Gas Industry Co

QUARTERLY REPORT

Quarter ended 31 March 2013

FROM THE CHIEF EXECUTIVE

The dynamic nature of the gas industry, and its close linkages to wider energy and economic factors, was well illustrated in a series of energy production and consumer site visits I was able to undertake recently.

This started with the opening of Nova Energy's new McKee peaker power plant in Taranaki. The event was notable in a number of respects. It continues a trend away from baseload gas-fired generation as highlighted by Contact Energy in its half year results commentary in February on the reduced future roles of the Otahuhu B and Taranaki Combined Cycle Power Stations. It was pertinent that, with severe drought conditions affecting much of the country at the time, Nova's peaker plant was running flat out on the day it was declared open by the Prime Minister.

The peaker plant is located adjacent to the McKee/Mangahewa production station, operated by Todd Energy, which is also responding to changing market influences. The production station has recently seen the addition of significant LPG processing facilities, and is currently the subject of a substantial production capacity expansion project. This in turn arises from Todd's commitment to further develop the Mangahewa field to support a gas supply arrangement concluded last year with Methanex, and which enabled the recommissioning of the second methanol production train at Methanex's Motunui plant in Taranaki during 2012.

I was also pleased to have the opportunity to visit Motunui. In the quarter covered by this report, Methanex announced the acquisition of further gas supplies enabling the restart of its third train at the mothballed Waitara Valley plant. This demonstrates further confidence in gas supply more widely across Taranaki. Importantly, the Methanex restarts are being underwritten by a buoyant global methanol market in which New Zealand can compete at current gas prices and despite the high New Zealand dollar value.

My trip then took me to Carter Holt Harvey's pulp and paper mill at Kinleith in the central North Island (quite a drive!). Theirs is a well-established industry and plant, but with foreign exchange and energy costs among the challenges it faces to compete effectively in its international markets. However, it is an industry backed by a wood resource that will expand over coming decades, and which has potential to significantly boost the New Zealand economy in productive areas. The gas industry's ability to continue to deliver gas to Kinleith - and other industrial users - in an efficient and competitive manner is an important element to this.

Continued on page 2….

Contents	Page

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

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… from page 1

Another export industry proving to be important to energy and the wider economy is aluminium. Like pulp and paper, aluminium produced in New Zealand competes in global markets. Much has been reported in the media recently about the reliance of aluminium production on electricity, and the importance of electricity supply arrangements to the future of the Tiwai Point smelter. These are matters outside Gas Industry Co's immediate purview. However, it is worth noting that the future of the smelter, which accounts for around 15 percent of total electricity generated in New Zealand, has a potentially major impact on the gas industry. This could particularly affect gas-fired generation should electricity currently dedicated to the smelter become available to the general market.

The recent policy announcements by the Labour and Green Parties also focus on the electricity market, but have further potential to significantly affect gas markets.

All of these developments remind us that the energy market, and gas's role within it, is fluid and is attended by significant risks and opportunities. New Zealand needs to be as well prepared, and as flexible as possible to accommodate major future gas finds and possibly changing demand patterns. Gas Industry Co's programme continues to seek effective governance arrangements for the market as it is today, while ensuring it provides a robust framework for what it may look like tomorrow.

Steve Bielby
Chief Executive

Industry Performance Highlights

This Quarterly Report includes Gas Industry Co's regular Industry Performance Report (**page 10**) against the Switching Rules, the Reconciliation Rules, and the Critical Contingency Management Regulations in the three months ended 31 March 2013.

- Secondary balancing gas volumes continue to decline, averaging less than 20,000 GJ per month in the first three months of 2013 - a fraction of what they were prior to 2009.
- Gas customer switching rates increased in March after a below-average January. Overall, the average switching rate remains about 3,200 switches per month, or around about 15 percent.
- The time required to process switches continues to fall and now averages about 5.2 days, substantially faster than the time taken prior to the introduction of the Switching Rules in 2009.
- Low unaccounted-for gas (UFG) volumes in the past quarter are consistent with previous years' seasonal trends. On a rolling annual basis, UFG accounts for less than 1 percent of allocated gas volumes.
- In March 2013, Todd Energy transferred customers from its subsidiary brand, Bay of Plenty Energy, to its other retail brand, Nova Energy. There are now eight gas retailer brands. The largest by customer numbers continues to be Genesis Energy, followed by Contact Energy, Mercury Energy, and Nova. Market share by gas volumes is led by Nova and OnGas.
- The Herfindahl–Hirschman Index (HHI) (a method of measuring market concentration by using size and number of competing firms) has decreased in all regions of the North Island in the past four years, reflecting the activities of new retailers entering the market and smaller retailers increasing their market share.
- Over 95 percent of gas consumers are connected to a gate where at least six retailers trade, demonstrating an actively contestable retail market throughout the North Island.

Gas Story portrays a generally robust New Zealand industry

A new review of the New Zealand natural gas sector paints a picture of an industry in generally good shape, continuing to make major contribution to New Zealand homes and businesses, and managing the key issues and opportunities it faces.

The New Zealand Gas Story – the State and Performance of the New Zealand Gas Industry has been released by Gas Industry Co, and updates the previous industry review in 2006.

The report has been prepared to fulfil two purposes: firstly, an obligation on Gas Industry Co to report to the Minister of Energy and Resources on the current state and performance of the industry and, secondly, as a response to a request by industry participants for Gas Industry Co to play a central role in bringing together the entire New Zealand gas story.

The report will be regularly updated to provide a continually current reflection of the state and performance of the gas industry, and can be viewed here.

CCM Regulation changes

Following analysis of submissions and two drafting workshops with industry stakeholders, Gas Industry Co is close to finalising proposed changes to the Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations).

Suggested changes to the CCM Regulations were originally outlined in a Statement of Proposal issued on 12 November 2012 and stemmed from a review of the CCM Regulations intended to capture lessons from the October 2011 Maui pipeline outage. The proposals have been modified following consultation and encompass:

- clarifying and tightening the criteria used to define eligibility for Essential Service Provider (ESP) designation, and specifying that the ESP designation would apply only to that part of the consumer's load that is 'essential'.
- introducing a new, highest priority, consumer band for Critical Care Providers (CCP).
- introducing a new band for Electricity System Security Providers (ESSPs) to better support the electricity system when gas is in short supply.
- establishing Gas Industry Co as the body responsible for processing and determining ESP, CCP, ESSP, and Minimal Load Consumer (MLC) designations.
- requiring retailers to periodically inform their customers about the CCM Regulations and the existence of the ESP/CCP/MLC/ESSP categories.
- adjusting and broadening criteria for MLC designations, to avoid serious damage to plant, or to mitigate serious environmental damage while undertaking an orderly plant shutdown.
- expanding the communications responsibilities of affected asset owners and the Critical Contingency Operator (CCO) to provide publicly available information.

Two drafting workshops were held on 13 March and 23 April. Both were well attended. Gas Industry Co has generated two marked up versions for comparison – one showing the changes made since circulation of the first draft, and the other showing all of the proposed changes.

Distribution contracts initial assessment

In consulting on the Distribution Contracts Oversight Scheme (Oversight Scheme), Distributors indicated that the first assessment should take place in early 2013 as they expected to have revised arrangements completed at that time. However, drafting of these new arrangements has taken longer than expected and thus the scope of the initial assessment has been revised to accommodate the incomplete nature of the draft documents and the fact that consultation and negotiation is still ongoing with retailers.

Gas Industry Co asked the Independent Assessor (Elwood Law) to produce a first assessment to record and assess progress against the Distribution Principles. Distributors have been advised that Gas Industry Co expects arrangements to be completed so that a full assessment can be conducted in February 2014.

The Oversight Scheme, endorsed by the Minister of Energy and Resources in 2012, involves an independent assessment against a common set of distribution principles of distributors' contracts – or Use of System Agreements (UoSA) – with retailers. It is a non-regulatory mechanism for open access distribution networks, promoting core access terms and conditions that are clear, reasonable and efficient, and enhance consumer outcomes.

Bridge Commitments update

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

During the March quarter there were no capacity offers listed on the Gas Transmission Exchange (GTX). Five large gas users on the North Pipeline switched supplier during the period, but there was little or no gas tendering activity.

GTIP Update

PEA prepares for next advisory report

The Panel of Expert Advisers (PEA) has identified a range of options it will canvas in its second round of advice to Gas Industry Co from its transmission capacity allocation and pricing deliberations. The PEA's follow-up report to its initial advice in mid-2012 is expected to be released in July 2013 for industry comment.

At a workshop held post quarter (on 11 April), the PEA set out for industry stakeholders the work it has done to take account of feedback on its initial advice, which presented a single 'straw man' proposal to address transmission capacity concerns over the longer-term. In the interim period, the PEA has reviewed its terms of reference and problem definition, looked afresh at a range of options, established a vision for the future based on its view of the characteristics of ideal transmission and pricing arrangements in the New Zealand context, and extended its assessment to include the Maui as well as Vector transmission systems.

As reported in the December Quarterly Report, the PEA is focusing on three priority issues in the near term – information transparency, congestion management and capacity nominations – to reflect a changing backdrop to its work. Since capacity allocation issues arose in 2009, with the announcement by Vector that it was unable to allocate new capacity contracts on its North Pipeline, the environment has moved:

- there is now a better understanding by industry participants of the issues, including through Vector's parallel industry consultation process (also refer below), the release of the Gas Industry Co-commissioned report on gas supply and demand (also refer 'Supply/demand report expanded to include Maui pipeline' article below), and the PEA's preliminary report.
- firm capacity reserved for thermal power stations has been reduced, and some capacity is now tradable or interruptible and available to other participants following changes to Supplementary and Non-Code Shipper transmission services agreements.

- demand for firm capacity is less than supply.
- a capacity trading market has been established through the development of an online bulletin board.

Material presented to the workshop can be found here.

The PEA's work is directed at improving current transmission capacity arrangements and is being undertaken as part of the GTIP. Overall, this programme is aimed at achieving more efficient use of existing gas transmission capacity and laying a pathway for efficient future investment in new capacity.

The PEA's March 2013 meeting (view meeting material here) was held in New Plymouth and incorporated a familiarisation visit to Vector's Gas Control headquarters at Bell Block.

Vector issues further consultation papers

In its separate process, on 28 March Vector issued a series of further consultation papers for industry comment by 22 April 2013:

- the *Capacity Determination for the Vector Gas Transmission System (as at 21 February 2013)* sets out the capacity for Vector's transmissions systems, excluding the North Pipeline system. Vector consulted on its transmission pipeline methodology in November 2012, and demonstrated its application on the North Pipeline System at that time.

- the Proposed 2013-14 Gas Transmission Pricing Methodology paper flows from Vector's Gas Transmission Pricing Methodology Update issued in December 2012, and an indication from Vector at that time that it would release a Cost Allocation Framework and Pricing Methodology document for consultation.

The documents represent a detailed exposition of Vector's capacity and modelling results and can be found on Vector's website here.

Advice to Minister on…

… insolvent retailer arrangements

Gas Industry Co has recommended to the Minister of Energy and Resources that permanent backstop regulation is not necessary to manage risks that may arise from the insolvency of a gas retailer.

This advice is the outcome of a review and consultation process, the genesis of which was the voluntary liquidation of the E-Gas group of companies in late 2010. The process included:

- an expert report from Castalia Strategic Advisers which identified that normal insolvency arrangements will satisfactorily manage gas retailer insolvencies. However, there is a low risk of orphaned customers resulting from an insolvency. Orphaned customers are those physically connected to a gas network - therefore, they are able to consume gas - but with no responsible retailer to pay for their consumption. This is an economic 'market failure' because orphaned customer gas consumption is a cost that will be picked up by the rest of the industry;

- issuing an Options Paper in December 2012 which set out the reasonably practicable options for managing the market failure risks posed by orphaned customer;

- analysing submissions on that paper (a submissions analysis can be found here).

In its advice to the Minister, Gas Industry Co comments that normal insolvency arrangements generally work well and should be allowed to run their course. Moreover, gas-specific backstop regulations could reduce the incentive for industry participants to reach a commercial agreement, may lack flexibility to deal with a range of potential retailer defaults and reduce the scope for a new competitor to enter the gas market by way of acquiring an insolvent retailer's assets.

Gas Industry Co suggests that a framework for regulations that could be made urgently would be an appropriate contingency measure in the unlikely event of standard insolvency arrangements not managing the orphaned customer risk. If the Minister accepts this advice, Gas Industry Co proposes convening an industry working group to discuss the drafting instructions for such a measure. It is envisaged these could be held in reserve and used in the unlikely event of orphaned customers persisting after a commercial sale process, and after any industry efforts to remedy a retailer insolvency had failed.

More information is available on our website here.

The Electricity Authority (EA) is also currently considering policies for electricity retailer insolvency, and some companies involved in both the electricity and gas markets have expressed a desire for regulatory responses to retailer insolvencies to be aligned. Gas Industry Co believes that as the two markets, the contractual arrangements, and the regulatory powers of Gas Industry Co and the EA are fundamentally different, a single solution is unlikely to be feasible.

… and information disclosure regime for gas processing facilities

Gas Industry Co has also recommended to the Minister that regulated access to gas processing facilities is not required. Accordingly, it cannot recommend the Gas (Processing Facilities Information Disclosure) Rules 2008 (the Rules) be extended beyond the initial expiry date of 27 June 2014.

The advice to the Minister confirms Gas Industry Co's proposed recommendation set out in a consultation paper issued in November 2012. The four submissions received agreed with the recommendation that regulated access to gas processing facilities is not necessary.

From its review, Gas Industry Co concluded there is no evidence to suggest there is any market failure with respect to access to gas processing facilities. It would be inconsistent with Gas Act objectives to recommend regulating an efficiently operating market. This recommendation does not limit Gas Industry Co's ability to make a regulatory intervention if required and if a market failure is discovered at a later time.

More information on the Gas (Processing Facilities Information Disclosure) Rules 2008 can be found on Gas Industry Co's website.

Supply/demand report expanded to include Maui pipeline

The Gas Industry Co-commissioned report *Gas Supply and Demand Scenarios 2012-2027* has been expanded to incorporate a more detailed discussion of the role of the Maui pipeline.

Gas Industry Co asked authors, Concept Consulting, to incorporate the Maui pipeline discussion as a result of industry feedback on the initial report released in December 2012.

The report includes an analysis of the demand on the Maui pipeline north of the Mokau compressor. The analysis develops projections for annual and peak day demands beyond this point, taking account of trends in generation demand, coal prices, and carbon dioxide prices.

The modelling tool has been expanded to include the Maui pipeline analysis and is available on our website here.

Reconciliation Rules changes made

Amendments to improve aspects of the Gas (Downstream Reconciliation) Rules 2008 (Reconciliation Rules) have been approved by the Minister of Energy and Resources. The changes were gazetted on 28 February and take effect on 1 June 2013. The amended Reconciliation Rules can be found here.

The amendments follow an extensive review of the Reconciliation Rules, with input from an industry advisory group. The changes include:

- codification of some long-standing exemptions, which will remove the compliance burden and uncertainty of rolling-over those exemptions.

- allowing for the explicit correction of erroneous annual unaccounted-for gas (UFG) factors, which will ensure accurate data integrity.

- eliminating the creation of some technical breaches, where the costs of administering those breaches outweigh their impact.

In association with the Reconciliation Rules changes, Gas Industry Co is required to consult, and make determinations, on a number of details and is producing guidelines on the new arrangements. A consultation paper covering the proposed determinations and guidelines, as well as the revocation and variation of existing exemptions, was issued for industry feedback on 17 April. The consultation also included an exemption application for the Allocation Agent's calculation of profile data. Submissions close on 6 May 2013.

The Allocation Agent, NZX, is making system changes to comply with the new functional specification that will come into effect with the new Rules.

Gas Industry Co continues to pursue the second phase of proposed Reconciliation Rules changes, dealing with alternative initial allocation methodologies. Discussions are being held with industry participants on options for improving the initial allocation.

The Reconciliation Rules are an important governance arrangement and ensure the effective reconciliation of downstream gas quantities. They have been particularly effective in reducing UFG volumes.

Transmission code changes

Vector Transmission Code (VTC) Appeals

Gas Industry Co has issued a Draft Recommendation in support of a VTC change request appeal relating to balancing processes, peaking charges, and disputed invoices. The changes, proposed by Vector, arise from balancing-related changes to the Maui Pipeline Operating Code (MPOC), which are scheduled to be implemented by Maui Development Limited (MDL) after 1 June 2013.

The proposed VTC changes did not receive the 75 percent support from shippers necessary to be implemented, and were referred by Vector to Gas Industry Co, as the VTC appeals body, on 27 November 2012 to have them allowed. Following consideration of the six submissions received, Gas Industry Co's Draft Recommendation was that, overall, the change request represents an improvement on current arrangements.

Because commercial arrangements on the Maui pipeline impact those on Vector's transmission pipelines, the changes to the VTC are necessary to align the two codes when the MPOC changes are implemented. The VTC changes are proposed to this end. Of the three changes proposed by Vector, two will accommodate the MPOC changes for back-to-back balancing and for a peaking charge. The third change seeks to limit the ability of shippers to dispute balancing invoices issued by Vector.

Subject to some further clarity, submitters generally considered that Vector's approach to accommodating back-to-back balancing and the peaking charge appeared reasonable, but all opposed the proposed restriction on disputing balancing invoices.

Gas Industry Co is considering submissions on the Draft Recommendation, which closed on 25 March 2013, prior to issuing a Final Recommendation.

Meanwhile, Vector has withdrawn a separate VTC appeal, lodged on 31 July 2012, relating to prudential security and disputed invoices.

MPOC Change Requests

On 28 February Gas Industry Co released its Final Recommendation supporting an MPOC change request to adjust the times certain nominations must be carried out under the MPOC. All submitters approved the proposed change.

On 28 March 2013, MDL lodged a request to make a number of minor and technical changes to the MPOC. Gas Industry Co has a role under the MPOC – and detailed in a Memorandum of Understanding with MDL – to consult with industry participants on any proposed amendment to the MPOC and to determine whether or not to support it. Gas Industry Co has accepted a request by MDL to expedite the normal MPOC change request process in this case in recognition of the minor nature of the proposed changes. The change request, together with Gas Industry Co's Draft Recommendation, which supports to proposed changes, were issued for industry feedback on 12 April, with a submissions deadline of 2 May 2013.

Gas Industry Co briefing to new Minister

Gas Industry Co has provided a Briefing Paper to the newly-appointed Minister of Energy and Resources, Hon Simon Bridges, setting out its role, responsibilities and view of the gas markets.

It has a particular focus on Gas Industry Co's function as the approved industry body (and co-regulator) under Part 4A of the Gas Act 1992, and the work it is doing to achieve Government policy objectives set out in the Gas Act and the 2008 Government Policy Statement on Gas Governance (GPS).

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

The paper also looks at the gas industry make-up, and provides more detail on the history of the establishment of Gas Industry Co and background to the introduction of a 'co-regulatory model'. It discusses Gas Industry Co's work programme in the current 2012/13 financial year (FY2013) and the indicative work plan for FY2014.
The Briefing Paper is available here.

Further details on proposed compliance reporting threshold

Gas Industry Co is considering submissions on its explanatory paper on a proposed threshold regime to be incorporated into the Gas Governance (Compliance) Regulations 2008 (Compliance Regulations).

Formulation of a number of proposed minor and technical changes is progressing as the outcome of a routine review of the Compliance Regulations as part of Gas Industry Co's practice to periodically revisit industry governance arrangements to ensure they remain efficient and effective.

The proposed changes include the introduction of a threshold regime for mandatory reporting by the Gas Registry Operator and Allocation Agent of alleged breaches of, respectively, the Gas (Switching Arrangements) Rules 2008 (Switching Rules) and the Gas (Downstream Reconciliation) Rules 2008 (Reconciliation Rules). The intention is to ameliorate the compliance burden for participants.

The Compliance Regulations set out processes for the efficient determination and settlement of alleged breaches of the Switching Rules, Reconciliation Rules, the CCM Regulations, and the Gas (Processing Facilities Information Disclosure) Rules 2008.

Amendments to the CCM Regulations are also expected to result in changes to the Compliance Regulations. The timing of a recommendation to the Minister on changes to the Compliance Regulations will depend on the completion of consultation for that workstream.

Documents relating to the proposed Compliance Regulations changes can be found here.

Coming up....

May	June
2nd – Submissions close, 28 March 2013 MPOC Change Request 6th – Submissions close, consultation paper on on Reconciliation Rules determinations and guidelines 16th – Submissions close, Reconciliation Rules determinations, guidelines and exemptions	1st – Phase 1 Reconciliation Rules changes take effect Gas Industry Co Statement of Intent published

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Performance Measures Quarterly Report for the period ending 31 March 2013

1 Summary

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

Highlights of the Report:

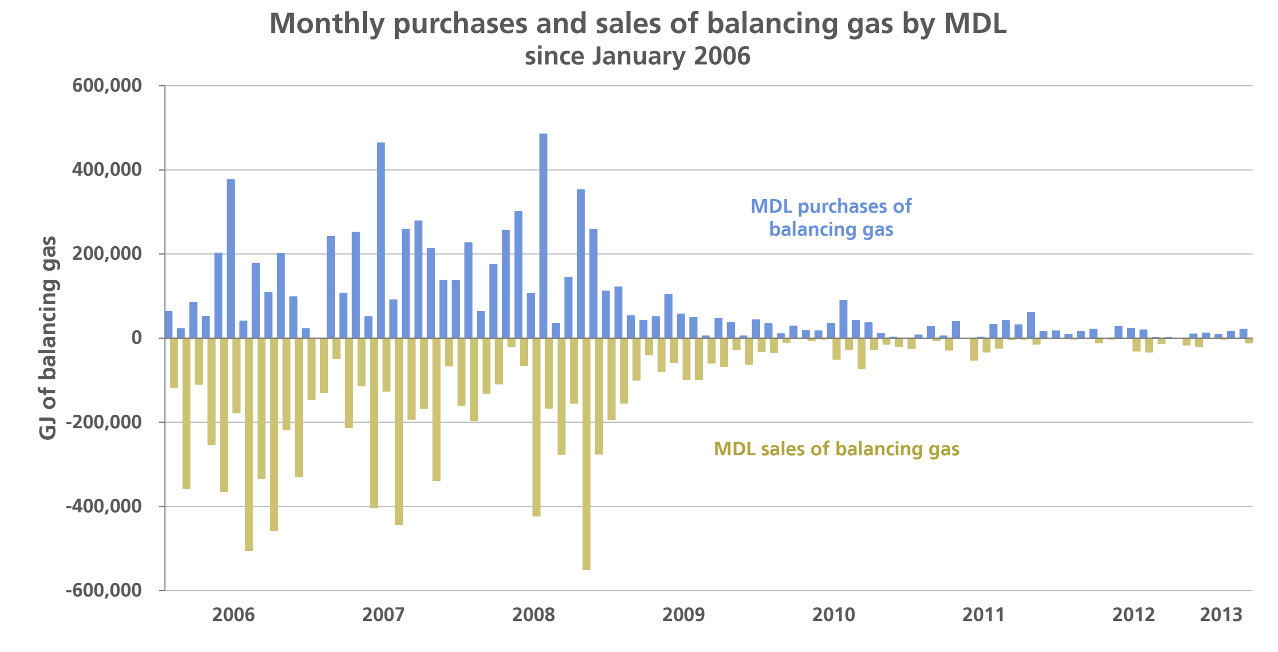
- Secondary balancing gas volumes continue to decline and are a fraction of what they were prior to 2009. Balancing gas volumes averaged less than 20,000 GJ per month in the first three months of 2013.
- Switching has had an uptick in March, after a below-average January. Overall, the average rate of switching remains at about 15%, or about 3,200 switches per month.
- The time required to process switches continues to fall and is now about 5.2 days on average, a fraction of the weeks that switching used to take before the inception of the switching rules.
- Unaccounted for gas (UFG) volumes have been low in the past quarter, consistent with previous years' seasonal trends. On a rolling annual basis, UFG accounts for less than 1% of allocated gas volumes.
- In March, Nova transferred customers from its subsidiary brand Bay of Plenty Energy to the Nova retail brand. There are now eight gas retailer brands. The largest by number of customers continues to be Genesis Energy, followed by Contact Energy, Mercury, and Nova.
- The Herfindahl–Hirschman Index (HHI) is a way of measuring market concentration by using size and number of competing firms. In all regions of the North Island, HHI has decreased in the past four years, reflecting the activities of new retailers entering the market and smaller retailers increasing their market share.
- In terms of market share by gas volumes, Nova and OnGas are the largest retailers, reflecting their focus on the industrial and commercial sectors of the gas market (although Nova also has a presence in the mass market segment).

- Over 95%, of gas consumers are connected to a gate where at least six retailers trade, demonstrating that gas retailers generally are competitive throughout the North Island.

2 Balancing gas volumes

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

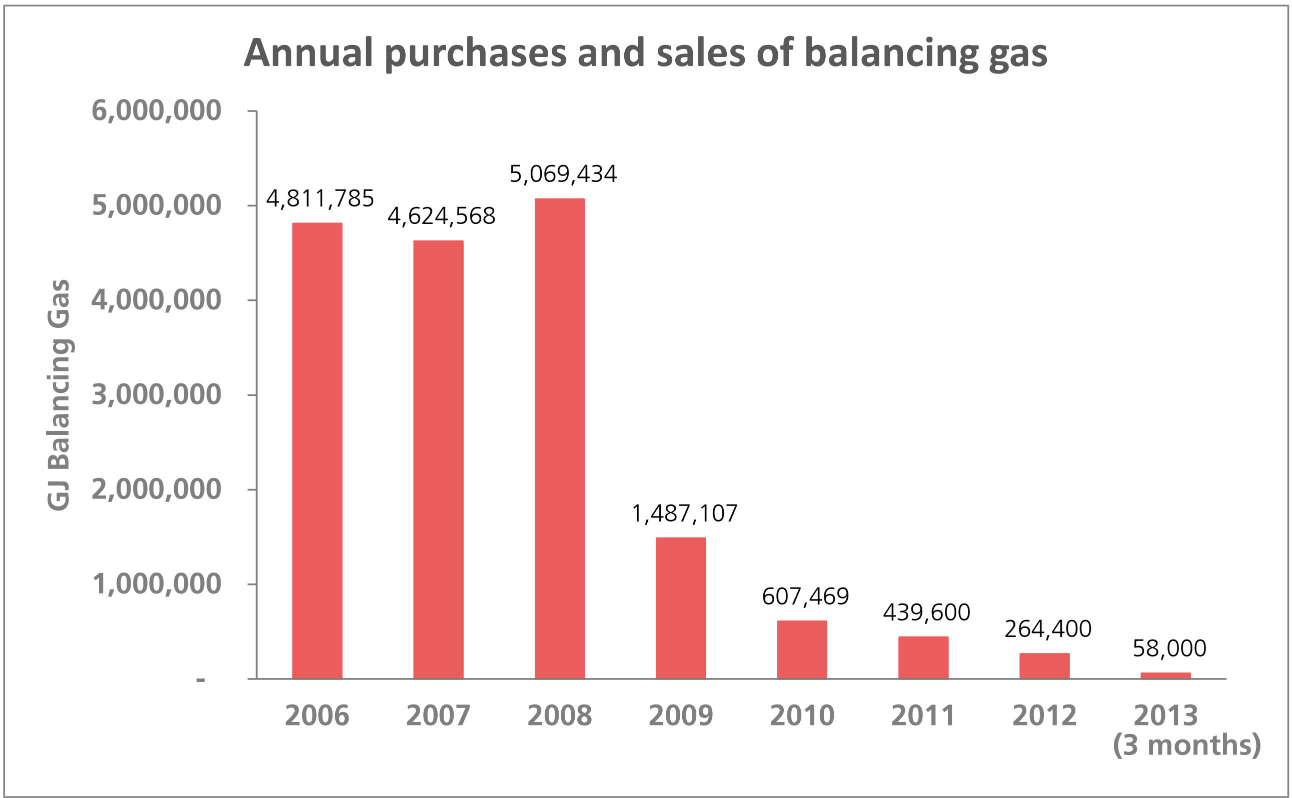
Prior to 2008, secondary balancing services were essentially free to holders of legacy Maui gas contracts, but changes implemented at the end of 2008 to the Maui Pipeline Operating Code, together with the arrangements in the Vector Transmission Code, mean that pipeline users are now responsible for imbalances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



Source: MDL and bgx.co.nz

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

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



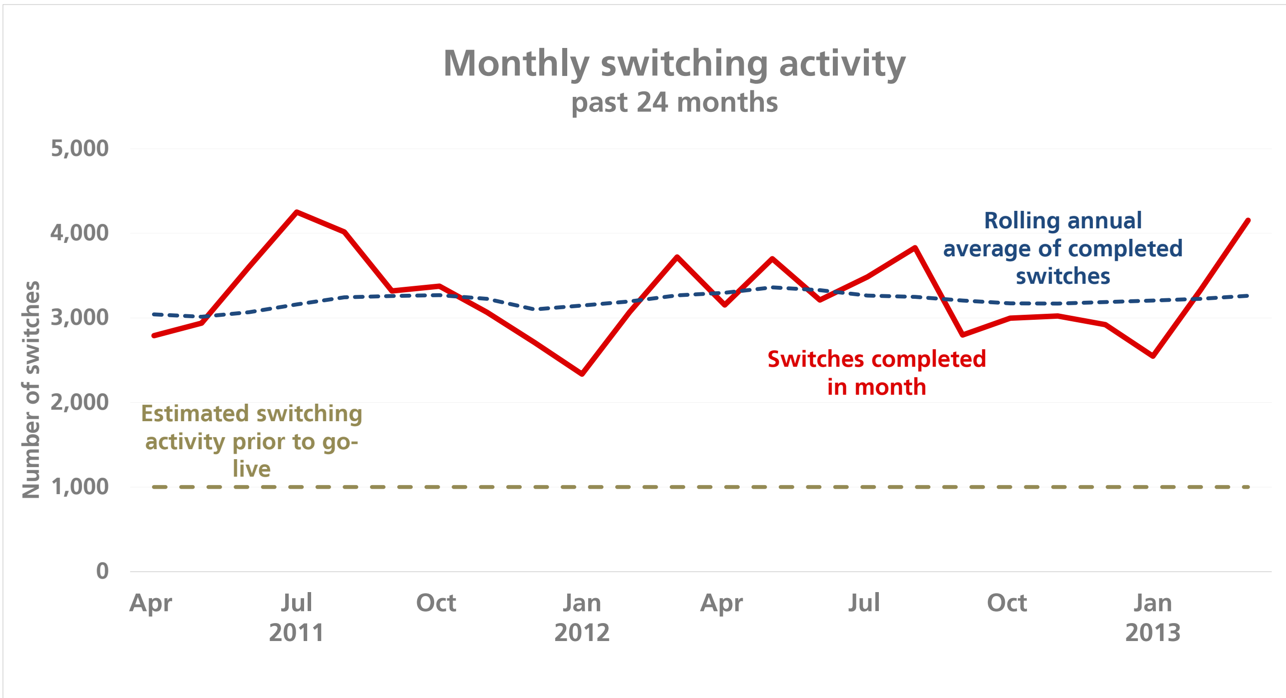
In each of the calendar years 2006, 2007, and 2008, over 4,600,000 GJ of balancing gas were bought and sold by MDL. Since then, balancing gas volumes have decreased each year. In the first three months of 2013, balancing gas volumes have averaged less than 20,000 GJ per month.

3 Switching performance measures

Monthly switching activity

The monthly average switching rate is about 3,200 switches, although the actual number of switches that occur in a month can vary greatly. In March, there was the highest number of switches in a month since the inception of the registry. In contrast, January had a lower than average number of switches.

Overall, the annual churn rate – that is, the percentage of gas customers who switch retailer in a year – is about 15%. Prior to the gas registry going live in March 2009, approximately 1,000 switches were processed on a monthly basis, and the annual churn rate was approximately 4.8%.



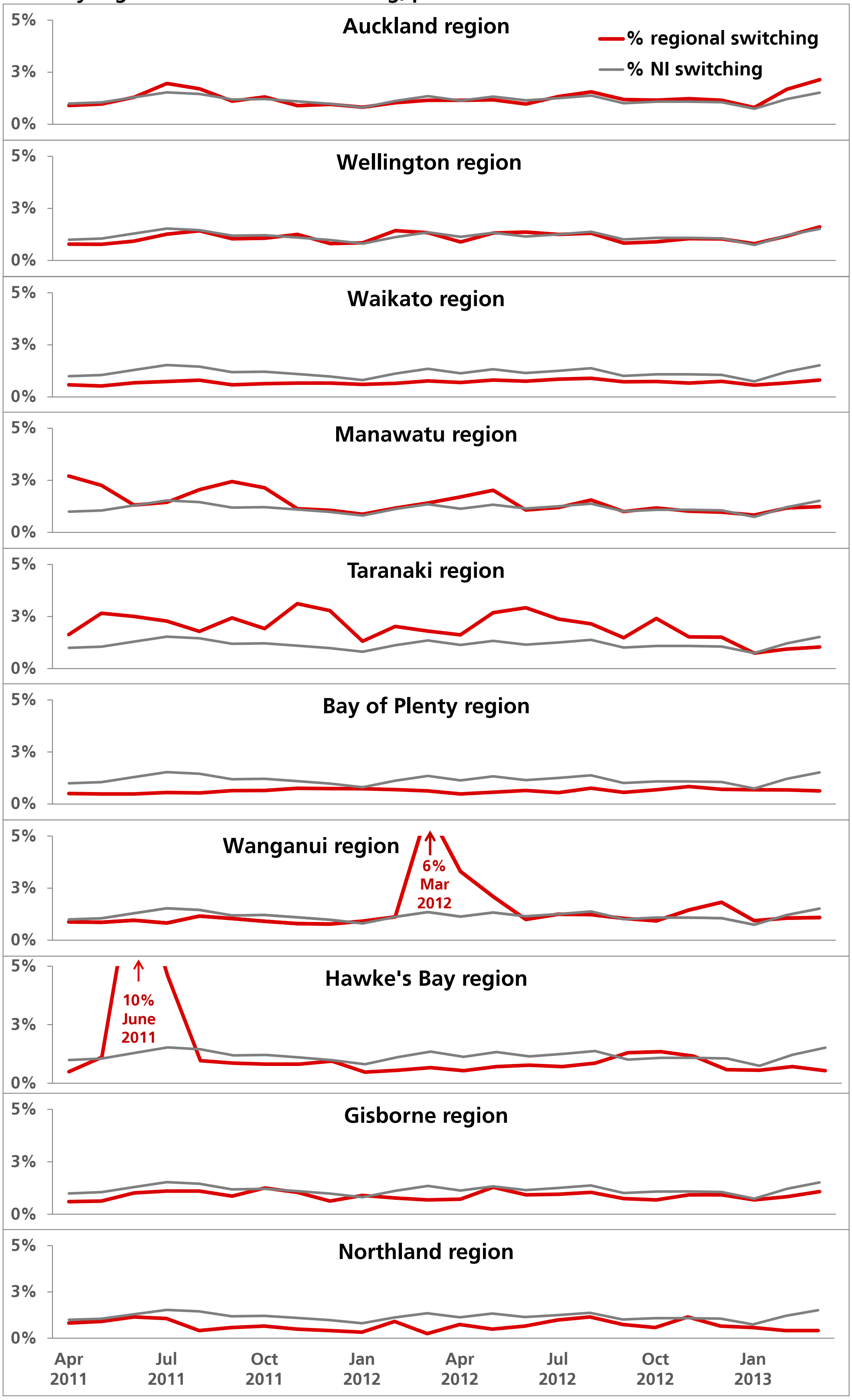
Regional switching activity

The charts below compare regional switching rates with total switching rates. The grey line is the same in all the charts below and shows number of switches (both move switches and standard switches) in a month as a percentage of active-contracted and active-vacant ICPS across all North Island gas consumers. As that line shows, monthly switching varies between about 0.7% and 1.5% per month.

The red line in each chart shows the number of switches in that region as a percentage of ICPs in that region. As might be expected, Auckland and Wellington switching rates tend to be similar to the North Island rates. Differences emerge in the smaller regions, though: in the past 24 months, for example, switching in Taranaki has tended to be higher than the average across all consumers, while switching in Bay of Plenty tends to be lower. There can be short-term fluctuations in switching as well, as evidenced by the spikes in switching rates seen in the Wanganui and Hawke's Bay regions.

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

Monthly regional and overall switching, past 24 months



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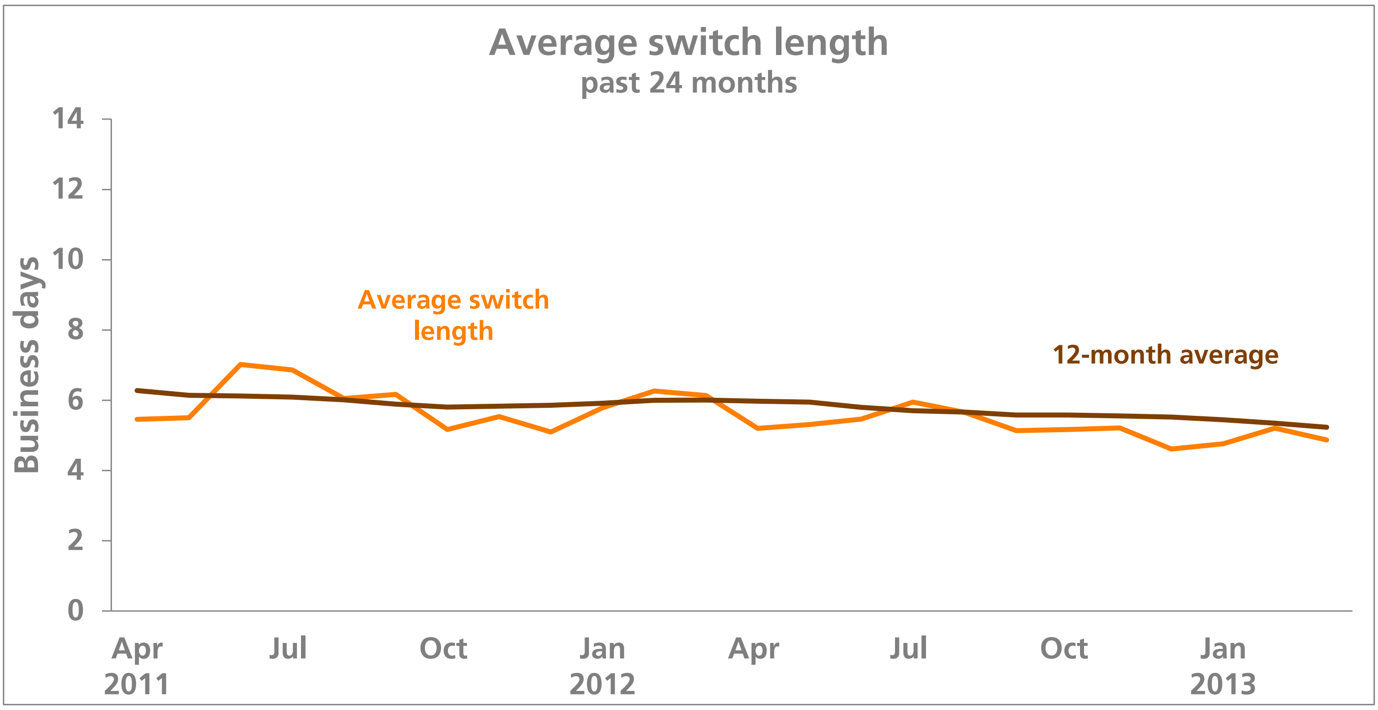
Time to process switches

The chart below shows the average length of time it has taken to process the switch requests that have been received in a month. The average time to process a switch has continued to fall. The twelve-month rolling average switching time now stands at about 5.2 business days. In comparison, switches could take weeks or even months to process prior to the inception of the switching registry.



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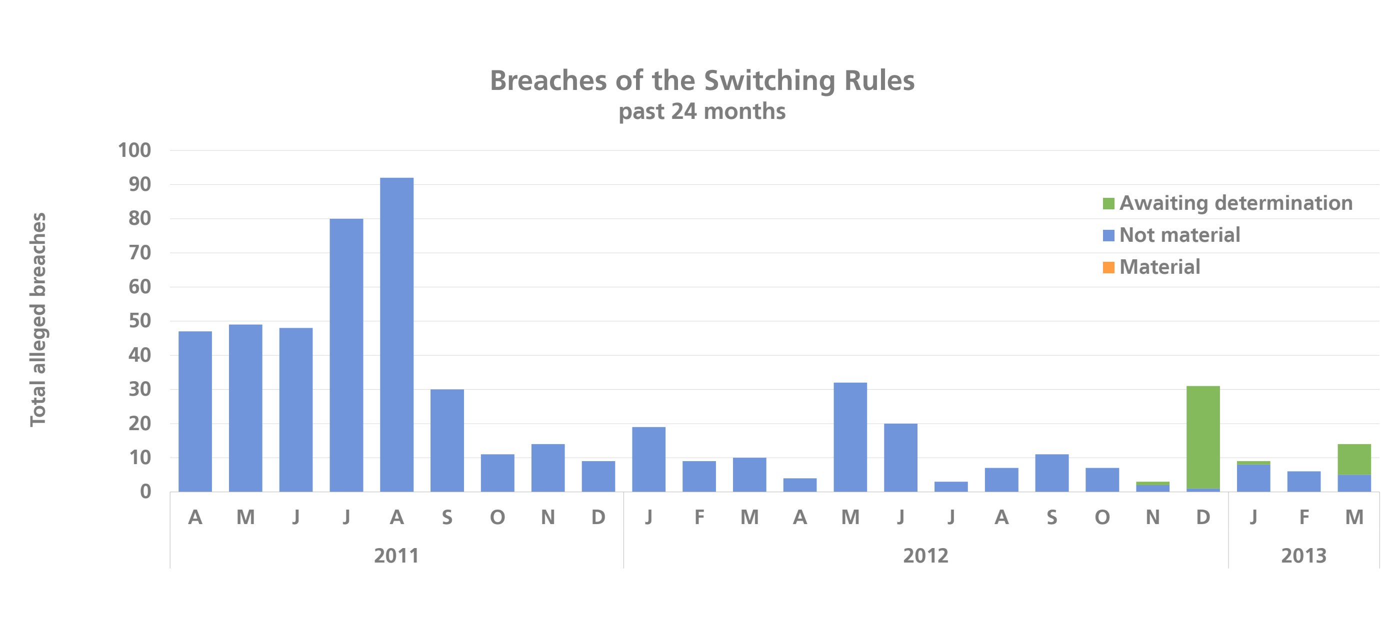
Number and severity of breaches of the Switching Rules

In the first year after the inception of the Switching Rules, nearly 5,500 switching breaches were alleged. Many of these breaches can be attributed to unfamiliarity with the Rules. Since that first year, the numbers of switching breaches have fallen significantly. The average number of alleged breaches per month has fallen significantly: from 450 in the first 12 months to the current average of fewer than 15 per month.



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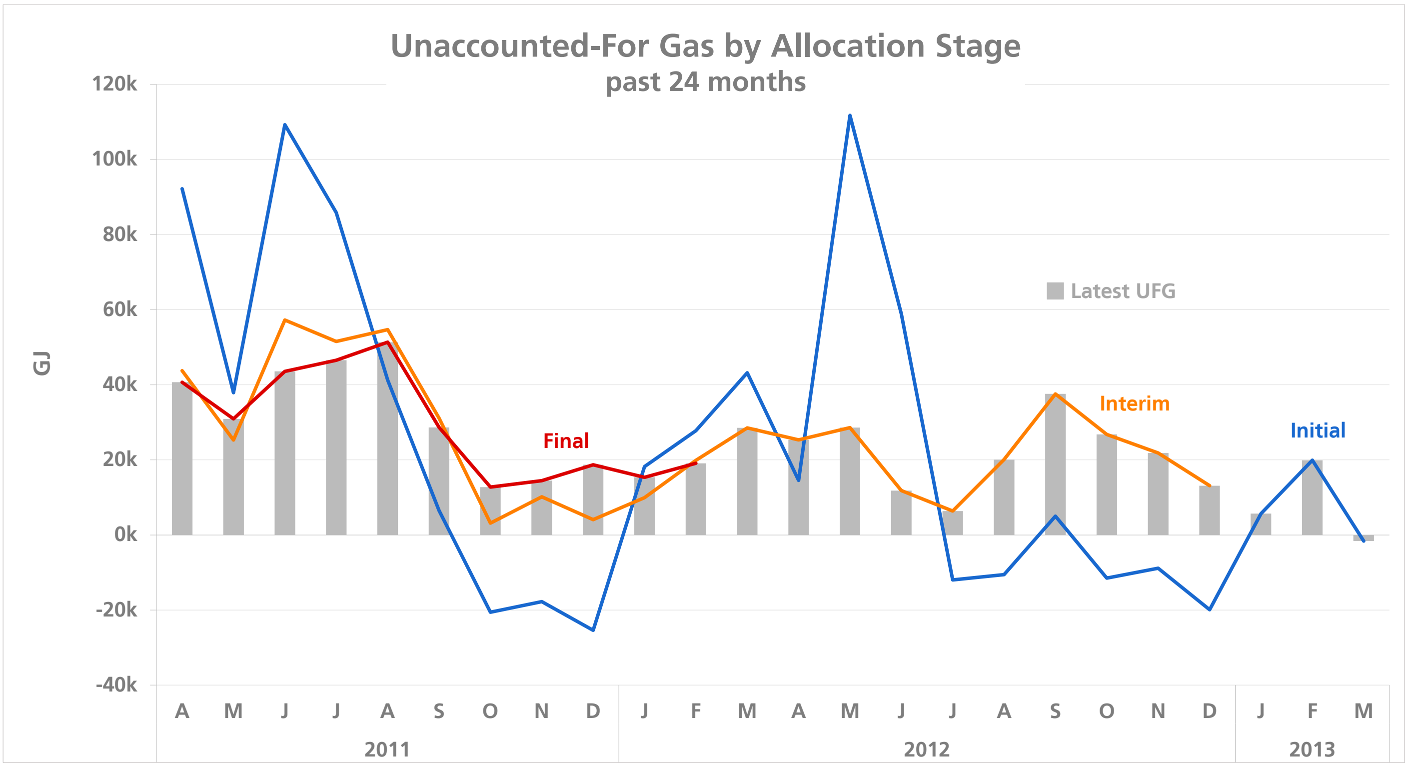
4 Allocation and reconciliation performance measures

Volumes of Unaccounted-for Gas

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

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

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



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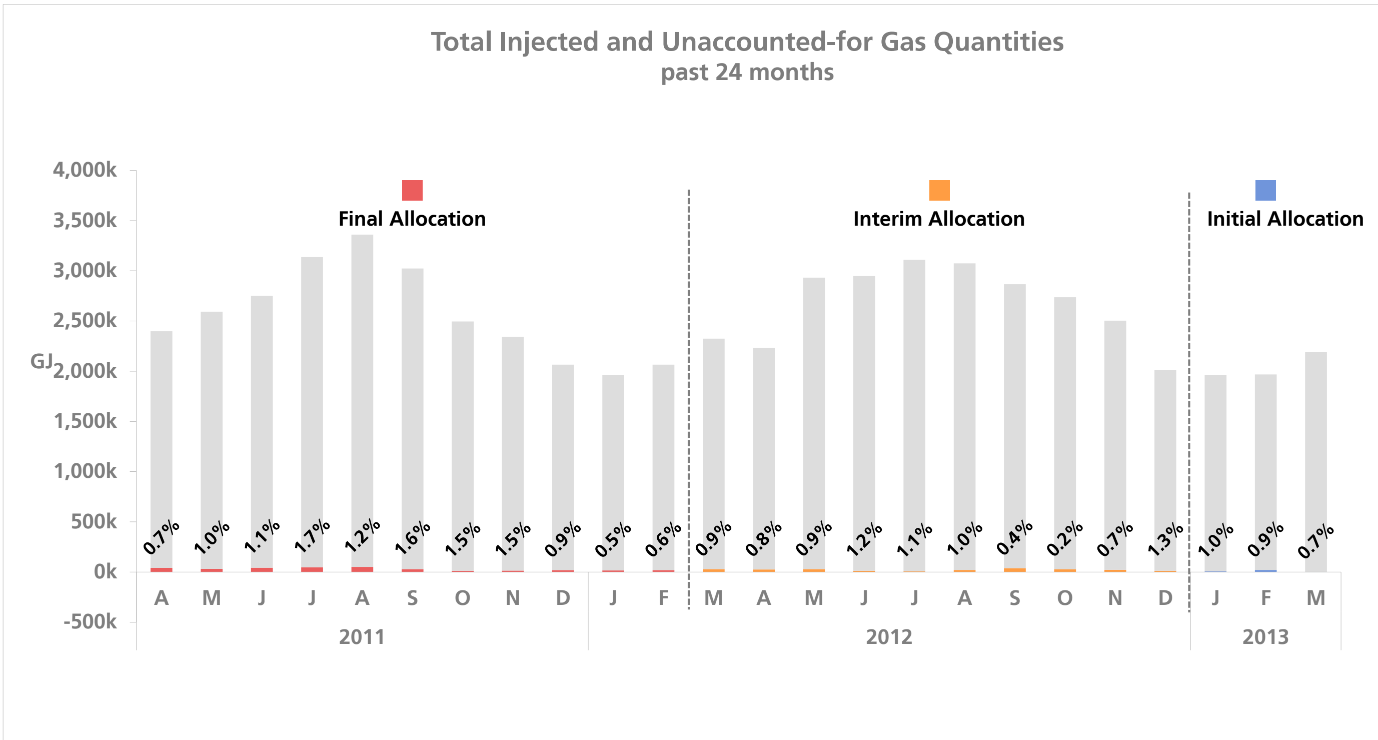
The chart below shows the amount of unaccounted-for gas in comparison to the total amount of allocated gas consumed each month. The grey bars show gas consumption at allocated gas gates, which follows a seasonal pattern: higher in winter and lower in summer. UFG as a percentage of volume follows a similar seasonal pattern.



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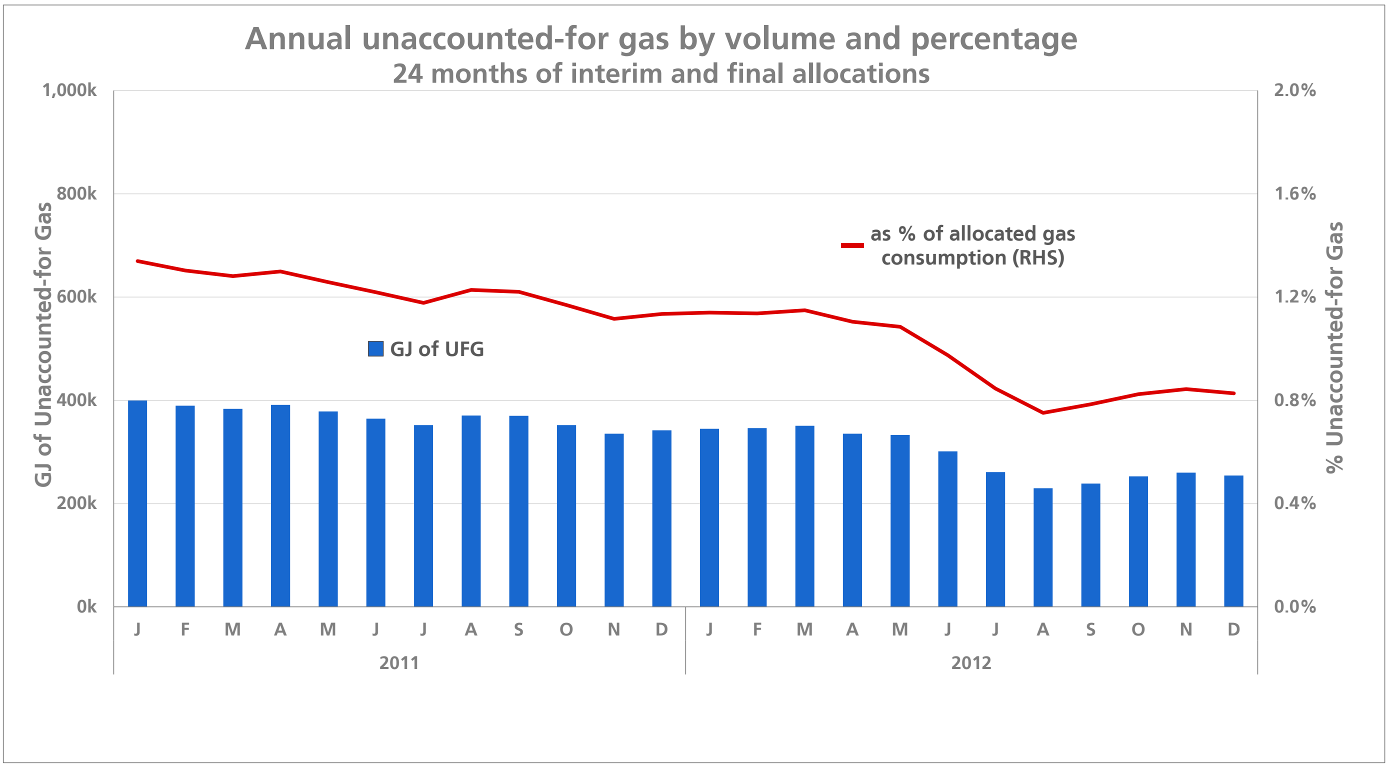
Another way to think about UFG is the amount recorded over a 12-month period. The chart below shows rolling 12-month UFG figures, both as a GJ total and as a percentage of gas consumed. As initial data are often inaccurate, the chart includes only consumption months for which interim or final data are available. The figures in the chart are based on the best data available at the time of publication, so, for example, the December 2012 total is based on ten interim results and two final results, while the December 2011 total is based on twelve final allocation runs.

For the first year after the Reconciliation Rules came into effect, annual UFG was about 2%. The proportion of UFG has been falling steadily over the past two years, and now stands at less than 1%.

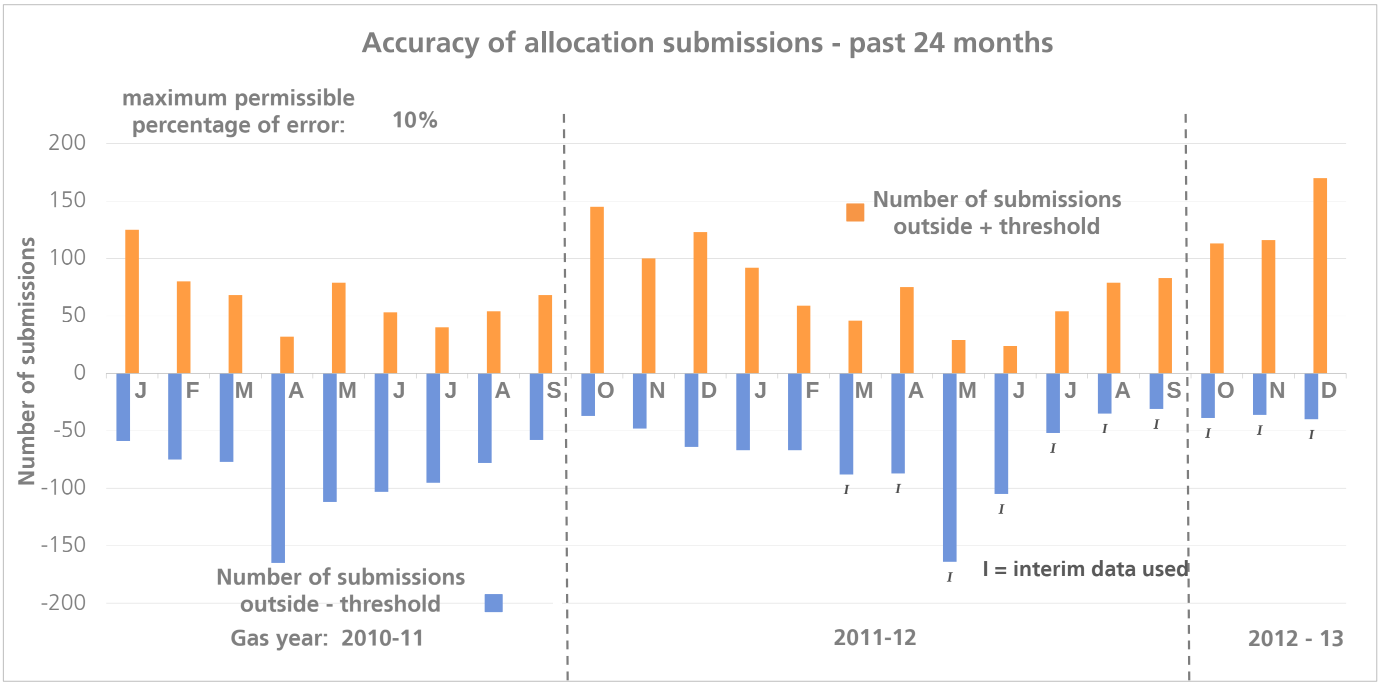


Accuracy of submission data

The accuracy of initial submissions is important, as balancing and peaking charges on the Vector transmission system are levied on the basis of initial allocation results and are not subsequently washed up. This means that the UFG created through inaccurate initial consumption submissions falls onto all retailers at the affected gate and affects their exposure to balancing costs. To limit the impact of this effect, the Reconciliation Rules require that initial consumption submissions are within a specified percentage of the final (and most accurate) consumption submissions.

The chart below shows the number of retailer submissions that were outside the maximum permissible error threshold in the last 24 months for which data are available. For this analysis, final submissions were compared to initial allocation submissions for the months they were available (January 2011 – February 2012). Other months use interim submissions (in place of final) for the comparison data and are marked with '*I*'. The percentage of error used to measure accuracy is 10%.

There is a pattern of retailers oversubmitting in October through January (shown by the orange bars), which corresponds with the negative UFG seen at the initial allocation stage in the preceding charts. Retailers also tend to undersubmit in the months of April through June (as seen in the blue bars), which corresponds with the high levels of UFG experienced in those months.



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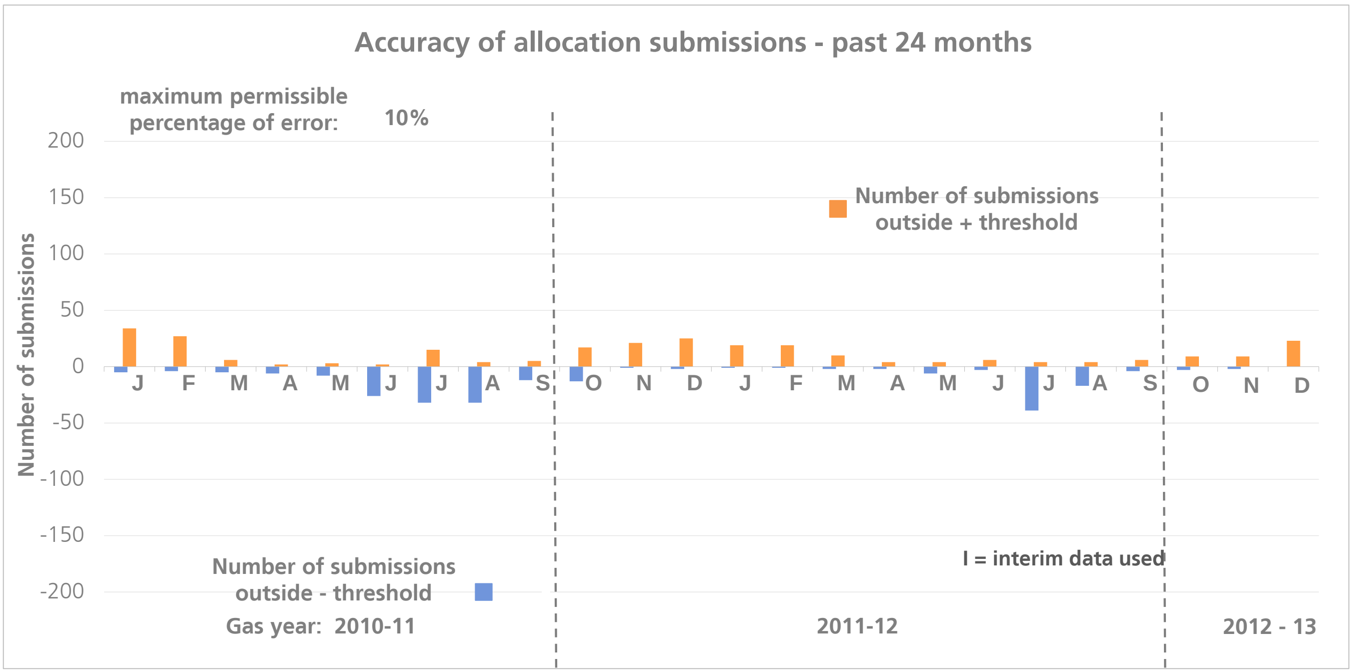
The market administrator uses a volume threshold of 200 GJ as a means of differentiating those breaches that are likely to have had a materially adverse effect on other market participants. The chart below shows the number of accuracy breaches that involve gas quantities larger than 200 GJ. As a comparison of the two charts illustrates, there is a significant proportion of accuracy breaches that have involved less than 200 GJ. Deeming these breaches not material allows industry participants to focus on addressing the harm caused by larger volume estimation errors.

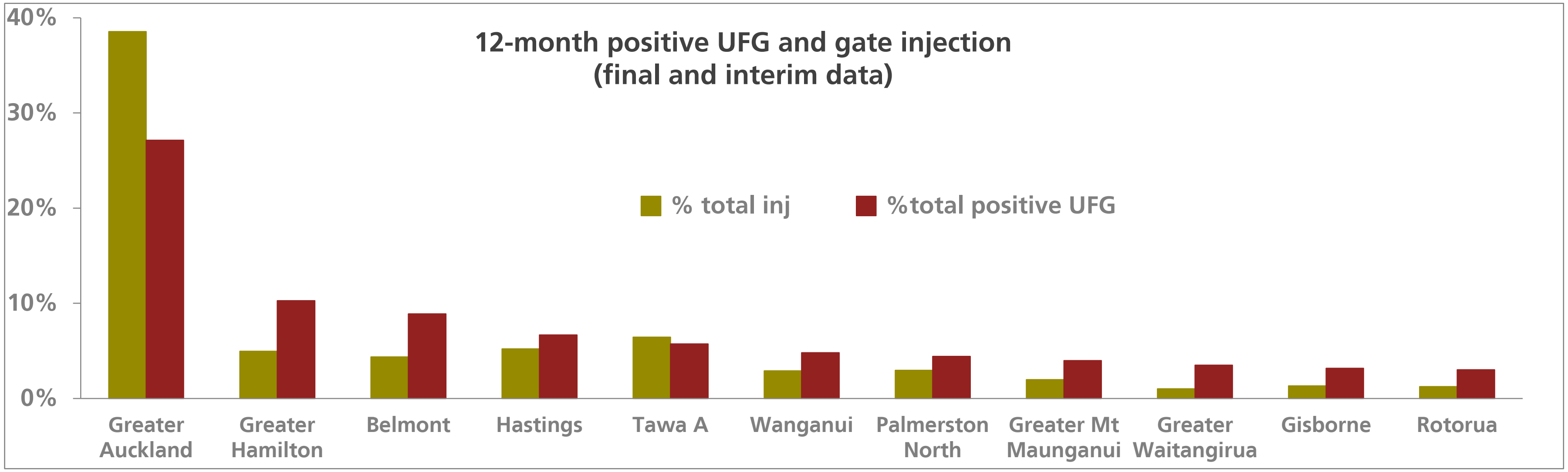


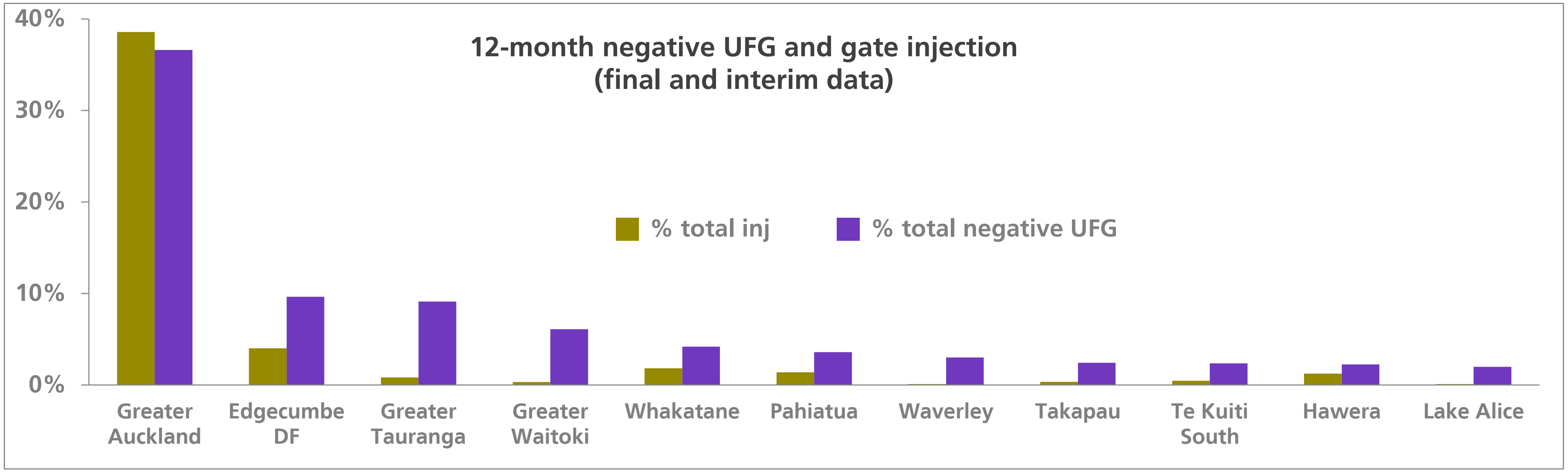
Gas gates where UFG is the highest

The charts below show the gates with the largest volumes of positive and negative UFG over the 12 months from January 2012 to December 2012, according to the most recent (final and interim) data. In those 12 months, a net of 254,489 GJ of UFG has been allocated: 364,981 GJ of positive UFG; and 110,491 GJ of negative UFG.

The first chart below shows that about 82% of positive UFG has occurred at the eleven gas gates shown. For context, the chart also shows the percentage of total gate injections each gate represents; that is, the proportion of total gas consumption that is drawn from those gates. The chart shows, for example, that nearly 40% of gas from shared gas gates was consumed in Greater Auckland, but less than 30% of positive UFG occurred there. Conversely, Greater Hamilton accounted for about 5% of gas consumption but 10% of positive UFG.

The second chart concerns negative UFG. The eleven gates shown account for 81% of the negative UFG experienced in the twelve months; and again the percentage of gate injections is shown for each of the gates.


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


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

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Audits commissioned

Event audits

There have been no event audits commissioned in the past quarter.

Performance audits

There have been no performance audits commissioned this quarter.

Number and severity of breaches of the Reconciliation Rules

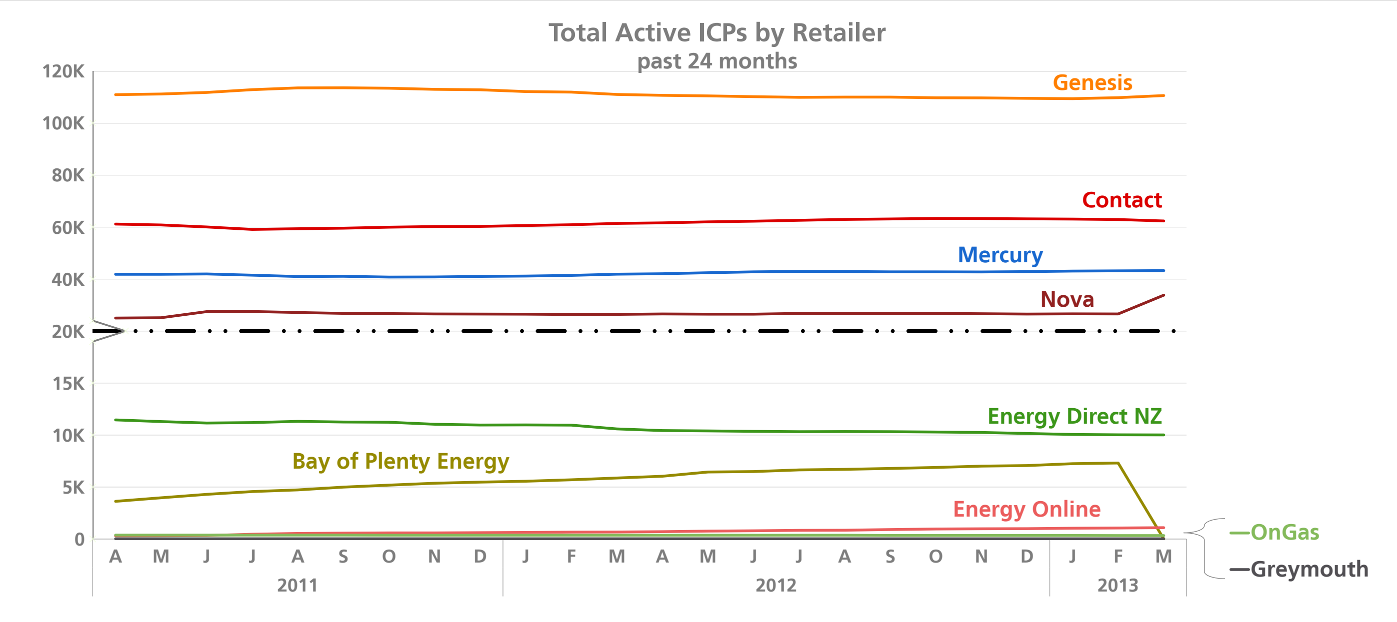
On average, about 85% of breaches alleged under the Reconciliation Rules relate to rule 37, the rule that requires the accuracy of consumption information provided at the initial allocation stage to be within a specified tolerance level of the information provided at the final allocation stage.

It has proven efficient for the Market Investigator to attempt to reach settlements in yearly batches of rule 37 breaches. In September of last year, the Rulings Panel approved a settlement of a batch of rule 37 breaches relating to consumption months December 2009 to March 2011 (and alleged February 2011 to May 2012). The next batch of rule 37 breaches will likely be determined by the Market Administrator later this month and in May, when the Market Administrator has 12 months of rule 37 breaches to consider.

5 Market competition performance measures

Market share of ICPs by retailer

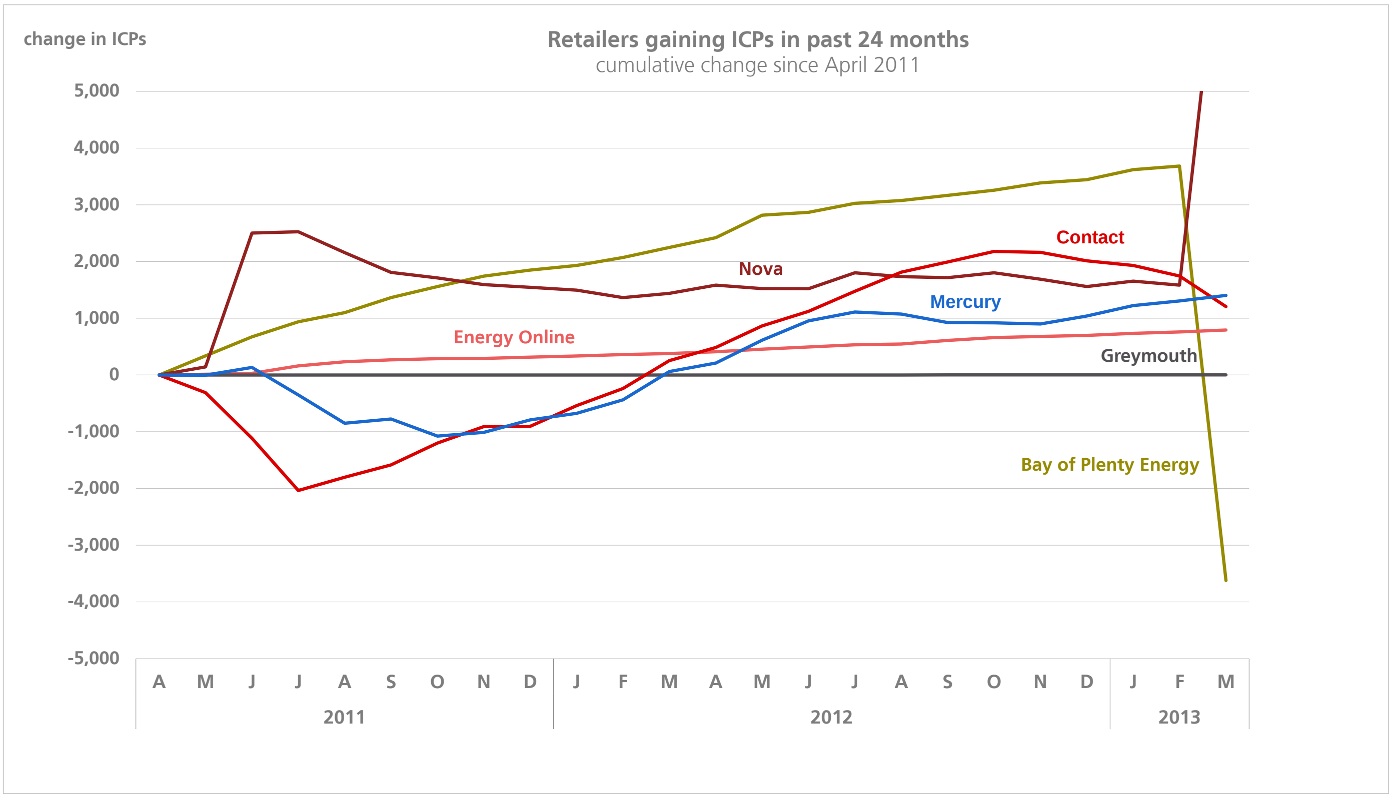
In the past quarter, Nova transferred all of its ICPs under the Bay of Plenty Energy brand to its Nova brand. There are now eight different gas retail brands in the market. There have been no major movements in market share among the other retailers.



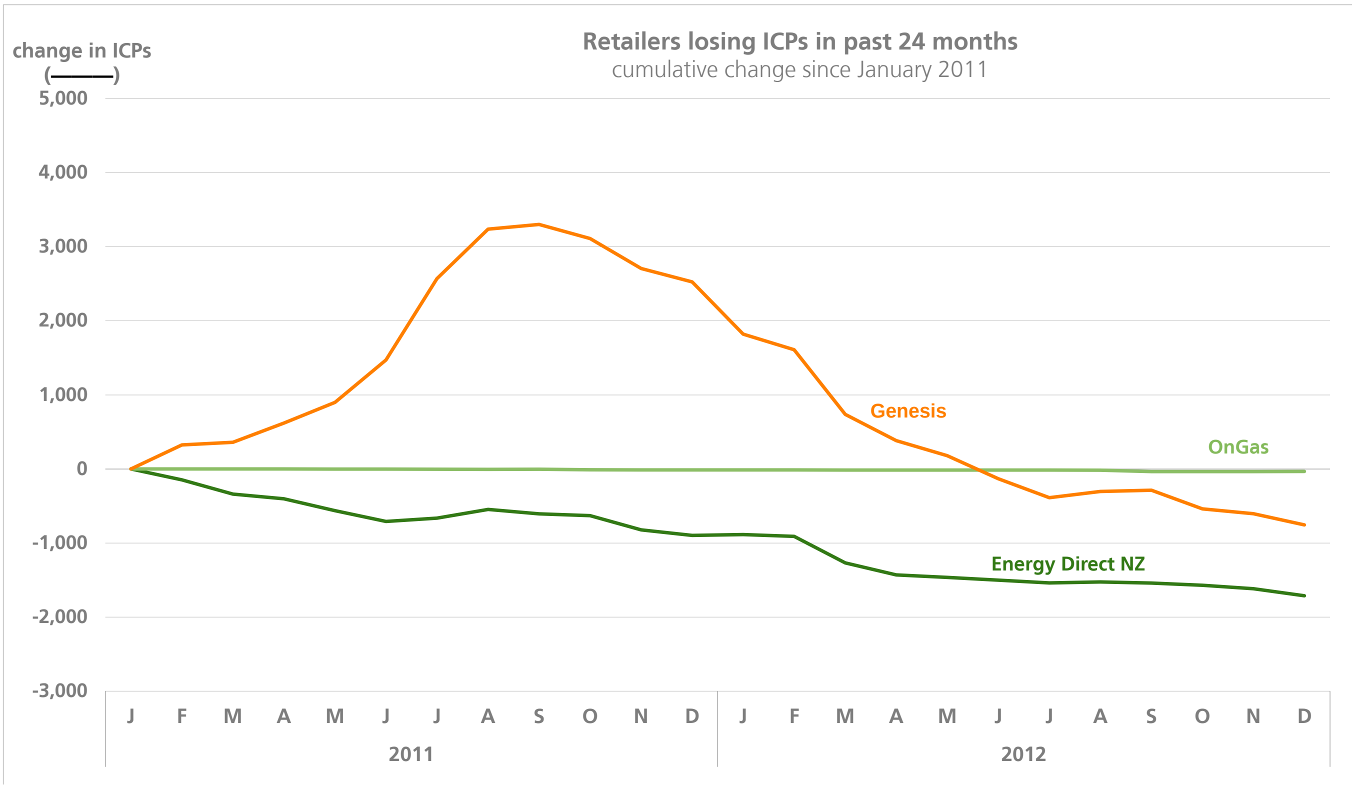
The two charts below are drawn from the same data set. Both show the cumulative changes in ICPs over the past two years; the first chart shows retailers who gained customers over that time; the second is retailers who have lost customers.

As noted above, Nova has now assimilated the Bay of Plenty Energy brand, though prior to that change, both Nova and Bay of Plenty were gaining customers. Contact Energy and Mercury Energy have overcome earlier customer losses and show an overall net gain over the past two years. Energy Online has gone from about 300 customers two years ago to over 1,000 customers today.

The three retailers with net losses of customers over the past two years are shown in the second chart.



change in ICPs
Retailers gaining ICPs in past 24 months
cumulative change since April 2011
5,000
4,000
3,000
2,000
1,000
0
-1,000
-2,000
-3,000
-4,000
-5,000
Contact
Nova
Mercury
Energy Online
Greymouth
Bay of Plenty Energy
A M J J A S O N D J F M A M J J A S O N D J F M
2011
2012
2013



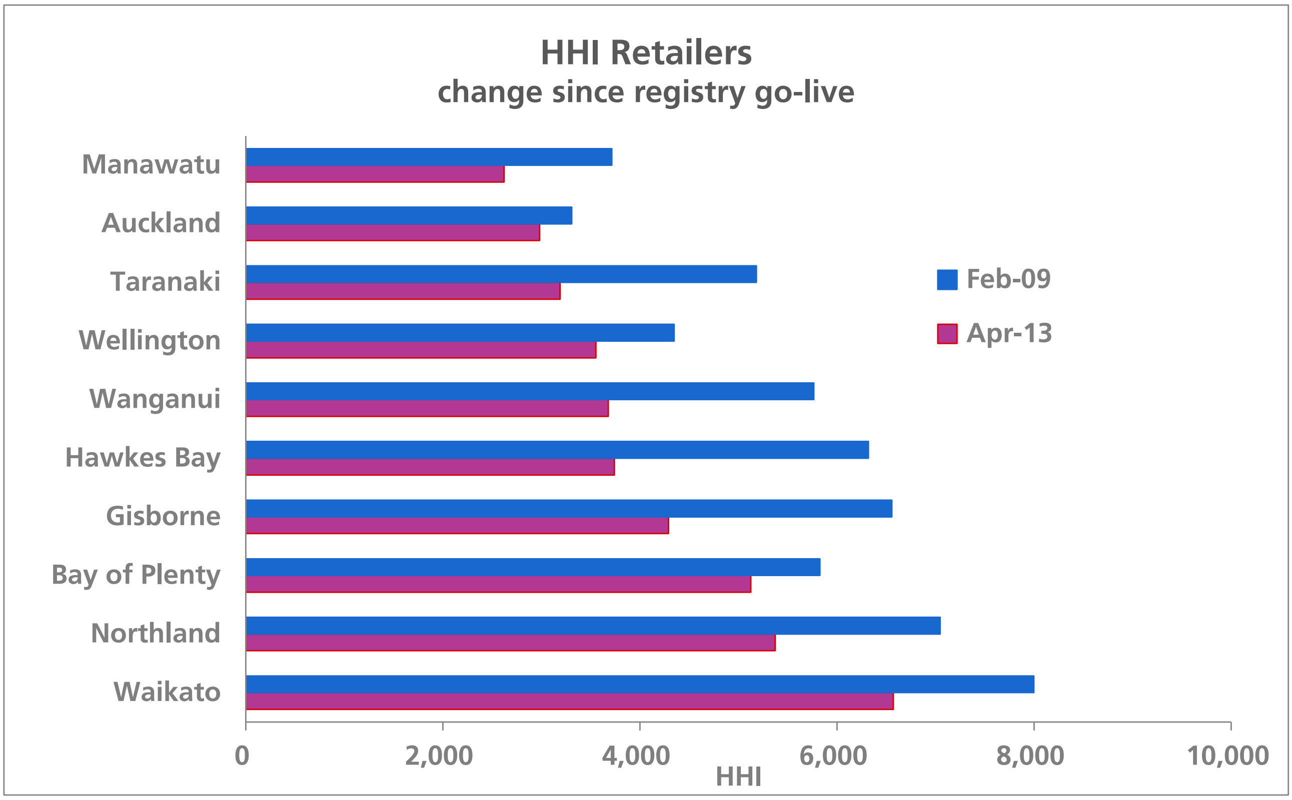
Note that all three of the ICP share charts above include data from ICPs on open-access distribution networks only; information about ICPs on bypass networks is not available in the Gas Registry.

Herfindahl–Hirschman Index

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

The chart below shows the HHI of the retail gas market as at the time the registry went live, in February 2009, and as of 1 April 2013. In all regions, the HHI has decreased, indicating that the retail gas markets in these regions have become less concentrated.

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



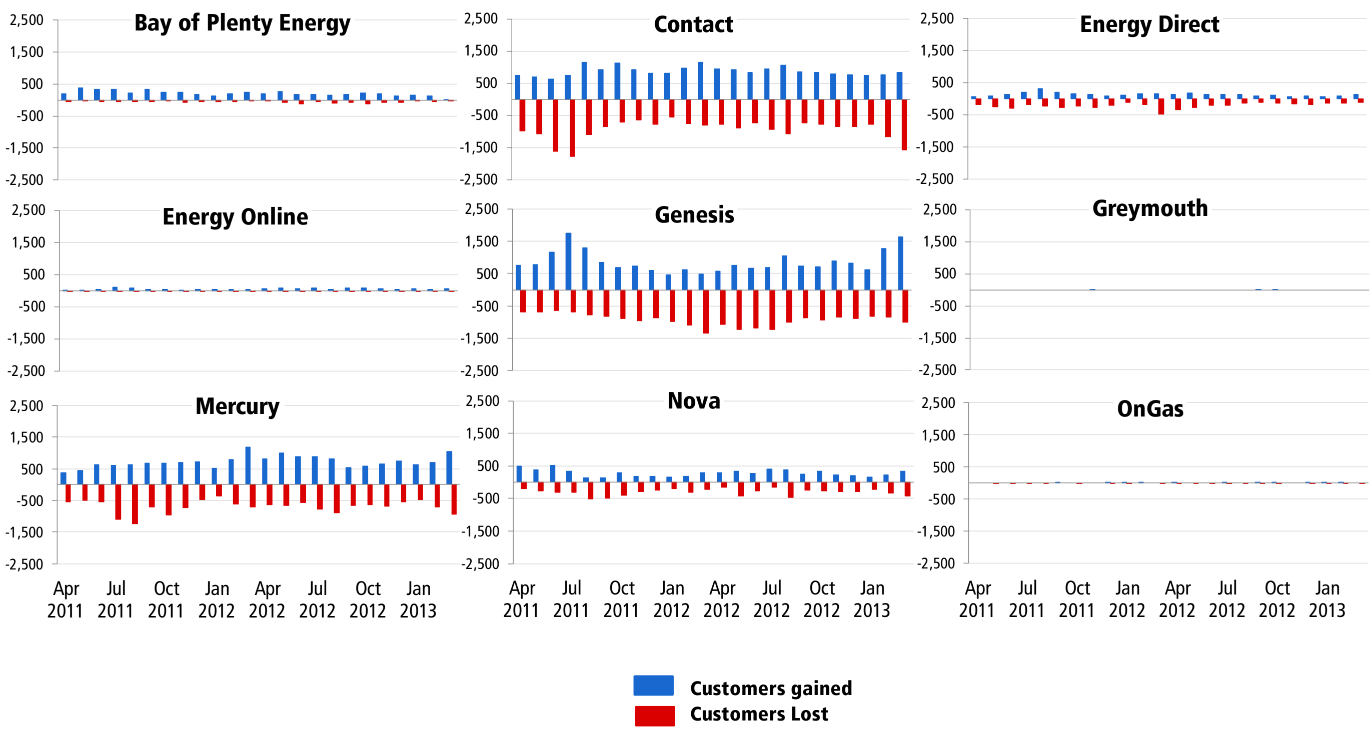
Switching activity by retailer

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

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

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

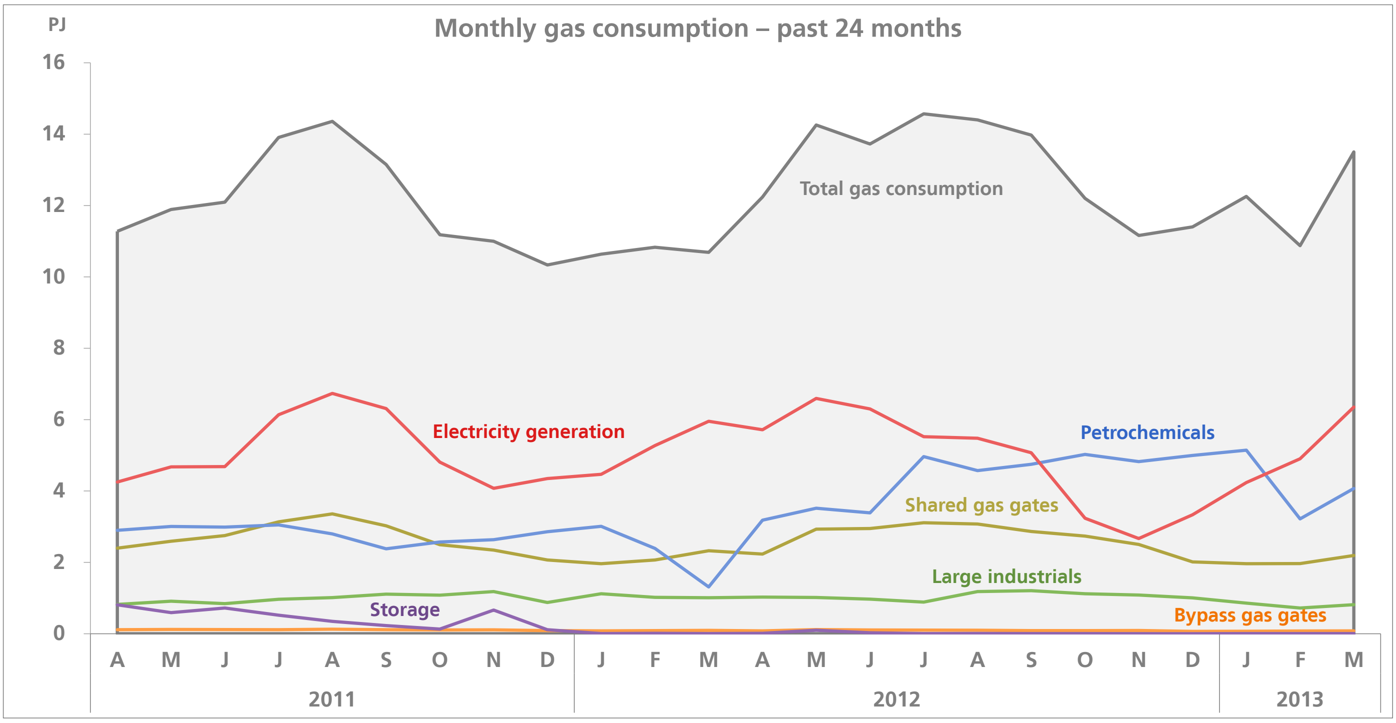
Switching activity by retailer



Total gas volumes

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

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

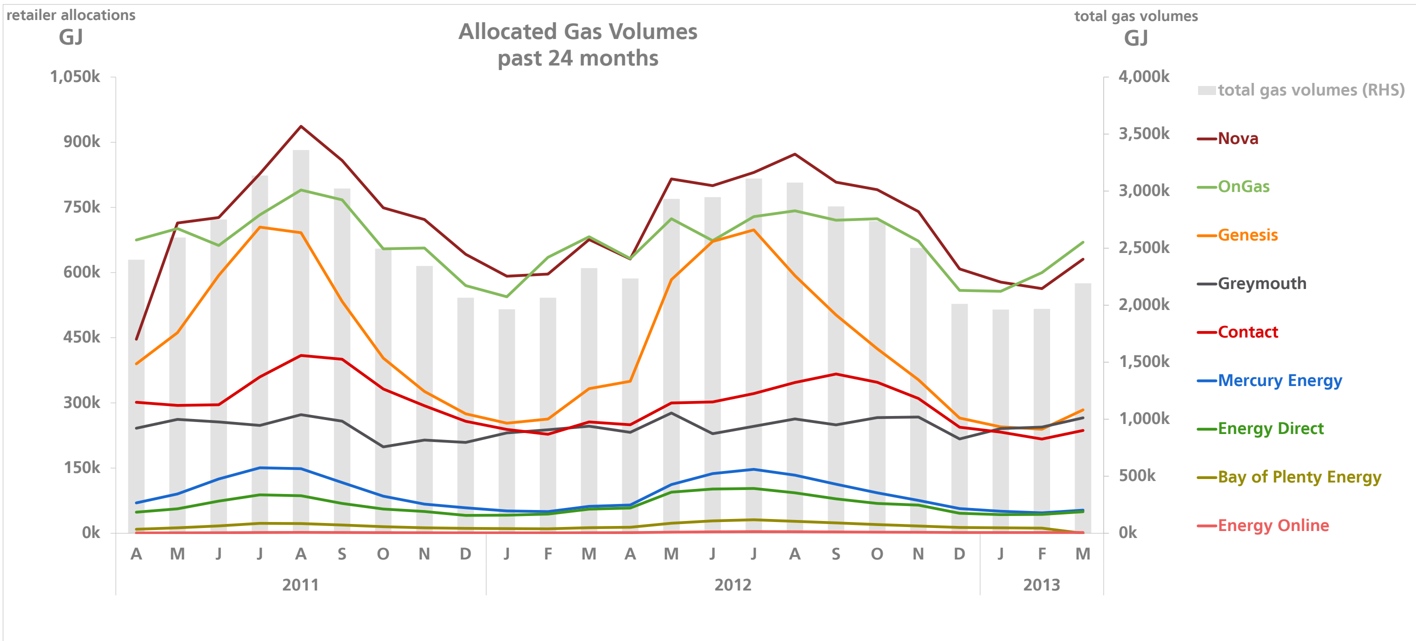


GAS INDUSTRY COMPANY LIMITED

Allocated gas volumes

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

Nova Energy is the largest retailer by allocated volumes, followed by OnGas. Genesis, the third largest retailer by volume, has a load profile that peaks in winter and troughs during the summer. Contact, Mercury, and Energy Direct all show similar – but less pronounced – winter peaking patterns. Greymouth's share of allocated gas, in contrast, is relatively steady throughout the year, reflecting its position as largely a supplier to industrial loads.

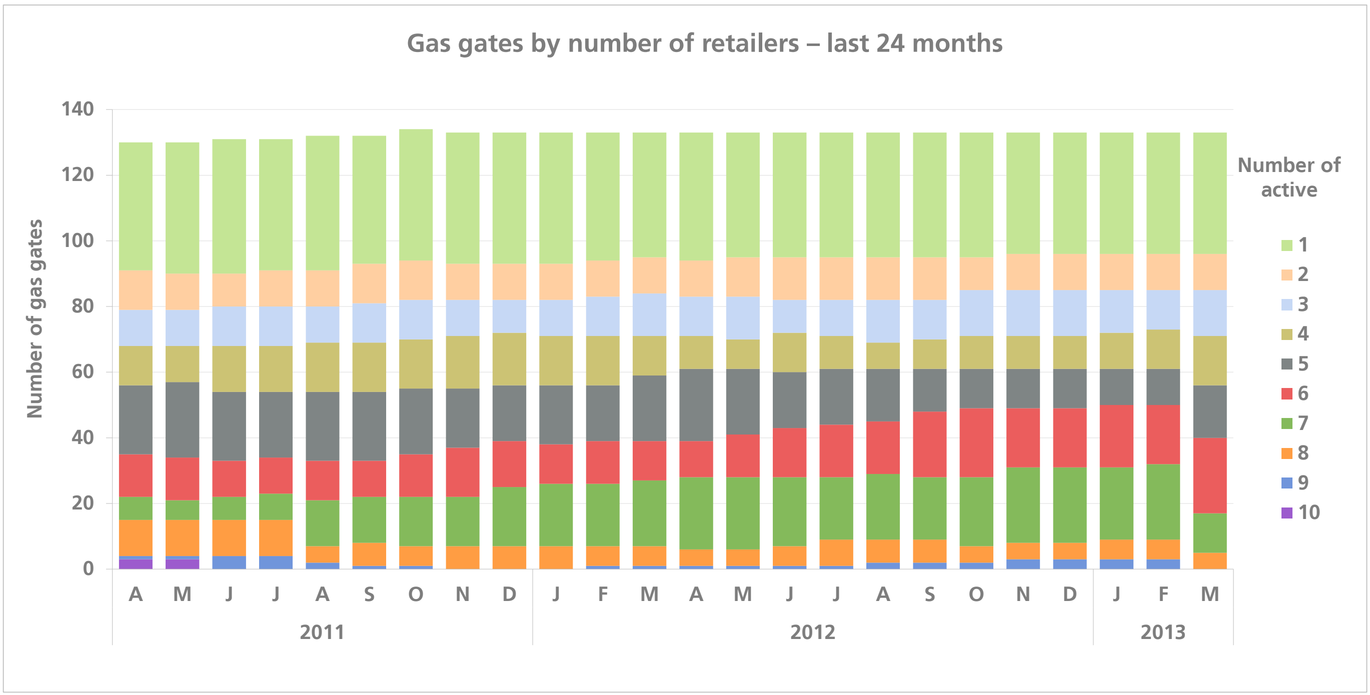


The data are from a mix of allocation stages: Final through February 2012; Interim for March 2012 through December 2012; and Initial for January 2013 through March 2013.

Gas gates by number of retailers

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

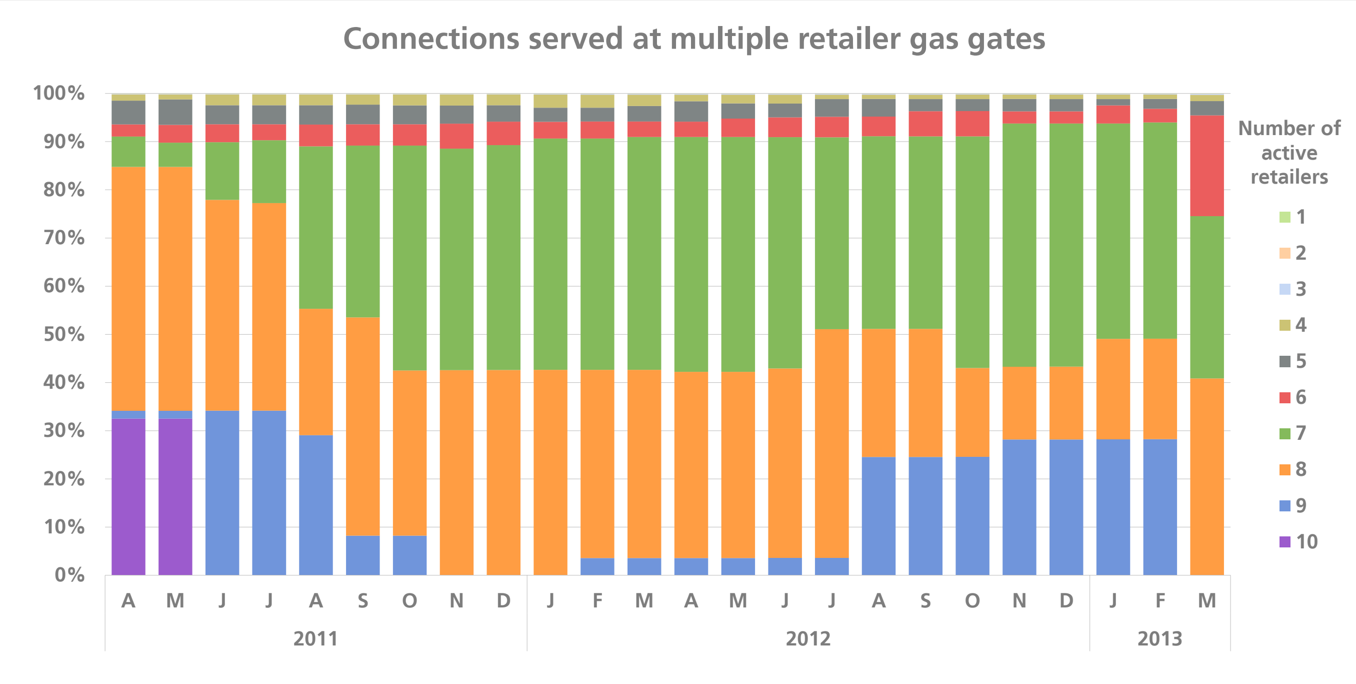
The biggest change in the past quarter is the step change resulting from the amalgamation of Bay of Plenty Energy with Nova, shown in March 2013.



Connections served by multiple retailers

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

This chart also shows the March 2013 step change caused by the amalgamation of Bay of Plenty Energy into Nova; it also shows the amalgamation in June 2011 of Nova and Auckland Gas. Still, over 95% of gas customers are connected to a gate where least six retailers trade.



Note that the above chart includes data from ICPs on open-access distribution networks only; information about ICPs on bypass networks is not available in the Gas Registry.

6 Critical Contingency Management performance measures

There were no critical contingencies in the previous quarter. A test exercise of the critical contingency management arrangements was held on 20 March, consistent with the requirements of the CCM Regulations. A copy of the Critical Contingency Operator's report on the exercise is available on the CCO website (using Explorer, go to www.oatis.co.nz; click the Critical Contingency Operator button; the report is under the Publications menu).

Strategic Progress: Quarterly Report 1 January – 31 March 2013

This report provides an update of progress towards Gas Industry Co's strategic goals. These reflect the Government's objectives and outcomes for the gas industry, as set out in the Gas Act 1992 and the April 2008 Government Policy Statement on Gas Governance, as implemented through the Company's FY2013-2015 Strategic Plan.

Project	Rationale	Activity	Status
Strategic Goal: Efficient Use of, and timely investment in infrastructure			
Transmission Pipeline Balancing	• Improved industry arrangements. Gas industry participants and new entrants are able to access transmission pipelines under reasonable terms and conditions.	• Assess balancing market developments. • Provide advice to Minister on balancing market developments by February 2012.	• Advice to Minister sent post Quarter (16 April 2013) reporting developments with balancing arrangements. • Maui Pipeline Code (MPOC) balancing changes may take effect from 1 June 2013; and working through complementary Vector Transmission Code (VTC) change request.
Interconnection	• Improved industry outcomes. Gas industry participants and new entrants are able to access transmission pipelines under reasonable terms and conditions.	• Monitor two new interconnection arrangements on each open access transmission pipeline (Vector, MDL). • Review transmission pipeline interconnections and consult on any issues by the end of 2013. • Investigate the extent, if any, of issues relating to access to private pipelines.	• Sidewinder field (TAG) interconnection reviewed, and no issues identified • Review planned for Cheal field (TAG) interconnection via Vector transmission.
Access to Processing Facilities	• Statutory Role under Gas (Processing Facilities Information Disclosure) Rules 2008.	• Collect, monitor, and publish disclosed information. • Recommend to Minister by 27 June 2013 as to continuance, amendment, or expiry of these Rules.	• All disclosures for current year received and published on Gas Industry Co website. • Recommendation to Minister post Quarter (16 April 2013) that regulated access to gas processing facilities is not necessary.

Strategic Goal: Build efficient, competitive, and confident gas markets			
Rule Changes	• Improved industry governance through regular review of existing arrangements and recommending changes where appropriate.	• Maintain rule change registers. • Review industry feedback on options paper on Reconciliation Rules review. • Consult on Statement(s) of Proposal for changes to Reconciliation Rules. • Review effectiveness of the Gas Governance (Critical Contingency Management) Regulations 2008 following any events/exercises. • Consult on proposed changes to the Compliance Regulations.	• Recommendation to Minister on minor amendments to the Reconciliation Rules approved and gazetted on 28 February 2013. Work continues on phase 2 changes dealing with allocation methodologies. • Drafting of CCM Regulations changes in progress following consideration of submissions and feedback from drafting workshops. • Revised Essential Services and Minimal Load Guidelines published in November 2012. • Submissions on a proposed threshold regime to be incorporated into the Compliance Regulations have been analysed. The proposed changes will be submitted to the Minister once other changes to the Critical Contingency Management Regulations, which will affect the Compliance Regulations, are finalised.
Gas Quality	• Maintain an acceptable standard of gas quality. • Ensure costs of gas quality incident are met efficiently. • Achieve improved transparency on gas quality incidents.	• Ongoing review of industry arrangements for managing gas quality. • Consider options for improving gas quality arrangements. • Report review findings to Minister by June 2012.	• Survey of gas quality monitoring completed. • Retailers establishing information exchange protocol to demonstrate compliance with gas quality requirements.
Insolvent Retailer Arrangements	• Following recommendation to revoke 2010 temporary Insolvent Retailer Regulations, consider whether generic regulatory solution is required to address retailer insolvency.	• Prepare Issues and options paper for industry consultation.	• Recommendation to Minister post Quarter (16 April 2013) that permanent backstop regulations are not necessary.

Gas Distribution Principles	• Improved industry outcomes. Gas industry participants and new entrants are able to access distribution pipelines on reasonable terms and conditions. • Ensure consistency in distribution services arrangements.	• Monitor and report annually to Minister on status of distribution arrangements. • Develop and publish distribution contract Principles. • Encourage publication of network services agreements.	• First assessment commenced in February 2013. As Distributors have yet to finalise new distribution arrangements, the scope of this assessment was revised. • A draft assessment is being reviewed by distributors, with a final assessment due to be provided to the Minister by June 2013.
Transmission Change Requests	• Contractual role pursuant to MoUs with MDL and Vector. • Ensure ongoing relevance and efficiency of multilateral terms of access to transmission pipelines.	• Process MPOC change requests and VTC change request appeals as they are received in accordance with respective Memorandum of Understanding (MoU).	• GIC Draft Recommendation on 28 February supports VTC change request appeal (dated 27 November 2012) on balancing processes, peaking charges, and disputed invoices. • Vector withdraws VTC appeal (dated 31 July 2012) relating to prudential security. • GIC Final Recommendation on 28 February supports MPOC change request on nomination time. • New MPOC change request dated 28 March 2013 seeks a number of minor and technical amendments. Draft recommendation issued post Quarter (12 April) supports the request. Submissions due 2 May.
Compliance	• Statutory role under the Compliance Regulations. • Improved industry operations through provision of a compliance and dispute resolution process for industry participants.	• Oversight of Gas Governance (Compliance) Regulations 2008.	• Gas Industry Co continues to fulfil its role as Market Administrator under the Compliance Regulations.
Customer Issues	• Enhanced consumer benefits through complaints process for small gas customers.	• Liaise with the Electricity & Gas Complaints Commission (the approved complaints scheme), and other relevant regulators to remain aware of consumer complaint issues.	• Regular liaison with Electricity & Gas Complaints Commission and other relevant regulators. Gas-related inquiries and complaints statistics included in Gas Industry Co Annual Report.

Retail Contracts	• Enhanced consumer outcomes by providing clarity around the respective roles and obligations of consumers and industry participants involved in the supply of gas to small users.	• Administer the Retail Gas Contracts Oversight Scheme. • Annual assessment of alignment of retail contracts with contract Benchmarks. • Report to Minister on the results of the 2012 assessment.	• The third assessment (published in November 2012) found that the industry had moved from 'moderate' to 'substantial' alignment with the Benchmarks. • Retailers have advised that it is unlikely that any contracts will be revised or materially altered in the next year or so. As such, a fourth assessment in July 2013 seems unnecessary. • Gas Industry Co has advised the Minister that it intends to defer the 2013 assessment and undertake a review of the Scheme.
Transmission Pipeline Capacity	• Improved consumer outcomes by addressing short and long-term competition issues arising from the North Pipeline capacity constraint. • Enhanced industry/consumer outcomes by improved level, and quality, of information on which to base business/energy use decisions.	• Address by regulatory and/or non-regulatory options any lessening of competition due to transmission constraints. • Implement the Gas Transmission Investment Programme (GTIP). • Improve the quality and availability of pipeline security standards and supply/demand information. • Promote changes to commercial and regulatory arrangements so the GTIP objectives can be met.	• Panel of Expert Advisers (PEA) presented update of their work to industry workshop post Quarter (11 April) and set out revised terms of reference/direction in advance of second report to GIC in August 2013. • Continued monitoring of information provided by signatories to the 'Bridge Commitments', designed to address short-term issues. • Continued monitoring of Gas Transmission Exchange (GTX) - one of the 7 Bridge Commitments.

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

Policy Development and Information Gathering	• Ensure Gas Industry Co has all information required to properly analyse issues in arriving at conclusions. • Industry and consumer benefits from improved level, and quality, of information on which to make business and/or energy use decisions.	• Proposal initiated following the publication in June 2011 of the FY2012-2014 Strategic Plan - to develop a process enabling Gas Industry Co to request and, if necessary, require the supply of specific information from participants to assist the timely development of market solutions.	• Developing information requests protocol.
Industry Facilitation	• Facilitate nexus between industry and Government. • Maintain informed industry participants and other stakeholders.	• Facilitate, influence and communicate with the industry and Government. • Liaise with other regulatory bodies, agencies and associations with responsibilities and interests encompassing the gas industry.	• NZ Gas Story completed and provided to Minister on 1 March. • Regular liaison with MBIE, Electricity Authority, and other relevant regulators.
Critical Contingency Management	• Statutory role under Gas Governance (Critical Contingency Management) Regulations 2008. • Improved industry outcomes through increased market confidence in industry's ability to manage critical events.	• Manage Critical Contingency Operator (CCO) via service provider agreement. • Review effectiveness of the Regulations following any events/exercises. • Operate critical contingency pool following an event.	• CCO activities monitored and reviewed quarterly. • CC exercise 'Tawiri' conducted on 20 March.