11th Annual National Power Conference New Zealand 2009

Sky City Convention Centre

Auckland, New Zealand

Thursday 26 February 2009

12 noon

Meeting Government objectives for the gas sector: how is the industry performing?

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Introduction

When I became the first employee of Gas Industry Company Limited four years ago, I was presented with a folder containing:

- the amended sections of the Gas Act – Part IVA (which established the co-regulatory model);
- the October 2004 GPS, which listed a number of tasks the Government required Gas Industry Co to undertake (most of which were due in six months); and
- a list of three working groups that had been established to help develop the new gas governance arrangements.

In early meetings with the working groups, it became apparent that members saw their role as one of a 'reviewer' rather than an 'originator' of policy papers. This meant that one of my first tasks was to recruit a core team of internal and external advisers to assist us in a body of policy work that would have seemed formidable to even an established organisation.

The next three years saw Gas Industry Co evolve into a policy workshop – some would say "sweat shop". We have written more than 400 Board papers, issued 54 consultation papers and analysed 400 submissions on issues raised by the GPS.

With the benefit of hindsight, the October 2004 GPS timeframes were very optimistic. The process we are required to follow under the Gas Act before making recommendations includes consultation on alternatives and a comparative cost-benefit analysis of the policy options that achieve the relevant regulatory objective.

Background

I am often asked where the Gas GPS comes from. To understand the tasks set out in the Gas GPS, it is necessary to go back to 2001 when the Minister of Economic Development published a review of the New Zealand gas sector by consultant ACIL Tasman Pty Ltd. This report prompted a rethink of Government policy for the gas sector.

Four key components formed the Government response to the ACIL report:

- the publication of a document stating the Government objectives for the gas sector. The first GPS was published in March 2003. It has since been revised in October 2004 and April 2008;
- a series of amendments to the Gas Act in 2004. These gave the Minister of Energy power to make regulations on the operation of gas markets, access to infrastructure and consumer outcomes, and provided for the establishment of an industry body to advise the Minister on the exercise of his powers;
- an invitation to Maui Development Limited to provide open access to the Maui pipeline. (The Vector pipelines had been subject to third-party access since 1995); and
- a review of gas pipeline companies to determine if they should become a controlled good or service under the Commerce Act.

Gas Industry Co is involved in the implementation of the first three components of the Government policy decisions. Our focus is on developing arrangements that promote competition, market access and that protect consumers. The Commerce Commission is entrusted with the economic regulation of pipeline companies.

New gas governance arrangements

Gas Industry Co has now made recommendations on, and received Ministerial approval for, six gas governance arrangements:

- the Gas (Processing Facilities Information Disclosure) Rules 2008;
- the Gas (Downstream Reconciliation) Rules 2008;
- the Gas (Switching Arrangements) Rules 2008;
- the Gas Governance (Compliance) Regulations 2008;
- the Gas Governance (Critical Contingency Management) Regulations 2008;
- a wholesale market trial (contract-based).

This paper outlines these new arrangements, their purpose and implementation status, and addresses the Company's strategic priorities for the next 12–18 months.

Information disclosure

The Gas (Processing Facilities Information Disclosure) Rules were the first to be put in place. They seek mandatory disclosure of information about surplus capacity in processing facilities and third-party access. The purpose of disclosure is to facilitate the market discovery process and identify inefficiency in the current arrangements. Gas Industry Co recommended this step as the case for access regulation was not strong. The new rules will enable the Company to identify access problems and came into effect on 26 June 2008. The Company is pleased to report that it has achieved full compliance with the new disclosure obligations. Copies of the disclosures are available on the Company website http://www.gasindustry.co.nz/work-programme/gas-processing-facilities-information-disclosure?tab=389.

Downstream reconciliation

Problems with the design of existing industry codes led to a project that explored more efficient arrangements for the reconciliation and allocation of gas quantities in distribution pipelines. This resulted in a recommendation to the Minister of Energy for new downstream reconciliation rules. The rules provide for the appointment of a single downstream reconciliation agent and the establishment of a standard methodology for determining and allocating gas quantities and unaccounted for gas (UFG) among retailers. The Minister approved the rules in May 2008, including the recommendation for a go-live date of 1 October 2008 (timed to coincide with the start of the gas year).

Implementation of the rules has involved the Company and the industry in a range of activities including tendering for the service provider to act as the allocation agent, negotiating a service provider agreement, establishing the allocation system, assisting with preparatory work by the industry, developing a range of determinations and guideline documents for the practical operation of the rules, and granting exemptions to deal with transitional and 'special case' issues. In terms of service delivery the implementation has been successful, with the achievement of policy objectives despite a very ambitious timeframe. However, it is acknowledged the planning estimate for establishment and development costs was inadequate, resulting in an under-recovery of costs for the Company in the current year and the need to levy for the recovery of these in FY2010.

Going forward, the Company expects that:

- minor allocation system changes over the next six months will be required to deal with technical issues or unexpected circumstances;
- long-term decisions will be required for a group of exemptions that expire on 30 June 2009;
- event audits will be instituted to address the cause of UFG at gas gates where this is a particular problem; and
- minor rule changes may be required this year with a major review to be held before the transitional period ends on 30 September 2010.

Switching arrangements

In parallel with the work on downstream reconciliation has been an implementation project for the Gas (Switching Arrangements) Rules 2008. The new rules establish a central registry to hold ICP-related data, and facilitate the customer-switching process by providing for timely and accurate exchange of information between gas customers, retailers, distributors and meter owners.

This is important for retail competition as an inefficient switching process dilutes incentives for retailers to seek new customers and for consumers to change retailers. Key objectives for the implementation project have included the selection of a registry operator and helping the industry prepare for the new arrangements, by populating the registry with accurate and complete data. The new rules go live on 2 March 2009.

Compliance regulations

To ensure that approved arrangements are complied with by industry participants, the Company recommended an industry-specific compliance regime. The resulting Compliance Regulations came into effect in September 2008 and cover all approved gas governance recommendations. They provide for a market administrator to process breach notices, an investigator and a one-person Rulings Panel to handle breaches of a material nature.

Wholesale market trial

Turning to the wholesale market, the Government is also seeking more 'efficient arrangements for the short-term trading of gas'. To meet the requirement of the GPS task, Gas Industry Co is proposing a simple electronic platform to match buyers and sellers of gas. You can think of this as 'Trade Me for Gas' in tranches of a day or a month. Because this is not considered to be a deep or particularly liquid market, a short trading window is likely. Potential participants have indicated that an hour a day for each weekday will be sufficient for a start.

This is a blind market, which raises the question of how to manage counter-party risk. As a way of keeping costs down and avoiding setting arbitrary prudential limits, parties will manage their exposures by two-way white lists. Thus Party A and Party B may execute a trade only if A is on B's white list and vice versa. The platform will also provide the option for different buying and selling white lists, where a party might be willing to accept counter-party risk on physical delivery but not for payment.

The Minister approved such a trial, regarding:

> the development of a formalised secondary market for the trading of excess and shortfall quantities of gas as an important component in fostering flexibility, transparency and competition around wholesale gas trading arrangements[1].

The results of the trial will inform a later decision and recommendation by Gas Industry Co's Board. The Company will be taking a hands-on role during the trial. However, if the trial demonstrates sufficient demand for such a market, the day-to-day processing will likely be undertaken by a service provider with Gas Industry Co administering the market.

Critical contingency management

Historically, the management of contingency situations has been by way of an industry plan, the National Gas Outage Contingency Plan (NGOCP). However, with the greater number of players now in the industry and more diverse ownership, the lack of commercial imperatives in the plan meant that not all parties were willing to support it. To address this, Gas Industry Co designed the Gas Governance (Critical Contingency Management) Regulations 2008, which came into effect in December 2008.

The design philosophy was to preserve industry capability and flexibility to ensure the right people manage critical contingency situations. Thus, transmission owners are required to prepare and publish plans describing how they will respond to such events. A Critical Contingency Operator is responsible for:

- determining the onset of a critical contingency;
- directing curtailment of end-user load so as to stabilise pipeline pressures; and
- determining when it is safe to terminate the critical contingency and allow restoration of load.

[1] Hon. David Parker, Minister of Energy, letter to Gas Industry Co, 5 December 2007

After critical contingency is over, the regulations provide that gas taken during a critical contingency by parties that did not have title to it is required to be paid for at the 'critical contingency price'. That price is determined by an independent expert appointed by Gas Industry Co. Parties that 'left' gas in the system that was taken by others during the critical contingency are to be paid the critical contingency price for that gas. This addresses the free-riding that occurred under the NGOCP, which gave rise to parties withdrawing support for that plan.

Gas Industry Co is preparing to 'go live' on these arrangements before June this year:

- transmission system owners have prepared draft plans and issued them for consultation;
- the industry and Gas Industry Co are processing applications from customers to be designated as 'minimal load' consumers or 'essential service providers'. Parties so designated are given some relief from the obligation to curtail load; and
- the CCO, a role filled by Vector – the operator for both pipelines – is in the midst of setting up systems and procedures.

Implications of approval of new arrangements

With the approval of these six gas governance arrangements, the Company is now undergoing a significant shift in its responsibilities from a policy workshop to a market services company.

Gas Industry Co has a number of specific roles entrusted to it in the new rules such as managing service providers, collating and publishing information, determining technical detail, appointing experts and auditors, and receiving and approving contingency plans. In addition, the Company has also accepted 'market services' roles under two industry agreements: in making change requests to the Maui Pipeline Operating Code; and in making recommendations on appeals against rule change requests under the Vector Transmission Code. It is therefore expected that market administration will become an increasing part of the Company's core business activities in the year ahead, although some policy work will remain.

Strategic priorities

Gas Industry Co suggested priorities for FY2010 were outlined in the Company's recently published levy consultation paper. They were to:

- develop the capability and systems to efficiently administer approved gas governance arrangements (many of the activities required by the existing rules and regulations are new to the Company);
- complete recommendations to the Minister on balancing, interconnection, retail contracts, and consumer complaints resolution; and

- develop a framework for monitoring industry performance, measuring the impact of the GPS interventions and assessing data requirements.

However, feedback from the industry during consultation was that the proposed work programme was too ambitious and we should instead seek an early opportunity to engage with the new government on its priority areas of action. We agree, and will discuss our forward work programme with the Minister in conjunction with our final levy recommendation and Strategic Plan. Subject to those discussions, we expect that balancing and interconnection will remain near the top of the list, particularly given the renewed interest in the nation's petroleum resources evident in the Minister's speech at the opening of this conference.

Balancing

Until recently, the balance between unplanned supply and demand variations in the pipeline network was addressed through the Maui production station either increasing or decreasing production. This legacy arrangement is being progressively phased out and a more market-oriented balancing function is evolving.

The balancing function involves:

- monitoring the pipeline status;
- buying or selling 'balancing gas' when required; and
- recovering the costs of balancing actions from system users.

Balancing actions are currently undertaken by pipeline owners. Gas Industry Co proposes that the function be split from other pipeline operations and performed by a single independent balancing agent. A paper studying options to improve the efficiency of the existing arrangements is being prepared. Of course there may be occasions when even the best efforts of the balancing agent fail to bring the pipeline into balance. In this event, there is a residual role for more draconian 'curtailment' actions. If these also fail, producers will be shut in or a contingency event will be declared, and the Contingency Regulations discussed previously will come into play.

Interconnection

Interconnection is about the ease with which parties can connect their assets to the transmission system and therefore, is at the core of any open access arrangements. It is largely a technical and engineering issue. However, it is an issue which has significant commercial implications. Delays in interconnection are costly for petroleum producers who have invested heavily, and are keen to get their products to market. Interconnection processes also affect pipeline owners who face significant risk through injection of non-specification gas or through incorrect injection rates. Gas Industry Co is aware of a number of case histories where interconnection has been an issue and has not ruled out regulating some minimum terms of interconnection. However, we first propose to give pipeline owners the opportunity to adjust their services to meet good practice standards set out in Interconnection Guidelines that we have developed and that will soon be issued.

Conclusions

Gas Industry Co is the industry body tasked with improving market outcomes. Successive Government policy statements have established the priority areas of action. The Company is required by law to pursue these areas and report its progress in their delivery.

Arrangements have already been approved by the Minister which are designed to:

- improve information about surplus capacity in gas processing facilities;
- ensure more efficient and accurate reconciliation of gas in downstream markets;
- improve customer switching arrangements;
- facilitate the short-term trading of gas in a multi-supplier, multi-user environment;
- establish backstop contingency arrangements that will minimise costs to the economy during a gas contingency and maintain market confidence; and
- provide confidence that approved arrangements will be adhered to by all industry participants.

The approval of these arrangements has created a different workload mix for Gas Industry Co, which has now added market services to its policy role. On the policy front it is expected, the Company's focus in the next 12-18 months will be on the transmission access work stream, particularly arrangements for balancing and interconnection.

As always, the Company relies on industry support to meet our objectives.