

Bridge Commitments: Progress Report

February 2012

Introduction

Following a Gas Industry Co proposal for regulation, Vector Transmission and the majority of shippers ('Shippers') on its North Pipeline (Contact, Energy Direct, Genesis, Mighty River Power (MRP), Nova and OnGas) committed to a package of measures ('Bridge Commitments') to address the perceived short-term competition issues large end users have been facing. This initiative is an industry response to Gas Industry Co concerns that, in a constrained pipeline situation, capacity can be retained by incumbent Shippers because their rights to capacity are 'grandfathered'. The consequence is that in response to tenders, large end users may only receive a bid for gas supply from the incumbent Shipper (or a few others).

The Bridge Commitments were agreed amongst Shippers and Vector in August, and comprise seven elements, including a commitment by Shippers to make capacity available to other Shippers 'at a price that reasonably reflects the value of that existing capacity to the Shipper, and at a quantity that will reflect the end user's demand, to the extent practicable'. The package of commitments creates a bridge to allow the industry to discuss how the transmission access and pricing arrangements can be developed to improve the economic allocation of capacity on the Pipeline.

Shortly after being agreed, Gas Industry Co assessed¹ the Bridge Commitments and concluded that they should:

- ensure existing large end users on the North Pipeline have an effective choice of supplier in the short term, by facilitating the transfer of capacity amongst Shippers;
- help to facilitate development of longer term access arrangements and investment; and
- materially change the market.

As a result of these conclusions, Gas Industry Co determined that intervention by way of Rules was not justified at that time. In its assessment paper, Gas Industry Co also noted that it would continuously monitor the effectiveness of the Bridge Commitments and update industry if anything occurred that might change its assessment.

The Bridge Commitments have been operative now for just over four months. This report provides Gas Industry Co's assessment of progress made by the Bridge Commitment signatories. An overall assessment is provided at the end of the report. In summary, good progress has been made, including facilitating associated work on long term solutions to transmission access issues through the Gas Transmission Investment Programme (GTIP). However, there have been

¹ http://gasindustry.co.nz/sites/default/files/u254/retail_competition_when_transmission_capacity_is_constrained_-_reevaluation_of_constrained_pipeline_rules_option_171755.12_1.pdf

insufficient tenders to evaluate the effectiveness of the primary commitment (on incumbent Shippers serving large end users to offer capacity to other Shippers) and more work is required to implement some of the other commitments. We acknowledge the substantial work and focus offered by Vector Transmission and the Shippers to date, and we urge them to continue their work in fulfilling their commitments. There is significant further potential that can be realised, including from the freeing up of power station capacity and use of a Bulletin Board Vector Transmission has developed to facilitate secondary trading of capacity. The key measure remains whether better outcomes are delivered to large end users to address short term competition concerns arising on the North Pipeline. Gas Industry Co considers that more work is required to demonstrate such outcomes and we will continue to support and monitor developments.

Capacity offers

1. *as a Shipper supplying a large end user (end user) who obtains gas from the Northern Pipeline, where the end user tenders for future gas supply to:*
 - a. *ensure that transmission capacity (capacity) is available to the preferred retailer of the end user of gas, at a price that reasonably reflects the value of that existing capacity to the Shipper, and at a quantity that will reflect the end user's demand, to the extent practicable;*
 - b. *provide that capacity and quantity information, at the end user's or another Shipper's request, within five business days, to allow competing bidders to incorporate it into their supply proposals; and*
 - c. *provide that information in paragraph 1(b) to the Gas Industry Company Limited (GIC), together with the name of the end user, relevant ICP number and any other material terms of the capacity transfer offer at the time they are made to assist the GIC in assessing the efficiency of the arrangement set out in this paragraph.*

Gas Industry Co is aware of two offers for capacity by incumbent Shippers of end users who have tendered their supply. We understand neither offer was accepted. Switching registry records show that four large end users on the North Pipeline switched to new suppliers in the last few months. Apparently, not all of these switches involved requests to the incumbent Shippers to offer capacity. It is possible that other tenders may have occurred where the customer chose to stay with the incumbent Shipper.

We are aware that a recent RFP for gas supply covering a number of sites included a provision requiring the incumbent Shipper/s to offer terms for transferring their capacity to competing

Shipper/s. Discussions with industry participants and brokers have also indicated that the coming months will continue to see low levels of activity.

The small amount of activity is not surprising to Gas Industry Co. There are only approximately 200 ICPs with time of use (TOU) meters on the North Pipeline. Some of these end users only tender once every few years, while others accept offers from their incumbent Shippers without testing the market. As noted above, not all end users are apparently requesting that incumbent Shippers offer capacity to competitors. More tender processes will need to be completed before the effectiveness of this commitment can be assessed.

Shippers have recently clarified that the reference to 'large end users' in the Commitment letter means all end users with a TOU meter.

Capacity price and quantity information posted on Vector OATIS

2. to ensure that within ten business days after the completion of the tender process initiated by the end user or Shipper, the information in paragraph 1(b) will be disclosed on the public version of the Vector Transmission Open Access Transmission Information System (OATIS).

Information on the capacity offers made to date has been posted under the publications page on OATIS (www.oatis.co.nz). The purpose of disclosing this information is to make the price and quantity of capacity offers transparent. Gas Industry Co continues to see value in the disclosure of this information, in providing transparency in a constrained market. But, as with commitment 1, more tender processes will need to be completed before the effectiveness of this commitment can be assessed.

Terms for the transfer of capacity under Supplementary Agreements and Non-Code Shipper agreements (ie. power station capacity)

3. to negotiate, and where practicable agree, on a set of reasonable commercial terms to govern the transfer of capacity under Supplementary Agreements and Non-Code Shipper transmission services agreements (including where relevant reasonable amendments to Supplementary Agreements and Non-Code Shipper transmission services agreements), by a target date of 1 December 2011.

Since the implementation of the Bridge Commitments, Contact Energy, MRP, and Vector Transmission ('the parties') have been negotiating to remove existing restrictions that prevent power stations trading capacity under supplementary agreements. Power station capacity accounts for around 60% of all capacity on the North Pipeline. Power station owners have been

running their stations differently than in the past, which could allow them to free up some capacity to be traded.

This commitment reflected a view that removing the initial barrier to trading of power station capacity was achievable, although no commitment was given as to what capacity might be traded. In particular, the power station capacity is strategically important for maintaining security of electricity supply into Auckland. The power station owners accordingly have needed to do detailed work on what capacity could be traded, and in what form, while maintaining security goals.

After three months of negotiating, the parties report that they are close to concluding an amendment that will allow spare capacity to be on-sold.

Gas Industry Co continues to see this commitment as offering significant potential in terms of getting best use of existing North Pipeline capacity. We acknowledge the work to date by the parties; note the significant potential value of freeing up power station capacity; and urge them to progress their further work in this area as a matter of priority.

Information request

4. to disclose to the GIC such information as the GIC reasonably requires to enable it to understand and assess the extent of the Northern Pipeline capacity constraint, the efficiency of the current capacity allocation mechanism and the need for asset investment, provided the GIC only uses the information for the purposes set out in this paragraph and keeps confidential any information identified by a discloser as confidential (including not disclosing that information to any competitor).

On 4 November 2011, Gas Industry Co issued an information request for individual Shipper daily capacity reservations and delivery information. All Shippers (as well as Greymouth Gas, which is not a signatory to the Bridge Commitments) have agreed to disclose this information.

Despite the Bridge Commitments only applying to the North Pipeline, we requested that the information be provided for all gas gates, as such information will be useful for the supply/demand study (one of the Information Projects under the GTIP). This was agreed and the information will provide insight on the seasonality of demand as well as other patterns that will be helpful for understanding the interplay between annual demand and peak daily demand.

Gas Industry Co considers that increased transparency needs to be a feature of both short and long term solutions to transmission issues. We believe this commitment is a good precedent for the future, both in terms of the way further information disclosure can improve market outcomes and the way industry can voluntarily aid in such processes.

Review of capacity constraint

5. to work with GIC on a review of the Northern Pipeline capacity constraint, with the results made public and presented in an open forum by a target date of 1 December 2011.

Vector has released the report, *North Pipeline Review as at 1 October 2011*. It includes:

- a summary of the way in which Shippers obtain Reserved Capacity;
- a record of Shippers' transmission capacity entitlements over recent years;
- use of firm transmission capacity (ie offtake), by retail and power generation Shippers; and
- pipeline performance during August 2011 peak week.

The report shows that while overall annual demand north of Rotowaro declined by 18% over the last five years, peak daily offtake increased 7% in the same period. This presents both opportunities and challenges: opportunities to increase annual demand on the pipeline, and challenges to facilitate more flexible peak demand arrangements. The GTIP is well positioned to address these as the overall picture shows that there is significant potential for more efficient use of the North Pipeline.

In addition to this review paper, Vector has taken the lead in a significant new initiative, its Capacity Determination Project, by commencing a detailed industry consultation process on its approach to capacity modelling, its management of capacity, and its security of supply standard. This work has already provided valuable insights into how Vector manages its access regime and operates its pipeline system, as well as opening up discussion about opportunities around optimum management of the system.

Gas Industry Co supports this initiative and sees it as a key contribution to the GTIP.

More information can be found on Vector's website: <http://www.vector.co.nz/gas/pipeline-capacity-consultation>

Bulletin Board

6. to work together to develop a platform (known as a Bulletin Board) to facilitate the open and transparent trading of capacity between willing buyers and sellers, by a target date of 1 December 2011.

A Bulletin Board system for trading transmission capacity has been developed by iPredict. Essentially the Bulletin Board, referred to as the Gas Transmission Exchange (GTX), is a bid matching service. It has been designed to facilitate open and transparent trading (whether by sale or by loan) of transmission capacity rights among Shippers who hold capacity rights on Vector's North Pipeline. Vector Transmission funded the initial stage of development and Gas

Industry Co has expressed a willingness to take responsibility for administering the GTX. The initial design has intentionally been kept simple, but the opportunity exists to make enhancements to the GTX to provide for a more sophisticated trading platform. Later this month Gas Industry Co will meet with Vector Transmission and Shippers to discuss the terms and conditions for using the GTX. Gas Industry Co has also indicated that it could fund the GTX until 30 June 2012. After this date, Gas Industry Co expects to have made an assessment of the ongoing cost of the platform and to charge Shippers a fixed fee for it.

The GTX can be accessed at www.thegtx.co.nz.

Gas Industry Co sees the GTX initiative as another valuable new step towards efficient utilisation of North Pipeline capacity and believes it fits well with long-term developments under the GTIP.

Gas Transmission Investment Project (GTIP)

7. to participate in a project with the objective of developing longer term market solutions; establishing the current need for gas transmission investment; and developing an effective pathway for gas transmission investment to take place, including correctly signalling the price of gas transmission capacity.

Following the implementation of the Bridge Commitments, Gas Industry Co issued the paper, *Gas Transmission Investment Programme: Structure and Scope*. The paper outlined a comprehensive programme of work for addressing longer term issues in relation to access and investment called the Gas Transmission Investment Programme (GTIP). The objectives of the GTIP are to:

- *ensure that existing and future gas transmission assets are used efficiently;*
- *establish the need for gas transmission investment; and*
- *develop an effective pathway for efficient gas transmission investment to take place.*

The paper also described the component projects comprising the programme and the governance arrangements, which included the formation of two advisory panels.

A Panel of Expert Advisers (PEA) has been created as a group of industry experts to provide technical and expert advice to Gas Industry Co in relation to the GTIP projects. The PEA's first key deliverable, to provide advice to Gas Industry Co on the scope of the GTIP, has been completed. The PEA's draft work programme heads us towards the development of preferred transmission access arrangements for the Vector system by Q1 of 2013.

A Panel of Strategic Advisers (PSA) comprising senior industry leaders has also been established to provide advice on strategic issues that may arise in relation to the GTIP. In particular, the PSA will consider the PEA's advice on various matters.

Opportunities will continue to arise for industry to participate in the GTIP as work by the PEA progresses. Although the GTIP work is still developing, Gas Industry Co believes it is already providing an effective platform for developing long term transmission access solutions. The

Bridge Commitments and Vector's Capacity Determination Project are key supports for this platform.

Overall assessment

Taken together, the progress on the Bridge Commitments outlined above shows a wide range of very important work is taking place. We are particularly pleased to see discussions occurring on matters that were previously unexplored (such as the trading power station capacity) and on ways to improve the overall efficiency of the capacity regime (such as the GTX). This greater alignment and pooling of resources has proven an effective means of achieving change, both incrementally in the short term and in designing robust long term solutions.

To date, however, there has been an insufficient number of large end user tenders to evaluate the effectiveness of the primary commitment (on incumbent Shippers serving large end users to offer capacity to other Shippers). Gas Industry Co is also conscious that progress on some Bridge Commitments has been slow and that more effort is required to ensure the full potential of the commitments is realised, including from the freeing up of power station capacity and the use of the GTX.

The crucial measure remains whether better outcomes are delivered to large end users to address short-term capacity issues arising on Vector's North Pipeline. Gas Industry Co considers that more work is required to demonstrate such outcomes and will continue to support and monitor developments.