



Gas Governance Issues in Distribution: Issues Paper

Date issued: 7 September 2010
Submissions close: 18 October 2010





About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

Its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy and Resources on the performance and present state of the New Zealand gas industry, and the achievement of the Government's policy objectives for the gas sector.

Authors

Bas Walker and
Ian Wilson

Executive summary

This paper assesses whether any issues associated with the distribution of natural gas warrant resolution through the development of gas governance arrangements.

Three companies offer open access to natural gas distribution networks—Vector Limited (Vector), Powerco Limited (Powerco), and Wanganui Gas Limited (GasNet). Todd Energy Limited owns several private distribution pipelines used exclusively by its gas trading arm, Nova Gas.

The proposed regulatory objective was developed to assess whether existing distribution arrangements meet certain objectives set out in the Gas Act 1992 (the Gas Act) and April 2008 Government Policy Statement on Gas Governance (the GPS). It is:

To ensure that arrangements for the distribution of gas are safe, efficient and reliable with particular regard to achieving:

- an efficient market structure for the provision of gas metering, pipeline, and energy services;
- clearly understood roles of gas metering, pipeline, and gas retail participants; and
- achieving reasonable access by new entrant and existing retailers to distribution services.

In addition to the Gas Act and the GPS, other relevant arrangements are:

- the Gas (Safety and Measurement) Regulations 2010;
- the Gas (Information Disclosure) Regulations 1997;
- the Commerce Commission price control authorisations on Vector and Powerco; and
- the Commerce Commission's forthcoming price-quality regime.

Following analysis of the current situation against this proposed regulatory objective, and considering the effect of the other relevant arrangements, we conclude that there are no issues warranting Gas Industry Co to recommend intervention. However, two options for improvement are briefly described:

- regular status reporting; and
- the development of high-level benchmarks (principles) for distribution contracts (some examples of possible benchmarks are given at the end of the paper).

We ask for industry feedback on these options. Submissions will be analysed and a response published. Work past this point will depend on the nature of the feedback received on the paper.

Contents

Executive summary	i
1 Introduction	1
1.1 Purpose of this paper	1
1.2 Approach	1
1.3 Structure of this paper	2
1.4 Invitation for submissions	3
2 Background	4
2.1 Gas distribution in New Zealand	4
2.2 Related work in the electricity sector	6
2.3 Previous work by Gas Industry Co	7
3 Regulatory objective	10
3.1 Overall context	10
3.2 Gas Act objectives	10
3.3 GPS objectives and outcomes	11
3.4 Proposed regulatory objective	12
4 Characteristics of distribution	14
4.1 Assets owned by distributors	14
4.2 Services provided by distributors	14
4.3 Market for distribution services	15
4.4 Arrangements between retailers and end users	15

5	Regulation relevant to distribution	16
5.1	Gas (Safety and Measurement) Regulations 2010	16
5.2	Gas (Information Disclosure) Regulations 1997	16
5.3	Price control of pipeline services by the Commerce Commission: current arrangements	17
5.4	Commerce Commission control of pipeline services: price-quality regulation	19

6	Discussion of potential issues	21
6.1	Access to distribution services	21
6.2	Gas quality	22
6.3	Arrangements between service providers	22
6.4	Disconnections and reconnections	26

7	Conclusion	27
7.1	Safety and reliability	27
7.2	Efficiency	29

8	Next Steps	32
Appendix A Possible high level benchmarks for distribution contracts		33
Appendix B Format for submissions		1

1

Introduction

1.1 Purpose of this paper

This paper assesses whether any issues associated with the distribution of natural gas warrant the development of gas governance arrangements.

We are seeking stakeholder submissions on the paper to determine whether further work is appropriate.

1.2 Approach

In this paper we:

- propose a regulatory objective based on the policy context provided by the Gas Act 1992 (the Gas Act) and April 2008 Government Policy Statement on Gas Governance (the GPS);
- analyse the characteristics of gas distribution in New Zealand; and
- assess gas distribution characteristics against the proposed regulatory objective, discuss potential issues, and consider what an appropriate response might be.

The analysis takes account of the Gas Act requirements for making regulations. It also considers action by the Commerce Commission under the Commerce Act. Currently, the Commerce Commission acts through price control authorisations on the gas distribution services provided by Vector Limited (Vector) and Powerco Limited (Powerco). From 1 July 2012, the Commerce Commission will administer a price-quality regime for gas transmission and distribution.

The assessment has been informed by informal discussions with retailers and distributors. It also draws on information from the Electricity and Gas Complaints Commission (EGCC) on distribution/distributor related complaints and queries over the past year.

The outcome is a set of potential governance issues in regard to gas distribution. We form an initial view on whether to further investigate gas governance arrangements for managing those issues.

Accountability for gas composition and contaminants are a part of the larger issue of supply reliability, which is considered in this paper. However, because the factors influencing gas quality are largely beyond the direct control of the distributor, Gas Industry Co has considered gas quality in a separate report: *Gas Governance Issues in Distribution: Issues Paper*.¹ The gas quality report and this report are being issued as a 'package' for consultation.

1.3 Structure of this paper

This paper is structured as follows.

Table 1 Structure of this paper

Section	Contents
2. Background	<ul style="list-style-type: none"> • Description of gas distribution in New Zealand. • Summary of related work on electricity distribution. • Summary of previous work by Gas Industry Co on distribution and related topics such as gas supply disconnections and reconnections.
3. Regulatory objective	<ul style="list-style-type: none"> • Description of the policy context for gas governance work on distribution, provided by the Gas Act and the GPS. • Presentation of a proposed regulatory objective for assessing the need for work on gas distribution.
4. Characteristics of distribution	<ul style="list-style-type: none"> • Analysis of the characteristics of distribution including the assets owned by distributors and services provided by distributors. • Outline of the market for distribution services and the arrangements between retailers and end users.
5. Regulation relevant to distribution	<ul style="list-style-type: none"> • Analysis of the coverage of safety issues by the Gas (Safety and Measurement) Regulations 2010 (Safety and Measurement Regulations). • Analysis of the effect of the Gas (Information) Disclosure Regulations 1997 (Information Disclosure Regulations) on distribution. • Analysis of the effect of current and expected future action by the Commerce Commission under the Commerce Act, for the control of gas distribution.
6. Discussion of potential issues	<ul style="list-style-type: none"> • Discussion on the need for the governance of gas distribution. Issues are considered in the following areas. <ul style="list-style-type: none"> ○ Distribution market efficiency, including its effect on efficiency of retail markets. ○ Access to distribution services. ○ Reliability issues in distribution. ○ Relationships between parties including distribution contracts. ○ Gas supply disconnections and reconnections.

¹ The companion paper is available from Gas Industry Co's website: <http://www.gasindustry.co.nz/work-programme/gas-quality-0?tab=1842>

	<ul style="list-style-type: none"> • Conclusions.
7. Conclusion	<ul style="list-style-type: none"> • Consideration of how potential issues relate to the regulatory objective. • Assessment of what intervention is appropriate.

1.4 Invitation for submissions

Gas Industry Co invites submissions on the analysis and conclusions presented in this paper. We are particularly seeking responses to the questions highlighted at various points in the body of the text. Submissions on the questions should be provided in the format in Appendix B.

Submissions are due by **5pm, Monday 18 October 2010**. Please note submissions received after that date may not be considered.

We prefer receiving submissions in electronic form (Microsoft Word format and PDF). Submissions may be uploaded on our website at www.gasindustry.co.nz. You will need to log in as a user and upload the submission on the consultation page by clicking on the submissions button.

Gas Industry Co will acknowledge receipt of all submissions electronically. If you do not receive electronic acknowledgement of your submission within two business days, please contact Jay Jefferies on 04 472 1800.

Gas Industry Co values openness and transparency and therefore submissions will generally be made available to the public on our website. If you intend to provide confidential information in your submission, please discuss this first with Ian Wilson at Gas Industry Co (04 472 1800).

Gas Industry Co will release a paper containing a summary of submissions as well as our analysis and conclusions.

2 Background

2.1 Gas distribution in New Zealand

Open access and private networks

Gas distribution systems (networks) transport gas from transmission pipeline gate stations to end users' gas measurement systems (GMS)². Distributors have contracts, in the form of network service agreements, with retailers who supply gas to end users. Distributors also have arrangements with interconnected transmission pipelines, although these may be customary and not recorded in a written contract.

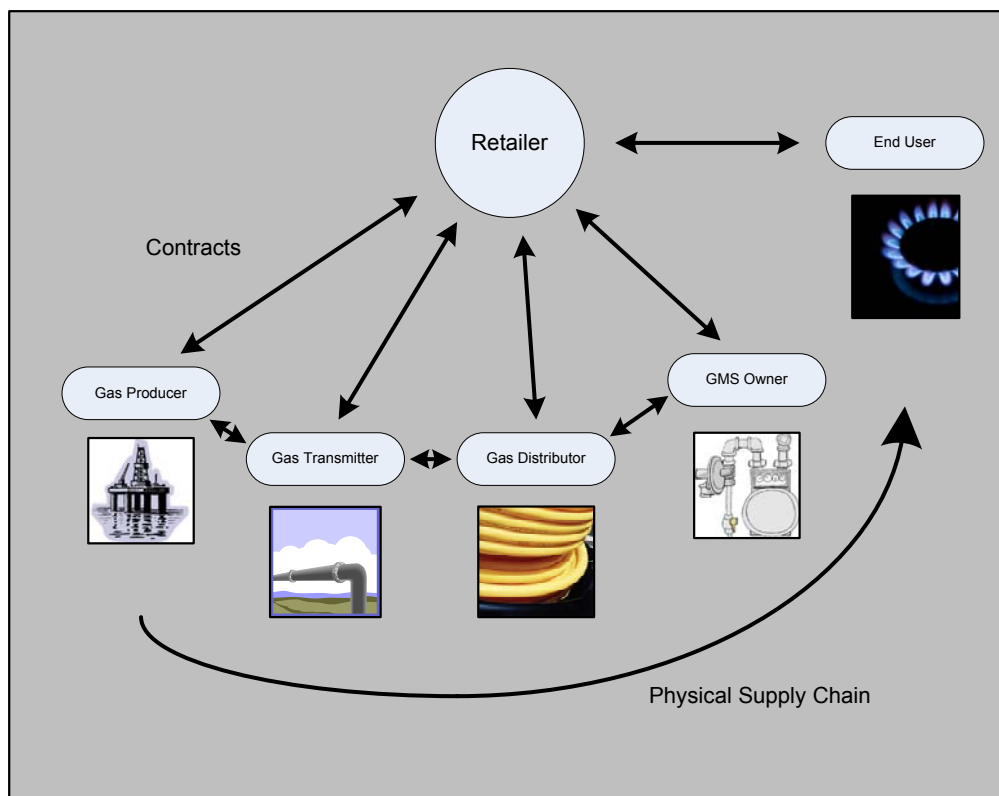


Figure 1 Position of the gas distributor in contractual matrix and physical supply chain

² A small number of end consumers are supplied directly from transmission pipelines. These are mostly large users such as petrochemical plants, power stations, and large industrial facilities.

Distribution networks may be open access (that is, available to all suppliers or retailers for the distribution of gas to their end users), or private. In this report, a 'private network' or 'private pipeline' is a pipeline system owned and operated by, and for the exclusive benefit of, a party or consortium that owns all gas transported on the system. The exclusion of third parties from use of the pipeline is the central feature of a private pipeline.

New Zealand has three open access networks, which are owned and operated by:

- Vector, who retails gas through its subsidiary OnGas;
- Powerco, the only distributor not also a gas retailer; and
- GasNet, a subsidiary of Wanganui Gas who retails gas through its subsidiary Energy Direct New Zealand Limited.

Todd Energy owns the only private gas pipelines. These are operated by its gas trading arm, Nova Gas. Most of these private pipelines operate in a 'bypass market', that is they operate in parallel with, or as an extension of, open access networks to provide gas to groups of Nova Gas end use customers.³

Statistics

Table 2 shows the location of the networks and associated statistics. It includes Gas Registry statistics on the number of installation control point (ICPs) connected to each distribution network, except the Nova Gas private network. (The ICPs approximate the number of end users connected.) Gas Registry statistics are published on Gas Industry Co's website. The figures shown in the table are for July 2010. The table also includes other recent information published on company websites or disclosed under the Information Disclosure Regulations (see section 5.2).

Table 2 Distribution network statistics

Owner	Access	Approximate system length	Number of ICPs	Areas of operation
Vector	Open	10,061 km	146,991	Northland, Greater Auckland, Waikato, Bay of Plenty, Rotorua, Taupo, Gisborne, and Kapiti
Powerco	Open	5,901 km	99,387	Napier, Hastings, Southern Hawkes Bay, Taranaki, Manawatu, Levin, Foxton, Hutt/Mana and Wellington
GasNet	Open	384 km	9,918	Wanganui and surrounding district

³ In the Commerce Commission's 'Gas Control Inquiry-Final Report', November 2004, paragraph 18.14, the 'bypass market' is defined as one with 'commercial and industrial consumers within the vicinity of bypass networks'.

Nova Gas ⁴	Private	100 km	unknown	Wellington, Porirua, Hutt Valley, Hastings, Hawera, Papakura and Manukau City
-----------------------	---------	--------	---------	---

The statistics show the major distributors are Vector and Powerco, with Vector the single largest distributor by a substantial margin.

2.2 Related work in the electricity sector

Electricity distribution exhibits some similar characteristics to gas distribution. Therefore, the history of work on electricity distribution is of interest when considering gas distribution issues. In general however, the case for governance of electricity distribution is inherently stronger than for gas. This is because:

- the electricity industry is technically more complex;
- there are many more distribution (lines) companies, all with regional monopolies and differing contracts;
- the electricity market is an order of magnitude larger than the gas market; and
- electricity supply is an essential service whereas gas is not.

In 2000, a ministerial inquiry into the electricity industry triggered work on electricity distribution. The inquiry recommended the development of a model distribution agreement. As a result, in 2003, various bodies worked on preparing draft interposed and conveyance models⁵. After its establishment in 2003, the Electricity Commission reviewed the models and released final versions in 2005.

Thus, governance of distribution by publishing model contracts has strong precedent in the electricity sector. In 2007, Gas Industry Co commissioned a review of the electricity sector work to identify implications for the gas industry. The (unpublished) review concluded the electricity work had been lengthy and costly, with further review and amendment likely. Throughout the process representatives from the retail and distribution companies struggled to find common ground on many issues. Therefore it was unclear how effective the development of model contracts would have been.

More recently, the Electricity Industry Bill has set out the policy direction for increased standardisation of distribution line tariffs and use-of-system rules. As a result, the Electricity Commission is currently

⁴ The system length figure was obtained from the Commerce Commission's 'Final Report on the Gas Industry Control Inquiry requested by the Minister of Energy on 30 April 2003', 29 November 2004.

⁵ Electricity distribution has two types of Use of System Agreements (UoSA). Under an **interposed** agreement, retailers act as an intermediary for supply of transmission and distribution services to all consumers. Under a **conveyance** agreement, distributors provide transmission and distribution services separately to all consumers and convey electricity for retailers.

gathering information to assess the costs and benefits of such standardisation. The incoming Electricity Authority will make any policy decisions⁶.

2.3 Previous work by Gas Industry Co

First review of distribution issues

Gas Industry Co first considered distribution sector issues in 2005. The main purpose was to establish the effect of the existing regulatory regime (based on information disclosure under the Information Disclosure Regulations) and the pending control of distribution services by the Commerce Commission. We accepted our work would need to complement that of the Commerce Commission.

Gas Industry Co later developed an indicative work programme on the review of distribution contracts. The areas of interest were terms and conditions of access, establishing minimum contract terms, and requiring enhanced price and service level disclosure. However, this work was set aside pending discussions with the industry on whether the issues warranted further work. Some of the more pressing concerns were considered in other work programmes.

Working group on disconnection and reconnection

In early 2006, Gas Industry Co established a working group to examine issues in gas supply disconnection and reconnection. Practices in this area involve retailers, meter owners, and distributors. At issue was the confusion arising from the lack of standard arrangements and charging regimes for disconnecting and reconnecting end user gas supply. However, the working group was unable to make any significant progress, partly because of lack of agreement on the issues; and partly because Powerco was concerned that the proposal that distributors should cease line charges after 14 days following a vacancy could constitute price fixing under the Commerce Act.

In an attempt to break the impasse, Gas Industry Co developed a proposal for dealing with what it saw as the key problems⁷. We were unable to obtain industry agreement to the proposal and, in late 2007, wrote to the Minister to advise that outcome. It was agreed that further work in this area would be incorporated in more general work on consumer issues.

Consumer issues discussion paper

Gas Industry Co prepared a consumer issues discussion paper, which was designed to be the basis for future work on consumer issues. The paper, *Current Issues for Domestic and Small Business Gas Consumers*, was published in mid 2008; an analysis of submissions and a response was published in

⁶ From 1 October 2010 a new entity, the Electricity Authority, will oversee the sector.

⁷ The main concerns were different retailer practices following vacancy, seasonal disconnection and reconnection, and inefficient retailer-initiated disconnections following vacancy.

February 2009⁸. Gas Industry Co's response to the issue of disconnections and reconnections is summarised below:

⁸ Gas Industry Co. 'Response to and Analysis of Submissions on the Consumer Issues Consultation paper dated 18 August 2008.' February 2009. Available on Gas Industry Co's website at http://www.gasindustry.co.nz/sites/default/files/u12/Consumer_Issues_Response_Document_v2_April_09_149789.3.pdf

A two step approach is proposed:

- Individual discussions will be held with participants who have expressed views to help crystallise the best way of designing and applying a broad set of solutions for dealing with disconnection/reconnection issues. This will be done as a part of the distribution work stream.
- The extent to which retail elements could be productively dealt with as a part of work on retail contract terms and conditions will be separately examined as a part of the broader work programme on retail contracts.

Benchmark statements on retail contracts

This later work by Gas Industry Co on consumer issues resulted in the development of benchmark statements on retail contract terms, which will be applied on a voluntary basis. The benchmarks include clauses on the topic of 'disconnections and reconnections' but these clauses deal mainly with supplier-instigated disconnections (for example, for non-payment of bills). The work on retail contracts did not deal with the substantive issues raised through the earlier work on disconnections.

3

Regulatory objective

3.1 Overall context

The Gas Act and the GPS provide the policy context for the analysis of distribution issues in the gas industry.

Subpart 2 of Part 4A of the Gas Act provides for co-regulation of the gas industry by the Government and Gas Industry Co (as the approved industry body under 43ZL(1) of the Gas Act).

The Minister of Energy and Resources is responsible for the energy portfolio. The Minister monitors the performance of, and receives recommendations and advice from, Gas Industry Co. Responsibility for gas industry matters was transferred to the Associate Minister of Energy and Resources on 5 March 2009.

This section of the paper examines the context provided by the Gas Act and the GPS. It then sets out a proposed regulatory objective for work on gas distribution.

3.2 Gas Act objectives

When recommending rules or regulations under the Gas Act, Gas Industry Co must have regard for the objectives out in section 43ZN. In effect, these objectives also apply to other means of dealing with issues in gas governance.

The principal objective of Gas Industry Co in recommending gas governance regulations and rules is to:

...ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner.

The other objectives are:

- 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; and
- consistency with the Government's gas safety regime is maintained.

3.3 GPS objectives and outcomes

Objectives

The GPS requires Gas Industry Co to have regard to two further principal objectives—fairness and environmental sustainability—in all of its recommendations.

Gas Industry Co must also have regard to the other objectives set out in the GPS as follows:

- energy and other resources used to deliver gas to end users are used efficiently;
- competition is facilitated in upstream and downstream gas markets by minimising barriers to access to essential infrastructure to the long-term benefit of end users;
- the full costs of producing and transporting gas are signalled to end users;
- the quality of gas services where those services include a trade-off between quality and price, as far as possible, reflect customers' preferences; and
- the gas sector contributes to achieving the Government's climate change objectives as set out in the New Zealand Energy Strategy, or any other document the Minister of Energy and Resources may specify from time to time, by minimising gas losses and promoting demand-side management and energy efficiency.

Outcomes

The GPS sets out specific outcomes Gas Industry Co is expected to pursue through its work programme. The outcomes relevant to gas distribution cover those for an efficient retail market, and access to key infrastructure.

Outcomes for an efficient retail market are:

- an efficient market structure for the provision of gas metering, pipeline, and energy services; and

- the respective roles of gas metering, pipeline, and gas retail participants are able to be clearly understood.

The Commerce Commission is currently designing a price-quality regime for gas transmission and distribution businesses. However, we consider that efficiency issues other than price and quality may warrant consideration.

Outcomes for access to key infrastructure are:

- gas industry participants and new entrants are able to access distribution pipelines on reasonable terms and conditions; and
- consistent standards and protocols apply to the operations relating to access to all distribution pipelines.

3.4 Proposed regulatory objective

From the above, the key objectives and outcomes are an efficient market structure for distribution (setting aside price and related aspects of quality), clarity of roles, and reasonable access to distribution services by new entrant and existing retailers.

We propose the following regulatory objective for distribution:

To ensure that arrangements for the distribution of gas are safe, efficient and reliable with particular regard to achieving:

- an efficient market structure for the provision of gas metering, pipeline, and energy services;
- clearly understood roles of gas metering, pipeline, and gas retail participants; and
- achieving reasonable access by new entrant and existing retailers to distribution services.

The wording of the proposed regulatory objective is non-technical, but it is helpful to explain what Gas Industry Co believes 'safe', 'efficient' and 'reliable' mean in this context.

Safety and reliability

Aspects of supply that relate to safety and to reliability are generally closely interdependent. For example, the safe operation of a gas appliance can depend on gas composition and supply pressure. Excursions of either of these measures beyond defined limits can also cause equipment malfunction at gate stations, thereby affecting the reliability of gas supply. For the purpose of this paper, the key aspects of a safe and reliable gas supply are as follows.

- Gas composition: maintaining the burning characteristics of the gas within a defined range, as specified by *NZS 5442:2008 Specification for Reticulated Natural Gas* (the Gas Specification).
- Contaminant levels: restricting the levels of particles of liquid (condensates) and dust.
- Adequate odourisation: maintaining detectable levels of odourant as specified in *NZS 5263:2003 Gas Detection and Odourisation*.
- Supply pressure: maintaining pressure within contracted limits.
- Continuity of supply: avoiding interruption to supply.

Efficiency

We believe each conception of efficiency—productive, allocative, and dynamic—is relevant.

The productive efficiency of distribution services refers to providing best practice service at least cost. Allocative efficiency refers to providing the combination of quality and quantity that would emerge in a competitive market where end users respond to prices that reflect the true costs of production. Dynamic efficiency recognises the importance of innovations in technology in providing allocative and productive efficiency over time. There can be tensions between these conceptions of efficiency.

For the distribution market we would expect efficiency to be evidenced by the following.

- Access:
 - non-discriminatory terms of access;
 - ease of entry and exit; and
 - clarity of roles, rights and obligations.
- Information: availability of accurate and complete information about the market, and services provided by market participants.
- Innovation: minimal restrictions to adopting new technologies.

Q1: Do you agree with the proposed regulatory objective? If you disagree please explain why and/or provide an alternative.

4

Characteristics of distribution

4.1 Assets owned by distributors

The 'gas gate' connects the transmission system and the distribution network. The transmission system owner usually owns and operates the gas gate facilities, which include pressure regulators, pressure relief valves, filters, and meters. Occasionally a distributor also owns equipment at the gate station, providing additional filtration, pressure regulation, or check metering.

Distribution networks carry gas from the transmission gas gate to individual end users. The networks mostly comprise underground pipelines, occasionally organised in differing pressure tiers. Pressure-regulating stations, commonly located above ground, control the pressures in the different pressure tiers, and usually contain additional filtration and safety relief valves.

The outlets of the distribution network are the various gas measurement systems (GMSs) located at end user premises. These comprise equipment similar to that located at the gas gate, but on a smaller scale. The GMS owner may be a retailer, distributor, or another party.

4.2 Services provided by distributors

Open access distribution networks provide non-discriminatory transport and interconnection. In support of these activities, the distributor contributes to various associated processes including customer switching, gas reconciliation, the reduction of unaccounted for gas (UFG) through leak surveys and repairs, and disconnections and reconnections.

Some distributors also provide metering services. In relation to metering services, the Commerce Commission has found⁹:

There are five principal suppliers of metering services—Contact, Vector, Powerco, Wanganui Gas and Nova Gas. However, Powerco and Wanganui Gas only supply in areas covered by their networks and Nova Gas only supplies its own customers. It is understood that all customers on Nova Gas's networks have Nova Gas meters but only some of its retail customers on other networks have meters supplied by Nova Gas.

⁹ Commerce Commission. 'Auntorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd: Decision Paper.' 30 October 2008, p.256.

Distributors also market gas by generically promoting its use.

4.3 Market for distribution services

The starting point for any analysis of the rationale for gas governance is an assessment of the degree of competition. Competition encourages efficient allocation and use of resources in markets, and ensures that the price, quality and range of services offered meets the needs of end users.

Distribution networks typically have economies of scale, which occur when the average cost of production falls as output increases; and economies of scope, which occur when providing a combination of services is cheaper than supplying them individually. In the Commerce Commission's decision paper on the control of distribution services provided by Powerco and Vector¹⁰, it noted that:

- gas distribution has a high proportion of shared inputs; gas is supplied through a single pipeline for multiple retailers (suppliers) and end users;
- investments in gas distribution are largely 'sunk'; that is they have no value in alternative uses; and
- the assets are long lived with lifetimes of as much as 80 years.

The combination of these factors raises barriers to entry for potential competitors. Each of the three companies offering open access distribution services is therefore dominant in each of the geographical areas it supplies. Although Nova Gas has brought some competitive pressure, this applies only to the very limited bypass market.

4.4 Arrangements between retailers and end users

A further characteristic of distribution services is that they are bundled with other retail services offered to end users. Typically, the arrangement between the retailer and the end user is for 'delivered gas'; that is, it includes the cost of transmission, distribution, and metering, as well as the cost of the gas itself.

The contracts between the parties behind that bundled service can inhibit competition or limit its effectiveness. For example, network service contracts can stipulate who is to provide metering services when, in principle, that is a competitive service. Any inefficiency in the distribution arrangements can be passed on to end users through the bundled retail contract, affecting the efficiency of retail markets.

Q2: Have we identified all relevant characteristics of distribution? If not, please suggest what other features you believe to be relevant, and explain why they are relevant.

¹⁰ Commerce Commission. 'Auntorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd: Decision Paper.' 30 October 2008.

5

Regulation relevant to distribution

5.1 Gas (Safety and Measurement) Regulations 2010

The Safety and Measurement Regulations are made under the Gas Act. The latest regulations were approved in March 2010 following a review by the Ministry of Consumer Affairs. All aspects of gas safety are comprehensively covered including the safety of gas distribution systems (Part 3) and safety of gas at the point of supply to the end user (Part 4).

Improvements over previous versions of the regulations include a clearer definition of the point of supply (the outlet of the GMS), and a clear allocation of responsibilities. For example, the regulations provide that:

- the odourisation of gas is the responsibility of:
 - the retailer at the point of supply; and
 - the gas distributor at points where gas is received into or delivered out of the distribution system, and while the gas is in the distribution system (section 19);
- compliance with NZS 5442 is the responsibility of the retailer or wholesaler supplying that gas at the end user's point of supply (section 41).
- the accuracy of gas measurement is the responsibility of the owner of the GMS (section 21);
- supplying gas at a pressure that '...ensures the safe supply, passage, and use of the gas...' at an end user's installation is the responsibility of the retailer or wholesaler supplying that gas at the end user's point of supply (section 42); and
- the design, construction, maintenance, and operation to provide continuity of supply and safety is the responsibility of every owner and operator of the distribution system (section 26).

5.2 Gas (Information Disclosure) Regulations 1997

The Disclosure Regulations are made under the Gas Act. These regulations were developed as a key part of the 'light-handed' regulatory regime for gas pipeline businesses, introduced in the mid-

nineties. The regulations require gas pipeline businesses to regularly disclose a range of information including:

- financial statements;
- financial and efficiency performance measures;
- methodologies for allocating costs and revenues between pipeline and other activities;
- line charges and pricing methodologies;
- certain contract information;
- capacity of pipeline assets including:
 - maps of the distribution system;
 - definition of, and gas flow at, off-take points; and
 - the throughput of gas for each separate distribution system.

Under s55J of the Commerce Act 1986, the Disclosure Regulations made under the Gas Act will eventually be replaced by a Commerce Commission determination, which will include an information disclosure requirement for each gas distributor.¹²

Disclosure statements are readily available, either on publically accessible websites or on request from the distributor. Although the information provided is comprehensive, it is strongly focused on financial data. Information on non-financial aspects of supply is relatively limited.

5.3 Price control of pipeline services by the Commerce Commission: current arrangements

The distribution services provided by Powerco and some of the distribution services provided by Vector are currently subject to separate authorisations issued by the Commerce Commission under s70 of the Commerce Act 1986.¹³ The authorisations for Powerco¹⁴ and Vector¹⁵ came into effect on 31 October 2008 and will end on 1 July 2012. The conditions of the authorisations cover aggregate pricing, pricing methodology, and quality. Powerco and Vector must supply an annual compliance statement to the Commission.

¹² Nova Gas is exempt from Part 4 of Schedule 6 of the Commerce Act and is therefore not subject to the disclosure regulations.

¹³ The authorisations do not cover Vector's distribution networks that were formerly owned by NGC.

¹⁴ Commerce Commission Authorisation Decision No 656 Authorisation pursuant to the Commerce Act 1986 in the matter of controlled services supplied by Powerco Limited 30 October 2008.

¹⁵ Commerce Commission Authorisation Decision No 657 Authorisation pursuant to the Commerce Act 1986 in the matter of controlled services supplied by Vector Limited 30 October 2008.

Limits on aggregate pricing

The existing authorisations set limits on aggregate pricing. In summary, the total allowable revenue in a year must be less than or equal to the total revenue in the previous year adjusted for changes in pass-through costs, CPI inflation, and an 'X' factor specified in a schedule to the authorisations.

Quality parameters

The current price control authorisations require Powerco and Vector to report on defined quality parameters in an annual compliance statement. This approach recognises quality can be traded off against cost, but that the trade-off should be constrained. If the actual values of quality parameters are outside threshold levels, the authorisations require an explanation. The areas in which quality performance reporting is required for distribution are summarised below.

- System reliability, including indicators on the duration of, and customers affected by, unplanned interruptions, and the number and cause of outages.
- System condition and integrity, including indicators on third party damage events, the number of detected leaks, escapes of gas reported by the public, poor pressure because of network causes and UFG.
- Customer services, including indicators on emergency responses and complaints.

Metering services

The authorisations separately control the provision of metering services. At the time of the authorisations, Vector did not have a metering service therefore, only Powerco's metering is covered. The Commission considered the supply of new or replacement meters was competitive (with five principal suppliers). But, for meters not needing to be replaced, the high cost of replacement effectively locked in retailers to the existing supplier—hence the decision to provide control for those locked-in meters.

The authorisations do not specify any quality parameters for metering services because the Commission considered the requirements of NZS 5259:2004 Gas Measurement to be sufficient.

Exclusions from the authorisations

The authorisation excluded certain services such as new connections, decommissioning, disconnection, and reconnection.

The exclusion of some services from control can have perverse consequences. One obvious consequence is that distributors may seek to increase charges and/or reduce costs (and thus increase net revenue) in areas excluded by the authorisation. They may reduce costs by passing on responsibilities to other parties, especially retailers, or reducing non-controlled aspects of quality.

Industry participants have suggested some distributors offload risk (and any cost consequences) to retailers.

Effects of the authorisations

The effects of the authorisations are as follows.

- **Efficiency:** the authorisations affect market efficiency and access, but the effects are largely focused on pricing. Although the authorisations define a range of quality parameters, these have been developed in light of the Commerce Act requirements. Non-price aspects of access still warrant further consideration against our regulatory objective.
- **Reliability:** the quality parameters are directly relevant to reliability. The parameters in the authorisations are potentially limited in their effects, because they are reporting requirements rather than required standards.
- **Safety:** the authorisations have no direct effect on safety (this is not the Commission's mandate); and no effect on disconnections and reconnections (because these are excluded services).

5.4 Commerce Commission control of pipeline services: price-quality regulation

The Commerce Act 1986 was amended in 2008 to provide for a new approach to the control of pipeline services (and other services). The regime is discussed in a consultation paper published¹⁶ by the Commerce Commission. Submissions closed on 31 May 2010, and a draft determination¹⁷ on the input methodologies was released on 2 July 2010.

The possible effects of the introduction of the new price-quality approach warrants consideration. The new approach requires gas pipeline services to be subject to a default or customised price-quality regulation under sub-part 10 of Part 4 of the Commerce Act.¹⁸ The Commission's intention is for the initial Gas Default Price-Quality Path (Gas DPP) to come into effect on 1 July 2012. A regulated business will have the option of proposing a customised price-quality path to the Commission. The default or customised price-quality path will be established using an input methodology (building block approach). Methodologies will be developed for determining the cost of capital, asset values, cost allocations, tax treatment, and pricing.

On quality standards, the Commerce Commission's consultation paper discusses a range of related topics including reliability, system integrity, and quality of gas (including pressure and gas composition). These topics are similar to those currently covered in the authorisations. Reliability is identified as the key concern. The paper does not commit to any particular set of standards, but it

¹⁶ Commerce Commission. 'Initial Default Price-Quality Path for Gas Pipeline Businesses' Issues Paper.' 12 April 2010.

¹⁷ Commerce Commission. 'Draft Input Methodology (Gas Distribution Services Input Methodologies) Determination 2010.' 2 July 2010.

¹⁸ As with the Disclosure Regulations, Nova Gas is also exempt from price-quality regulations.

makes clear the regime will set in place objective quality standards with defined and measurable indicators.

On information disclosure, the paper simply reaffirms that any data requirements additional to current ones will depend on how the Gas DPP is framed.

Effects of price-quality regulation

Gas Industry Co expects the effects of the price-quality regulation to be similar to those of the current authorisations. Specifically:

- **Efficiency:** The regulations significantly affect market efficiency and access, but the effects are largely focused on pricing. Although the authorisations define a range of quality parameters, they are benchmarks for reporting, not required standards. Therefore, non-price aspects of access are still at risk. We consider other aspects of market efficiency to be appropriately covered by the authorisations.
- **Reliability:** The quality parameters are directly relevant to reliability. However, the parameters are potentially limited in their effects, because, again, they are benchmarks for reporting rather than required standards.
- **Safety:** We expect the regulations will have no direct effect on safety.

Q3: *Have we identified all regulatory arrangements that are relevant to this analysis of gas distribution? If not, please suggest what other regulatory arrangements are relevant, and explain why they are relevant.*

6

Discussion of potential issues

This section draws on the preceding analyses to determine whether there are outstanding issues warranting further work. The following subjects are discussed:

- access to distribution services;
- gas quality;
- arrangements between service providers; and
- disconnections and reconnections.

6.1 Access to distribution services

Private networks

The lack of access to the Nova Gas private network is known to be an issue of concern to some retailers. Efficiency issues arising from this are likely to be minor where a private network runs in parallel to an open access network, and end users have a low-cost option of being supplied by either network. But efficiency issues could be significant where there is no parallel open access network and the private network is the only means of supplying end users, or where end users cannot easily change from the private network to the open access network. A counter-argument is that, regardless of these considerations, the private network will have brought users a choice they did not previously have, and this should have enhanced competition.

A report commissioned by Gas Industry Co and published in 2009¹⁹ examined whether existing rules and regulations for open access pipelines should also cover private networks. The report concluded they should, but the legal validity of that conclusion depended on private networks falling under the Gas Act's definition of 'gas distribution'. The Rulings Panel established under the Gas Governance (Compliance) Regulations 2008 has recently considered this matter. The panel determined Nova Gas is not a gas distributor in terms of the current definition in the Gas Act.

Access to private networks is not considered any further in this paper.

¹⁹ Geoff Bertram, Simon Terry and Associates. 'Application of Gas Governance Arrangements to Private Networks', 6 March 2009.

Open access networks

In principle, access issues could also arise in open access networks. For example, delays in providing access, or the imposition of unreasonable non-price conditions for access. However, open access distributors have no incentives to create these kinds of difficulties, because it is in their interests to increase the quantity of gas distributed. We have also spoken to some retailers who confirm access issues are generally not a problem on open access pipelines.

Open access can be expected to increase the competitive choices available to end users. However, conditions of open access can raise concerns for competition in related markets. For example, network services agreements might stipulate who is to provide metering services when, in principle, that is a competitive service.

6.2 Gas quality

Gas quality issues have caused loss of gas supply to distribution systems or end users. One incident involved hydrates forming in pilot regulators at a gas gate, causing the main regulators to close, temporarily interrupting gas supply. Another incident involved dust from pipeline cleaning operations clogging the filters at an end user's GMS. These are distinct situations, but both relate to particular aspects of gas 'quality', and raise similar issues about control and liability.

Gas Industry Co understands gas quality issues have for some time been a point of contention between industry participants. We are aware of industry concerns that the responsibilities for monitoring gas quality are unclear. Some participants are concerned downstream parties (in particular retailers and distributors) are the most likely to suffer damage or liability from a gas quality incident; but an upstream participant (in particular a producer or transmission system owner) is likely to be the party who caused, or failed to prevent, the incident.

Although issues related to gas composition and contaminants can affect distributors, they need to be considered in the overall context of the gas supply chain. For this reason we have dealt with these in a companion paper *Gas Governance Issues in Quality: Issues Paper*.

6.3 Arrangements between service providers

Common practice in New Zealand is to provide bundled gas services; therefore end users have a relationship with their retailer and not with the distributor of the gas supplied, nor usually with the GMS owner. If problems in distribution or gas measurement affect supply to end users (for example, interruptions, loss of pressure, gas leaks in the distribution pipes, water ingress), usually end users' only recourse is to the retailer. This is satisfactory only if distributors and GMS owners have incentives to deal with end users' and retailers' problems. The relationships between the retailer and the distributor and GMS owner, are thus critical to the provision of an effective end user service. The

network services agreement principally, but not wholly, represents the relationship between the retailer and the distributor.

The Safety and Measurement Regulations comprehensively assign responsibility for factors affecting safety and reliability. However, in some instances responsibility is assigned to a person who does not physically control that factor. In those instances the person will wish to pass that responsibility back along the physical supply chain. For example, the Safety and Measurement Regulations make the retailer responsible for gas pressure at the end user’s installation. But the retailer does not physically control the pressure at the point of supply—the regulators in the GMS determine pressure. So the retailer will wish to make the GMS owner responsible for supplying a particular GMS outlet pressure. To meet that requirement the GMS owner needs to be confident that the distributor provides sufficient pressure at the GMS inlet. So the GMS owner will wish to make the distributor responsible for supplying a particular GMS inlet pressure. And so on, along the physical supply chain. The passing of risk is illustrated in Figure 2.

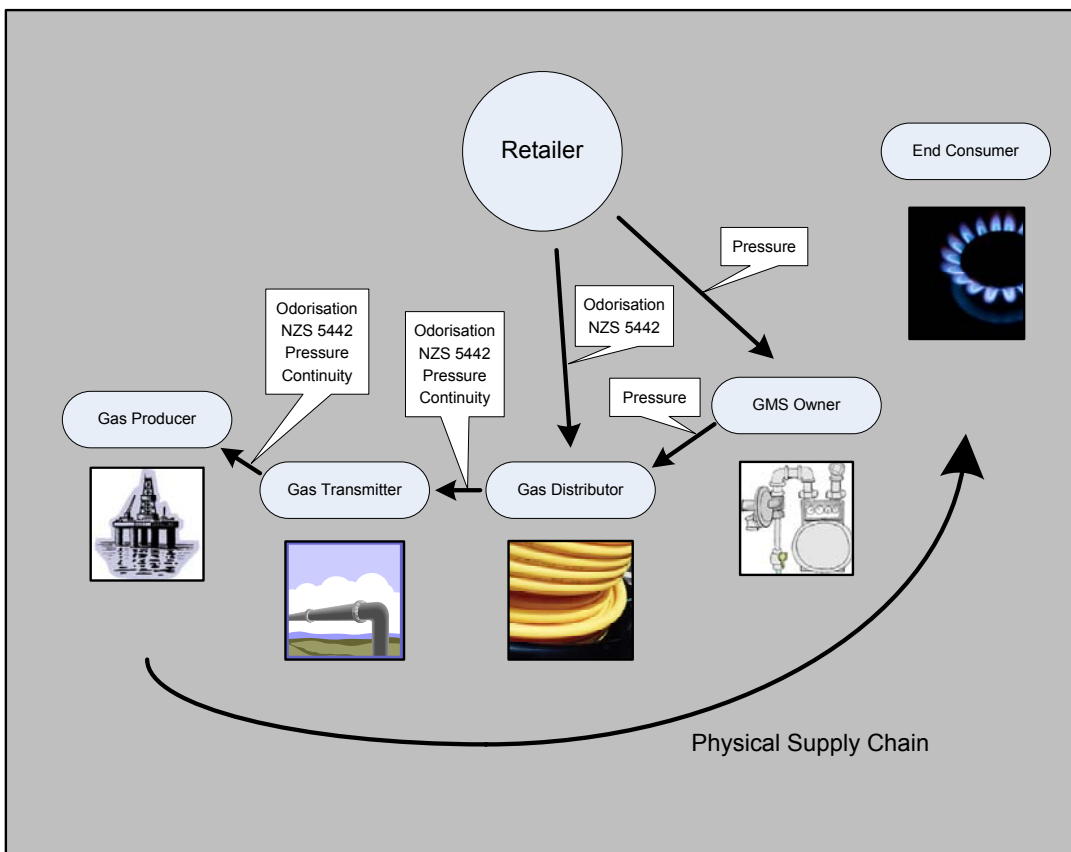


Figure 2 Passing of responsibility to the parties in control

An important principle that should apply to the chain of contractual arrangements is that of ‘alignment’. Alignment ensures retailers’ contractual commitments to the end user are backed by equivalent commitments in related contracts, back to the party with control.

Retailer-end user arrangements

End user complaints are a good indication of consumer issues. The EGCC has informed Gas Industry Co that over the past year it has received about eight complaints and 15 queries involving gas distributors and/or distribution. However, distribution *per se* does not appear to be an issue. Complaints are generally about poor information flows between distributors/retailers and the end user, particularly in relation to new connections and disconnections.

Retailer-GMS owner arrangements

We are aware that end users sometimes experience difficulties when they change retailers. Problems can arise when the customer's GMS must be replaced. A replacement GMS is required if the losing retailer owns the GMS, but is not providing GMS services to the winning retailer. If the GMS is large or complex, replacing it means that switching the customer to the new retailer can take several hours or days. The length of the switch-over time can be a significant problem for the gas end user who may lose gas supply during that period. Losing retailers have little incentive to facilitate the timely replacement of the GMS.

Providers of metering services compete for new connections, when meters reach the end of their economic life and are replaced, and for existing connections. The Commerce Commission's pricing authorisation acknowledged²⁰ that competition in the first two situations is greater than competition for providing metering services to existing connections.

Although the retailer/GMS owner switching problem is real, it is also rare. In most cases a losing retailer who owns the GMS will offer the winning retailer GMS services. Retailers with whom we have talked generally have no concerns about arrangements with GMS owners.

Retailer-distributor arrangements

Retailer-distributor arrangements might also have problems that could affect end users. The arrangement between a retailer and a distributor is generally termed a network services agreement. Informal industry discussions have indicated current concerns regarding these network services agreements include:

- the structure of pricing for distribution services;
- arrangements for allocating or sharing liability;
- arrangements for dealing with regional effects of critical contingency events;
- the provision of metering services;

²⁰ Commerce Commission. 'Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd—Decision Paper.' 30 October 2008, p.256-257.

- provision of information between the parties and audits;
- arrangements for the reconciliation and invoicing of network charges; and
- the process for advising price changes.

Key provisions in network services agreements and retail contracts should align. However, retailers are concerned many of the network services agreements are out of date. Some agreements have expired, but have been rolled over because there is no other option. Retailers perceive that distributors have been unreasonably slow in updating agreements and have little incentive to do so, because they provide a monopoly service. As stated by more than one retailer: 'all the power in this relationship lies with the distributor'. Nevertheless, some agreements have been updated. Our impression from discussions is that distributor delays result from their priorities under limited staff resources, the compliance cost in a regulated environment, and possible interpretation of a change as implying that prior arrangements were not appropriate.

Does the prevalence of out-of-date network service agreements matter? It could be argued an out-of-date agreement is an inconvenience (rather than a serious concern) providing that the distributor takes responsibility for matters under its control, even if the retailer is legally responsible. However, the information available to us suggests out-of-date agreements do matter because:

- the failure to re-negotiate replacement network services agreements on expiry implies unresolved issues between distributors and retailers (if each party were happy with the contractual terms, agreements would have been reached);
- the failure to agree is notable because retailers consider out-of-date agreements to present significant risks with liability and cost implications;
- out-of-date provisions might not reflect changes in regulations;
- without contractual certainty distributors and retailers will not always act congruently on particular issues (the treatment of disconnections is a good example—see below);
- lack of alignment between retail contracts and network service agreements creates risks for end users they cannot mitigate because they have no relationship with distributors; and
- industry participants appear to have no certainty or commitment on when the situation will be fully corrected.

It may be that distributors are waiting for a good opportunity to update these agreements, such as the introduction of the price-quality regime.

6.4 Disconnections and reconnections

Disconnections and reconnections are arrangements between the service providers. These arrangements are discussed separately here because this topic has been part of the earlier Gas Industry Co work programme.

Section 2 summarises the history of work on disconnections and reconnections. The outcome was a set of proposals from Gas Industry Co, which were not fully supported by the industry, particularly distributors. The proposals were thus set aside. The proposals are summarised below.

- Retailers would provide clearer and more readily accessible information to end users about the charges for connection and disconnection and the circumstances under which they would apply.
- Distributors and retailers would continue to manage the issue of seasonal disconnections.
- Distributors would adopt a policy of ceasing line charges 14 days following a vacancy, rather than following a disconnection. This policy would reduce the incentive for retailers to request disconnections prematurely.
- Distributors and retailers would agree to modify network service agreements to clarify that retailers are responsible for monitoring vacant end user installations through to the point of disconnection.

The key issues are commercial, especially the suggestion distributors should cease line charges after 14 days following a vacancy. Industry discussions as a part of the present work indicate other approaches may be worth investigating. Examples are incorporating the effect of vacant connections in overall line charges so line charges can be discontinued immediately after a vacancy. However, solutions such as this would need to be discussed with the parties before being taken further. Past experience indicates such discussions would be difficult to set up and unlikely to produce results. In particular, industry concerns that discussions on retail disconnection and reconnection charges will be deemed as price fixing, mean any such proposal will likely require either regulation or a Commerce Commission authorisation.

We think the best way to progress work on disconnections and reconnections is to incorporate it in any work on retailer-distributor arrangements (see section 6.3). Such a work programme would have to recognise that regulation may be cost effective for elements with price fixing risk.

Q4: Have we identified all issues relevant to the analysis of gas distribution? If not, please suggest what other issues are relevant, and explain why they are relevant.

7

Conclusion

This section considers the material presented in previous sections in the context of the regulatory objective to assess what intervention, if any, is appropriate.

7.1 Safety and reliability

To test whether any additional work may be required to meet the regulatory objective, we look at each component of safety and reliability.

Composition and contaminants

The companion paper, *Gas Governance Issues in Quality: Issues Paper*, considers whether there are any outstanding issues in relation to composition and contaminants. That paper concludes the three main issues are: a relatively low level of prescription for monitoring arrangements through the supply chain, gaps in the contractual arrangements for aligning liabilities and indemnities, and lack of gas quality monitoring procedures.

Odourisation

The Safety and Measurement Regulations make the retailer responsible for odourisation of gas at the point of supply, and the gas distributor responsible at points where gas is received into or delivered out of the distribution system, and while the gas is in the distribution system (regulation 19).²¹ This places responsibilities on the retailer, the owner of distribution networks, and the owners of transmission pipelines.

Producers connected to transmission pipelines containing odourised gas are usually the first party in the physical supply chain to be contractually responsible for adding odourant.²³ Where Vector's transmission pipeline contains odourised gas, Vector requires producers to odourise the gas before

²¹ The definition of 'gas distributor' in the regulations is the same as in section 2(1) the Gas Act: ...any person who supplies line function services to any other person or persons. It follows that the obligation applies to both distributors and transmitters.

²³ Not all transmission pipelines contain odourised gas. For example, gas is not odourised in the Maui pipeline or in the Kapuni to Frankley Road pipeline. These pipelines supply gas to major petrochemical facilities (methanol and ammonia-urea plants) that prefer to receive unodourised gas because odourant would contaminate catalysts used in their production processes. This is generally not an issue. Leaks in high pressure above-ground facilities are generally audible, and leaks in underground transmission pipelines are usually detectable by dead vegetation. However, leaks in distribution pipelines are more common and also more hazardous, because distribution pipelines are generally in built-up areas.

injecting it. In practice odourisation is usually contracted to Vector who has the technical expertise to maintain odourant equipment and handle odourant.

The smell of odourised gas is known to fade under certain conditions. So even if the producers faithfully inject odourant at transmission receipt points, gas delivered to an end user cannot be guaranteed to be odourised to a safe level. Only monitoring can determine the levels of odourant in delivered gas.

As noted above, the Safety and Measurement Regulations allocate responsibility for odourisation of gas. We have not enquired into how transmitters, distributors, and retailers test odourant levels to determine if their obligations are being met. Nonetheless, their statutory obligations are clear.

Supply pressure

As noted in section 5.1, the Safety and Measurement Regulations makes the party supplying an end user (whether wholesaler or retailer) responsible for gas pressure at the point of supply. However, it is the meter owner or distributor who provides the physical means of pressure control—pressure regulators within the GMS or distribution system. We expect GMS agreements and/or network services agreements to deal with this matter.

Continuity of supply

As noted in section 5.1, the Safety and Measurement Regulations makes owners and operators of distribution systems responsible for maintaining continuity of supply and safety. Owners and operators are required to take all practicable steps to ensure their systems are designed, constructed, maintained, and operated in a manner that, as far as practicable, achieves continuity of supply and safety. Compliance with relevant New Zealand standards is deemed to meet this requirement. Failure to comply is a 'Grade A offence' under the regulations, exposing the company in default to a fine of up to \$50,000.

Performance indicators and thresholds in the current price authorisations on Vector and Powerco also relate to continuity of supply. For example, the controlled companies are required to report on the duration and frequency of interruptions. We expect similar reporting measures to be included in the price-quality regime when it is introduced.

Overall assessment of safety and reliability issues

We consider the Safety and Measurement Regulations and the role of the Energy Safety division of the Ministry of Economic Development (MED) cover all generic safety and reliability risks, and the initial allocations of responsibility to manage those risks. However, it is unclear whether arrangements between the parties in the supply chain would always ensure those responsibilities are passed back to the party best able to control the risk. Nor is it known how those responsibilities would be discharged.

Gas Industry Co believes MED considered these matters when the Safety and Measurement Regulations were developed. We assume MED thought it sufficient to allocate responsibilities, and not to require reporting on how those responsibilities are managed. Should new concerns arise, MED can, to some extent, deal with them when it audits distributors' Safety Management Plans.

Our informal discussions with retailers indicate they have few issues in meeting their safety and reliability obligations. EGCC information on complaints also indicates that safety and reliability rarely emerge as an issue in practice. However, although this indicates safety and reliability failures are uncommon, it must be remembered that the consequences of reliability failures can be significant. They can be 'low-frequency, high-impact' events.

From the above, our major concern is whether contracts between distributors and transmission companies (upstream) and GMS owners (downstream) adequately deal with composition, contamination, odorant monitoring, and pressure. Our gas quality issues paper considers the first two matters in more detail.

We conclude that statutory obligations in respect of safety and reliability are comprehensive and clear. Gas Industry Co assumes parties in the supply chain will behave as reasonable and prudent operators and discharge their safety responsibilities with due diligence. Further Gas Industry Co work on safety and reliability issues in relation to distribution services is therefore unwarranted.

Q5: Do you agree Gas Industry Co should do no further work on the safety and reliability aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.

7.2 Efficiency

Access

A thorough analysis of the strength of the arguments on access to private networks is beyond the scope of the present paper. This is particularly so because mandating open access to such networks would require regulatory action including an amendment to the Gas Act. We therefore set aside the issue of private networks.

In relation to open access distribution networks, there is no evidence that ease of entry and exit is a problem.

Regarding non-discrimination, it is difficult to assess the degree of standardisation of access arrangements on a network because contracts between retailers and distributors are generally confidential. Although the Information Disclosure Regulations require disclosure of certain 'prescribed terms and conditions' of gas conveyance contracts, we see no reason why the terms and conditions of the system owner's generic contract should not also be disclosed. We think it odd that open access distributors do not routinely make such terms and conditions available. However, this may reflect the 'thinness' of the New Zealand distribution market—new retailers emerge infrequently.

Information

Gas Industry Co would like to see open access distributors make their standard distribution services contracts they offer to retailers readily available. We have no reason to believe access is provided on discriminatory terms and conditions, but we would like market participants to have the information to make their own assessments.

Innovation

We have no concerns that current industry arrangements place inappropriate contractual or other restriction on the adoption of new technologies.

Overall assessment of efficiency issues

We consider the distribution of gas is currently operating at a level of efficiency that falls well short of justifying regulation. None of the retailers we spoke with suggested regulation was necessary; neither are there any third party issues (with end users especially) that would justify this approach.

However, we believe standard contracts for open access distribution services should be disclosed. Information disclosure would allow market participants to confirm that the terms being offered are non-discriminatory.

Also, we are disappointed that distributors have been slow to update their distribution arrangements to reflect the changing roles and responsibilities of parties, and the introduction of the Safety and Measurement Regulations. Below we set out possible approaches for ensuring distribution arrangements are updated.

- Gas Industry Co could maintain a watching brief. This watching brief could take the form of a short annual status report. The report could include progress on updating network service agreements, the availability of standard contracts for open access distribution services, and outstanding issues of concern for retailers and distributors.
- Gas Industry Co could develop and publish benchmarks for best practice in network services agreements. These benchmarks would be at a high level and designed to enhance the watching

brief. Appendix A sets out some preliminary ideas on how such benchmarks might be constructed. The benchmarks are illustrative only (they are not being proposed). They are also selective not comprehensive. Nevertheless the industry's view on whether benchmarks at this level are appropriate would be useful. Either the industry could decide whether to adopt the benchmarks; or Gas Industry Co could monitor the degree to which they are adopted in a way similar to the approach being taken for retail contracts. However, the latter approach would depend on distributors agreeing to provide copies of distribution contracts for monitoring purposes. Electricity experience especially (see section 2) suggests going beyond benchmarks to, for example, a model contract, would be difficult and expensive and almost certainly not cost-effective.

These options would require the co-operation of the industry, but would not involve regulatory intervention. If more extreme measures are thought preferable—for example, direct prescription of key terms of contracts—regulatory intervention would be required. Regulatory intervention could also be used to bolster one or more of the options above. For example, if distributors continue to be unwilling to disclose their standard distribution contracts for monitoring, then mandating information disclosure would have to be considered. Accordingly, the industry's views on what, if anything, should be done are crucial.

Q6: Do you agree with the options identified for dealing with slow progress on updating standard distribution agreements? Which option do you think is most appropriate?

Q7: Do you agree Gas Industry Co should do no further work on the other efficiency aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.

8

Next Steps

Submissions on this paper are sought no later than 5pm on Monday, 18 October 2010. We expect publishing an analysis of submissions and a response before the end of the year. The definition and timing of any work past that point depends on responses.

Appendix A Possible high level benchmarks for distribution contracts

Gas Industry Co has developed and published benchmarks for retail gas supply arrangements (principally incorporated in retail contracts). The retail benchmarks are intended to be specific enough to enable assesment of the alignment of retail gas contracts with the benchmarks.

In the case of distribution contracts, we consider it more appropriate to set benchmarks at the level of principles; that is, statements guiding the content of distribution contracts but not necessarily presenting specific comparators for contract terms. The key difference from retail contracts is that the parties to distribution contracts are industry participants who are better able to negotiate mutually acceptable terms. Any proposed benchmarks would provide a high-level context for such negotiations.

Elements of a possible set of principles are set out below for illustrative purposes only. These elements are selective not comprehensive. The principles have been developed from:

- a brief perusal of a sample distribution contract; and
- issues raised in the course of discussions with retailers and distributors.

We have also taken account of the pricing principles in the Commerce Commission authorisations for Vector and Powerco^{4,5} and the distribution pricing principles published by the Electricity Commission in February 2010.

General principles

1. There should be access under equal or equivalent terms for all retailers.
2. The interests of retailers and the distributor should be fairly represented in the contract terms.
3. The contract should be consistent with, and the parties should act in accordance with, the requirements of all relevant legislation, regulations, and rules.
4. As far as possible, and without inhibiting innovation and the need to reflect special circumstances, distribution terms of access should be standardised across all networks and retailers.
5. Where retailers are responsible (by the requirements of any relevant legislation, regulations and rules) for matters that are under the control of the distributor, or one of the distributor's

service providers, the gas distribution arrangements should acknowledge those matters and say how the distributor will respond.

Obligations and rights of the parties

6. The obligations and rights of the parties should be clearly and comprehensively set out.

Services provided

7. The services to be provided by the distributor and the quality standards for those services should be set out. The services and quality standards should include all those aspects that are under the reasonable control of the distributor, or a service provider to the distributor.

Pricing including price changes

Note: Overall pricing levels for Vector and Powerco are controlled by the authorisations issued by the Commerce Commission. The authorisations also set out pricing principles. Similar principles have been proposed by the Electricity Commission for electricity distribution. In view of this the material below looks only at price changes.

8. Changes to pricing structures and methodologies should be subject to meaningful consultation with retailers before they are finalised and notified.
9. Price changes should be accompanied by all of the information required to enable the effective implementation of the price changes by retailers.
10. The notice period given by distributors for changes in pricing structures or levels should reflect the notice period that retailers must provide to end users for consequential changes in retail prices and the time for notice preparation.

Commencement and cessation of line charges

11. As far as possible the commencement and cessation of line charges should occur at the time that supply commences or ceases being taken by the end user.

Information exchange and use

12. Information should be exchanged between the parties in formats that are, as far as possible, standardised and agreed between the parties.
13. Contractual requirements for the provision of information will be only for the purposes of enabling efficient and effective gas distribution and information will only be used for the purpose for which it is provided.

Service interruptions

14. In determining the incidence and duration of planned distribution service interruptions, the distributor should take account of the costs of notification for the retailer and whether other lower-cost alternatives can be adopted.
15. When unplanned service interruptions occur the distributor should provided timely information to retailers on issues and progress.

Managing critical contingencies

16. Contracts should provide for the management of the regional effects of critical contingencies so the risks for all of parties are minimised and appropriately managed.

Review of distribution contracts

17. Distribution contracts should be reviewed and updated at intervals that enable those contracts to reflect current best practice and the current industry and regulatory environment.

Q8: Do you consider the high level benchmarks for distribution contracts proposed in Appendix A are appropriate? If not, please suggest what alternatives should be considered.

Appendix B Format for submissions

To assist Gas Industry Co to analyse responses, please use the table below to format submissions. The questions are the same as those contained in the body of this document. Submitters are free to include other relevant material in their responses.

A word version of this template is available on Gas Industry Co's website at: www.gasindustry.co.nz

Question	Comment
Question 1: Do you agree with the proposed regulatory objective? If you disagree please explain why and/or provide an alternative.	
Question 2: Have we identified all relevant characteristics of distribution? If not, please suggest what other features you believe to be relevant, and explain why they are relevant.	
Question 3: Have we identified all regulatory arrangements that are relevant to the analysis of gas distribution? If not, please suggest what other regulatory arrangements are relevant, and explain why they are relevant.	
Question 4: Have we identified all issues relevant to the analysis of gas distribution? If not, please suggest what other issues are relevant, and explain why they are relevant.	
Question 5: Do you agree Gas Industry Co should do no further work on the safety and reliability aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.	

Question	Comment
<p>Question 6: Do you agree with the options identified for dealing with slow progress on updating standard distribution agreements? Which option do you think is most appropriate?</p>	
<p>Question 7: Do you agree Gas Industry Co should do no further work on the other efficiency aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.</p>	
<p>Question 8: Do you consider the high level benchmarks for distribution contracts proposed in Appendix A are appropriate? If not, please suggest what alternatives should be considered.</p>	