



Briefing for the Minister of Energy and Resources

January 2013





About Gas Industry Co.

Gas Industry Co is the gas industry body and co-regulator under the Gas Act 1992. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

1

Introduction

This briefing paper focuses on the New Zealand gas industry, and particularly the role and work of Gas Industry Co as the 'approved industry body' under Part 4A of the Gas Act 1992.

Section 2 summarises the New Zealand gas industry, the policy context, governance arrangements, Gas Industry Co's role and strategies, current industry issues, and the interface between Gas Industry Co and key stakeholders, including the Minister of Energy and Resources.

Section 3 looks at the gas industry make-up, and the development of the co-regulatory model as the industry has transitioned from a reliance on a dominant field, Maui, to more complex supply arrangements involving multiple, smaller fields.

Section 4 discusses Gas Industry Co's work programme in the current 2012/13 financial year (FY2013) and the indicative work plan for FY2014.

Section 5 concludes this paper with information about Gas Industry Co, including its Board, Management, strategic priorities, and relationships with other agencies.

We have also provided in **Appendix B** more detail on the history of the establishment of Gas Industry Co and the background to the introduction of a 'co-regulatory model'.

2

Key Gas Industry Parameters and Issues

Gas in New Zealand

Natural gas has contributed to New Zealand's energy supply for over 40 years. Currently:

- Natural gas is produced from 15 fields, all onshore or offshore Taranaki, and is available only in the North Island.
- Total gas market demand is approximately 160 petajoules¹ (PJ) /year.
- Natural gas accounts for 20 percent of total primary energy supply and 11 per cent of consumer energy.
- About half (46 percent) of natural gas production is used for electricity generation (in turn, gas fuels approximately 18 per cent of total electricity generation).
- Approximately 16 percent of natural gas is used as a feedstock for petrochemicals manufacture (methanol, and urea fertiliser).
- Industrial customers consume 30 percent of annual natural gas production and include many of New Zealand's key export industries.
- The commercial and residential consumer groups each account for about 4 percent of annual natural gas consumption.
- Gas is used by approximately 258,000 consumers (247,000 residential; 10,000 commercial; 1,300 industrial).
- There are two high pressure gas transmission pipeline systems (Maui, Vector) totalling approximately 2,500km in length.
- Local area, lower pressure distribution networks total approximately 16,000 km.
- LPG is a mix of propane and butane gases extracted from natural gas. Currently:
 - New Zealand market demand is approximately 140,000 tonnes a year
 - Following the Kupe field coming onstream, New Zealand is a net LPG exporter
 - LPG is supplied nationally, including in reticulated networks in some South Island centres (Christchurch, Wanaka, Queenstown), to residents in 9kg and 45kg cylinders, and to businesses in larger cylinders.

By its nature, the gas industry is complex and ever-changing. It is dependent on a range of players, from upstream explorers and producers through to customers, as well as on competitive markets and ongoing investment at all stages.

¹ 1 petajoule =1 million gigajoules (GJ). Based on average residential consumption of 28 GJ/year, 1 PJ equates to the annual gas consumption of approximately 35,700 households.

1. ***The Government’s New Zealand Energy Strategy 2011-2021 (August 2011) (‘NZES’) envisages a significant ongoing role for gas in the country’s future supply makeup - as an important feedstock for electricity generation, and as a direct energy source for New Zealand homes, businesses, and industry.***

The NZES recognises the tension between making the most of gas – a fossil fuel – in an era of increasing global concerns over climate change, and seeks to take a balanced approach to building a sustainable energy and resources future. Its objective is to make the most of all of New Zealand’s energy assets – renewable and non-renewable – and to use them responsibly to strengthen energy supply security, grow the economy and improve standards of living.

Accordingly, in parallel with continued development of renewable energy resources, including the goal of achieving 90 per cent renewable electricity generation from renewable sources by 2025, and improving energy efficiency, the NZES seeks also to develop the full potential of New Zealand’s oil and gas resources.

2. ***It is important that industry assets and market arrangements support the realisation of the role envisaged for gas under the NZES, through reliable infrastructure, efficient competitive markets, and timely industry-led investment to ensure gas is extracted, treated and transported to end users.***
3. ***Gas Industry Co was established in 2004 under the Gas Act 1992 (the ‘Act’) as the “approved industry body” and co-regulator. The industry requested a regulatory model (based on the then-New South Wales regime) that avoided an undue regulatory burden on a small gas industry.*** Key elements reflecting the co-regulatory model are:

- the Company is owned by key gas industry participant shareholders, and is funded by user-pays market fees and a levy on industry participants.
- we are governed by a Board of Directors that comprises a mix of independent and industry-representative directors. A majority of independent directors is required by the Act. The Board has been chaired by the Right Honourable Jim Bolger since inception.

Further details are contained in section 5 below. In particular:

- our focus is on industry governance in delivering gas to consumers from the point it enters the gas transmission system.
 - we believe that the co-regulatory model continues to serve the industry and Government well.
4. The industry moved from a reliance on the predominant Maui field to a market supplied from multiple, smaller fields. Gas Industry Co’s work programme essentially ensures that industry arrangements in the post-Maui era are developed to meet these goals. As a “co-regulator” Gas Industry Co is able to develop arrangements, including developing regulations where appropriate, which improve:

- the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes.
5. In recommending such arrangements to the Minister, Gas Industry Co is directed by the objectives of the Act, and must also take account of the objectives set out in the Government Policy Statement on Gas Governance (April 2008 – the ‘GPS’). The principal objective of any gas governance regulation is ensuring ‘that gas is delivered to existing and new customers in a safe, efficient and reliable manner’. Other objectives include:
- providing access to essential infrastructure;
 - providing competitive market arrangements;
 - minimising barriers to competition in the gas industry;
 - enhancing incentives for investment in key facilities;
 - ensuring that delivered gas costs and prices are subject to downward pressure;
 - risks to security of supply are properly managed; and
 - ensuring there is consistency with the Government’s gas safety regime.
6. The GPS applies these objectives also to non-regulated arrangements, and adds two further objectives: fairness and environmental sustainability.
7. Gas Industry Co’s priorities, work programmes, and levies are set following industry consultation. We publish a Statement of Intent annually (previously in the form of a “Strategic Plan”), and levies are authorised by annual regulations.
8. In the eight years since it commenced operations, Gas Industry Co has introduced significant market reforms, and has fulfilled most of the current GPS objectives. In that time, Gas Industry Co has recommended eight gas governance arrangements, which have essentially modernised and strengthened our gas markets:
- two sets of Regulations (Compliance and Critical Contingency Management);
 - three sets of Rules (Switching Arrangements, Downstream Reconciliation, and Gas Processing Facilities Information Disclosure);
 - a set of guidelines for interconnection with transmission pipelines;
 - a voluntary oversight scheme of benchmarks for Retail Gas Contracts; and
 - a voluntary oversight scheme of principles for Gas Distribution Contracts.

There has also been a range of less formal industry arrangements. Apart from the proposed voluntary arrangements for pipeline interconnections, which remain under ministerial review, these governance initiatives have all been approved or endorsed by the Minister.

9. These arrangements have been successful in achieving improved industry efficiency, market contestability, and enhanced customer outcomes. This is best exemplified by the market arrangements put in place for customer switching between retailers and gas reconciliation. Customer switching, for example, has tripled. Other achievements have included:
 - much greater market transparency as a result of data on switching and reconciliation that is now published, and which promotes competition;
 - effective and rigorous monitoring and audit processes, which revealed serious and systematic consumption misreporting by one retailer, E-Gas, leading to it exiting the market. In October 2010, regulations were introduced to protect the supply of gas to E-Gas customers if the commercial liquidation process was unable to see them transferred to a new retailer. E-Gas's liquidation in late 2010 reflected issues going back some years, but which were only identified following introduction by Gas Industry Co in 2008 of new gas reconciliation systems.
 - an increase to around 15% in small customer churn, close to the 17% churn in the electricity sector (and aided by the Electricity Authority's *What's My Number* campaign), and a reduction from weeks or months to an average of about six days in the time taken to complete switches. Over 96% of customers have a choice of six or more retailers at the gas gate servicing their area.
 - significant reductions in the rate of 'unaccounted-for gas' (UFG), which otherwise represents a deadweight loss to the industry and, ultimately, is a cost to consumers; and
 - development of coordinated, industry-wide emergency management arrangements through the Gas Governance (Critical Contingency Management) Regulations 2008 ('CCM Regulations').
 - approval of an effective, free, and independent complaints resolution process through the Electricity and Gas Complaints Commissioner Scheme.
10. Gas Industry Co continues to develop a range of regulatory and non-regulatory options as it addresses significant issues in the immediate future. Two merit particular comment in this briefing.
11. First, Gas Industry Co is responsible for overseeing the effective management of 'critical contingencies' under the Critical Contingency Management Regulations. These were well tested in October 2011 by a major outage on the Maui Pipeline. Reviews by Gas Industry Co and Vector have led to improvements, and we also expect to present you with recommended changes to the Regulations for you in the next few months.

12. Second, there is a strong industry-focus on gas transmission and investment. Gas Industry Co is leading the industry's search for short-term and long-term solutions to constraints on the Vector North Pipeline transmitting gas to the Auckland market, and into Northland, as well as potential future constraint issues elsewhere on the transmission system. This work is referenced in the National Infrastructure Unit's *Infrastructure 2012 National State of Infrastructure Report*.

It is important to highlight that initial suggestions that significant new pipeline investment might be needed to meet Auckland gas demand have not proven to be needed in the short to medium term. Amongst other factors, reduced use of gas for electricity generation in Auckland has freed up some of the 60% of Auckland transmission capacity previously committed to that use. Our work has also uncovered scope for more efficient use of the existing transmission capacity, which is now the focus of our industry work.

The Gas Transmission Investment Programme ('GTIP') is accordingly dedicated to taking transmission arrangements to the next phase. GTIP comprises a suite of projects and also involves Gas Industry Co working with panels of industry strategic advisers and technical experts. It is looking in particular at how existing transmission capacity can be utilised in a competitive and efficient manner, and whether industry arrangements and wider conditions support further investment if needed.

The GTIP has also produced New Zealand's first detailed gas supply/demand study, *Supply and Demand Scenarios 2012-2027*, commissioned by Gas Industry Co from Concept Consulting. This reflects substantive industry input and is helping inform gas industry investment decisions by providing a form of 'Statement of Opportunities'.

13. Other immediate priority issues for Gas Industry Co include:
- transmission balancing and associated industry efforts to develop a practicable wholesale gas trading platform;
 - improving gas quality arrangements;
 - developing appropriate arrangements in the event of gas retailer insolvency;
 - receiving a regime for assessing contracts between retailers and small gas customers;
 - implementing principles for contracts between gas distributors and retailers; and
 - developing new options for information gathering to aid in the timely development of gas market solutions.
14. Gas Industry Co is advanced in the preparation of a substantial report on the current State and Performance of the Gas Industry. This is a comprehensive end-to-end review of the industry and

will be published in February 2012. The last report of this nature was completed in 2006². Gas Industry Co understands that the current (2008) GPS is also scheduled for review and is well positioned to contribute to that work as required.

15. Gas Industry Co liaises closely with MBIE in the development, implementation, and ongoing monitoring/administration of industry governance arrangements. We also take an interest in MBIE's role of overseeing the upstream exploration and production sector, the success of which provides the foundation for the rest of the industry.

Gas Industry Co also liaises directly with the Minister and the Minister's office in respect of:

- approval of Gas Industry Co recommendations for regulated arrangements, and endorsement of non-regulated arrangements (a list of recommendations and advice to the Minister in the period 2005-2012 is included as **Appendix A**);
- reviewing of Gas Industry Co's annual Statement of Intent, which sets our strategic work activity for the ensuing three years;
- enacting of annual regulations giving effect to the levies to be applied to industry participants for each financial year;
- presenting Gas Industry Co's Annual Report by 30 September each year for tabling in Parliament;
- correspondence on matters upon which Gas Industry Co has undertaken to report to the Minister. Currently, these matters include:
 - advice on any new interconnection issues relating to open access pipelines by 2013;
 - a recommendation by 27 June 2013 as to the continuance, amendment or expiry of the Gas (Processing Facilities Information Disclosure) Rules 2008; and
- providing reports on the state and performance of the industry (a requirement on us under the Gas Act), including through Quarterly Reports; and
- responding to specific directions or requests the Minister may make from time to time for Gas Industry Co to investigate, or give advice on, a particular matter.

² *The New Zealand Gas Industry in 2006 – Review of its state and performance* – Allen Consulting Group, 15 November 2006

Gas Industry Co has appreciated arrangements with previous Ministers to meet every quarter, with officials present, to discuss current issues within the gas industry and the strategies being pursued to address them.

We have also appreciated an arrangement for the Minister to meet with our full Board of Directors once a year for a higher level sharing of minds on gas industry matters. We would very much like to maintain such arrangements with you, including (if possible) a meeting with the Board in the first half of 2013.

16. Looking to the future, Gas Industry Co sees the key challenges for the overall gas industry as:

- robust gas supplies – the Government, through the *Petroleum Action Plan* and MBIE, has rightly led work to incentivise upstream investment in gas. Although current reported gas reserves have a nominal horizon of approximately 11 years based on present market demand, during 2012 there were very positive investment signals that have led commentators (including Concept Consulting's report to Gas Industry Co, *Gas Supply and Demand Scenarios 2012 – 2027*) to note that New Zealand's gas supply position is currently stronger than it has been for many years.
- efficient use of existing transmission capacity and improving the pathway for future transmission investment;
- creating confident consumers and other investors and providing a clear gas option proposition for small energy consumers;
- the effect of price increases expected to accompany new discoveries, or in the event of a market need to import or export gas; and
- communicating the gas story to end users, and more generally to enhance public understanding of the role and contribution of gas to New Zealand's energy mix and economic wellbeing.

Gas Industry Co has been instrumental in developing a small consumer proposition for gas by commissioning a report on Consumer Energy Options, which updates a 2009 report on the benefits of direct use of gas, and confirms the competitive positioning of gas in the wider consumer energy market. The report was published in November 2012.

17. Gas Industry Co believes the New Zealand Gas Story is now built upon:

- its role as an important fuel of choice for New Zealand, including in a key contribution to security of electricity supply and sustainability goals;
- Government support for resource extraction, particularly through its *Petroleum Action Plan*;

- private sector ownership of, and investment in, infrastructure assets³;
- competitive customer markets;
- economic regulation of monopoly infrastructure;
- governance arrangements that drive efficient markets; and
- customer confidence in the gas supply chain.

18. Gas Industry Co's corporate strategy reflects these challenges and the foundations for the role of gas in future.

- our central strategic goal is to optimise the contribution of gas to New Zealand;
- we seek to provide leadership for the gas industry,
- our overall corporate objectives are to:
 - deliver effectively on our accountabilities as the gas industry body;
 - build and communicate the New Zealand Gas Story;
 - facilitate efficient investment in, and use of, gas infrastructure; and
 - build efficient, competitive, and confident gas markets.

19. Gas Industry Co's scope covers the bottled LPG markets and gaseous LPG supplied via reticulated networks. It does not extend to bottles themselves, the supply and bulk storage of LPG, or to pipelines carrying LPG in liquid form between transport depots and bulk storage facilities. Gas Industry Co is monitoring the LPG markets but is not aware of any issues that would warrant regulatory intervention.

LPG is available nationwide. It is produced from New Zealand oil and gas fields, and in recent years domestic production has been supported by imports. During the past three years, New Zealand market demand has declined from about 180,000 to 140,000 tonnes per annum. Currently the LPG industry in New Zealand is experiencing a transition to a small excess of domestic supply and continuous exports are expected to resume in the near future.

20. We would be pleased to provide further detail on the industry and Gas Industry Co.

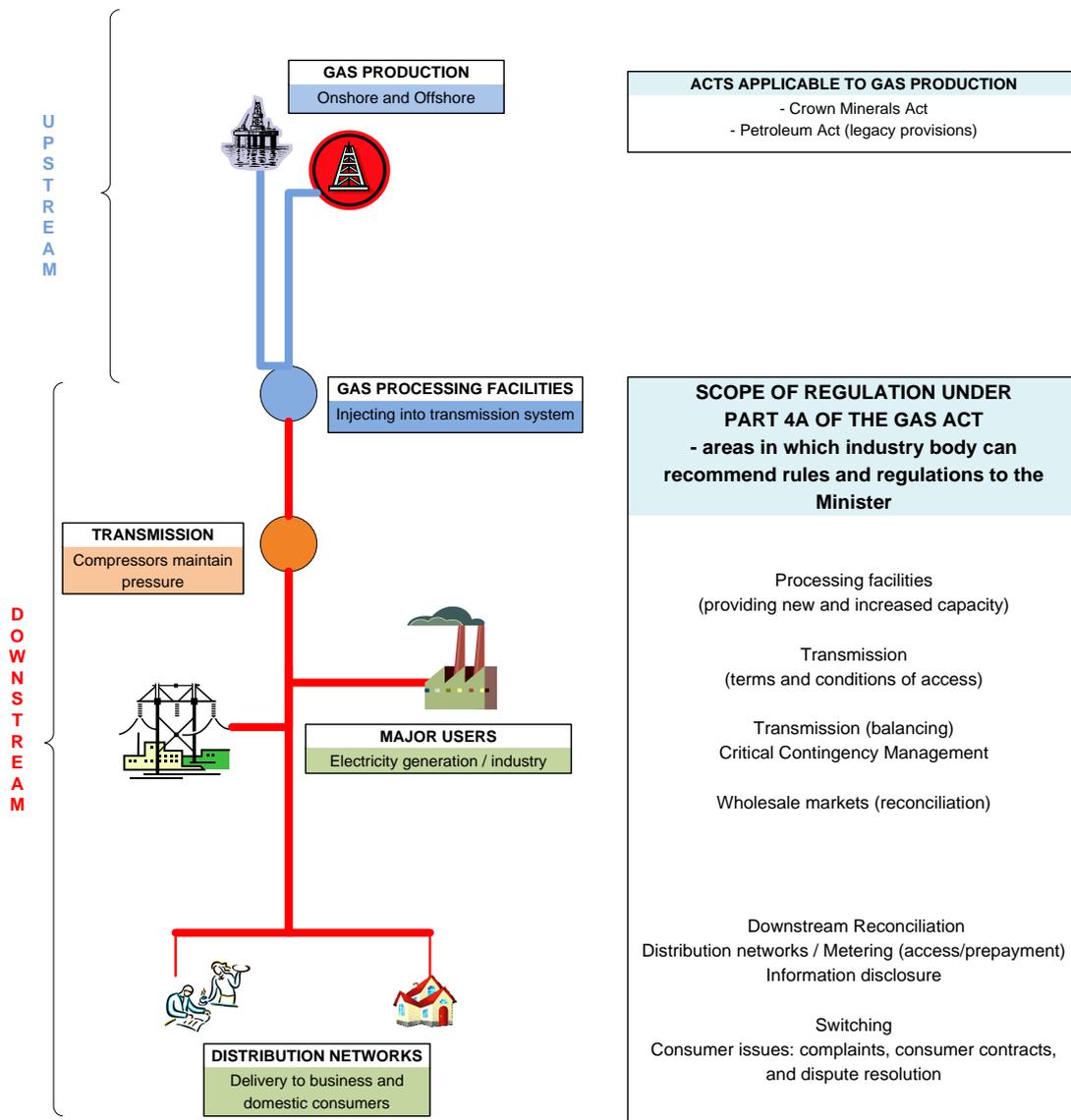
³ The National Infrastructure Plan states : 'Investment decisions in gas infrastructure are entirely private [and] there is an expectation that private sector investment will continue to meet the country's ongoing demand requirements.'

3

Industry makeup

3.1 Key elements

The diagram below shows the key elements of the gas industry.



3.2 Development of the co-regulatory model

The co-regulatory model for the gas industry stems from the Government's desire for industry involvement in developing the industry as it has become more complex, as well as an industry desire to avoid any undue regulatory burden on a comparatively small 'challenger' energy industry. The model provides an opportunity for the Government and industry, facilitated by an industry body, to work together on market arrangements, with regulation being only one option. **Appendix B** sets out this background in greater detail.

Gas Industry Co's role, as the industry body, is to oversee the development of gas governance arrangements for the operation of gas markets, access to key infrastructure, and protection of consumers; and to monitor compliance with, and enforce, such arrangements and rules. These gas governance arrangements may take the form of industry-led arrangements, rules, or regulations.

Gas Industry Co has progressed a long way towards completing the objectives and tasks required by the April 2008 GPS, particularly in relation to consumer market arrangements. Industry participants can now trade with the confidence that there are robust systems for switching customers, accurately reconciling downstream quantities of gas, and managing critical contingencies. (See **Appendix A** for a list of advice and recommendations submitted by Gas Industry Co).

In summary, Gas Industry Co's role commences where gas enters gas processing facilities and the gas transmission system, through to the point of customer delivery. MBIE's role includes the primary policy and regulatory responsibilities for upstream gas. However, Gas Industry Co's corporate strategy recognises the complexity and interdependence of the gas industry, and we seek to take an 'end to end' leadership role in telling the whole New Zealand gas story.

Gas producers sell gas to gas wholesalers who transport (or 'ship') the gas through high pressure transmission pipelines. Gas wholesalers re-sell the gas to retailers, who then contract with gas distributors to deliver the gas to end-users (consumers) through low pressure distribution networks.

Focus areas for Gas Industry Co include:

- access to the transmission pipelines;
- interconnection arrangements on those transmission systems;
- access to, and conditions of use on, distribution networks;
- terms and conditions between gas retailers and consumers;
- the ability for customers to switch easily between gas retailers; and
- accuracy of reporting in respect of gas volumes transported and delivered on the transmission and distribution systems (upstream and downstream reconciliation).

3.3 Changing industry dynamics

In the past decade, the New Zealand gas industry has successfully transitioned from a single dominant source (the Maui gas field) to supply from multiple gas fields, and a more sophisticated gas market. Similarly, Gas Industry Co has broadened from a focus on developing gas governance arrangements to include the administration of those arrangements. The increasing complexity of the gas market requires these arrangements to be constantly monitored and reviewed to ensure their continued relevance and efficiency, and the delivery of benefits to consumers and efficiency for the industry.

The strategic focus for Gas Industry Co has increasingly shifted to infrastructure access and investment. Use of gas transmission pipelines is covered by the industry Codes that govern the Vector and Maui Development Ltd transmission systems, and Gas Industry Co has a role in reviewing change requests, or appeals to change requests, to those Codes. While key work has been completed in this infrastructure area, such as the gas processing information disclosure rules and guidelines for interconnection to transmission pipelines, there is more to do in other areas such as transmission pipeline balancing arrangements and options for allocating capacity on the constrained North Pipeline owned by Vector.

4

Work programmes for FY2013 & FY2014

This section provides an outline of Gas Industry Co's scope of operations, milestones, and expenditure in the current 2012/13 financial year (FY2013), and proposed activity in FY2014. These plans are developed through a detailed consultation exercise with the industry, MBIE officials, and other key stakeholders. They are then approved by the Gas Industry Co Board and result in a draft Statement of Intent and a levy recommendation to the Minister.

4.1 Strategic priorities FY2013

The GPS sets out a list of outcomes for Gas Industry Co to pursue and report on. Gas Industry Co consults widely annually on priorities for its work programme, and to provide the basis for the levy it seeks to support that programme. The strategic priorities set for FY2013, are detailed in Gas Industry Co's Strategic Plan FY2013-2015 and in essence fall into these categories:

- progress priority issues developed in consultation with industry and MBIE, especially the GTIP and CCM Regulations review;
- complete currently committed workstreams;
- maintain core industry systems to ensure the ongoing smooth operation of market arrangements and recommend improvements where required. Specific workstreams include:
 - continue to work with the industry to deliver benefits from the Bridge Commitments to address short-term issues arising from the North Pipeline constraint. Maintain a focus on Gas Transmission Exchange trading and freeing up potential capacity held by electricity generators.
 - progress the GTIP to achieve improved transmission access and capacity pricing arrangements.
 - complete a review of critical contingency management arrangements and make recommendations to improve the industry's emergency response processes.
 - implement the Gas Distribution Contracts Oversight Scheme, using a set of Principles to assess contractual arrangements between distributors and retailers.

- complete the third annual review of retailers' contracts with small consumers against Benchmarks as part of small consumer protection measures. Publish individual retailers' alignment with those benchmarks.
- complete a review of the Downstream Reconciliation Rules and implement appropriate changes, including to initial allocation processes.
- support enhanced, industry-led, non-regulated transmission pipeline balancing arrangements in the form of changes to the Maui Pipeline Operating Code (MPOC), and parallel changes to other balancing-related arrangements.
- introduce arrangements to improve Gas Industry Co's access to information to support its policy development process.
- publish and communicate the New Zealand Gas Story. Establish as a routinely-updated, living document.
- further develop and implement the Company's broader strategy to optimise gas's contribution to New Zealand, and to increase general awareness of gas's role in the economy.

4.2 Strategic priorities FY2014

Gas Industry Co has commenced the process of developing its FY2014 work programme, including industry consultation. In December 2012, it issued a Statement of Proposal setting out its proposed strategy, work programme and levy for that period. In essence, the FY2014 work programme carries through current priorities and there are no major new initiatives to be funded. Consequently, work programme costs are forecast to reduce from those for FY2013.

5

Profile of the industry body

5.1 Composition

Company Shareholders

The Constitution of Gas Industry Co provides eligibility for all gas industry participants to become shareholders in the Company. The shareholders as at December 2012 are shown below. The shareholding is diverse, representing nearly all sectors of the gas industry – production, transmission, distribution, wholesaling, and retailing.

The shareholders are:

- Contact Energy Limited
- Greymouth Gas New Zealand Limited
- Genesis Power Limited
- Mighty River Power limited
- OMV New Zealand Limited
- Powerco Limited
- Shell (Petroleum Mining) Limited
- Vector Limited.

Each shareholder is entitled to one vote on resolutions at shareholders' meetings, including those that appoint directors and change the Constitution.

Board of Directors

The Board of Gas Industry Co is a mix of independent and non-independent (industry) directors appointed by shareholders. At every annual meeting, the Company's Constitution requires that two directors must retire from office. The Company's Constitution limits the Board to no more than seven directors, four of whom (including the Chair) must be independent of the gas industry. When voting on any matter, the number of independent directors voting must exceed the number of non-independent directors voting on the same matter. The Board generally meets monthly to consider operational reports and recommendations from the Gas Industry Co executive.

The composition of the Board is currently:

| Name | Role |
|---------------------------------------|--------------------------|
| Rt Hon. James Bolger, ONZ | Independent Chair |
| Robin Hill | Independent Deputy Chair |
| Andrew Brown | Independent Director |
| Keith Davis | Independent Director |
| Dennis Barnes (Contact Energy) | Non-independent Director |
| Albert Brantley (Genesis Energy) | Non-independent Director |
| Andrew Knight (New Zealand Oil & Gas) | Non-independent Director |

5.2 Resourcing and Approach

The Company comprises a Chief Executive, a small executive group, and a core professional team of 15 people. The Management team is:

| Name | Role |
|--------------|----------------------------|
| Steve Bielby | Chief Executive |
| Ian Dempster | General Manager Operations |
| Greig Hinds | Principal Legal Counsel |

In delivering on its work programme, Gas Industry Co may seek support from external advisers, industry project teams, or working groups.

Gas Industry Co is committed to:

- developing industry-led solutions to issues facing the New Zealand gas industry;
- being consultative with industry participants and consumers;
- taking a pragmatic approach in adopting principles to meet its objectives;
- being professional and independent, with transparent processes;
- acting with integrity, responsibility and respect; and
- achieving high standards of excellence.

The Company's quarterly reports, the regular industry and consumer forums it hosts, its website and its approach to consultation are all examples of meeting this commitment.

Funding

The majority of Gas Industry Co's funding comes from an annual levy. Each year, the Company makes a recommendation to the Minister for levy regulations to recover the costs it will incur in the next financial year. Prior to making this recommendation, Gas Industry Co consults with affected stakeholders on its proposed levy and work programme for the following year.

In addition to the retail and wholesale levies applied each year to cover the costs of Gas Industry Co's policy and market administration work, Gas Industry Co has two other sources of funding to meet the costs it incurs. They are:

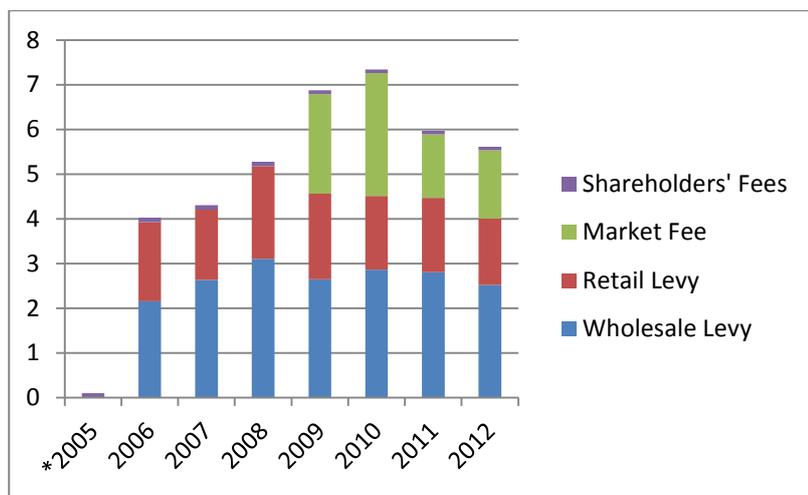
- market fees pursuant to gas governance rules or regulations for the ongoing costs of administering those arrangements, and
- an annual shareholder fee (set aside as a reserve). This is currently set at \$5,000 per shareholder per year.

Market fees provide stability of funding and the flexibility to enter into long-term arrangements with service providers. The design of market fees is consulted on during the policy development process, although the actual fees are set later once the costs of the service providers are finalised.

Gas Industry Co is committed to ensuring that the levies are well justified and used carefully.

As illustrated in the graph (below) the composition of Gas Industry Co's total levy revenue has changed in the last three years as the user-targeted market fees have been introduced.

Levy and Fee Revenue



*8 months. 2005 revenue comprised only the annual fee on shareholders

Work programme costs for FY2013, and the associated levy, increased slightly from FY2012. As noted above, estimated FY2014 work programme costs are less than the costs forecast for FY2013, with consequently reduced levy rates. The cost of operations will continue to be partly met by market fees raised under specific gas governance regulations.

5.3 Strategic Priorities

Gas Industry Co is required under the Act to publish annually a Statement of Intent (previously called a Strategic Plan), setting out key measures and standards (financial and non-financial).

The Company's Annual Reports, Statement of Intent, and Quarterly Reports to the Minister collectively provide a comprehensive narrative on key achievements and projected milestones for each of the workstreams.

5.4 Challenges to finding solutions

The preference for developing non-regulatory arrangements is a key feature of the co-regulatory model. Accordingly, when Gas Industry Co is developing and recommending fit-for-purpose arrangements, it considers all available policy instruments including voluntary guidelines, codes of practice, industry agreements and regulatory arrangements under the Act.

The Act provides that before making a recommendation for regulations or rules, Gas Industry Co will 'ensure that the objective of the regulation is unlikely to be achieved by any reasonably practicable means other than the making of the regulation (for example by education, information, or voluntary compliance)'.

Although industry participants often contend that industry-agreed arrangements should be preferred to regulatory arrangements, in practice, Gas Industry Co has found that obtaining agreement is not straightforward. As a consequence, Gas Industry Co's powers to recommend regulations have been a key success factor in promoting agreed arrangements. In other situations, industry will support regulatory solutions where there are benefits of clarity, especially in underpinning investment confidence.

5.5 Relationships with other agencies

The primary relationship is with MBIE. Regular meetings are held with MBIE officials to keep them apprised of workstream progress. This aims to ensure that the Company understands the Government's objectives and allows for a 'no surprises' relationship.

A good working relationship is also maintained with the Commerce Commission (with respect to transmission and distribution pipeline issues especially). The relationship is underpinned by a Memorandum of Understanding that recognises the common interests of Gas Industry Co and the Commission in areas of the gas business. Strong relationships are also held with the Ministry of Consumer Affairs (with respect to the Electricity and Gas Complaints Commission, or 'EGCC'), the Energy Efficiency and Conservation Authority (EECA) in the area the contribution gas can make to

efficient energy use and the warm homes programme, and the Electricity Authority ('EA') in recognition of the importance of gas to electricity generation.

Appendix A - Recommendations and advice to the Minister 2005-2012

- The New Zealand Gas Industry in 2006: Review of its status and performance (Allen Report 06)
- Final Recommendation to the Minister of Energy by the Gas Industry Co on Fixed Charges for Small Users and Other Consumer Issues (including invoice transparency) (Jun 06)
- Recommendation to the Minister of Energy on the specification for reticulated natural gas (Jul 06)
- Recommendation to the Minister of Energy on Switching Arrangements for the New Zealand Gas Industry (May 07)
- Recommendation to the Minister of Energy on regulations for enforcement of switching arrangements (May 07)
- Recommendation to the Minister of Energy on wholesale market development (Aug 07)
- Recommendation to the Minister of Energy on gas disconnection and reconnection (Sept 07)
- Recommendation to the Minister of Energy on arrangements for the allocation and reconciliation of downstream gas quantities (Mar 08)
- Recommendation to the Minister of Energy on arrangements for the effective management of critical contingency (June 08)
- Recommendation to the Minister of Energy on Gas (Downstream Reconciliation) Rules 2008 (Jul 09)
- Recommendation to the Associate Minister of Energy and Resources on the approval of a complaints resolution system under the Gas Act (Nov 09)
- Various recommendations on the enforcement of gas governance arrangements (Compliance Regulations)
- Advice to the Associate Minister to extend review of compliance with Interconnection Guidelines (Nov 09)
- Recommendation to the Associate Minister on the Direct Use of Gas (Dec 09)
- Recommendation to the Associate Minister of Energy and Resources on the endorsement of arrangements for the oversight of gas retail contracts (Mar 10)
- Advice to the Associate Minister on Interconnection to private transmission pipelines (May 10)
- Recommendation to Associate Minister of Energy Transmission Pipeline Balancing (Sept 10)
- Advice on Gas Distribution Arrangements (Dec 10)
- Advice to the Associate Minister on Interconnection to Open Access Pipelines (Dec 10)
- Advice to the Associate Minister on Gas Quality Arrangements (Dec 10)
- Recommendation to the Acting Minister of Energy & Resources on arrangements for insolvent retailers (May 11)
- Update on Gas transmission pipeline balancing (Mar 12)
- Recommendation to the Minister on Downstream Reconciliation Rules Review (Dec 12)

Appendix B - History of Gas Industry Co

The steps that led to Gas Industry Co's establishment

In 2001, the Ministry of Economic Development published a *Review of the New Zealand Gas Sector*, prepared by consultant ACIL Tasman Pty Ltd. The review led to a number of Government policy decisions for the sector in late 2002, which included:

- articulating the Government's objectives and desired outcomes for the gas sector,
- enabling the industry to establish an industry body to develop arrangements relating to production, wholesale markets, transmission and distribution networks, and retail markets,
- requiring the Maui pipeline to move to an open access arrangement, and
- reviewing regulation of gas pipeline companies.
- These new policies were implemented through an amendment to the Gas Act 1992, the publication of a Government Policy Statement on Gas Governance (GPS), and the commencement of a Commerce Commission inquiry into the possibility of controlling the services provided by pipeline companies.

The first GPS, released in March 2003, invited the gas industry to establish a governance structure and work programme to deliver on the expectations set by the Government. The GPS noted that industry-led solutions were favoured where possible, but that regulatory solutions would be used if necessary.

A Gas Industry Steering Group (GISG) was formed to respond to the GPS. Following some careful consideration, that group advised the Government that the industry would require some form of regulatory backing to achieve the Government's objectives and outcomes. As such, changes to the Gas Act were enacted to give effect to a co-regulatory model of governance.

The new model provided the Minister of Energy with powers to make rules, or recommend regulations, in relation to: consumer outcomes and retail arrangements; the wholesaling of gas; infrastructure access; contingency management; and other gas governance matters. The Gas Act amendments also provided for the establishment of an 'industry body' to advise the Minister on the exercise of these powers.

A new GPS was published in October 2004 to reflect the co-regulatory model in the Gas Act, and a further revision was put out in April 2008 after release of the New Zealand Energy Strategy (NZES).

Establishment of Gas Industry Co

Gas Industry Co is a special purpose company incorporated under the Companies Act 1993. It was formed by industry participants to be the co-regulatory partner with the Government under Part 4A of the Gas Act.

The Gas Act requires the Board of Gas Industry Co to have a majority of independent directors and a constitution that identifies the Company's purpose as the performance of the functions and duties of the industry body under the Act.

Gas Industry Co's Constitution has been designed to ensure that the Company complies with the requirements for approval as an industry body under the Act, and continues to do so over time. The current Board membership is listed in Section 5 to this Briefing Paper.

Gas Industry Co was approved as the industry body by Order-in-Council in December 2004. This approval gives it the power to recommend gas governance arrangements to the Minister of Energy, and to recover its policy development costs by way of levies on industry participants.

The Co-Regulatory Model

The development of the co-regulatory model for the gas industry stems from the Government's desire for industry involvement in developing new policy settings. It provides a unique opportunity for the Government and industry to work together on market regulation.

Co-regulation enables the Government to establish objectives and outcomes (in a GPS) that it wants the industry body to pursue and against which the industry body must report. As the industry body, Gas Industry Co's role is to oversee the development of gas governance arrangements for the operation of gas markets, access to key infrastructure, and protection of consumers; and to monitor compliance with, and enforce, such arrangements and rules.

The combination of the Act, the GPS, and the constitution of Gas Industry Co provide the framework within which the Company operates in developing gas market arrangements. The key features of the co-regulatory model are set out in the table following.

Key Features of the Co-Regulatory Model

| Minister | Gas Industry Co |
|--|--|
| <ul style="list-style-type: none"> • Sets out, in a GPS, the objectives and outcomes that Government wants Gas Industry Co to pursue • Has power to make rules and recommend regulations • Must have regard to recommendations made by Gas Industry Co • May make rules and recommend regulations in some areas without a recommendation from Gas Industry Co • May request Gas Industry Co to provide advice | <ul style="list-style-type: none"> • Power to recommend rules and regulations to the Minister • Must have regard to objectives in the Gas Act and GPS • May recommend non-regulatory arrangements such as industry agreements and codes where appropriate • Must consider all reasonably practicable options, assess costs and benefits, and consult • Must report regularly to the Minister on: <ul style="list-style-type: none"> - the performance and present state of the New Zealand gas industry; - Gas Industry Co's performance and achievement of its objectives; and - any other matters Gas Industry Co thinks fit or that the Minister requests. |

The co-regulatory model envisages a combination of industry solutions, regulatory solutions, and proactive advice to address gas sector issues and challenges. Gas Industry Co has no powers to direct the industry to take certain actions or to require participants to provide information, although it can recommend to the Minister that he or she regulate for information disclosure. In addition it needs to maintain a representative shareholder group to be eligible for approval as the industry body. Therefore, it relies on active participation and co-operation by industry participants and stakeholders across all parts of the gas supply chain.

The Gas Act also provides that, where Gas Industry Co ceases to meet the criteria of the 'industry body' in the Gas Act, the Government may revoke Gas Industry Co's approval. It may then combine the industry body's functions with those of the Electricity Authority to create an Energy Commission governing both the electricity and gas sectors. This potential merger carries with it an implicit threat that, if Gas Industry Co (and, in a wider sense, the industry itself) does not deliver on the Government's policy objectives and outcomes, the Government will take greater direct control of the sector through a Crown Entity governance body.

The Gas Act 1992 and the GPS

Brief Overview of Part 4A of the Gas Act

Part 4A of the Gas Act is concerned with the creation of the industry body and provides for the industry body to make recommendations to the Minister for making rules and/or regulations covering matters such as:

- wholesale gas markets, including arrangements for gas outages and contingencies;
- access to gas processing facilities;
- access to transmission and distribution pipelines; and
- a range of retail or consumer issues including complaints resolution, customer switching, and retail gas contract minimum terms and conditions.

Provision of advice to the Minister is an important aspect of the co-regulatory model. The Act requires Gas Industry Co to report regularly to the Minister on:

- the performance and present state of the New Zealand gas industry;
- Gas Industry Co's performance and achievement of its objectives; and
- any other matters Gas Industry Co thinks fit or that the Minister requests in writing.

Policy Objectives in the Gas Act

The policy objectives prescribed in the Act for Gas Industry Co when making recommendations under section 43F of the Act are set out in the table below:

Gas Act Objectives

| |
|--|
| Principal objective |
| To ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner. |
| Other objectives |
| <ul style="list-style-type: none">• The facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure and competitive market arrangements.• Barriers to competition in the gas industry are minimised.• Incentives for investment in gas processing facilities, transmission and distribution are maintained or enhanced.• Delivered gas costs and prices are subject to sustained downward pressure.• Risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties.• Consistency with the Government's gas safety regime is maintained. |

The GPS

The Minister may set objectives and outcomes for the industry body to pursue in relation to governance of the gas industry and against which the industry body must report. These are set out in a Government Policy Statement and the industry body to have regard to the GPS objectives and outcomes when making recommendations for gas governance regulations.

The current GPS, issued in April 2008, reconfirms existing policy objectives and makes reference to the New Zealand Energy Strategy (NZES). Within the NZES, the gas sector has a critical role to play in achieving the Government's objective of maintaining security of energy supply at competitive prices as the country makes the transition to a sustainable energy future. The GPS also adds fairness and environmental sustainability to the principal objective in the Act and extends this objective to all of Gas Industry Co's recommendations.

The full set of objectives and outcomes contained in the April 2008 GPS amount to a clear statement of work priorities for Gas Industry Co, and have formed the basis for the Company's past Strategic Plans and work programming. A large number of the objectives in the current GPS have been met, with many resulting in governance arrangements that will require ongoing monitoring and administration by Gas Industry Co.

A new NZES was issued in August 2011. MBIE has also been requested to undertake an industry performance review. The Company expects that the new energy strategy and the performance review will lead to the issuance of a revised GPS to provide Gas Industry Co with guidance as to its work programme over the next several years.

Gas Governance Arrangements

As noted above, the role of Gas Industry Co is to work with industry and Government to develop arrangements to govern various aspects of the operation of the gas industry and its retail operations. These 'gas governance arrangements' may take the form of industry-led arrangements, rules, or regulations.

The drivers for establishing gas governance arrangements are summarised in the following table.

Drivers for New Gas Governance Arrangements

| Driver | Commentary |
|---|---|
| Consistency with Government policy | Government requirements and expectations for the gas sector are set out in legislation and GPS, etc. |
| Leadership and co-ordination | Co-ordinating significant industry involvement in a way that encourages participation and facilitates the emergence of a common view. Ensuring that arrangements are workable (practical) and efficient. The co-regulatory model is central to addressing these issues. |
| Enhancing competition | Government policy emphasises enhancing competition as the principal means of delivering efficiencies, maintaining downward pressure on prices and improving outcomes for consumers. |
| Consumer protection | There is an expectation that consumers will benefit over the long term from enhancing competition. The small size of the gas sector means that it may be necessary to intervene to protect the interests of consumers, particularly smaller ones such as domestic and small businesses. |
| Administering market operations | Once implemented, arrangements must be administered, including managing service providers and undertaking specific roles. Parties must understand and comply with any obligations they might have under the arrangements. |
| Effectiveness assessment | Ongoing monitoring of the effectiveness of the new arrangements is also critical to market confidence as further development will be required due to experience and changing circumstance. |