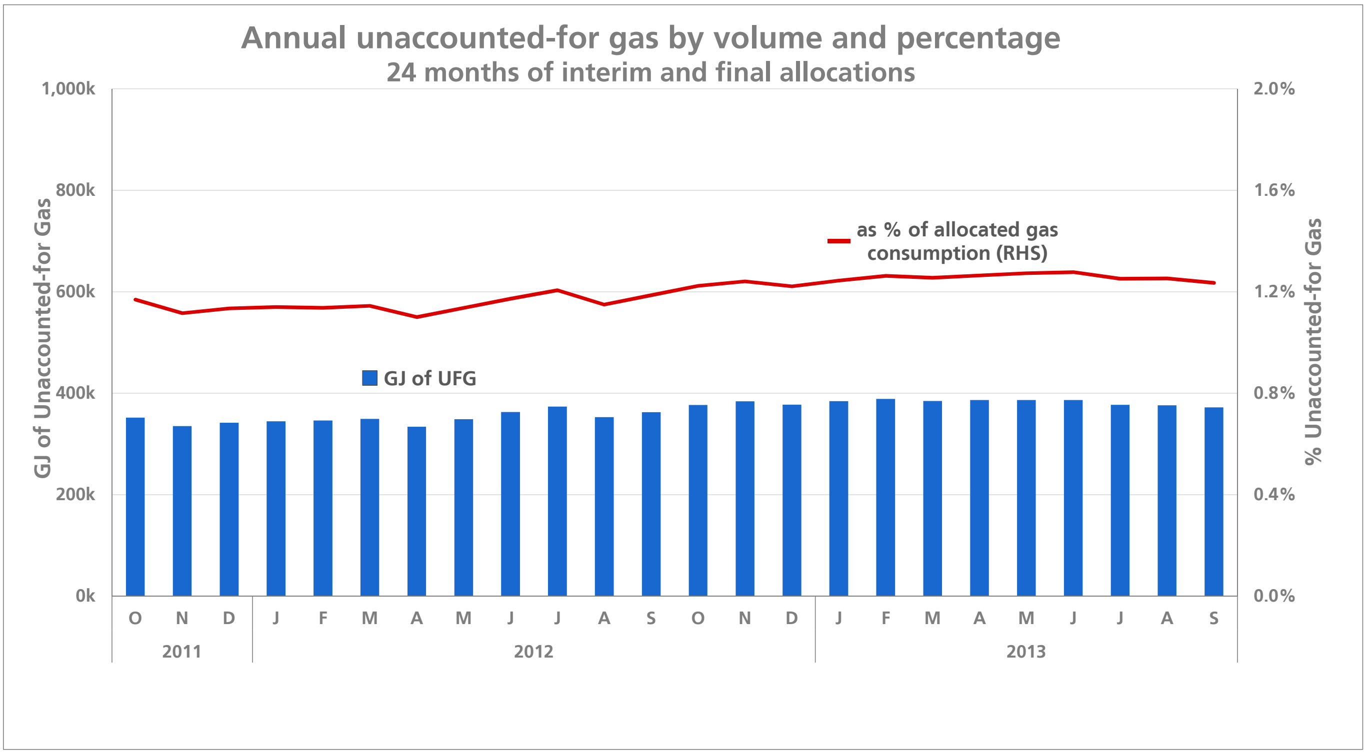


The chart below shows the amount of unaccounted-for gas in comparison to the total amount of allocated gas consumed each month. The grey bars show gas consumption at allocated gas gates, while the coloured bars show UFG volumes, by allocation stage. The labels show the percent of UFG as a proportion of total allocated gas.



Another way to think about UFG is the amount recorded over a 12-month period. The chart below shows rolling 12-month UFG figures, both as a GJ total and as a percentage of gas consumed. As initial data are often inaccurate, the chart includes only consumption months for which interim or final data are available. The figures in the chart are based on the best data available at the time of publication.

For the first year after the Reconciliation Rules came into effect, annual UFG was about 2%. Average UFG now stands at about 1.2%.

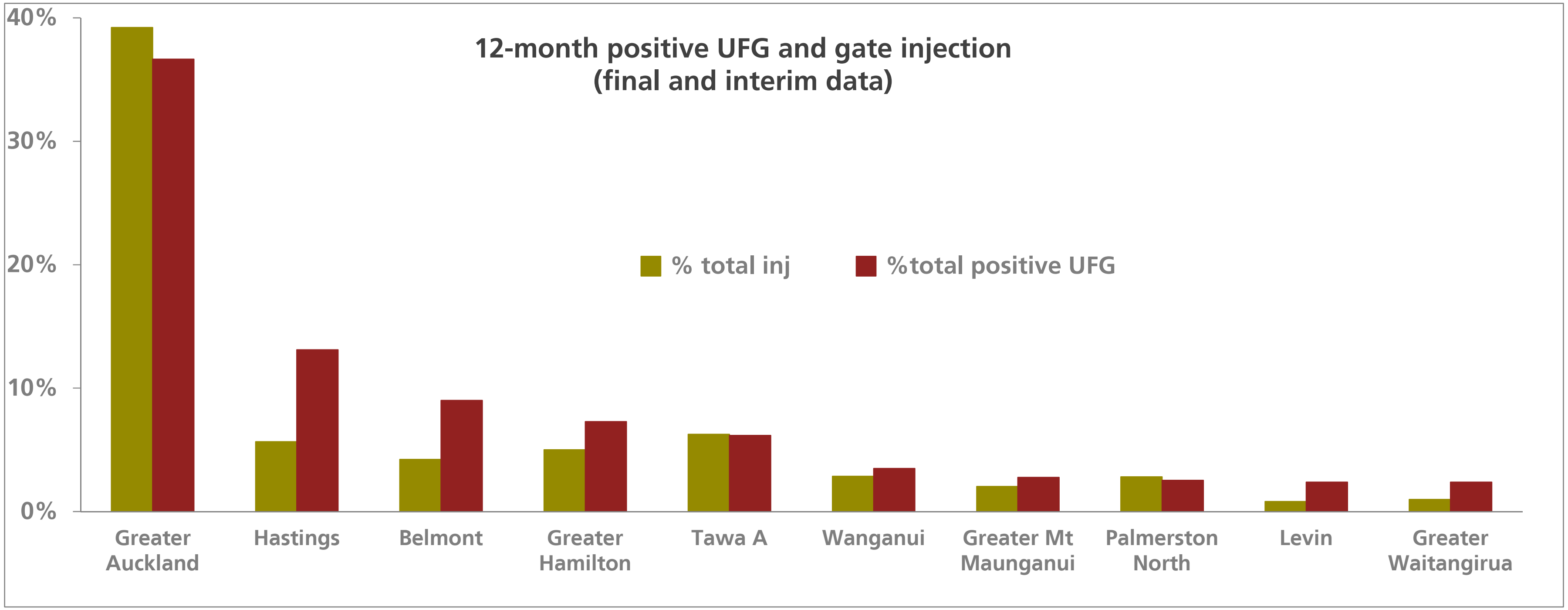


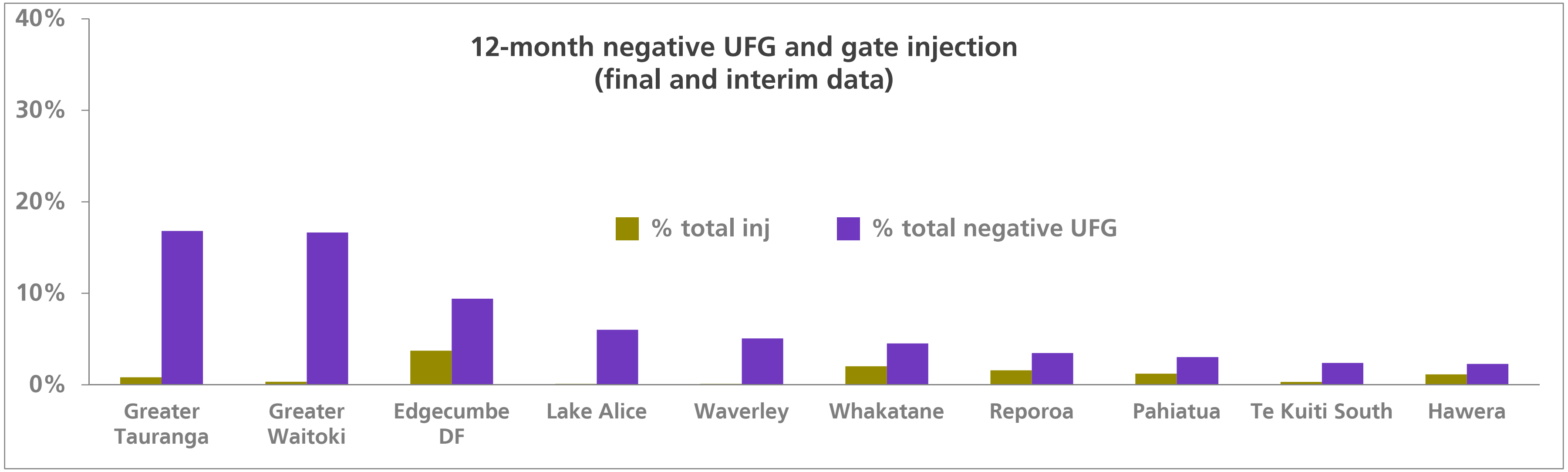
Gas gates where UFG is the highest

The charts below show the gates with the largest volumes of positive and negative UFG over the 12 months from October 2012 to September 2013, according to the most recent (final and interim) data. In those 12 months, a net of 372,091 GJ of UFG has been allocated: 439,850 GJ of positive UFG; and 67,759 GJ of negative UFG.

About 86% of positive UFG has occurred at the ten gas gates shown in the first chart below. For context, the chart also shows the percentage of total gate injections each gate represents; that is, the proportion of total gas consumption that is drawn from those gates. The chart shows, for example, that nearly 40% of gas from shared gas gates was consumed in Greater Auckland, and a slightly smaller percentage – about 37% – of positive UFG occurred there. Conversely, Hastings accounted for about 6% of gas consumption and 13% of positive UFG.

The second chart concerns negative UFG. The ten gates shown account for about 70% of the negative UFG experienced in the twelve months; and again the percentage of gate injections is shown for each of the gates. Six of the gas gates shown – Edgecumbe DF, Waverly, Whakatane, Reporoa, Pahiatua, and Te Kuiti South – have been determined to be global one-month gates, since, among other things, they have a high proportion of industrial load. The global one-month methodology commenced with the new gas year in October 2013.


12-month positive UFG and gate injection
(final and interim data)
% total inj
%total positive UFG
40%
30%
20%
10%
0%
Greater Auckland
Hastings
Belmont
Greater Hamilton
Tawa A
Wanganui
Greater Mt Maunganui
Palmerston North
Levin
Greater Waitangirua


12-month negative UFG and gate injection
(final and interim data)
% total inj
% total negative UFG
40%
30%
20%
10%
0%
Greater Tauranga
Greater Waitoki
Edgecumbe DF
Lake Alice
Waverley
Whakatane
Reporoa
Pahiatua
Te Kuiti South
Hawera

Audits commissioned

Event audits

There have been no incidents requiring that event audits be commissioned in the past quarter.

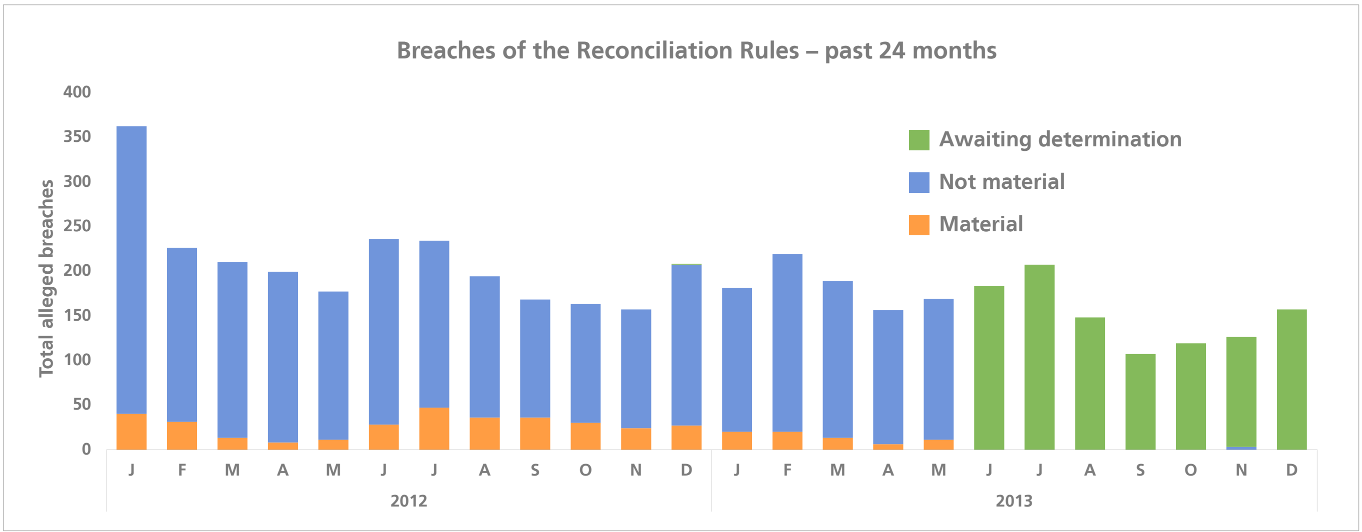
Performance audits

There have been no performance audits commissioned this quarter. However, Gas Industry Co is commencing a programme of performance audits that will cover all allocation participants over the next year.

Number and severity of breaches of the Reconciliation Rules

Over 90% of alleged breaches of the Reconciliation Rules in the past year have occurred in relation to rule 37 – the rule that requires initial consumption information submitted by retailers to be within a percentage of accuracy of the consumption information submitted for the final allocation.

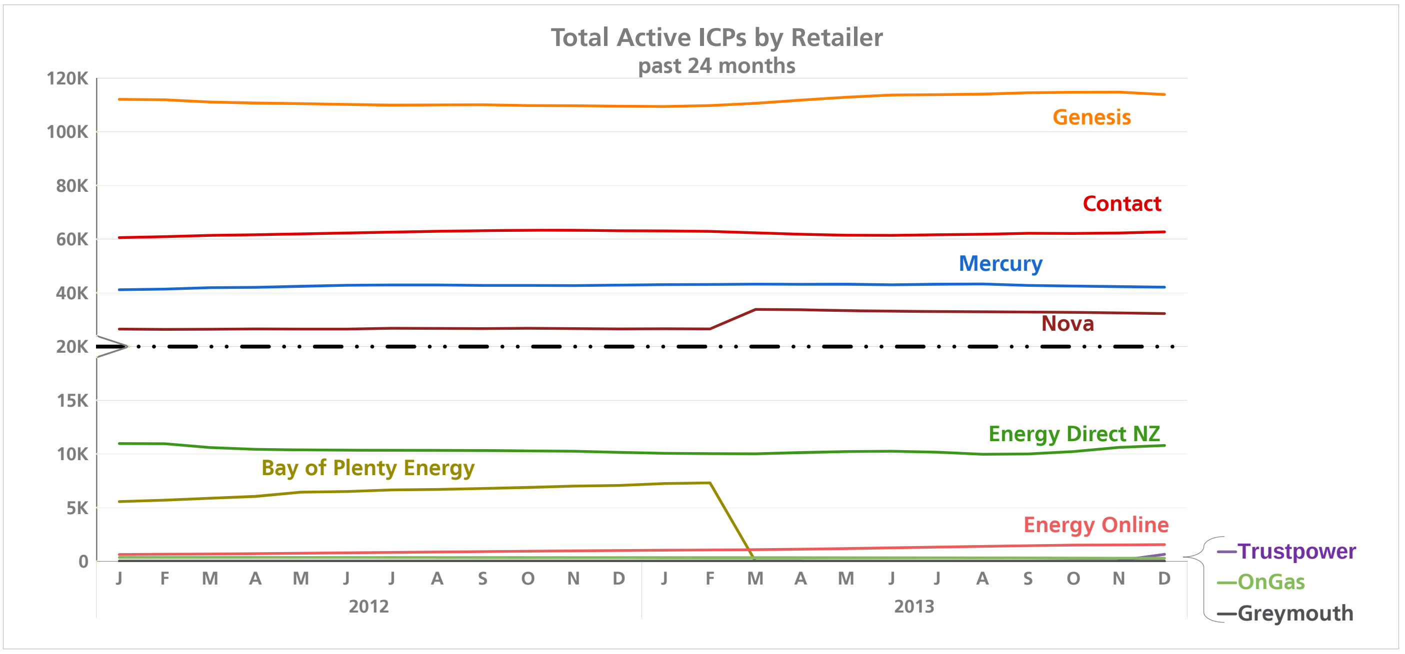
It has proven efficient for the market investigator to attempt to reach settlements in yearly batches of rule 37 breaches. The previous batch, encompassing material breaches alleged from June 2012 to May 2013, was settled in August 2013.



5 Market competition performance measures

Market share of ICPs by retailer

In the last quarter, Trustpower has entered the gas retail market under its own brand, following the company's acquisition of Energy Direct in July 2013. There are now ten distinct retail brands, owned by eight different retail companies (Energy Online is owned by Genesis Energy)., Trustpower has become a gas retailer



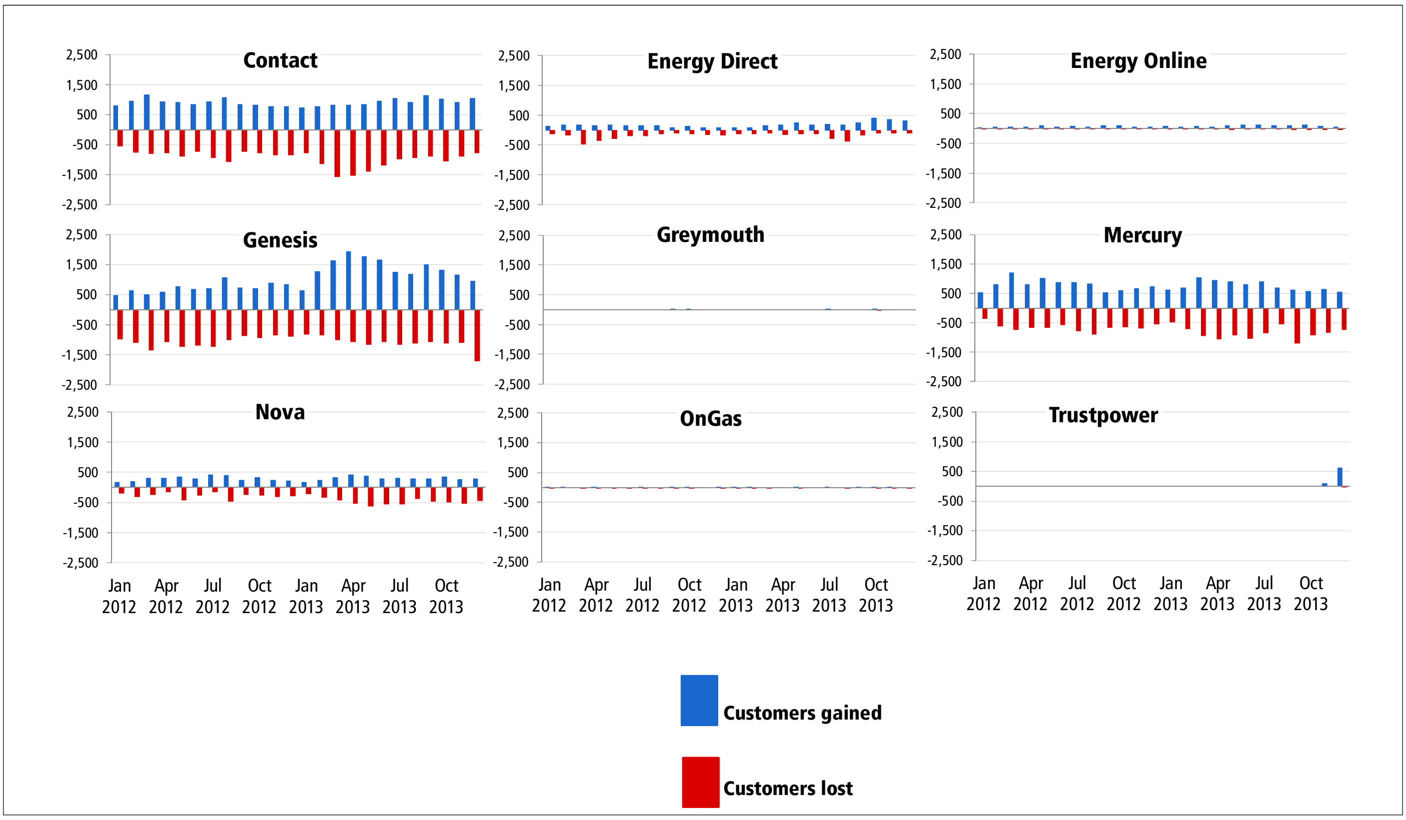
Switching activity by retailer

This chart shows the numbers of ICPs gained and lost by retailers over the past two years. The blue bars show the number of customers gained by the retailer each month, and the red bars show the numbers of customers lost.

As shown by these charts, although the net changes in number of customer ICPs may not change significantly from month to month for some retailers, there is a lot of underlying switching activity, particularly for the mass market retailers Contact, Genesis, and Mercury.

Note that the figures in the chart below do not include transfers of Bay of Plenty Energy customers to Nova in March 2013.

Switching activity by retailer

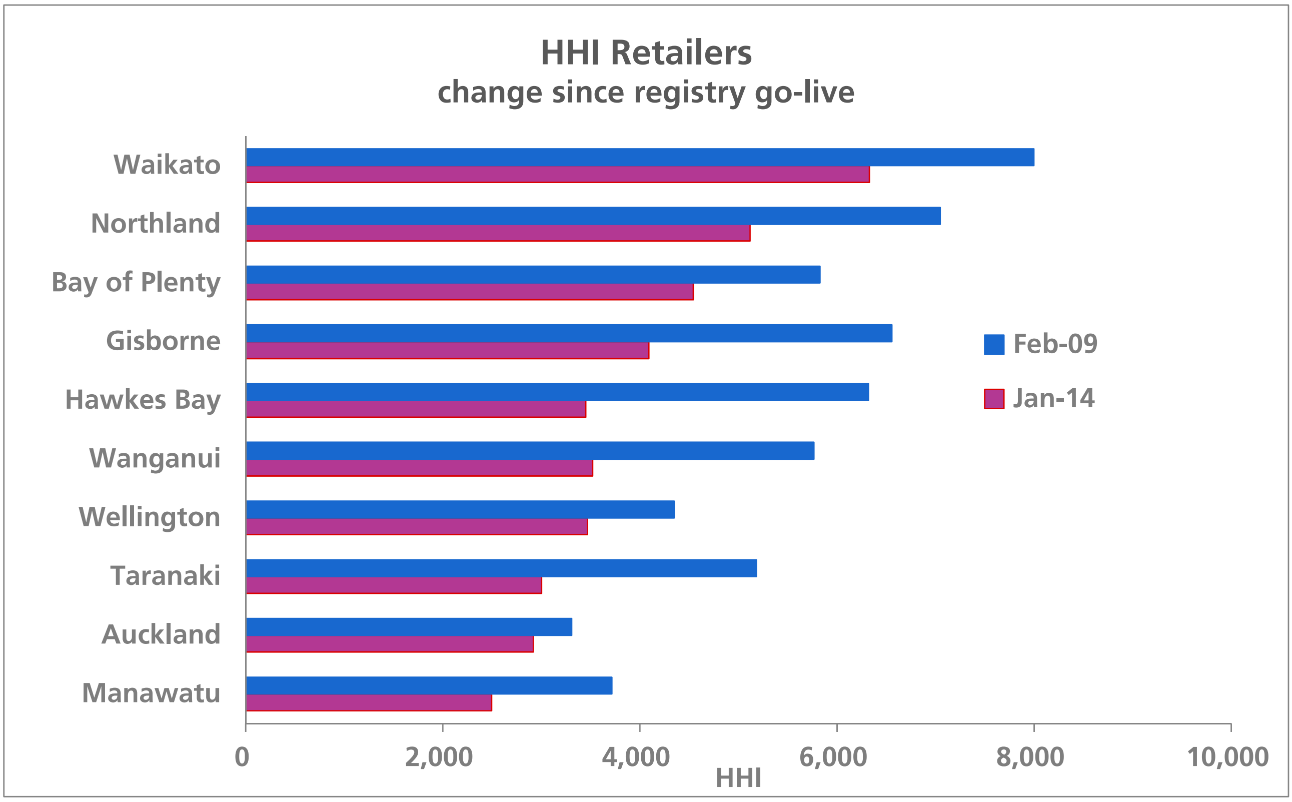


Herfindahl–Hirschman Index

The Herfindahl–Hirschman Index (HHI) is one way of measuring market concentration by using size and number of competing firms. The index ranges from 0 to 10,000. A low score indicates a low level of market concentration, which arises when there is a large number of small firms in the market, each with a small proportion of market share. Conversely, an HHI score of 10,000 represents a market with a single retailer. The measure is used because market concentration is often inversely related to market competition; that is, the more retailers there are, and the more that market share is spread among them, the greater the competition for customers is thought to be.

The chart below shows the HHI of the retail gas market as at the time the registry went live, in February 2009, and as of 1 January 2014. In all regions, the HHI has decreased, indicating that the retail gas markets in these regions have become less concentrated.

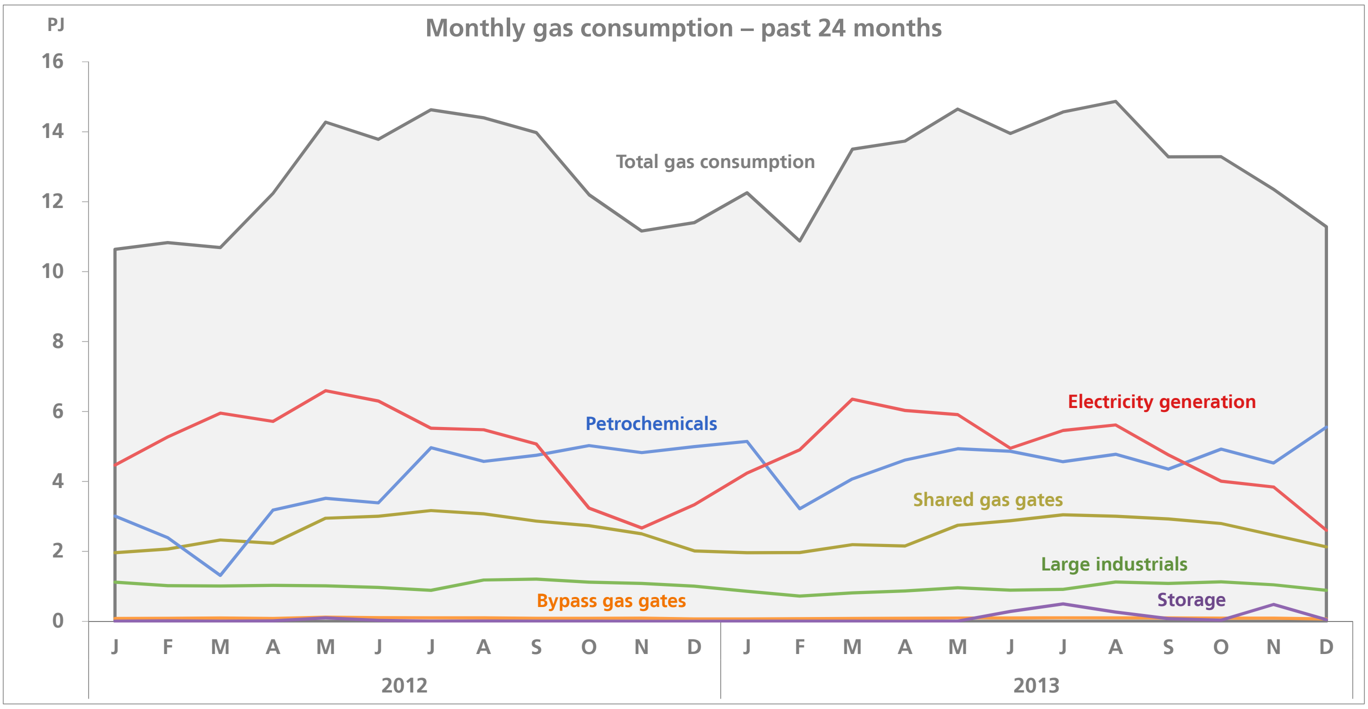
Until 1992, when the new Gas Act disestablished local exclusive franchise areas, gas retailing occurred through local vertically-integrated monopolies. With the consequent onset of retail competition, and as in the electricity sector, these former monopoly providers became ‘incumbents’, subject to competing retailers vying for customers in their areas. In most regions, there is still a dominant retailer, but the decrease in HHI shows that they have become less dominant in the past four years. With the introduction of the Switching Rules, new retailers have entered the market and smaller retailers have increased their market share.


HHI Retailers
change since registry go-live
Waikato
Northland
Bay of Plenty
Gisborne
Hawkes Bay
Wanganui
Wellington
Taranaki
Auckland
Manawatu
Feb-09
Jan-14
0
2,000
4,000
6,000
8,000
10,000
HHI

Total gas volumes

The chart below shows the total amount of gas consumed over the past two years by all gas users. The top grey line shows total consumption; the coloured lines provide a breakdown by type of use.

- The red line shows the seasonal peaks and troughs in gas used for thermal electricity generation.
- Consumption for petrochemicals is shown in blue.
- The tan line shows the amount of gas used by customers connected to shared gas gates. This represents the majority of commercial and residential customers. There is a seasonality trend to the consumption, higher in winter and lower in summer.
- The green line represents volumes of gas used by large industrials, including steel, wood products, dairy processing, and oil refining.
- The purple line shows the volumes of gas going to storage.
- The orange line represents gas used by consumers connected to the private pipelines owned by Nova.

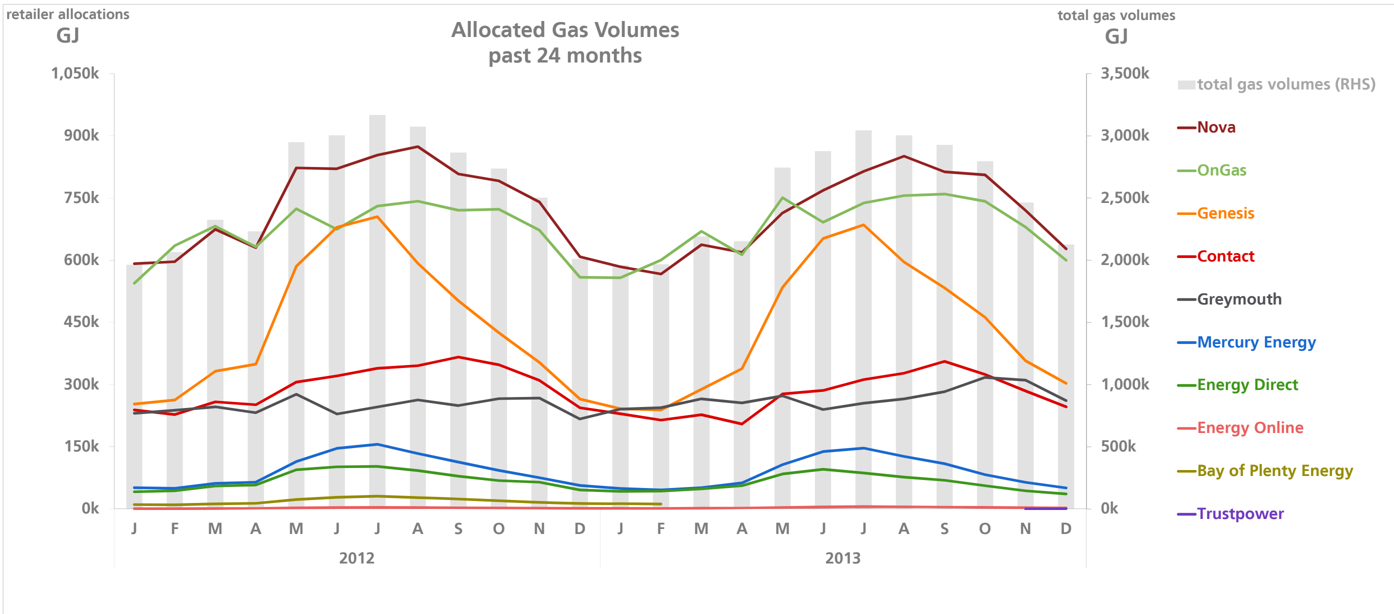


Gas used by consumers connected to distribution pipelines is allocated by retailer and shown in the next section.

Allocated gas volumes

This chart shows the gas volumes allocated to retailers at shared gas gates over the past two years, i.e. gas gates connected to a network that supplies multiple customers. This includes gas consumed by industrial, commercial, and residential customers, but it excludes gas volumes from direct connect gas gates; that is, from gas gates that supply a single customer directly from the transmission system. For this reason, gas volumes supplied through direct connect gas gates to such industrial sites as thermal power stations, oil refinery, and paper and chemical factories are not included in the chart below.

The grey bars in the chart show total volumes of allocated gas (using the right-hand scale); company volumes are denoted by coloured lines and use the left-hand scale. The bars show the seasonality of gas consumption: higher in winter and lower in summer, and many of the retailers show similar patterns in their allocated volumes. Nova Energy is the largest retailer by allocated volumes, followed by OnGas. Genesis, the third largest retailer by volume, has a load profile that peaks in winter and troughs during the summer. Contact, Mercury, and Energy Direct all show similar – but less pronounced – winter peaking patterns. Greymouth's share of allocated gas, in contrast, is relatively steady throughout the year, reflecting its position as largely a supplier to industrial loads.

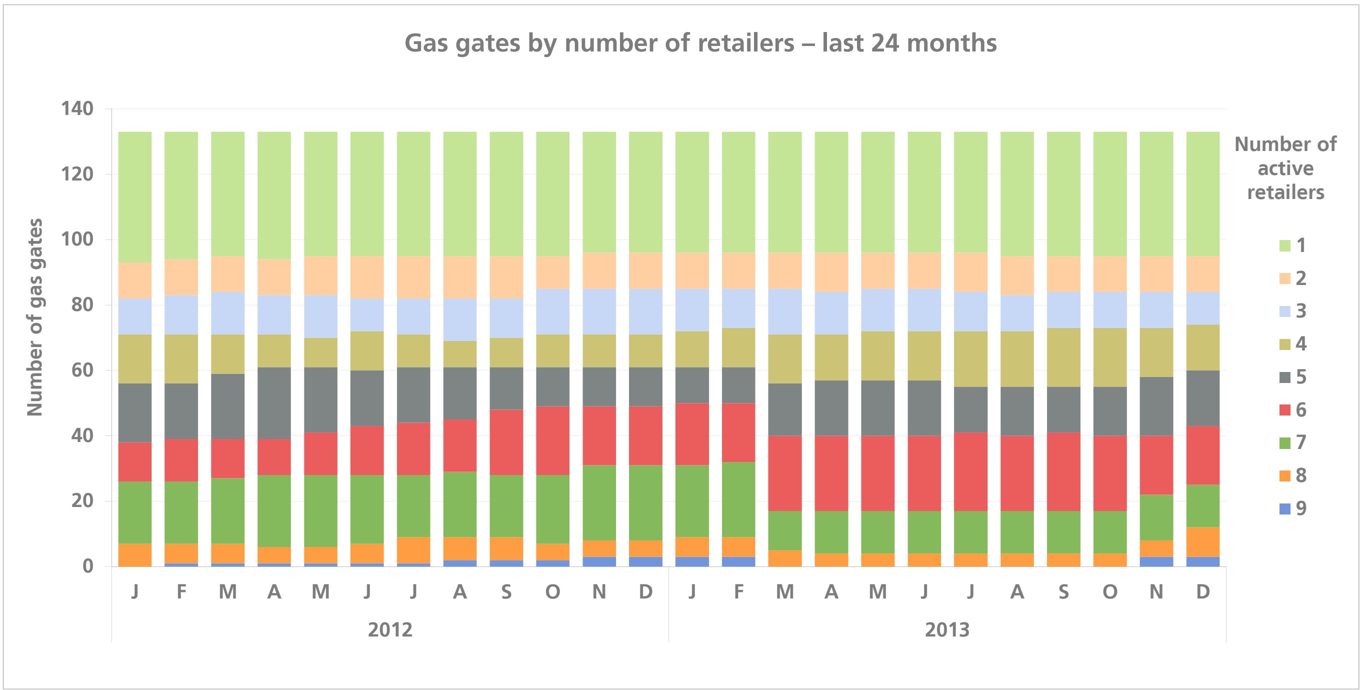


The data are from a mix of allocation stages: Final through December 2012; Interim for January 2013 through September 2013; and Initial for October 2013 through December 2013.

Gas gates by number of retailers

This chart shows, by month, numbers of gas gates by the number of active retailers. The greater the number of retailers that trade at a gas gate, the greater is the potential competition for customers.

There are now nine retailers active at some gas gates, due to Trustpower's entry into the retail market.

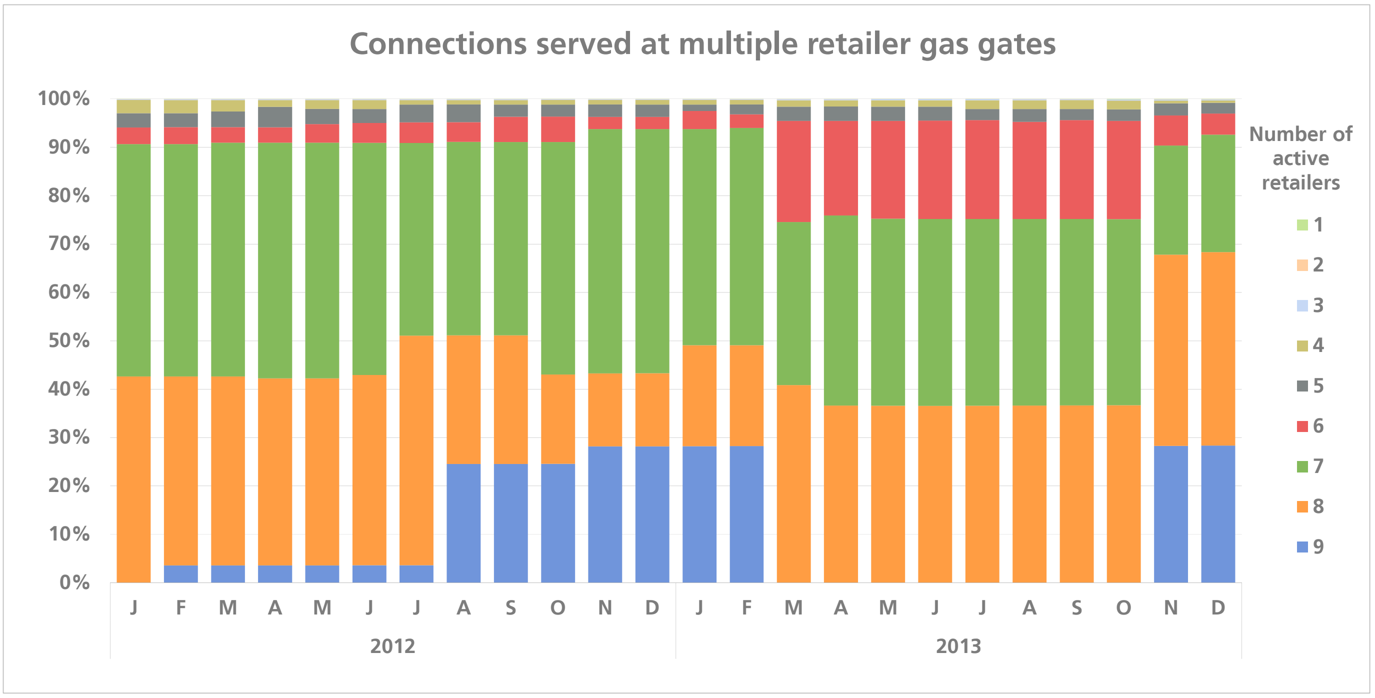


Connections served by multiple retailers

This chart plots the proportion of gas customers who are served from the gas gates in the chart above; that is, customers served at gas gates where multiple retailers trade.

This chart also shows the March 2013 step change caused by the amalgamation of Bay of Plenty Energy into Nova, as well as the recent entry of Trustpower in November 2013.

About 97% of gas customers are connected to a gate where least six retailers trade.



6 Critical Contingency Management performance measures

There were no critical contingencies in the previous quarter.

Strategic Progress: Quarterly Report 1 October – 31 December 2013

This report provides an update of progress towards Gas Industry Co's strategic goals. These reflect the Government's objectives and outcomes for the gas industry, as set out in the Gas Act 1992 and the April 2008 Government Policy Statement on Gas Governance, as implemented through the Company's FY2014-2016 Statement of Intent.

Project	Rationale	Activity	Status
Strategic Goal: Efficient Use of, and timely investment in infrastructure			
Transmission Pipeline Balancing	• Improved industry arrangements. Gas industry participants and new entrants are able to access transmission pipelines under reasonable terms and conditions.	• Assess balancing market developments. • Provide advice to Minister on balancing market developments as appropriate.	• Formal balancing update provided to Minister on 16 April 2013. • Way open for implementation of back-to-back balancing following GIC Final Recommendations supporting changes to MPOC and VTC. Implementation now in the hands of MDL and Vector respectively.
Interconnection	• Improved industry outcomes. Gas industry participants and new entrants are able to access transmission pipelines under reasonable terms and conditions.	• Monitor two new interconnection arrangements on each open access transmission pipeline (Vector, MDL). • Review transmission pipeline interconnections and consult on any issues by the end of 2013. • Investigate the extent, if any, of issues relating to access to private pipelines.	• Cheal and Sidewinder field (both TAG) interconnections reviewed (both on the Vector system); no issues identified. • Reviews to be completed on Maui pipeline of physical and wholesale market interconnections.
Access to Processing Facilities	• Statutory Role under Gas (Processing Facilities Information Disclosure) Rules 2008.	• Collect, monitor, and publish disclosed information. • Recommend to Minister by 27 June 2013 as to continuance, amendment, or expiry of these Rules.	• All disclosures received and published on Gas Industry Co website. • Minister has accepted GIC recommendation that regulated access to gas processing facilities is not necessary. The Gas (Processing Facilities Information Disclosure) Rules 2008 will expire in June 2014.

Strategic Goal: Build efficient, competitive, and confident gas markets			
Rule Changes	• Improved industry governance through regular review of existing arrangements and recommending changes where appropriate.	• Maintain rule change registers. • Review industry feedback on options paper on Reconciliation Rules review. • Consult on Statement(s) of Proposal for changes to Reconciliation Rules. • Review effectiveness of the Gas Governance (Critical Contingency Management) Regulations 2008 following any events/exercises. • Consult on proposed changes to the Compliance Regulations.	• Phase 1 amendments to the Reconciliation Rules took effect on 1 June 2013. Work continues on phase 2 changes dealing with allocation methodologies. • Changes to CCM Regulations changes approved by Minister and take effect 1 March 2014. • Changes to the Compliance Regulations, approved by Minister and take effect on 1 March 2014.
Gas Quality	• Maintain an acceptable standard of gas quality. • Ensure costs of gas quality incident are met efficiently. • Achieve improved transparency on gas quality incidents.	• Ongoing review of industry arrangements for managing gas quality. • Consider options for improving gas quality arrangements.	• Survey of gas quality monitoring completed. • GIC continues to work with Retailers on has facilitated industry discussions on Retailers' Information Exchange Protocol designed to demonstrate compliance with gas quality requirements.
Insolvent Retailer Arrangements	• Following recommendation to revoke 2010 temporary Insolvent Retailer Regulations, consider whether generic regulatory solution is required to address retailer insolvency.	• Prepare Issues and options paper for industry consultation.	• Minister has accepted GIC recommendation that permanent backstop regulations are not necessary.
Gas Distribution Principles	• Improved industry outcomes. Gas industry participants and new entrants are able to access distribution pipelines on reasonable terms and conditions. • Ensure consistency in distribution services arrangements.	• Monitor and report annually to Minister on status of distribution arrangements. • Develop and publish distribution contract Principles. • Encourage publication of network services agreements.	• First assessment of contracts conducted as at 1 February 2013. Arrangements not progressed as well as expected, but positive indication from industry as to completion. • Next assessment in February 2014.

Transmission Change Requests	• Contractual role pursuant to MoUs with MDL and Vector. • Ensure ongoing relevance and efficiency of multilateral terms of access to transmission pipelines.	• Process MPOC change requests and VTC change request appeals as they are received in accordance with respective Memorandum of Understanding (MoU).	• GIC's Draft Recommendation rejects Contact Energy's VTC change appeal (single issue - dated 6 May 2013). Assessing submissions prior to concluding the Final Recommendation. Second ground of Contact's appeal not to proceed in absence of agreement by the parties. • GIC Final Recommendation supports VTC change request appeal (dated 27 November 2012) on balancing processes, peaking charges, and disputed invoices. Supplementary note published addressing matters outside GIC's rule as appeals body un the VTC. • Final Recommendation on 10 June 2013 supports MPOC change request (dated 28 March 2013) seeking a number of minor and technical amendments. • VTC change appeal (dated 31 July 2012) relating to prudential security withdrawn by Vector. • GIC Final Recommendation on 28 February 2013 supports MPOC change request on nomination time. • GIC Final Recommendation finds against Contact Energy's single issue VTC Appeal confirming the Draft Recommendation.
Compliance	• Statutory role under the Compliance Regulations. • Improved industry operations through provision of a compliance and dispute resolution process for industry participants.	• Oversight of Gas Governance (Compliance) Regulations 2008.	• Gas Industry Co continues to fulfil its role as Market Administrator under the Compliance Regulations. • Breach activity has been low; a positive indicator of industry compliance.

Customer Issues	• Enhanced consumer benefits through complaints process for small gas customers.	• Liaise with the Electricity & Gas Complaints Commission (the approved complaints scheme), and other relevant regulators to remain aware of consumer complaint issues.	• Regular liaison with Electricity & Gas Complaints Commission and other relevant regulators. Gas-related inquiries and complaints statistics included in Gas Industry Co Annual Report.
Retail Contracts	• Enhanced consumer outcomes by providing clarity around the respective roles and obligations of consumers and industry participants involved in the supply of gas to small users.	• Administer the Retail Gas Contracts Oversight Scheme. • Annual assessment of alignment of retail contracts with contract Benchmarks. • Report to Minister on the results of the 2012 assessment.	• Third assessment (published in November 2012) increases retailers' overall rating from 'moderate' to 'substantial' alignment with the benchmarks. • Gas Industry Co advised the Minister of deferral of the 2013 assessment pending a Scheme review. • Submissions on Consultation Paper generally support continuation of the Scheme, with modifications, rather than replacement with regulated regime. • Statement of Proposal for scheme modifications issued 6 January 2014. Submissions close 17 February.

Transmission Pipeline Capacity	• Improved consumer outcomes by addressing short and long-term competition issues arising from the North Pipeline capacity constraint. • Enhanced industry/consumer outcomes by improved level, and quality, of information on which to base business/energy use decisions.	• Address by regulatory and/or non-regulatory options any lessening of competition due to transmission constraints. • Implement the Gas Transmission Investment Programme (GTIP). • Improve the quality and availability of pipeline security standards and supply/demand information. • Promote changes to commercial and regulatory arrangements so the GTIP objectives can be met.	• Submissions analysis on PEA's Second Advice and GIC's companion GTIP status update report acknowledged good GTIP progress, but divided on what direction the project should now take. On GIC's invitation Transmission System Owners have agreed to lead industry initiatives in accordance with PEA's future path proposals. In parallel, GIC is continuing with policy development which, depending on industry progress, may lead to Statement of Proposal. • Continued monitoring of information provided by signatories to the 'Bridge Commitments', designed to address short-term issues. • Continued monitoring of Gas Transmission Exchange (GTX) - one of the seven Bridge Commitments.

Project	Rationale	Activity	Status
Strategic Goal: Deliver effectively on accountabilities			
Downstream Reconciliation	• Statutory role under Reconciliation Rules. • Improved industry arrangements and consumer outcomes through the objective of fairly allocating, and reducing, unaccounted-for-gas (UFG) and its associated costs.	• Oversight of Gas (Downstream Reconciliation) Rules 2008.	• Gas reconciliations being performed each month. • Long-term UFG has flattened out at approximately 1%.
Switching and Registry	• Statutory Role under Switching Rules 2008. • Efficient retail market and improved consumer outcomes by facilitating market contestability through customer switching between retailers.	• Oversight of Gas (Switching Arrangements) Rules 2008.	• Customer switching facilitated through rules and registry processes. • Switching statistics report issued monthly.
Performance Measures	• Improved industry and consumer outcomes through the provision of public information on industry performance. • Monitor the effectiveness of governance arrangements.	• Determine and publish information on each gas governance arrangement that has been implemented.	• Performance measures computed and reported quarterly.

Industry Facilitation	• Facilitate nexus between industry and Government. • Maintain informed industry participants and other stakeholders.	• Facilitate, influence and communicate with the industry and Government. • Liaise with other regulatory bodies, agencies and associations with responsibilities and interests encompassing the gas industry.	• NZ Gas Story completed and provided to Minister on 1 March 2013. Document updated and re-issued December 2013. • Regular liaison with MBIE, Electricity Authority, and other relevant regulators.
Critical Contingency Management	• Statutory role under Gas Governance (Critical Contingency Management) Regulations 2008. • Improved industry outcomes through increased market confidence in industry's ability to manage critical events.	• Manage Critical Contingency Operator (CCO) via service provider agreement. • Review effectiveness of the Regulations following any events/exercises. • Operate critical contingency pool following an event.	• CCO activities monitored and reviewed quarterly.