**GAS INDUSTRY COMPANY LIMITED**

2016/2017

# Annual Report

# Let’s clear the air.
# What’s the story with natural gas in New Zealand and climate change?

Natural gas has a direct role to play for over a quarter of a million New Zealanders in providing secure and affordable energy with around 21% of the country’s energy supply. That role will change as the world transitions to meet the challenge of climate change.

New Zealand has signed and ratified the 2015 Paris Agreement on climate change and is committed to reducing our greenhouse gas emissions to 30 percent below 2005 levels by 2030. As with other Agreement signatories, the Government is developing policies aimed at meeting that commitment. Under those polices, the use of natural gas in New Zealand will inevitably change with the introduction of new technologies, such as carbon capture and storage and more renewable energy sources.

Natural gas is a fossil fuel. When burned to produce heat, either for direct use or for electricity generation, natural gas produces $CO^2$, albeit at much lower levels than other fossil fuels.[1]

But natural gas has an important and continuing role in fulfilling New Zealand's energy needs. It is relied upon by around 270,000 New Zealand homes and businesses. The range of gas users is broad – including hospitals, medical centres, aged care facilities, schools and swimming pools.

For many residential consumers, gas-fired water and space heating is an economical choice that is likely to have a similar carbon footprint to a house with standard resistance water heating and a heat pump.[2]

For industrial consumers, natural gas can provide a reliable supply of process heat, displacing coal and complementing renewable process heat in locations where renewable fuels are unavailable or impractical.

Natural gas also has a critical role in providing cost-effective electricity supply security. It supports renewable electricity generation, especially when our hydro lake levels are low during cold winter months.

It is inevitable that natural gas's role will change as the future unfolds, but for now it provides secure, affordable, and relatively low-carbon energy to New Zealand homes and businesses. Gas Industry Co looks forward to providing input into developing government policy as New Zealand and the world transition to a low-carbon future.

1 According to the US Energy Information Administration, $CO^2$ emissions from natural gas are about 55-57% those of subbituminous and bituminous coal. See https://www.eia.gov/tools/faqs/faq.php?id=73&t=11

2 Concept Consulting, '*Consumer Energy Options in New Zealand: 2016 Update*', 7 March 2016. Available: http://gasindustry.co.nz/about-us/news-and-events/events/release-of-consumer-energy-options-in-new-zealand-2016-update-by-simon-coates/.

# CONTENTS

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## KEY ARRANGEMENTS GOVERNING THE GAS INDUSTRY

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Gas Industry Co oversees various arrangements for the downstream gas industry.

Regulatory arrangements made under the Gas Act include:

» Gas (Switching Arrangements) Rules 2008 (Switching Rules), which provide for a central registry of ICP data and facilitate customer switching among retailers.

» Gas (Downstream Reconciliation) Rules 2008 (Reconciliation Rules), which prescribe the process for attributing volumes of gas consumed to the responsible retailers.

» Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations), which set out how industry participants plan for, and respond to, a serious incident affecting gas supply via the gas transmission pipelines.

» Gas Governance (Compliance) Regulations 2008 (Compliance Regulations), under which alleged breaches of the rules and regulations set out above are determined and settled efficiently. Gas Industry Co performs the role of Market Administrator under the Compliance Regulations.

Industry arrangements include:

» Retail Gas Contracts Oversight Scheme.

» Gas Distribution Contracts Oversight Scheme.

» Framework for Gas Retailer Insolvency Arrangements, which sets out the process Gas Industry Co will follow in the event of a retailer insolvency.

» Guidelines on Interconnection with Transmission Pipelines (Interconnection Guidelines), detailing expectations for transmission system owners' policies and procedures for third party connections to their pipelines.

The ongoing effectiveness of these arrangements is monitored and reviewed. This is both at a high level, through a set of industry performance measures, and at a detailed level, through audits and daily monitoring.

Highlights of the Performance Measures Report for the quarter ended 30 June 2017 are found on page 8.

Publications referred to in this Annual Report can be found on our website www.gasindustry.co.nz

### Gas Industry Company Limited (Gas Industry Co) was approved in 2004 as the industry body under Part 4A of the Gas Act 1992 (Gas Act).

Gas Industry Co's role as the industry body is to:

» develop arrangements, including regulations where appropriate, which improve:
  – consumer outcomes;
  – the operation of gas markets; and
  – access to infrastructure;

» develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and

» oversee compliance with and review such arrangements.

When recommending industry arrangements, Gas Industry Co takes into account the objectives of the Gas Act and the Government Policy Statement on Gas Governance 2008 (GPS).

Our strategy is to *optimise the contribution of gas to New Zealand* by:

» promoting efficient, competitive, and confident gas markets;

» facilitating efficient use of, and timely investment in, gas infrastructure;

» delivering effectively on our accountabilities as the industry body; and

» building and communicating the role of gas in meeting New Zealand's energy needs.

## STRUCTURE OF THE GAS INDUSTRY

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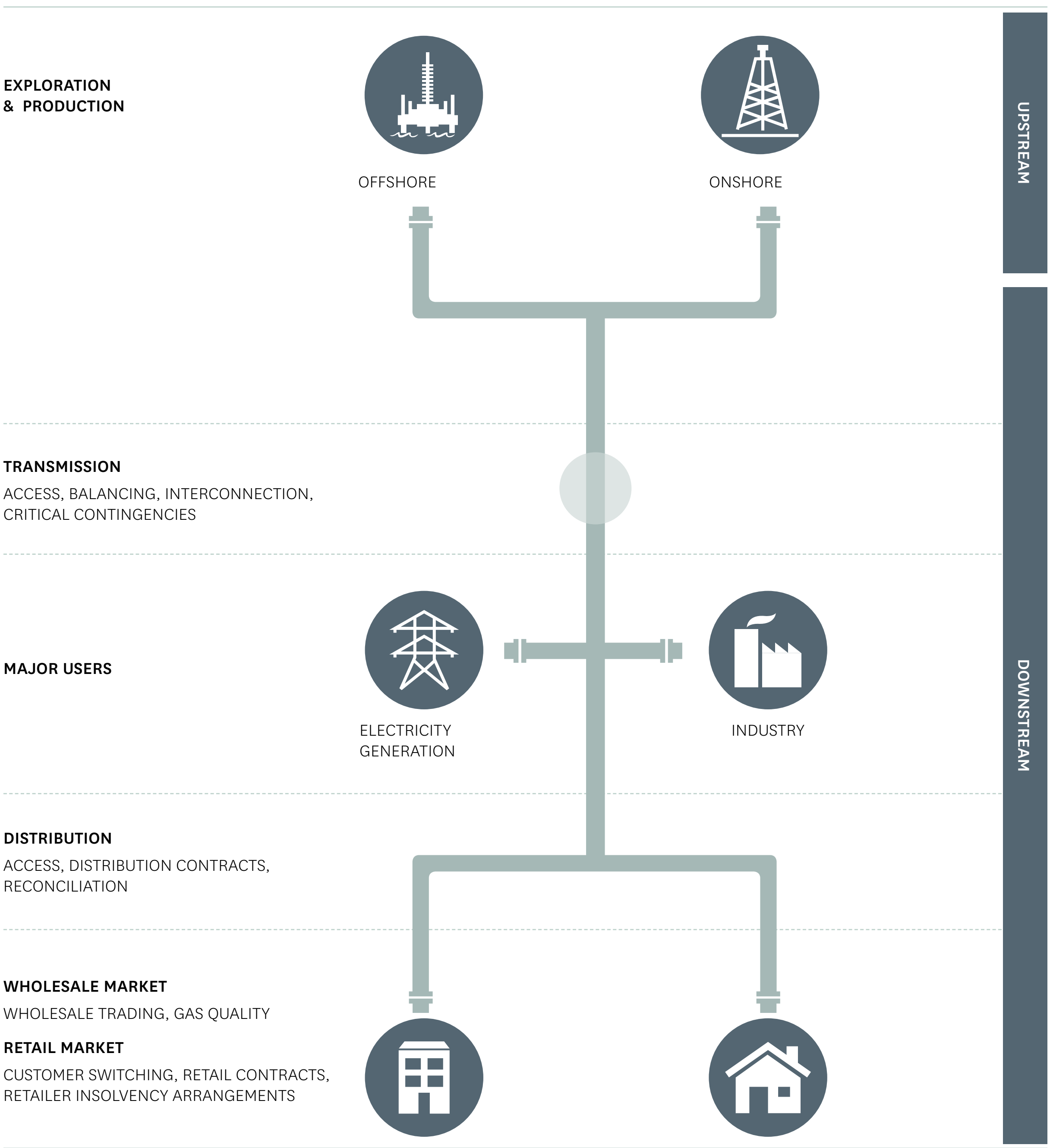
The gas industry comprises four main sectors - upstream exploration and production, high pressure transmission, gas distribution, and consumers. The upstream sector is governed primarily through the Crown Minerals Act 1991 administered by the Ministry of Business, Innovation and Employment. Gas Industry Co's regulatory oversight encompasses the downstream sector, comprising processing facilities, transmission, distribution, wholesale, and consumer markets.



# Chair's Foreword

At a time when tension and distrust seem dominant themes in the world, I believe it is appropriate to reflect briefly on the work of Gas Industry Co, where cooperation and seeking the right answer have guided us.

It has now been over 14 years since the Government invited the gas industry to '*establish a governance structure and decision-making process to manage the … development of gas market arrangements…*'.[3] I had the privilege of chairing the Gas Industry Steering Group, which was formed in response to that invitation.

The group comprised representatives from the upstream and downstream gas industry and gas consumers. Together, we developed a framework that combined industry self-regulation with strong independent governance. The Government accepted the proposal, albeit with the backstop of full regulation if the co-regulatory model did not deliver on the Government's objectives. Gas Industry Co was formed to fulfil the role of the industry body under the co-regulatory framework.

As envisaged by Government in 2003, industry co-regulation means favouring industry-led solutions where possible, utilising strong independent governance to provide discipline, and being prepared to use regulatory solutions where necessary. It is this first part, *favouring industry-led solutions*, that makes us different. A regulatory agency faced with an identified problem will identify options, analyse possible outcomes, and enact regulation to put into place the preferred identified option.

At Gas Industry Co, our options are both deeper and broader. We work to define issues and support the industry as it identifies its own solutions. We look to our members and stakeholders to provide the expertise and the knowledge needed to tailor solutions to both industry and consumer needs, whilst respecting broader stakeholder objectives. We strive to develop and maintain an open dialogue with our stakeholders, and we consider that some of the best work on industry governance happens when we gather our stakeholders into a room together.

Of course, we also have the backstop of developing *regulatory solutions where necessary*. At times, the industry cannot reach agreement and, in those instances, Gas Industry Co can and does act like a regulator, identifying and developing a preferred option to recommend for regulation. This process is also informed as much as possible by discussions and consultation with stakeholders but, in this case, Gas Industry Co takes a leading role in developing a preferred option.

The current Gas Transmission Access Code (GTAC) work is a perfect example of the industry co-regulatory framework in action. The design work is led by First Gas, who is the owner of both the Maui and the ex-Vector transmission pipelines.

3 Lianne Dalziel, Minister of Commerce, '*Statement to the Commerce Commission of Economic Policy of the Government: Government Policy Statement – Development of New Zealand's Gas Industry*,' New Zealand Gazette, no. 30, pp. 839-841, 27 March 2003. Available: https://www.gazette.govt.nz/notice/id/2003-go2084

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Its aim is to develop a cohesive set of access arrangements over the whole gas transmission system. Gas Industry Co is strongly supportive of this work, and we recognise the constructive engagement and significant investment that First Gas, industry participants, and stakeholders have put into the code development process. Gas Industry Co encourages the industry to follow a rigorous process in this work and is contributing such inputs as periodic consultation papers, independent analyses of submissions, and independent review of the final, proposed code.

At the same time, Gas Industry Co recognises that stakeholders' hard work and dedication may not be enough to achieve industry agreement on a set of access arrangements. Should the industry solution fall short, then Gas Industry Co stands ready and able to proceed with developing a regulatory solution to recommend to Government.

I would like to take this opportunity to thank all of the industry participants and stakeholders for their commitment and contributions to the GTAC work over the past year. I look forward to observing progress on this front over the coming year.

I would like to thank my fellow Directors for their continued commitment to executing their duties on behalf of Gas Industry Co to the highest governance standards.

As always, on behalf of the Board, I would like to record our appreciation for the executive and staff of Gas Industry Co for their excellent work and dedication over the year. I would particularly like to acknowledge the contributions of Ian Dempster and Susan Dunne, who stepped up into Acting Chief Executive and General Manager Corporate Services roles, respectively, to cover extended leaves of absence. Your efforts ensured that Gas Industry Co continued to operate efficiently and effectively throughout the year.

**Rt Hon James B Bolger, ONZ**

CHAIR

## PRIORITIES FOR 2017/2018

» **Continue working** with First Gas (owner of the gas transmission system), industry participants, and stakeholders to produce a detailed design of a new gas transmission access code (GTAC). Assess the detailed design against Gas Act and GPS objectives and outcomes, and report to the Minister of Energy and Resources on the suitability of GTAC. Move to the development of regulation if the industry process stalls or arrangements do not meet Gas Act objectives.

» **Consider outcomes** of the Commerce Commission's planned work relevant to gas transmission disclosure and determine whether further improvements are appropriate or necessary to achieve the relevant objectives and outcomes of the Gas Act and GPS.

» **Oversee industry-led work** on gas quality and consider whether further action is required arising from the *Gas Quality Requirements and Procedures* document.

» **Continue the running** of the D+1 pilot scheme, and once the new GTAC is produced, implement any required changes to the Reconciliation Rules and consult.

» **Review critical contingency pricing** and imbalance arrangements and consult with stakeholders on any improvements to these arrangements. Consult and work with stakeholders to ensure CCM arrangements are aligned with the final GTAC.

» **Develop any future activity** required in light of the findings from the initial gas measurement review which commenced in FY2016.

» **Continue the monitoring** of activity and developments in the wholesale market with a particular focus on the market's role as the source of volume and pricing for transmission balancing.

» **Work with stakeholders** on balancing-related matters and incorporate findings from the Market-based Balancing (MBB) review to enhance efficiency where warranted.

» **Continue the monitoring** of the performance of the Registry Operator and assess ongoing performance of the Switching Rules.

» **Maintain the currency** of *The New Zealand Gas Story* and undertake related initiatives to assess, develop and report on the state and performance of the New Zealand gas industry.

# Chief Executive's Review

## As I write this review, industry participants are grappling with the question of what an amalgamated gas transmission access code should look like.

To me, the GTAC project is emblematic of the co-regulatory model at its best.

In relation to the GTAC, our objective is twofold: to support the industry as much as we can in its journey to develop a new transmission code; and to remain ready to develop a regulatory solution.

On the support side, I am pleased to report that Gas Industry Co has been active on a number of fronts related to GTAC. In September 2016, Gas Industry Co agreed to co-lead the code development work with First Gas. In this role, Gas Industry Co has worked in a secretariat function, developing analyses of stakeholder submissions, hosting workshops, and ensuring that the code development process runs smoothly. We have assessed progress and provided initial thoughts on First Gas's proposals. And we have contributed resource papers on important aspects of code development: code governance options, gas quality, and transmission pricing. We remain committed to providing this type of support to the GTAC development process.

I would like to take this opportunity to acknowledge the significant levels of engagement and support that First Gas and stakeholders have put into the GTAC process over the past year. The discussions have been thoughtful, detailed, and constructive; and they have been invaluable in the code development process.

Once a code is developed, Gas Industry Co will independently evaluate the design of the code, using the objectives set for us in the Gas Act and the GPS. In relation to transmission, those objectives include facilitating and promoting the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure and competitive market arrangements; and maintaining or enhancing incentives for investment in transmission. If the proposed code does not adequately meet these objectives, we may recommend that the industry considers changes to certain aspects of it.

More generally, Gas Industry Co has continued to support transmission code changes through the daily allocation trial, which runs twice a day and provides allocation figures for the previous day. This trial was initially developed in response to the implementation of market-based balancing in the Maui Pipeline Operating Code. The daily allocation information that the trial produces is vital to the smooth operation of the cash-out provisions in the gas transmission codes as they stand. We are working with stakeholders to assess their needs for daily allocation results under the GTAC, and our aim is to develop and implement a fully-functional allocation system for producing these results.

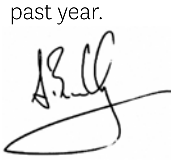
We will also consider whether any existing gas governance arrangements need to be amended once the code design is defined. For example, the arrangements for managing gas critical contingencies may require some adjustment to better align those arrangements with the new code.

We anticipate that our involvement with the GTAC will set us up for being able to move quickly in any regulatory work that we will need to do. We are familiar with the issues and the industry-led design process, and our analysis of the final, proposed design will not only identify any shortcomings but also require that we give consideration as to how best to address those issues.

I am pleased to note that the gas industry otherwise appears to be in good health. We continue to have a robust reserves:production ratio of 10 to 12 years, the wholesale market has been seeing strong growth over the past year, and the metrics for the sector are in good shape as evidenced by Gas Industry Co's quarterly performance measures reporting.

During the year, Gas Industry Co signed a new lease on its current office spaces. The new lease came with a lower rental rate and the offer of a free office refurbishment. We have taken advantage of the opportunity to expand both the Maui and Pohokura meeting rooms, to make them more useful for holding workshops and other industry meetings. I look forward to welcoming stakeholders to our upgraded premises.

I would like to offer my thanks and congratulations to the staff of Gas Industry Co for their achievements over the past year.



**Steve Bielby**
CHIEF EXECUTIVE

## HIGHLIGHTS FROM GAS INDUSTRY CO'S PERFORMANCE MEASURES REPORT TO 30 JUNE 2017

» About **4,100** gas consumers switch gas supplier each month.

» Around **18 percent** of gas consumers have switched in the past 12 months. Gas customers can switch retailers for many reasons, but the high level of activity in the gas retail market suggests that customers find changing retailer easy and can put pressure on retailers to offer competitive terms and pricing. Switching rates have been over 18 percent for more than two years.

» Over **75 percent** of customer switches have been completed within three business days of the switch being requested by the new retailer.

» **63 percent** of residential consumer sites have switched retailer at least once in the past eight years; 66 percent of small commercial and 79 percent of large commercial sites have switched at least once.

» Over **99 percent** of gas customers are connected to a gas gate where seven or more retailers trade, suggesting that the gas retail sector is generally competitive throughout the North Island.

» Average annual unaccounted-for gas (UFG) over the past year stands at about **0.8 percent** (compared with about 2 percent in 2009).

» Genesis is the largest retailer by customer share. Nova has the largest share of commercial and industrial customers.

» Nova, Genesis, and Vector Gas are the largest retailers by volume market share.

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| KEY WORK PROGRAMME ACHIEVEMENTS IN 2016/17 [4] | | |
|---|---|---|
| ACTIVITY | PRIORITIES SET FOR 2016/17 | OUTCOMES FOR 2016/17 |
| TRANSMISSION – CAPACITY/ ACCESS | Work with First Gas (owner of the gas transmission systems), industry participants, and stakeholders to define a single new transmission code. | As of June 2016, both the Maui and Vector pipelines came under the ownership of First Gas Limited[5] who intends to replace the two existing access codes with a single Gas Transmission Access Code (GTAC). First Gas and Gas Industry Co agreed to co-lead the new code development work, each with its complementary responsibilities. Each has since consulted on and workshopped a range of papers addressing the various regulatory, contractual, design and process issues involved. First Gas aims to bring the new arrangements into operation on 1 October 2018.<br>Gas Industry Co is facilitating discussions and will continue to focus on access convergence. |
| SECURITY AND RELIABILITY | Complete the review of gas transmission security and reliability. Consider outcomes of the Commerce Commission's planned work relevant to gas transmission disclosure and determine whether further improvements are appropriate or necessary. | In March 2017, Gas Industry Co released the *Gas Transmission Security and Reliability Update Paper* (S&R Update).<br>Gas Industry Co worked closely with the Commerce Commission to share information and ensure that we are aware of each other's activities and that there is no duplication of work between our two agencies. |
| SUPPLY AND DEMAND STUDY | Develop an updated edition of the gas supply/demand study and associated model, to assist industry strategy and investment over the medium to long terms. | *Long Term Gas Supply and Demand Scenarios 2016 Update* was released on 14 October 2016. The report will be updated biannually with the next release planned for 2018. |
| CRITICAL CONTINGENCY MANAGEMENT | Review performance of the Critical Contingency Operator (CCO); monitor any critical contingency events; monitor results of the annual exercise. | CCO function is working well. Exercise Interface successfully tested critical contingency arrangements in April 2017. System imbalance critical contingency in May 2017 was well managed. |
| CONSUMER OUTCOMES | Review retailers' contracts and provide additional information to assist new entrant retailers to understand their obligations and governance processes. | A review of retail gas contracts was completed in FY2016.<br>The Independent Assessor concluded that retail gas contracts are, overall, substantially aligned with the Retail Scheme's principles. Gas Industry Co continues to monitor retail gas contracts on an exceptions basis. |
| GAS QUALITY | Review remaining issues on gas quality. | Gas Industry Co's *Gas Quality – June 2017* update paper reviewed previous gas quality work to assess whether there were any outstanding issues still requiring attention. Although the paper identified a number of outstanding matters, it concluded that time should be allowed for the new First Gas access arrangements to take shape before holding an industry meeting to discuss these matters. |
| DOWNSTREAM RECONCILIATION | Continue to run the day-after delivery (D+1) pending any change to transmission arrangements. | D+1 trial has been running successfully since December 2015, with shippers using the daily allocation information to manage their gas positions and First Gas using the results in its balancing and peaking pool (BPP) process. Gas Industry Co is working with stakeholders to ensure that an allocation system is in place to support the converged transmission arrangements. |
| TRANSMISSION BALANCING | Monitor the efficiency of market-based transmission balancing operations, including wholesale market activity, as a prelude to undertaking a post-implementation review. | MBB arrangements were introduced on 1 October 2015.<br>In November 2016, we issued a *Review of Market-based Balancing (MBB Review)*. |
| CONSUMER SWITCHING | Complete consultation on proposed changes to the Switching Rules, as well as switching and reconciliation thresholds under the Compliance Regulations and implement as appropriate. | The Minister supported the recommended Switching Rules changes, and the changes were implemented accordingly.<br>Gas Industry Co has commenced the process of implementing substantial consequential changes to the operations of the Gas Registry. |
| PERFORMANCE AND CURRENT STATE OF THE INDUSTRY | Maintain the currency of *The New Zealand Gas Story*. Undertake initiatives to assess, develop and report on the state and performance of the New Zealand gas industry. | Fifth edition of *The New Zealand Gas Story* issued in December 2016. |

4 With reference to objectives in the FY2018-20 *Statement of Intent*

5 On 20 April 2016, Vector Gas Limited – owner of the Vector transmission system – was acquired by First State Funds, two infrastructure funds managed by First State Investments, known in Australia as Colonial First State Global Asset Management. Vector Gas Limited was renamed First Gas Limited (First Gas). Then, on 15 June 2016, First Gas purchased the Maui pipeline from Shell, Todd and OMV (collectively known as the Maui Mining Companies).

**CHAPTER 3**

# Promoting efficient, competitive and confident gas markets

Gas Industry Co develops, monitors and oversees industry arrangements designed to ensure that the gas markets are efficient and competitive, and that participants have confidence to maintain their investment in the production, delivery and use of gas.

Particular policy attention is paid to promoting and protecting the longer-term interests of small consumers who do not have the resources or market influence of larger commercial enterprises.

ELECTRICITY GENERATION
PETROCHEMICAL PRODUCTION
INDUSTRIAL PROCESSES
COMMERCIAL/RESIDENTIAL

Photo courtesy of Todd Corporation: Nova Energy's 100 megawatt, gas-fired McKee Power Plant in Taranaki

## Downstream reconciliation

The Reconciliation Rules improve market efficiency through a process for reconciling volumes of gas leaving the high pressure transmission system with volumes consumed by end-users, and attributing those volumes, plus any unaccounted-for-gas (UFG), to the relevant retailers. The enforceability of the Reconciliation Rules, and the transparency that they bring to the process of gas reconciliation, have contributed to greater accuracy in the process and lower UFG amounts.

In volume terms, UFG has decreased dramatically since 2009, when UFG was about 600,000 GJ (600 Terajoules (TJ)) per year. It now stands at about 266,000 GJ (266 TJ), about 0.8 percent of allocated gas consumption (using interim and final allocation data) (Figure 1).

Gas Industry Co has continued to run a pilot of the D+1 gas allocation process over the course of the year. D+1 provides parties with daily allocation information for the previous business day (hence 'D+1'). Shippers use D+1 allocation information, together with information on cash-outs from First Gas, to manage their respective balancing positions. First Gas uses the daily allocations to calculate shipper mismatch positions in its market-based balancing process and then uses those mismatch positions to apply cash-outs where necessary.

Those cash-outs are intended to provide an incentive for shippers to self-balance (so-called primary balancing) and Gas Industry Co reported on the improvement in primary balancing following the introduction of MBB. Gas gate level information is also used by First Gas to calculate transmission charges for shippers.

Feedback on the information delivered from the D+1 pilot has been very positive.

Gas Industry Co initially envisaged that the pilot would be a precursor to a production system incorporated into the Reconciliation Rules.

However, First Gas's development of its GTAC has affected the D+1 pilot timeline since changes to the transmission access regime are likely to affect the need for and shape of daily allocation information. Once the way forward is clear, either Gas Industry Co will codify D+1 into the Reconciliation Rules (and commission a production system) or First Gas will provide an initial daily allocation service from its transaction management system. In the meantime the D+1 pilot phase will continue.



**FIGURE 1:** ANNUAL UNACCOUNTED-FOR-GAS

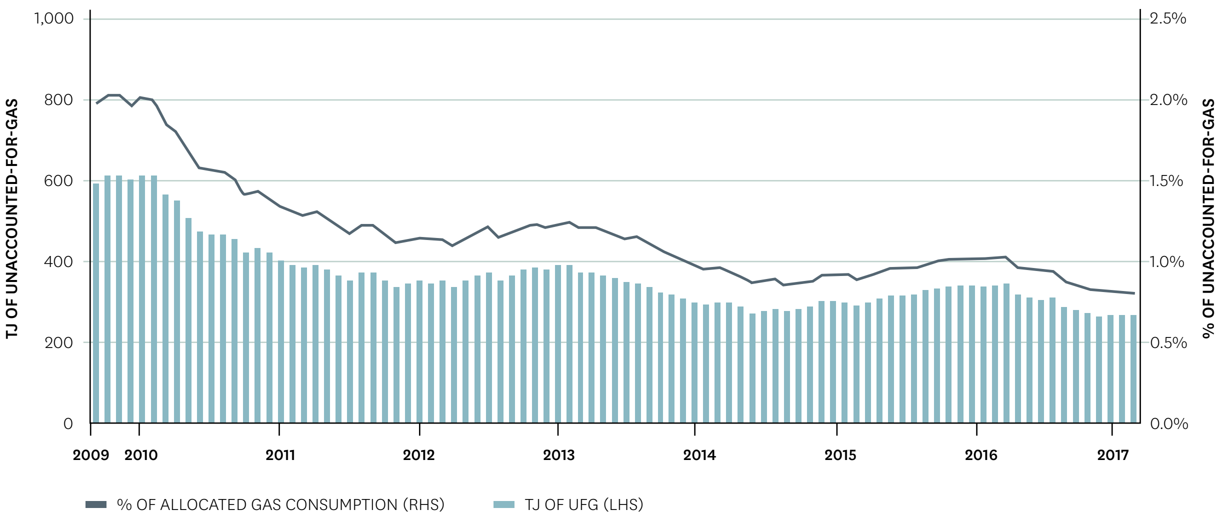

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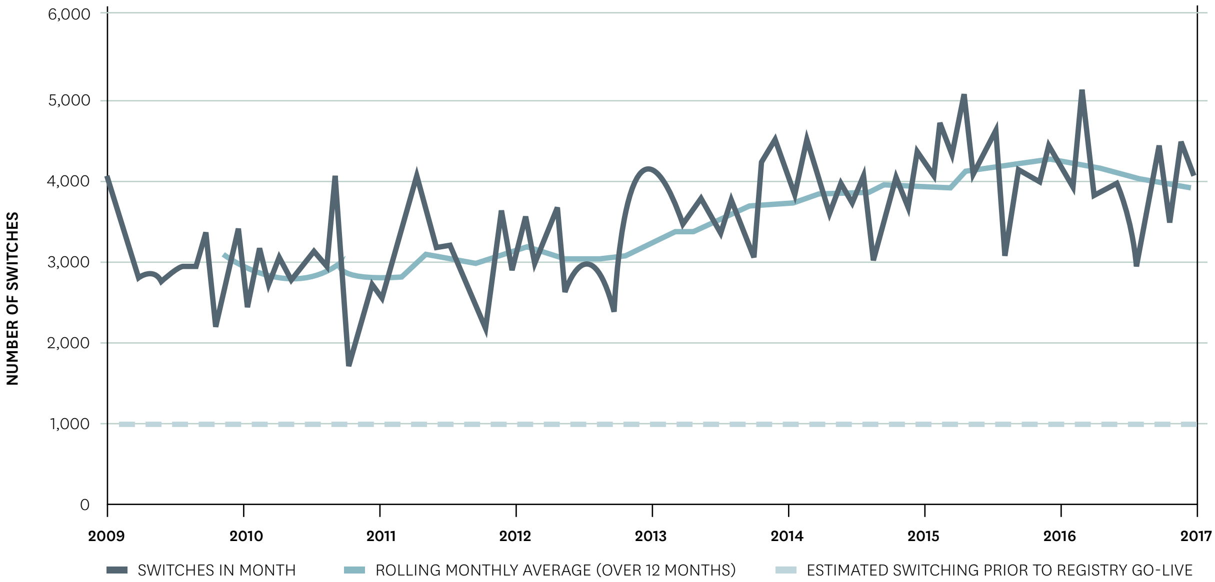
FIGURE 2: GAS CUSTOMER SWITCHES




NOTES:

» Includes only switches on open-access distribution networks. Switches from open-access to bypass networks (or vice versa) are not recorded as a switch in the Gas Registry.

» Excludes the following customer transfers as a result of purchases of retailer customer bases and rebranding: E-Gas to Nova, November 2010; Auckland Gas to Nova, June 2011; Bay of Plenty Energy to Nova, March 2013; and Energy Direct to Trustpower, September and October 2016.

## Gas customer switching

The Switching Rules enable customers to choose, and efficiently alternate between competing retailers through the establishment of the Gas Registry. The Gas Registry stores key information about every gas customer installation and facilitates and monitors each customer switch, from initiation through to completion. A high level of switching activity in a gas retail market suggests customers find changing retailers easy, which can put pressure on retailers to offer competitive terms and pricing. Prior to the Gas Registry, it is estimated there were about 1,000 customer switches a month and these could take weeks or months to complete.

During FY2017, there was a high level of activity in the retail market (Figure 2). A total of 46,781 switches occurred, averaging approximately 3,900 per month. This is a slight decrease in numbers from FY2016, when there was a total of 50,478 switches, or about 4,200 per month. The number of switches had been steadily increasing since the start of the Gas Registry but this last financial year suggests that the number of customer switches may be levelling off. However, with a churn rate of 16.8 percent, one of the highest rates of retail utility switching worldwide[6], this levelling off is unlikely to indicate a loss of switching ease, but rather that switching may have reached its natural rate.

Once the Gas Registry went live, average switching times dropped to about ten business days (Figure 3). In FY2017, the 12-month average switching time reached a record of two business days. Faster switching times are a benefit to consumers, as they make switching to a preferred retailer easier.

6 See, for example, VaasaETT, "*World Energy Retail Market Rankings 2012*." Available: http://www.vaasaett.com/projects-2/#ucsrp; or Arthur D Little, "*Churn management in utilities*," 2015. Available: http://www.adlittle.com/downloads/tx_adlreports/ADL_Churn_management_in_utilities.pdf.

**FIGURE 3:** GAS CUSTOMER SWITCH TIME

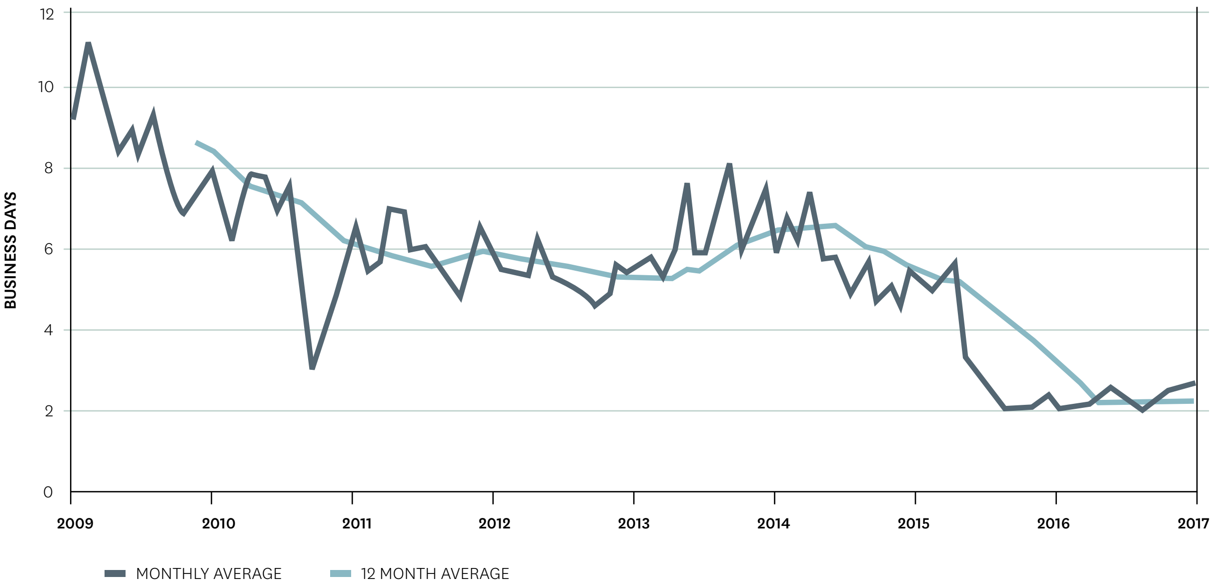
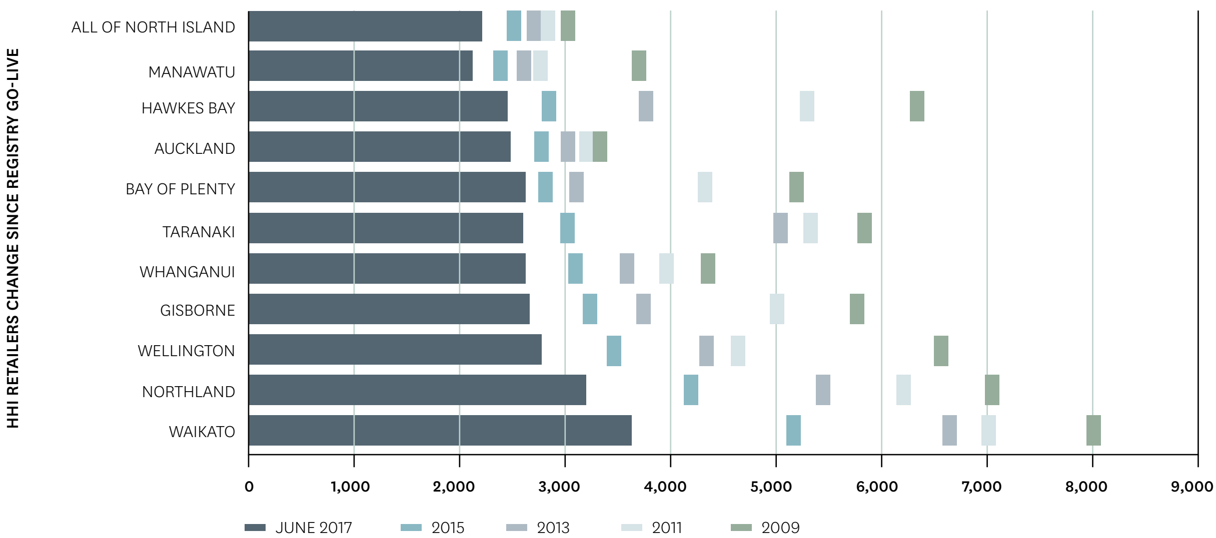



**FIGURE 4:** HERFINDAHL-HIRSCHMAN INDEX OF MARKET CONCENTRATION – REGIONAL CHANGE SINCE REGISTRY GO-LIVE




The Herfindahl-Hirschmann Index (HHI), which measures market concentration using the size and number of competing retailers, shows a significant and continuous reduction in market concentration since 2009 (Figure 4). HHI scores can range 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 HHI for the retail gas market has decreased in all regions since 2009, indicating that the market is becoming less concentrated across the North Island. Nationally, the HHI stands at 2,214 compared with 3,033 in February 2009 (the start of the registry).

There are now ten distinct retail brands competing in the retail gas market. This is one less than FY2016 because Energy Direct NZ customers have been transitioned across to Trustpower. Trustpower purchased Energy Direct NZ in mid-2013 but continued to operate the brand until late last year.

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## Gas quality

To check that the industry's gas quality arrangements are fit for purpose and aligned with the Gas Act objectives, Gas Industry Co reviews them from time to time, particularly as changes occur or new information comes to hand. During the year, we reviewed our previous gas quality work and stakeholder feedback to determine what outstanding issues required attention. Our report, *Gas Quality – June 2017 Update*, concludes that further work is required in some areas:

1. In relation to a situation where damage is caused by non-specification gas, we are concerned that the party responsible may not be liable for the damage caused. For example, if a producer injects non-specification gas into the transmission pipeline which then causes damage to an end-user, there may not be a contractual 'line of sight' from the end-user to the producer. It is important that the risks of gas supply are properly and efficiently managed by all parties, so we will be doing further work in this area.
2. In relation to the monitoring of gas quality, and the handling of non-specification gas events, the transmission system operator has a key role. The new transmission system owner, First Gas, is currently reviewing and consolidating the gas quality arrangements of the previous owners. First Gas has kept Gas Industry Co abreast of its work in this area and has been very helpful to our gas quality investigations. Once First Gas has its new access and interconnection arrangements in place, Gas Industry Co will review them and update the industry's *Gas Quality Requirements and Procedures* document (an industry resource describing the roles and responsibilities of industry participants and how they meet those responsibilities).

## Contract oversight schemes

Two non-regulated contract oversight schemes are administered by Gas Industry Co: one covering retailers' contract arrangements with small consumers; and one on distributors' standard contracts with retailers.

The Retail Scheme was introduced in 2010 to help meet the GPS objective for contractual arrangements between gas retailers and small consumers that adequately protect the long-term interests of those consumers. The first three assessments – a baseline assessment in 2010, a transitional assessment in 2011, and a full assessment in 2012 – saw the alignment of retailers' contracts with the benchmarks improve from a score of Moderate to Substantial.

In light of that improvement, significant design changes were introduced following a review of the Retail Scheme after the third assessment. The changes included a move from annual to three-yearly assessments and the inclusion of a set of reasonable consumer expectations – those matters that a consumer would expect to see in a contract. Retailers provide Gas Industry Co with an annual notice as to whether they have amended their standard published contracts.

The fourth independent assessment carried out in June 2015 was the first since the changes were made to the Retail Scheme. It confirmed that improved terms continue to be offered to small gas consumers and again demonstrated the benefits of this voluntary governance arrangement. The *Benchmark Assessment Report – 2015* by Independent Assessor, Palairet Law, concluded with an overall rating of Substantial alignment with the Retail Scheme's 18 outcome-based benchmarks. Although this overall rating was unchanged from the result of the previous full assessment in 2012, a number of retailers had improved their individual ratings (Table 1).

**TABLE 1: RETAIL SCHEME ASSESSMENT RESULTS 2011-2015**

| | NUMBER OF RETAILERS | | |
|---|---|---|---|
| OVERALL ALIGNMENT SCORE | 2015 | 2012 | 2011 |
| Full | - | - | - |
| Substantial | 9 | 6 | 3 |
| Moderate | 1 | 3 | 4 |
| Low | - | 1 | 3 |
| TOTAL RETAILERS ASSESSED | 10 | 10 | 10 |

Gas Industry Co acknowledged the high level of engagement by retailers in the 2015 assessment, which confirmed that they were keen to meet the reasonable expectations of customers. Gas Industry Co will conduct a further assessment in FY2019.

The objectives of the Distribution Scheme introduced in 2012 are to ensure that core terms and conditions of distribution services agreements are clear and reasonable, promote market efficiency, and enhance consumer outcomes.

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Under the Distribution Scheme, Gas Use of System Agreements (GUoSAs) are assessed against a set of contract principles. With its introduction, distributors significantly revised their contracts and the second, and most recent, independent assessment in 2014 found their contracts exhibited Substantial alignment with the principles.

Since then, Gas Industry Co has been monitoring distributors' progress with executing new distribution contracts with retailers. Monitoring of processes will continue throughout 2017/18 with a view to determining whether further facilitation is required.

## Consumer complaints scheme

Utilities Disputes (formerly Electricity and Gas Complaints Commissioner (EGCC) scheme) offers an independent service for resolving complaints in respect to specific industries including gas providers.

In its Annual Report for the year ended 31 March 2017, Utilities Disputes records total electricity and gas cases (inquiries and complaints) of 5,534, a 16 percent decrease over the 6,596 in 2015/16 (Figure 5). Total consumer inquiries decreased by 6.3 percent from 3,658 to 3,427, and the number of complaints decreased by 28 percent from 2,938 to 2,103.

There were 225 deadlocked cases, compared with 348 in the previous year.



**FIGURE 5:** ELECTRICITY AND GAS COMPLAINTS PER 10,000 ICPS

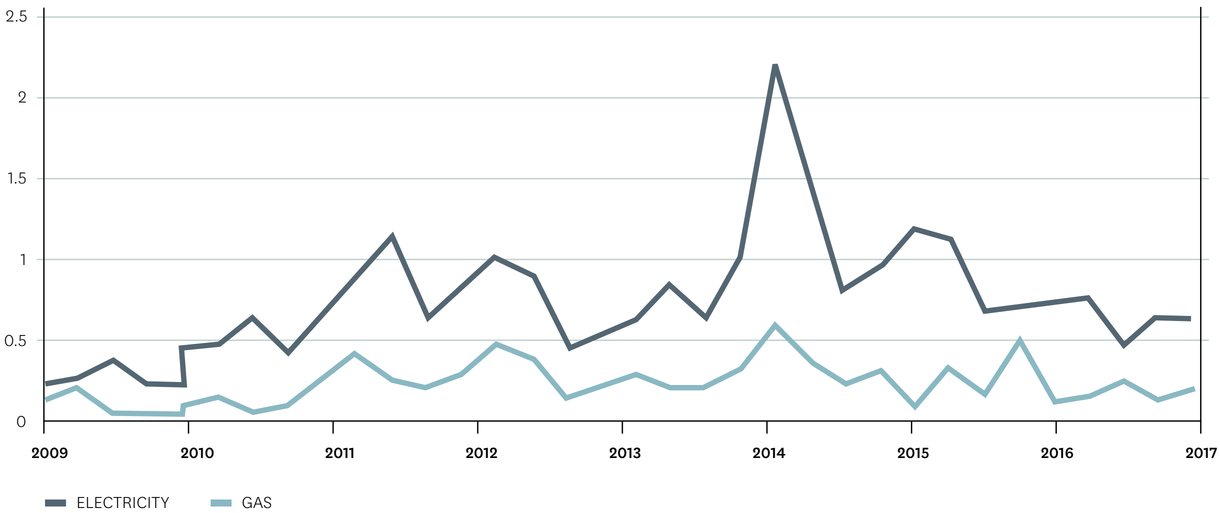
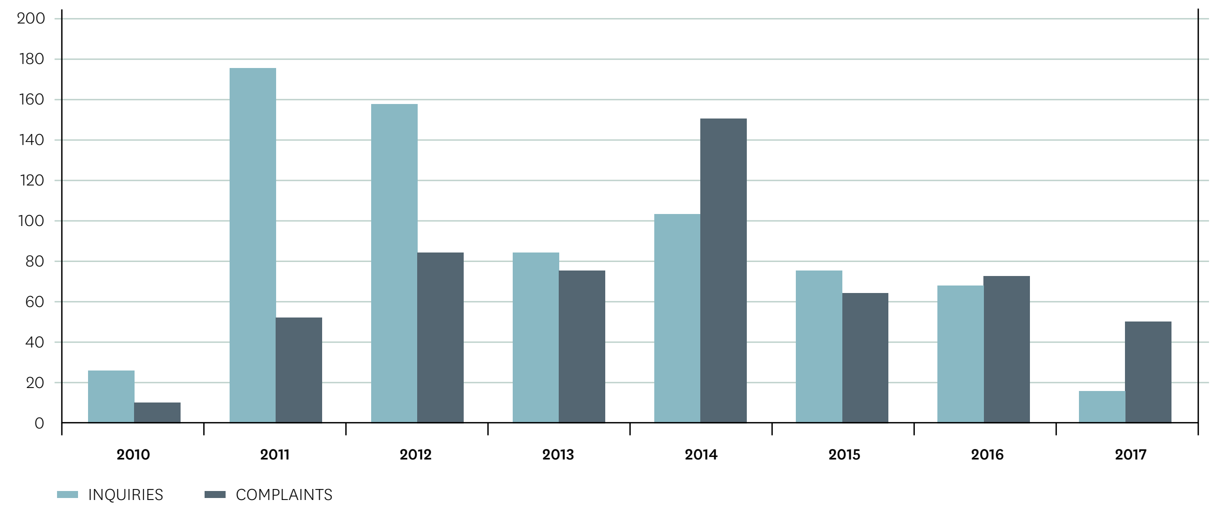



**FIGURE 6:** GAS-RELATED INQUIRIES AND COMPLAINTS




NOTE:
» 2010 covers only three months, from 1 April 2010 to 30 June 2010

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In the Annual Report, the Commissioner noted that even with increased participation, the Utilities Disputes workload for electricity and gas complaints had fallen. Providers were resolving more complaints themselves, and their focus on facilitating early dispute resolution benefits both consumers and providers.

Total gas-related cases in the year ended 30 June 2017 decreased by 52.5 percent to 66. There were 16 gas inquiries, down from 67 in the previous year, and gas complaints also decreased from 72 to 50 (Figure 6).

Dual fuel (electricity and gas) inquiries reduced from 13 to just 5. At 38, there were 28 fewer dual fuel complaints.

At 47.6 percent, billing was again the largest single cause of consumer issues, followed by customer service (16.5 percent), disconnection (7.7 percent), metering (6.2 percent), and supply (4.7 percent).

The gas sector continued to draw significantly fewer complaints than the electricity sector on a complaints per 10,000 ICPs basis. During 2016/17, complaints per 10,000 ICPs relating to gas averaged 0.15 per month (down on 0.22 in 2015/16), compared with an electricity sector monthly average of 0.63, which was lower than the 0.94 in the previous year.

## Liquefied petroleum gas

Gas Industry Co's jurisdiction covers consumer-facing aspects of Liquefied Petroleum Gas (LPG). It does not extend to LPG bottles, the supply and bulk storage of LPG, or to pipelines carrying LPG in liquid form between transport depots and bulk storage facilities. Gas Industry Co receives reports from Utilities Disputes regarding consumer complaints about LPG supplies and maintains regular communication with the LPG industry trade group, the LPG Association of New Zealand.

This year, in response to concerns raised by market participants, Gas Industry Co began a review of the LPG market. This review is expected to be completed in the first half of FY2018.

## Wholesale market

The emsTradepoint wholesale gas market that commenced in 2013 continues to make a significant contribution to delivering the GPS outcome of *efficient arrangements for the short-term trading of gas*. Calendar 2016 saw an almost 70 percent increase in traded volumes over 2015. The volume weighted average price (VWAP) for 2016 was $5.19 per GJ, a reduction of 30 cents per GJ relative to 2015.

In the first six months of calendar 2017 some 3.3 PJ was traded or reported through the market. In addition, the spreads being experienced by First Gas for its balancing trades have narrowed to the extent that many shippers appear less concerned about being cashed-out. That, in turn, has led to increased volumes being purchased by First Gas to offset its position against the pipeline so as to maintain linepack levels.

**CHAPTER 4**

# Facilitating efficient use of, and timely investment in, gas infrastruture

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Infrastructure access is essential to the operation of competitive and efficient markets. Gas Industry Co's work in this area currently encompasses gas transmission access, transmission pipeline balancing, transmission code changes, transmission pipeline interconnection and, transmission security and reliability.

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## Transmission access and pricing

The objective of this workstream is to ensure that transmission pipeline access arrangements transparently provide for the efficient utilisation of physical capacity and effectively signal any need for efficient investment in additional capacity.

For several years, Gas Industry Co and stakeholders have been reviewing transmission access arrangements and considering various proposals to converge the two pipeline codes; the Maui Pipeline Operating Code (MPOC) and the Vector Transmission Code (VTC). On becoming the new transmission system owner, First Gas confirmed that it wished to develop a new access regime and a single new transmission code.

As the industry body under the Gas Act, Gas Industry Co is concerned to ensure that any new access arrangements meet the objectives of the Gas Act and the GPS.

Gas Industry Co may recommend regulation to the Minister if it is necessary to achieve these objectives. Considering these matters, First Gas and Gas Industry Co agreed to co-lead the new code development work, each with its complementary responsibilities. In particular, First Gas has developed various design proposals and consulted with stakeholders on them.

While good progress has been made, the design, IT development, testing and implementation of the new regime will all be challenging. However, First Gas has maintained the support of stakeholders and believes that a 1 October 2018 implementation date is achievable.

The key documents and workshops held for the period up to 30 June 2017 are listed in Table 2 below. Copies of all documents, including stakeholder submissions and presentations, are available from Gas Industry Co's website.

**TABLE 2: GTAC DEVELOPMENT TIMELINE**

**AUG 2016**

- ***MEMORANDUM ON SINGLE CODE DEVELOPMENT PROCESS*** — FIRST GAS — 12 AUGUST 2016
- **STAKEHOLDER WORKSHOP** — 24 AUGUST 2016

**SEP**

- ***SINGLE CODE OPTIONS PAPER (SCOP1)*** — GIC — 13 SEPTEMBER 2016
- **STAKEHOLDER WORKSHOP** — 20 SEPTEMBER 2016

**OCT**

**NOV**

- **STAKEHOLDER WORKSHOP** — 9 NOVEMBER 2016
- ***SCOP1 ANALYSIS OF SUBMISSIONS*** — GIC — 23 NOVEMBER 2016
- ***SINGLE CODE OPTIONS PAPER (SCOP2)*** — FIRST GAS — 28 NOVEMBER 2016

**DEC**

- **STAKEHOLDER WORKSHOP** — 5 DECEMBER 2016
- ***SCOP2 ANALYSIS OF SUBMISSIONS*** — GIC — 27 JANUARY 2017

**JAN 2017**

**FEB**

- ***GTAC DEVELOPMENT: PROPOSED DECISIONS AND NEXT STEPS*** — FIRST GAS — 17 FEBRUARY 2017
- **STAKEHOLDER WORKSHOP** — 28 FEBRUARY 2017

**MAR**

**APR**

- ***GTAC GOVERNANCE OPTIONS*** — CONCEPT CONSULTING — 20 APRIL 2017

**MAY**

- ***EMERGING VIEWS ON DETAILED DESIGN (EV PAPER)*** — FIRST GAS — 12 MAY 2017
- **STAKEHOLDER WORKSHOP** — 17 MAY 2017

**JUN**

- ***INFORMATION PAPER - INITIAL SUMMARY OF GTAC IT RISKS*** — GIC — 7 JUNE 2017
- ***INFORMATION PAPER – PRELIMINARY DRAFT CODE CHANGES*** — FIRST GAS — 12 JUNE 2017
- ***GTAC GOVERNANCE OPTIONS FINAL ADVICE TO GIC*** — CONCEPT CONSULTING — 12 JUNE 2017
- **STAKEHOLDER WORKSHOP** — 22 JUNE 2017

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## Transmission pipeline balancing

Market-based Balancing (MBB) arrangements were introduced on 1 October 2015. In November 2016, Gas Industry Co reviewed the performance of the regime and published our findings in the paper *Review of Market-based Balancing (MBB Review)*. The review found that pipeline users were maintaining better balance than previously, and that on occasions where the pipeline operator needed to buy or sell gas to maintain the overall balance of the pipeline, those transactions were more efficient. However, the *MBB Review* also found that there was scope for further improvement.

The *MBB Review* considered the costs of implementing MBB and found that they varied considerably between shippers but were of the same order as those used in the 2015 Cost Benefit Analysis that evaluated MBB.

MBB was developed and introduced by Maui Development Limited, but it was generally not well supported by pipeline users or by Vector, the then owner of the other transmission system. Now that the entire transmission system is under the single ownership of First Gas, there is an opportunity to simplify the balancing arrangements. As part of the development of its new access regime, First Gas is discussing a possible new balancing design with stakeholders.

## Transmission code changes

### MPOC Transition Change Request (TCR)

Gas Industry Co has a role in considering any proposed change to the Maui Pipeline Operating Code (MPOC) and advising the pipeline owner whether it supports the proposal or not. No changes to the MPOC were proposed in the year ended 30 June 2017; however, a significant change request proposal was submitted to Gas Industry Co on 14 July 2017; the *MPOC Transition Change Request (TCR)*.

The *TCR* was proposed by First Gas as a means of bringing the contracts that incorporate the terms of the MPOC to an end, once new access arrangements are in place. At the time of writing this Annual Report, we are awaiting submissions on the *TCR* and we anticipate making a final recommendation on whether or not we support the *TCR* by the end of October 2017.

## Transmission pipeline interconnection

No new transmission pipeline connections were reviewed during the year.

## Transmission security and reliability

In March 2017, Gas Industry Co released the *Gas Transmission Security and Reliability Update Paper (S&R Update)*. The *S&R Update* reviewed progress following consultation on the April 2016 *Gas Transmission Security and Reliability Issues Paper*, including an assessment of First Gas's initial *Asset Management Plan (New AMP)*.

During our review of security and reliability (S&R), the two gas transmission systems came under the single ownership of First Gas. As part of its submission on the *Issues Paper*, First Gas noted the importance of S&R to its business and its desire to improve related communications, including continued constructive discussions with Gas Industry Co, shippers, and end-users. This was borne out by First Gas engaging widely with stakeholders in the course of preparing its *New AMP*, including an update on key projects.

Among other matters, the *S&R Update* concluded that stakeholder engagement on S&R matters had improved considerably since First Gas became owner of the transmission system. The content of the *New AMP* was also much improved, although Gas Industry Co made a number of suggestions for future AMPs, such as including more discussion on the relative ranking of the risks identified and providing a dashboard of S&R performance. The *S&R Update* also recommended that the *AMP* provide stakeholders with sources of information on what is expected of them when incidents or emergencies occur.

Gas Industry Co believes its consultation with stakeholders on S&R issues has now substantially addressed the concerns that gave rise to the review. However, we expect that matters with a strong S&R component will emerge from time to time and these will be dealt with as they arise. In the meantime, we will assess the next First Gas *AMP* against the outstanding matters identified in the *S&R Update*.

# Delivering effectively on our accountabilities as the industry body

As the industry body, Gas Industry Co recommends and administers governance arrangements that fulfil the principal policy objective set by the Gas Act, which is to ensure gas is delivered to existing and new customers in a safe, efficient, and reliable manner. The GPS requires Gas Industry Co to have regard to fairness and environmental sustainability in its recommendations.

The Gas Act and GPS together set other objectives and outcomes that Gas Industry Co takes into account when formulating industry arrangements, either regulated or non-regulated. Many of the Government's policy objectives have been met through the introduction of governance arrangements. Gas Industry Co monitors and periodically reviews these arrangements to ensure their ongoing relevance and effectiveness.

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## Critical contingency management

The Critical Contingency Operator (CCO) conducted a test exercise of the critical contingency management arrangements in April. The CCM Regulations require that test exercises be run regularly, and this exercise was devised particularly to test the newly drafted First Gas Critical Contingency Management Plan (CCMP). The CCO concluded that the test exercise provided sufficient evidence to conclude that the CCMP was effective and made several recommendations to improve the efficiency of some of the processes and procedures outlined in the CCMP.

A critical contingency was declared by the CCO at 10:50 on Tuesday 23 May 2017. The cause of the event was low linepack due to downstream delivery points taking significantly more gas than was being injected into the pipeline, which was exacerbated during a planned outage of the Pohokura Production Station. During the period of this outage, the imbalance between supply and demand caused pipeline linepack and pressures to fall to the point where the critical contingency threshold of 3 hours to 37.5 barg at the Kapuni Gas Treatment Plant was breached. The critical contingency was terminated at 18:15 the same day, after Pohokura returned to expected flows and the CCO considered that the supply of gas into the system was sufficient to meet expected demand.

As required under the CCM Regulations, the CCO has published an incident report, which outlined the events and the actions taken during the critical contingency; and a performance report, which assessed the effectiveness of the critical contingency arrangements. The performance report found that the CCMP, the CCO Communications Plan and the CCO Information Guide were all effective in achieving the purpose of the Regulations and no amendments were required. Also, as required by the CCM Regulations, Gas Industry Co engaged an industry expert to determine the critical contingency price, used to settle volume imbalances incurred on the day.

All CCO reports are available on the CCO website at www.cco.org.nz .

## Compliance

Gas Industry Co oversees governance arrangements that ensure the integrity of key markets. This includes the role of the Market Administrator under the Compliance Regulations, which provide for the monitoring and enforcement of rules and regulations.

Overall, the industry has a high compliance rate and breach allegations were again predominantly associated with the Reconciliation Rules and Switching Rules.

The number of total breach allegations considered by Gas Industry Co in its role as the Market Administrator during financial year 2016/17 totalled 589, compared to 1,192 alleged breaches referred to it in 2015/16.



**FIGURE 7:** RECONCILIATION RULES BREACHES

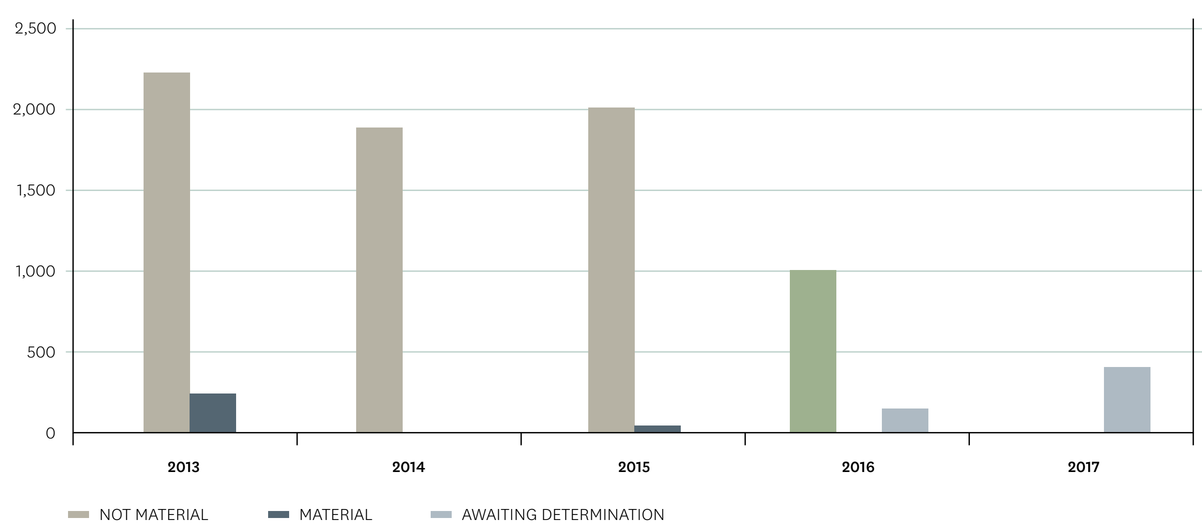
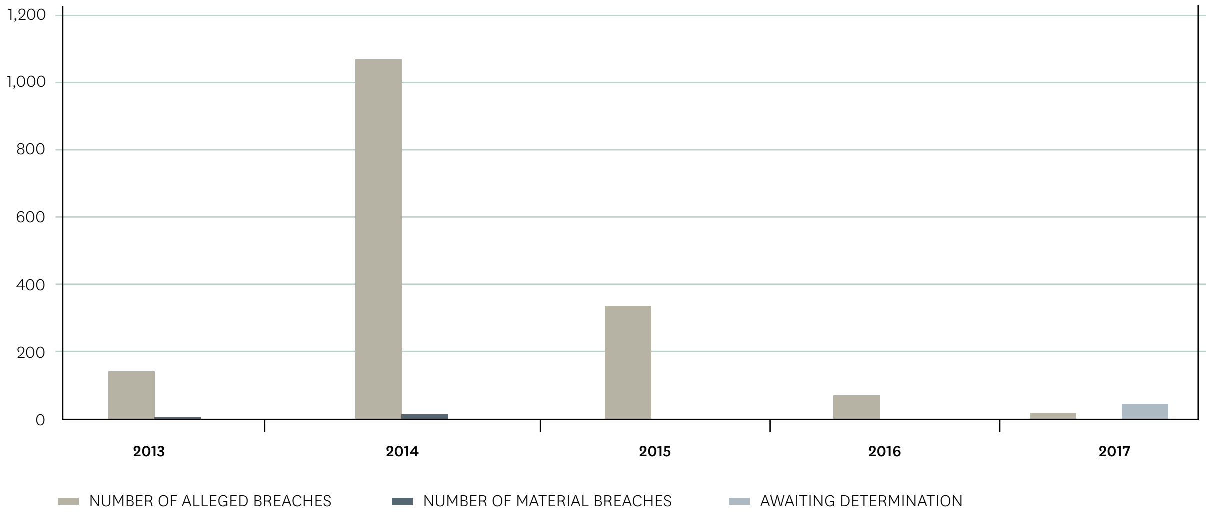


**FIGURE 8:** SWITCHING RULES BREACHES




NOTES:

» 4 material breaches of the Switching Rules occurred in 2014

» Alleged breaches are recorded by the date of receipt of the breach notice

The decrease in breaches was expected, given the change in approach to breaches of rule 37 of the Reconciliation Rules in late 2015 (this rule relates to the accuracy of consumption information submitted by a retailer for the initial allocation runs). Following consultation with the industry, it was decided that the difference between consumption information submitted for each allocation run would need to exceed a 200 GJ threshold for the Allocation Agent to allege a breach. This reduced the number of breaches that needed to be alleged by the Allocation Agent (Figure 7).The number of breaches of the Reconciliation Rules is now at an historical low.

Switching breaches are also at an historic low (Figure 8). Participants are now familiar with the requirements of the Switching Rules. The key risk to compliance with the Switching Rules continues to be major system change.

## Investigator and Rulings Panel – approved settlements and determinations

In accordance with the Compliance Regulations, Gas Industry Co must appoint one or more persons as Investigators to carry out independent investigations of alleged breaches that have been determined by the Market Administrator as raising a material issue.

The Investigator must endeavour to effect settlements of alleged breaches, and these must be referred to the Rulings Panel for approval or rejection.

The Rulings Panel is an independent body appointed by the Minister under the Compliance Regulations. The current Rulings Panel is Hon Sir John Hansen, KNZM. The Rulings Panel approves or rejects settlements proposed by the Investigator and, in a quasi-judicial process, determines breach allegations that are unable to be settled, or in respect of which a settlement has not been approved.

The Rulings Panel was referred 132 breaches of the CCM Regulations in the 2016/17 financial year. Those breaches stemmed from significant non-payment of the market fees over several years by one party. Those breaches are currently before the Rulings Panel.

**CHAPTER 6**

# Building and communicating the New Zealand gas story

—

Gas Industry Co is required by the GPS to ensure that good information is publicly available about the performance and present state of the gas sector.

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## The New Zealand Gas Story

*The New Zealand Gas Story* presents a comprehensive account of the gas industry's history, structure, performance, and contribution to New Zealand's energy supply, as well as the policy and regulatory framework in which it operates. It also includes Gas Industry Co's assessment of how the industry is performing against the Government's policy objectives and outcomes set out in the Gas Act and GPS.

*The New Zealand Gas Story* is generally updated annually. The fifth and most recent edition was published in December 2016.

## Supply/demand model

The report *Long Term Gas Supply and Demand Scenarios – 2016 Update (Scenarios 2016)* was published in October 2016. This was the third edition of the report commissioned by Gas Industry Co from independent expert Concept Consulting Group.

*Scenarios 2016* explores gas supply and demand scenarios over the period to 2040.

The report found that New Zealand's gas sector is in a period of increased uncertainty. Over recent years, the oil industry has seen a significant fall in oil prices, affecting parties' exploration programmes for both oil and gas. This may result in lower gas reserves in New Zealand over at least the next few years.

The energy sector as a whole is also experiencing changes that could affect the natural gas market. A greater share of renewable generation, increased energy efficiency, and new technologies are altering the nature of the electricity sector. The future of the Tiwai aluminium smelter may also affect the structure of the industry. The implications of these electricity sector changes on New Zealand's gas industry are unclear. Overarching these issues, New Zealand's response to climate change will affect the whole energy sector, including the gas sector.

The analysis in the report identified that gas supply conditions will most likely tighten over the next several years. Beyond this timeframe, the conditions in the market are less clear, depending on the scale and success of exploration and how demand in the sector may change.

*Scenarios 2016* noted that residential and commercial gas users are likely to be mostly unaffected by changing gas supply conditions. These consumers represent a small proportion of overall gas demand and have a relatively high willingness to pay.

The report found that changes in demand are likely to come from the petrochemical sector, with Methanex effectively acting to balance the New Zealand gas market. This is a role that Methanex previously performed in the early 2000s as supply in the sector tightened following the re-estimation of economic reserves in the Maui gas field.

## Other reporting

Other regular reports produced by Gas Industry Co include quarterly reports to the Minister, quarterly performance reports, and monthly switching reports, all of which are published on our website. These documents continue to fulfil the requirements to report regularly on the present state and performance of the industry.

Gas Industry Co contributes further to the gas industry information pool by periodically commissioning reports from external experts on subjects of specific and current interest and through presentations to industry and public conferences and seminars.

**CHAPTER 7**

# Effective co-regulation

—

Gas Industry Co was established in 2004 and was approved as the gas industry's co-regulatory body under Part 4A of the Gas Act that same year. The Company fully commenced operations in 2005 and works with both Government and stakeholders to develop recommendations on governance arrangements that meet the objectives of the Gas Act and the GPS.

Our oversight encompasses the gas wholesale and retail markets, processing facilities, and the transmission and distribution sectors of the industry.

Gas Industry Co is also progressing a broader corporate strategy, involving close liaison with industry stakeholders, to *optimise the contribution of gas to New Zealand*.

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## Stakeholder relations

Gas Industry Co works closely with other regulatory bodies, including the Ministry of Business, Innovation and Employment (MBIE) and the Commerce Commission, whose responsibilities also encompass the gas industry. We also maintain relationships with many other agencies engaged in the energy and related sectors, including the Electricity Authority, Energy Efficiency and Conservation Authority, the Petroleum Exploration and Production Association of New Zealand, Gas Association New Zealand, and Utilities Disputes.

Facilitating industry contributions and debate is an important function for the effective operation of the co-regulatory model and Gas Industry Co conducts an annual Co-regulatory Forum to discuss the forthcoming year's work programme, upon which the levy is calculated. We also convene workshops to engage with the industry on particular issues arising from ongoing workstream activity.

## Funding

Gas Industry Co derives its income from wholesale and retail levies and from market fees. We are committed to ensuring that these levies and fees are well justified and used carefully.

We conduct a detailed consultation programme annually between October and March to establish the strategic priorities for the upcoming financial year and, from that, to recommend levies to the Minister for regulatory approval.

Gas Industry Co's revenue has remained much the same over recent years (Figure 9). It includes market fees under each of the rules and regulations to fund the administration of those rules and regulations (including recovery of the costs of external service providers and consultants). In addition, retail and wholesale levies are applied each year to cover the costs of Gas Industry Co's policy and market administration work.

Gas Industry Co's constitution enables the Board to charge shareholders an annual fee. At its November 2016 meeting, the Board approved reducing the annual fee for the FY2017 year and onwards to $2,000 per shareholder per annum. Shareholders' fees are kept aside as a contingency reserve.

## Financial discussion

Gas Industry Co's financial year ends on 30 June. Its work programme and associated budget for the forthcoming financial year are developed in a consultation process beginning with the Co-regulatory Forum for stakeholders in the preceding November and concluding the following March with the preparation of a *Statement of Intent* and the making of a recommendation to the Minister for levy regulations.

The budget is set to ensure Gas Industry Co has sufficient resources to meet its work programme obligations, while recognising the need to be cost-effective, as the levy is ultimately incorporated into consumer prices.

As Gas Industry Co has more control over what it spends than what it collects in revenue, our financial performance is most meaningfully measured by comparing budgeted to actual expenditure. As shown in Figure 10, budgeted and actual expenditure has been held at similar levels in recent years and we expect this to continue in 2017/18.

In the year ended 30 June 2017, actual operating expenses were $4,731,025, against the *Statement of Intent* budgeted expenses of $5,396,931. This reflects the deferral of costs in relation to some significant workstreams and the undertaking of other work without the use of external consultants. Some workstreams also include provision for contingent amounts, such as the cost of an expert to determine imbalance pricing during a critical contingency event. Expenses were $5,189,181 in the previous financial year.

Total operating revenue of $5,656,100 for the year ended 30 June 2017 was above the budgeted figure of $5,492,060 and 4.1 percent below the $5,899,065 collected in 2015/16. The variance largely relates to higher operating revenues in FY2016 which resulted from the collection of $501,334 of levies that related to earlier years from one industry participant. Gas Industry Co's equity reserve as at 30 June 2017 has two components – the Industry Advances Reserve of $918,062 and Retained Earnings of $676,000.

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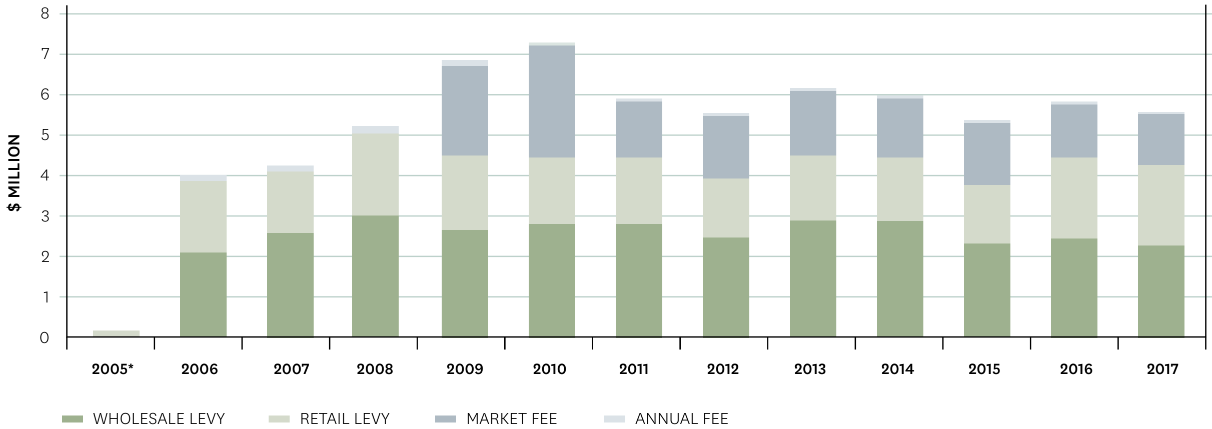
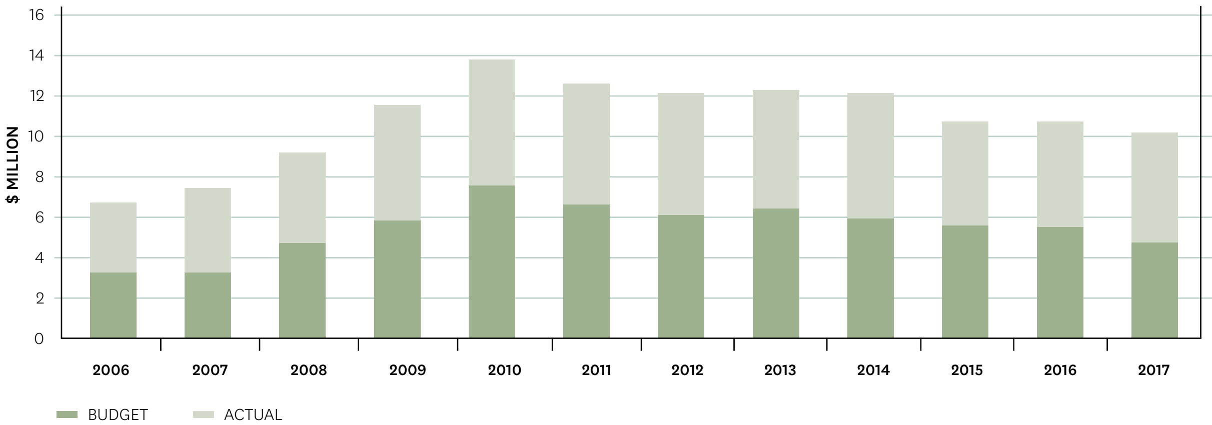
**FIGURE 9:** REVENUE




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

**FIGURE 10:** OPERATING EXPENSES VS BUDGET




The Industry Advances Reserve comprises the over-recovery of levy revenue. The Board's policy is to return such over-recoveries, subject to retaining adequate capital reserves, as soon as practicable after the annual accounts have been received by shareholders at the Company's Annual Meeting. In November 2016, the balance of surplus levy from FY2016, $331,757, was returned to industry participants.

Retained Earnings are the accumulation of the shareholders' annual fees, and are set aside as a reserve against future contingencies. They do not impact on the levy calculation.

**CHAPTER 8**

# Corporate governance

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Gas Industry Co is owned by industry participant shareholders and is funded by levies on industry participants. It is incorporated as a company under the Companies Act 1993 and operates in accordance with the Gas Act, the GPS, and the Company's Constitution.

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## Shareholders

| |
|---|
| CONTACT ENERGY LIMITED |
| EMSTRADEPOINT LIMITED |
| FIRST GAS LIMITED |
| GENESIS ENERGY LIMITED |
| GREYMOUTH GAS NEW ZEALAND LIMITED |
| METHANEX NEW ZEALAND LIMITED |
| MERCURY NZ LIMITED |
| NEW ZEALAND OIL & GAS LIMITED |
| NOVA ENERGY LIMITED |
| OMV NEW ZEALAND LIMITED |
| POWERCO LIMITED |
| SHELL NEW ZEALAND (2011) LIMITED |
| TRUSTPOWER NEW ZEALAND LIMITED |
| VECTOR LIMITED |

Gas Industry Co's shareholders represent sectors across the gas industry – production, transmission, distribution, wholesale, retail and consumers. There were 14 shareholders as at 30 June 2017.

Each shareholder holds a $1 share, which is redeemable at the option of the shareholder. Shareholders are entitled to one vote in a poll on resolutions at shareholders' meetings, including those that appoint directors and change the Constitution. Shareholders pay an annual fee set by the Board.

## Board of directors

The Board of Gas Industry Co meets on regularly scheduled occasions to consider operational reports and recommendations from Gas Industry Co's management. Unscheduled meetings are held from time to time to consider matters requiring immediate attention. Directors attend either in person or via teleconference.

The Board is a mix of independent and industry-associated directors, all appointed by the shareholders. Its composition accords with the Gas Act requirement to have a majority of independent directors, including the Chair. This reflects the aim of creating a gas industry co-regulatory body that benefits from industry participation and experience, balanced by a range of independent expertise. The Company's Constitution limits the Board to no more than seven directors, four of whom are independent of the gas industry. The number of independent directors voting on an issue must exceed the number of industry-associated directors voting on the same matter.

## Board committee

The Board has one standing committee, the Independent Directors' Committee, comprising the four independent directors. The Committee addresses matters where the industry-associated directors have potential or actual conflicts of interest.

## Board mentoring scheme

In 2015, Gas Industry Co established a Board Mentoring Scheme as a way of promoting greater gender diversity. The scheme, which is similar to one run by the Institute of Directors, is aimed at promoting governance opportunities for aspiring female directors and gives the appointees an opportunity to obtain experience and mentoring around Gas Industry Co's board process. There have been three appointees to the role since the introduction of the scheme, including a lawyer in private practice and an appointee from within our shareholders.

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### RT HON JAMES B BOLGER
ONZ

**Chair,**
**Independent Director**

APPOINTED 4 NOVEMBER 2004

Jim Bolger has had a distinguished career in politics that includes being Prime Minister of New Zealand from October 1990 to December 1997, holding ministerial positions for 16 years, and leading the New Zealand National Party for 12 years. He has been the Chair since the Company's establishment.

**Interests register**

Chair: Mt Cook Alpine Salmon Limited

Chair: Hollow Lands Limited

Director: Te Urewera

Board Chancellor: Waikato University

### ROBIN G HILL
BCom

**Deputy Chair,**
**Independent Director**

APPOINTED 4 NOVEMBER 2004

Robin Hill has an extensive background in financial and business management. He was Chairman and Chief Executive of PricewaterhouseCoopers New Zealand from 1992 to 2003. He has been the Deputy Chair since the Company's establishment.

**Interests register**

No interests relevant to Gas Industry Co

### ANDREW BROWN
LLB

**Independent Director**

APPOINTED 10 JUNE 2010

Andrew Brown is a leading corporate lawyer with over 25 years' experience as a partner at Bell Gully. Since leaving Bell Gully in 2010, Mr Brown worked on his own account and as general counsel for both KiwiRail and Housing New Zealand Corporation. He is currently practising as a commercial lawyer on his own account.

**Interests register**

No interests relevant to Gas Industry Co

### KEITH DAVIS
PGDipBus

**Independent Director**

APPOINTED 31 JULY 2006

Keith Davis has extensive experience in the information technology, telecommunications, and venture-funding industries. He has held senior management roles with McDonnell Douglas, Compaq Computers, and BellSouth.

**Interests register**

No interests relevant to Gas Industry Co

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## NIGEL BARBOUR
BCom, LLB

### Industry-Associated Director

APPOINTED 21 NOVEMBER 2013

Nigel Barbour is the Chief Executive of Powerco. He joined Powerco in October 2002, serving in executive management roles, including General Manager Electricity. He was appointed Chief Executive in October 2011. Mr Barbour has an economics and legal background and previously held roles with Transpower Limited and the Bank of New Zealand.

**Interests register**

Chief Executive Officer: Powerco Limited

Member: New Zealand Electricity Networks Association

## DENNIS BARNES

### Industry-Associated Director

APPOINTED 11 MAY 2011

Dennis Barnes is the Chief Executive Officer of Contact Energy. His role followed 13 years in Australia with Origin Energy, including in a range of gas-related roles and serving on the boards of two Australian gas regulators. Prior to that, Mr Barnes worked in various international energy markets, including managerial roles with Scottish and English electricity companies.

**Interests register**

Chief Executive Officer: Contact Energy Limited

Director: Various Contact Energy subsidiaries

## GABRIEL SELISCHI

### Industry-Associated Director

APPOINTED 16 NOVEMBER 2016

Gabriel Selischi is the OMV Senior Vice President for Australasia.

Mr Selischi joined OMV in 2006, where he served as Head of Strategy, Projects & Engineering, Assets and member of the Executive Board of Petrom. His international positions have taken him to several countries around the world.

Mr Selischi studied power engineering in Bucharest and graduated an MBA in Paris in 1994. He has worked previously for Schlumberger and Gemini Consulting.

**Interests register**

Senior Vice President Australasia: OMV

Director: OMV New Zealand & OMV Australia PTY

Director: PEPANZ

Director: Maui Development Ltd

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## Other Directors who served during the year:

ANDREW KNIGHT
Industry-Associated Director

APPOINTED 6 JUNE 2012
RESIGNED 16 NOVEMBER 2016

**Interests register**

Chief Executive/shareholder: NZ Oil & Gas Limited (until 26 August 2016)

Director: Various NZOG subsidiaries (until 26 August 2016)

Director: PEPANZ (until 26 August 2016)

Director: Taranaki Iwi Holdings Management Limited

## Alternate Directors:

STUART DICKSON

APPOINTED 22 MAY 2014

Alternate for Mr Barbour

Officer: Powerco Limited

Chair: Gas Association of New Zealand

CATHERINE THOMPSON

APPOINTED 3 JUNE 2014

Alternate for Mr Barnes

Officer: Contact Energy Limited

Director: Liquigas Limited

Director: Contact Aria Limited

Director: Contact Energy Trustee Company Limited

Alternate Director: Electricity Retailers Association Incorporated

PATRICK TEAGLE

APPOINTED 23 FEBRUARY 2017

Alternate for Mr Selischi

MICHAEL WRIGHT

APPOINTED 10 JUNE 2014
RESIGNED 16 NOVEMBER 2016

Alternate for Mr Knight

Officer: NZOG

Director/Owner: Energy Acumen Limited (currently dormant)

## Attendance

The Board met on 6 occasions during the year ended 30 June 2017. At other times, matters that required the Board's attention were addressed by circular resolutions.

| DIRECTORS | MEETINGS ATTENDED |
|---|---|
| J Bolger | 6 |
| R Hill | 6 |
| A Brown | 6 |
| K Davis | 5 |
| N Barbour | 5 |
| D Barnes | 4 |
| G Selischi (appointed 16/11/16) | 3 |
| A Knight (resigned 16/11/16) | 3 |

| ALTERNATE DIRECTORS | MEETINGS ATTENDED |
|---|---|
| C Thompson | 2 |
| S Dickson | – |
| P Teagle | – |
| M Wright | – |

## Directors' remuneration

Directors' remuneration is authorised by ordinary resolution of shareholders and is paid to the independent directors only.

The current maximum level of directors' fees, being $275,000, was authorised by shareholders in 2004. Annual fee payments of $93,500 for the Chair, $63,360 for the Deputy Chair, and $52,800 for the other two independent directors were set by the Board in June 2007. Directors' remuneration payments in respect of the year ended 30 June 2017 were:

| DIRECTORS | $ |
|---|---|
| J Bolger (Chair) | 93,500 |
| R Hill (Deputy Chair) | 63,360 |
| A Brown | 52,800 |
| K Davis | 52,800 |
| N Barbour | – |
| D Barnes | – |
| G Selischi | – |
| A Knight | – |

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## Indemnification of Directors

As permitted by the Constitution and the Companies Act 1993, Gas Industry Co has indemnified its directors and has provided directors' liability insurance for officers and directors. This insurance and indemnity is with respect to potential liabilities and costs they may incur for acts or omissions in their capacity as directors and officers.

During the financial year, Gas Industry Co paid insurance premiums in respect of directors' and officers' liability insurance.

## Annual meeting

Gas Industry Co's Annual Meeting was held on 17 November 2016. Mr Knight retired as a Director at the Annual Meeting and Mr Selischi was elected to the resulting vacancy.

Mr Brown retired at the meeting in accordance with the director rotation provisions of the Company's Constitution, and, being eligible, was re-elected as an independent director. No other nominations for the independent director position had been received by Gas Industry Co.

Amongst other matters, the Chair noted in his address the sale of the Vector and Maui pipelines to First Gas and the current focus on climate change following the Paris Agreement.

The Chair welcomed Gas Industry Co's two new shareholders (First Gas Limited and emsTradepoint Limited). On behalf of the Board, the Chair acknowledged Gas Industry Co's shareholders for the time and resources they had put in to supporting the Company, and thanked them for their continuing support. He recorded his view that the unique co-regulatory model continued to work exceptionally well.

## Delegations

The Board delegates to the Chief Executive the right to exercise all the financial powers of the Board in relation to the operation of Gas Industry Co in accordance with any applicable Board policies and directives, as well as defined financial delegations for business operations. The Board reserves to itself certain powers, including the approval of strategic and business plans, budgets, accounting policies and other financial matters, and transactions or contracts over specified thresholds.

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## Executive

Gas Industry Co has a small Senior Management Team and total staff of around 14 who deliver the Company's strategy and work programme.

STEVE BIELBY
BA, LLB (Hons), LLM (Lond)

**Chief Executive**

Steve Bielby commenced as Chief Executive in January 2011. Prior to that, he held executive positions in listed New Zealand energy companies NGC, Vector, and Contact Energy over more than 10 years and spanning most parts of the sector. Steve began his career as a lawyer and was a partner in a leading national law firm.

IAN DEMPSTER
BE (Hons), MCom (Hons)

**General Manager Operations**

Ian Dempster, a foundation member of Gas Industry Co's Executive since 2005, leads the Operations Group, a team of advisers with responsibilities for arrangements relating to access and operation of gas pipelines, switching, downstream reconciliation, the wholesale market, critical contingency management, and compliance and enforcement.

Ian was previously a consultant for network industries, including water, gas, ports and telecommunications. His energy sector experience includes corporate finance and mergers, acquisitions and divestments arising from legislation-driven industry restructuring. He has a background in electricity generation planning.

SUSAN DUNNE
LLB, BCA, CA

**General Manager Corporate Services**

Susan Dunne joined Gas Industry Co in April 2013 as Senior Legal Counsel. She was appointed Company Secretary in 2014 and General Manager Corporate Services in May 2017. As well as providing legal and company secretarial services to Gas Industry Co, Susan leads the Corporate Services team responsible for administrative support functions including finance, technology, human resources, risk and property management.

Prior to joining Gas Industry Co, Susan worked as both Legal Counsel and Tax Manager at Westpac New Zealand Limited. Susan began her career with PricewaterhouseCoopers in Wellington.

## Employee remuneration and benefits

Employees receiving remuneration and related benefits over $100,000 per annum:

| | YEAR ENDED 30 JUNE 2017 |
|---|---|
| $110,001-120,000 | 2 |
| $130,001-140,000 | 1 |
| $140,001-150,000 | 1 |
| $220,001-230,000 | 1 |
| $270,001-$280,000 | 1 |
| $470,001-$480,000 | 1 |

## Business governance and corporate responsibility

Gas Industry Co maintains a comprehensive suite of policies and procedures to govern behaviour and ensure employee wellbeing. These include:

### Code of conduct and ethics

Gas Industry Co expects its people to act ethically, safely and legally at all times in conducting the Company's business, and to comply with the four principles of conduct outlined in the Code, as well as any ethical standards applying to them by virtue of their membership of a professional body.

### Conflicts of interest

Employees must inform the Company in writing where they enter into any business arrangement or have personal interests that may conflict with either the Company's business or affect the full, effective, and impartial discharge of the employee's obligations with the Company as the industry body and co-regulator.

Independent directors and employees have restrictions on ownership of interests in industry participants.

### Gifts and hospitality

Gas Industry Co requires that its employees do not solicit, accept or offer money, gifts, favours, or entertainment that might influence, or appear to influence, their business judgment, particularly given the Company's role as the industry body and co-regulator.

### Health and safety

The Company is committed to providing and maintaining a safe and healthy work environment for employees and visitors to its premises. Gas Industry Co's Health and Safety Policy is set by the Board and includes a goal of zero harm with a range of initiatives designed to support employee health and well-being.

### Confidential information and privacy

This policy provides that employees must protect the privacy of Gas Industry Co's confidential business information, except as permitted or required by law.

### Risk management

Gas Industry Co's Risk Management Policy is set by the Board and includes an enterprise risk register to record and mitigate strategic, operational, and physical risks that could affect the Company's business. Gas Industry Co also maintains business continuity and emergency preparedness plans. The management team reviews the Company's enterprise risk register each month and the register is presented to the Board each quarter.

**CHAPTER 9**

# Financial Statements



## DIRECTORS' REPORT

The Board of Directors have pleasure in presenting the Annual Report of Gas Industry Company Limited, incorporating the Financial Statements and the Audit Report, for the year ended 30 June 2017.

The Board of Directors of the Company authorised the financial statements presented on pages 39 to 48 for issue on 18 August 2017.

For and on behalf of the Board.

**Rt Hon James B Bolger, ONZ**
CHAIR

18 AUGUST 2017

**Robin G Hill**
DEPUTY CHAIR

18 AUGUST 2017

KPMG

# Independent Auditor's Report

To the shareholders of Gas Industry Company

**Report on the financial statements**

## Opinion

In our opinion, the accompanying financial statements of Gas Industry Company (the company) on pages 39 to 48:

i. present fairly in all material respects the company's financial position as at 30 June 2017 and its financial performance and cash flows for the year ended on that date; and

ii. comply with Public Benefit Entity Standards Reduced Disclosure Regime (Not-For-Profit).

We have audited the accompanying financial statements which comprise:

— the statement of financial position as at 30 June 2017;

— the statements of comprehensive income, changes in equity and cash flows for the year then ended; and

— notes, including a summary of significant accounting policies and other explanatory information.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ("ISAs (NZ)"). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the company in accordance with Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the Auditor's Responsibilities for the Audit of the financial statements section of our report.

Our firm has also provided other assurance services to the company. These matters have not impaired our independence as auditor of the company. The firm has no other relationship with, or interest in, the company.

## Other Information

The Directors, on behalf of the company, are responsible for the other information included in the entity's Financial Statements. Our opinion on the financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Use of this Independent Auditor's Report

This report is made solely to the shareholders as a body. Our audit work has been undertaken so that we might state to the shareholders those matters we are required to state to them in the Independent Auditor's Report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the shareholders as a body for our audit work, this report, or any of the opinions we have formed.

## Responsibilities of the Directors for the financial statements

The Directors, on behalf of the company, are responsible for:

- the preparation and fair presentation of the financial statements in accordance with generally accepted accounting practice in New Zealand (being Public Benefit Entity Standards Reduced Disclosure Regime (Not-For-Profit));
- implementing necessary internal control to enable the preparation of a set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

## Auditor's Responsibilities for the Audit of the financial statements

Our objective is:

- to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to issue an Independent Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of these financial statements is located at the External Reporting Board (XRB) website at:

https://www.xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Page8.aspx.

This description forms part of our Independent Auditor's Report.

KPMG

KPMG
Wellington

18 August 2017

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## GAS INDUSTRY COMPANY LIMITED
## STATEMENT OF COMPREHENSIVE REVENUE AND EXPENDITURE

FOR THE YEAR ENDED 30 JUNE 2017

| | NOTES | ACTUAL 2017 $ | BUDGET 2017 $ | ACTUAL 2016 $ |
|---|---|---|---|---|
| **Revenue from exchange transactions** | | | | |
| Operating income | 4 | 5,613,235 | 5,457,060 | 5,855,523 |
| Interest income | | 42,865 | 35,000 | 43,542 |
| | | 5,656,100 | 5,492,060 | 5,899,065 |
| Refunded levy income | 4 | (821,973) | (714,250) | (163,568) |
| **NET INCOME** | | **4,834,127** | **4,777,810** | **5,735,497** |
| **Expenditure** | | | | |
| Operating expenditure | 5 | 4,731,025 | 5,396,931 | 5,189,181 |
| Finance costs | | 5,129 | 5,129 | 4,601 |
| | | 4,736,154 | 5,402,060 | 5,193,782 |
| **SURPLUS / (DEFICIT) BEFORE TAX** | | **97,973** | **(624,250)** | **541,715** |
| Income tax expense | 6 | 12,002 | 9,800 | 12,192 |
| **SURPLUS / (DEFICIT) FOR THE YEAR** | | **85,971** | **(634,050)** | **529,523** |
| Other comprehensive revenue and expenditure | | – | – | – |
| **TOTAL COMPREHENSIVE REVENUE AND EXPENDITURE FOR THE YEAR** | | **85,971** | **(634,050)** | **529,523** |

The accompanying notes form an integral part of these financial statements.

CHAPTER NINE

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## GAS INDUSTRY COMPANY LIMITED
## STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 30 JUNE 2017

| | INDUSTRY RESERVES $ | RETAINED EARNINGS $ | TOTAL EQUITY $ | BUDGET $ |
|---|---|---|---|---|
| *Balance at 1 July 2015* | 383,568 | 595,000 | 978,568 | 1,782,279 |
| **Total comprehensive revenue and expenditure for the year** | | | | |
| Surplus / (Deficit) for the year | – | 529,523 | 529,523 | (393,027) |
| Other comprehensive revenue and expenditure | – | – | – | – |
| Total comprehensive revenue and expenditure for the year | – | 529,523 | 529,523 | (393,027) |
| **Transfer between equity reserves** | | | | |
| Industry Advances Reserve transfers | 474,523 | (474,523) | – | – |
| **BALANCE AT 30 JUNE 2016** | **858,091** | **650,000** | **1,508,091** | **1,389,252** |
| *Balance at 1 July 2016* | 858,091 | 650,000 | 1,508,091 | 1,389,252 |
| **Total comprehensive revenue and expenditure for the year** | | | | |
| Surplus / (Deficit) for the year | – | 85,971 | 85,971 | (634,050) |
| Other comprehensive revenue and expenditure | – | – | – | – |
| Total comprehensive revenue and expenditure for the year | – | 85,971 | 85,971 | (634,050) |
| **Transfer between equity reserves** | | | | |
| Industry Advances Reserve transfers | 59,971 | (59,971) | – | – |
| **BALANCE AT 30 JUNE 2017** | **918,062** | **676,000** | **1,594,062** | **755,202** |

The accompanying notes form an integral part of these financial statements.

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## GAS INDUSTRY COMPANY LIMITED
## STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2017

| | NOTES | ACTUAL 2017 $ | BUDGET 2017 $ | ACTUAL 2016 $ |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | 7 | 2,180,469 | 1,627,806 | 2,088,022 |
| Trade and other receivables | 8 | 452,978 | 87,813 | 400,216 |
| Prepayments | | 124,961 | 52,865 | 41,234 |
| Income tax receivable | 6 | – | 9,800 | – |
| Total current assets | | 2,758,408 | 1,778,284 | 2,529,472 |
| **Non-current assets** | | | | |
| Property, plant and equipment | | 80,292 | 85,922 | 66,679 |
| Intangible assets | | 12,548 | 12,273 | 9,350 |
| Total non-current assets | | 92,840 | 98,195 | 76,029 |
| **Total assets** | | **2,851,248** | **1,876,479** | **2,605,501** |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Trade and other payables | 9 | 951,957 | 834,764 | 790,331 |
| Asset restoration provision | | 48,777 | 48,777 | 43,648 |
| Employee entitlements | | 256,438 | 237,725 | 263,419 |
| Redeemable shares | 11 | 14 | 11 | 12 |
| Total current liabilities | | 1,257,186 | 1,121,277 | 1,097,410 |
| **Total liabilities** | | **1,257,186** | **1,121,277** | **1,097,410** |
| **Net assets** | | **1,594,062** | **755,202** | **1,508,091** |
| **EQUITY** | | | | |
| Industry reserves | 12 | 918,062 | 50,202 | 858,091 |
| Retained earnings | 12 | 676,000 | 705,000 | 650,000 |
| **Total equity** | | **1,594,062** | **755,202** | **1,508,091** |

These financial statements were authorised for issue by the signatories below on 18 August 2017.

On behalf of the board,

**Rt Hon James B Bolger, ONZ**
CHAIR
18 AUGUST 2017

**Robin G Hill**
DEPUTY CHAIR
18 AUGUST 2017

The accompanying notes form an integral part of these financial statements.

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## GAS INDUSTRY COMPANY LIMITED
## STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2017

| | ACTUAL 2017 $ | BUDGET 2017 $ | ACTUAL 2016 $ |
|---|---|---|---|
| **Operating activities** | | | |
| *Cash was provided from* | | | |
| Levy revenue | 4,485,180 | 4,257,617 | 4,020,302 |
| Market fee revenue | 1,372,004 | 1,489,000 | 1,712,090 |
| Annual fees | 26,000 | 55,000 | 55,000 |
| Interest received | 42,865 | 35,000 | 43,543 |
| Net GST | – | – | 7,000 |
| | 5,926,049 | 5,836,617 | 5,837,935 |
| *Cash was applied to* | | | |
| Payments to suppliers | (2,526,840) | (3,014,863) | (3,133,544) |
| Payments to employees | (2,046,217) | (2,149,634) | (1,983,657) |
| Payments to directors | (264,304) | (275,000) | (262,460) |
| Refund of levy to industry participants | (820,673) | (714,250) | (163,560) |
| Taxes paid | (12,002) | - | (12,192) |
| Net GST | (137,595) | - | - |
| | (5,807,631) | (6,153,747) | (5,555,413) |
| ***Net cash inflows from operating activities*** | **118,418** | **(317,130)** | **282,522** |
| **Investing activities** | | | |
| *Cash was applied to* | | | |
| Purchase of property, plant and equipment | (16,148) | (24,000) | (13,973) |
| Purchase of intangible assets | (9,823) | – | – |
| ***Net cash outflows from investing activities*** | **(25,971)** | **(24,000)** | **(13,973)** |
| Net increase/ (decease) in cash and cash equivalents | 92,447 | (341,130) | 268,549 |
| **Opening cash and cash equivalents** | **2,088,022** | **1,968,936** | **1,819,473** |
| **CLOSING CASH AND CASH EQUIVALENTS** | **2,180,469** | **1,627,806** | **2,088,022** |

The accompanying notes form an integral part of these financial statements.

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## GAS INDUSTRY COMPANY LIMITED NOTES TO THE FINANCIAL STATEMENTS

### 1. Reporting entity

These financial statements comprise the financial statements of Gas Industry Company Limited (the "Company") for the year ended 30 June 2017.

Changes to the Gas Act 1992 (the "Act") in late 2004 provided for the co-regulation of the gas industry by the Government and an industry body. The Company was established to fulfil the role of the industry body under the Act and was approved by Order in Council on 22 December 2004.

The Company is a limited liability company incorporated and domiciled in New Zealand and is registered under the Companies Act 1993. The address of its registered office is 95 Customhouse Quay, Wellington.

The financial statements have been prepared in accordance with the requirements of the Gas Act 1992, the Financial Reporting Act 2013 and the Companies Act 1993.

The principal activity of the Company is to act as a co-regulatory body for the gas industry in New Zealand. This includes making recommendations to the Minister of Energy on a wide range of industry matters, including the making of rules and regulations in relation to the wholesaling, processing, transmission, distribution and retailing of gas.

The financial statements have been approved for issue by the Board of Directors on 18 August 2017.

### 2. Basis of preparation

#### (a) Statement of compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP"). They comply with the PBE Accounting Standards as appropriate for Tier 2 not-for-profit public benefit entities. The company is a Tier 2 reporting entity as it has total expenditure less than $30 million in the two preceding reporting periods and is not publically accountable. All available exemptions under Tier 2 Reduced Disclosure Requirements have been applied.

#### (b) Basis of measurement

The financial statements have been prepared on a historical costs basis, except for financial assets and liabilities that have been measured at fair value. The accrual basis of accounting has been used unless otherwise stated and the financial statements have been prepared on a going concern basis.

#### (c) Presentation currency

The financial statements are presented in New Zealand dollars ($), which is the Company's functional currency.

#### (d) Budget figures

The budget figures are approved by the Board of Directors in line with the Company's strategic plans. The budget figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those used in preparing these financial statements. The budgeted figures are not audited.

#### (e) Judgments and estimations

The preparation of financial statements in conformity with PBE Accounting Standards requires judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Where material, information on significant assumptions and estimates is provided in the relevant accounting policy or will be provided in the relevant note.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Subsequent actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimates is revised and in any future years affected.

### 3. Summary of significant accounting policies

#### (a) Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

#### (b) Trade debtors and other receivables

Trade debtors and other receivables are measured at amortised cost using the effective interest method less any impairment losses.

A provision for impairment is established where there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivable.

Receivables with a short duration are not discounted.

### (c) Intangible assets

Software costs, which includes those items classified as "Industry Assets" have a finite useful life. Software costs are capitalised and amortised over an economic useful life of between 4 and 6 years.

"Industry Assets" relate to the databases created and established for the Downstream Reconciliation and Switching & Registry rules.

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## (d) Trade creditors and other payables

These amounts represent liabilities for goods and services provided to the Company prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

## (e) Employee entitlements

### Short term benefits

Employee benefits that the Company expects to be settled within 12 months of balance date are measured at nominal value based on accrued entitlements at current rate of pays.

These include salaries and wages accrued up to balance date and annual leave earned, but not yet taken at balance date.

The Company recognises a liability and expense for bonuses where they are contractually obliged or where there is a past practice that has created a constructive obligation.

### Long-term benefits

The Company does not provide long service leave to employees or members of the governing body and has not entered into any defined benefit/contribution pension plans.

## (f) Preference shares

Preference share capital (disclosed as "Redeemable Shares") are classified as a liability if it is redeemable on a specific date or at the option of the shareholders.

## (g) Revenue from exchange transactions

Revenue is recognised to the extent that it is probable that the economic benefit will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of consideration received. The Company assesses its revenue arrangements against specific criteria to determine if it is acting as the principal or agent in a revenue transaction. In an agency relationship only the portion of revenue earned on the Company's own account is recognised as gross revenue in the Statement of Comprehensive Revenue and Expenditure.

The following specific recognition criteria must be met before revenue is recognised.

### Levy revenue

Levy revenue comprises amounts received or due in accordance with the applicable Gas (Levy of Industry Participants) Regulations. Levy revenue is recognised when the underlying activities upon which the levy is raised have occurred and the amount of levy revenue can be reliably measured.

### Market fee revenue

Market fees raised to recoup the capital and operating costs of implementing gas governance regulations are recognised in conformance with International Public Sector Board standard 23: Non-reciprocal transfers in the following manner:

» Market fees to recoup operating costs to be recognised as revenue at the time the invoice is raised as a proxy for recognising it at the time the leviable event occurs.

» Market fees to recover capital costs to be recognised as revenue once the expenditure the fees were raised to cover has been incurred.

### Annual fees

Annual fees are recognised when invoiced.

### Interest income

Interest income is recognised as it accrues, using the effective interest method.

## (h) Revenue from non-exchange transactions

Non-exchange transactions are those where the Company receives value from another entity (eg: cash or other assets) without giving approximately equal value in exchange. During the year no non-exchange transactions were entered into.

## (i) Income tax

Taxation expense in the Statement of Comprehensive Revenue and Expenditure comprises current tax charges. Industry participation levies, annual fees and market fees received are not regarded as gross income, in terms of section CB 1 of the Income Tax Act 2007 and therefore are not taxable. Deductions are not available in respect of the costs incurred in providing services.

Current tax charges are based on taxable surplus' for the year, which differ from the surplus before tax reported because it excludes items that are taxable or deductible in other years, and items that are never taxable or deductible.

The Company has no material deferred tax balances as the majority of assets and liabilities are used to provide non-taxable activities.

## (j) Goods and Services Tax (GST)

All amounts are shown exclusive of Goods and Services Tax (GST), except for receivables and payables that are stated inclusive of GST.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Statement of Financial Position.

## (k) Reserves / Equity Policy

The Board holds surplus levy income in a dedicated industry advance reserve for the future reduction of levy income.

## 4. Operating income

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Wholesale levy revenue | 2,317,410 | 2,449,569 |
| Retail levy revenue | 1,913,973 | 1,884,654 |
| Market fee revenue | 1,355,852 | 1,466,300 |
| Annual fees | 26,000 | 55,000 |
| **TOTAL OPERATING INCOME** | **5,613,235** | **5,855,523** |
| Refunded levy income | (821,973) | (163,568) |

## 5. Operating expenditure

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Depreciation & amortisation | 46,740 | 44,730 |
| Operating lease expenses | 307,857 | 303,123 |
| Fees paid to audit firm – financial statement audit | 14,593 | 14,593 |
| Fees paid to audit firm – other services | 12,290 | 12,290 |
| Directors' fees | 262,460 | 262,460 |
| General expenses | 323,899 | 403,844 |
| Bad debts / (bad debts recovered) | (1,181) | (6,325) |
| Recruitment expenses | 4,000 | 50,198 |
| Technical, economic, and legal advice | 498,868 | 770,399 |
| Service provider fees | 1,237,722 | 1,338,467 |
| Kiwisaver contributions | 46,350 | 44,049 |
| Employee benefit expense | 1,977,427 | 1,951,353 |
| **TOTAL OPERATING EXPENDITURE** | **4,731,025** | **5,189,181** |

## 6. Income tax

### (a) Income tax expense

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Current year income tax expense | 12,002 | 12,192 |
| **TOTAL INCOME TAX EXPENSE** | **12,002** | **12,192** |

### (b) Reconciliation of current year income tax expense

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Surplus for the year | 97,973 | 541,715 |
| Income tax expense at 28 percent | 27,432 | 151,680 |
| Permanent differences | (15,430) | (139,488) |
| Timing differences | – | – |
| **CURRENT YEAR INCOME TAX EXPENSE** | **12,002** | **12,192** |

—

(c) Income tax receivable

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Opening balance | – | – |
| Tax refunds received | – | – |
| Current year income tax expense | (12,002) | (12,192) |
| Income tax paid | 12,002 | 12,192 |
| **CLOSING BALANCE** | **–** | **–** |

The Company has no material deferred tax balances on temporary timing differences.

## 7. Cash and cash equivalents

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Bank account | 996 | 996 |
| Interest bearing account | 2,178,973 | 2,086,526 |
| Petty cash | 500 | 500 |
| **TOTAL** | **2,180,469** | **2,088,022** |

The carrying amount of cash and cash equivalents approximates their fair value.
Cash at bank and the interest bearing account earns interest at floating rates based on daily deposit balances.

## 8. Trade and other receivables

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Levy debtors | 388,913 | 396,240 |
| Other receivables | – | 3,976 |
| GST receivable | 64,065 | – |
| **TOTAL** | **452,978** | **400,216** |

No provision for doubtful debts has been required as all significant receivable balances are collectable within normal trading terms.

## 9. Trade and other payables

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Accounts payable | 353,252 | 295,980 |
| Accrued expenses | 598,705 | 415,468 |
| GST payable | – | 78,883 |
| **TOTAL** | **951,957** | **790,331** |

Trade creditors and other payables are non-interest bearing and are normally settled on 30- day terms; therefore the carrying value of trade creditors and other payables approximates their fair value.

## 10. Related party transactions

### (a) Transactions with shareholders

Levy payments (which are detailed in note 4) are made by industry participants who, in many cases, are also shareholders of Gas Industry Company Limited.

### (b) Transactions with key management personnel

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| **Salaries and other short-term employee benefits** | **1,182,635** | **1,112,801** |

Key management personnel include the Chief Executive, his direct reports and the Directors.

The above includes remuneration of $262,460 (30 June 2016 $262,460) paid to the directors for the year.

## 11. Redeemable shares

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Redeemable shares – value in dollars | 14 | 12 |
| Redeemable shares – number | 14 | 12 |

All redeemable shares rank equally with one vote attached to each fully paid share. The shares are redeemable at any time for the consideration of $1 payable on redemption. The redeemable shares confer on the shareholders the rights set out in section 36(1) of the Companies Act 1993.

## 12. Reserves and retained earnings

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Industry advances reserve | 918,062 | 858,091 |
| Retained earnings | 676,000 | 650,000 |
| **TOTAL EQUITY RESERVES** | **1,594,062** | **1,508,091** |

### (a) Industry advances reserve

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Opening balance | 858,091 | 383,568 |
| Transfer from retained earnings | 59,971 | 474,523 |
| **CLOSING BALANCE** | **918,062** | **858,091** |

To allow for the timely enactment of the levy regulations each financial year, Gas Industry Co must set its budget and work programme nine months prior to the beginning of that year and prior to the completion of the Strategic Plan. In practice, this requires the company to forecast where it expects to be in the policy development process before it has fully analysed the issues, or engaged with stakeholders on their concerns.

This factor, and the fact that the levy is based in part on variable gas sales volumes, means every year there is a risk of over or under recovery of levy funds.

Section 43ZZC(3) of the Gas Act provides that any over or under recoveries can be taken into account in setting the levy in subsequent financial years. However, to ensure transparency around the calculation of each year's levy, the Board has determined that, unless required for unanticipated, ongoing work programme costs, any surplus should be returned to levy payers by way of refund once the year-end accounts have been received by shareholders at the Annual General Meeting.

The Board holds surplus levy income in a dedicated industry advance reserve for the future reduction of levy income.

—

### (b) Retained earnings

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| Opening balance | 650,000 | 595,000 |
| Surplus for the year | 85,971 | 529,523 |
| Transfer to Industry advances reserve | (59,971) | (474,523) |
| **CLOSING BALANCE** | **676,000** | **650,000** |

## 13. Contingencies

As at 30 June 2017, the Company has no contingent liabilities (2016: nil). There is an arrangement with Westpac New Zealand Limited whereby Gas Industry Company has a business facility (limit $100,000) and a payroll Letter of Credit facility (limit $180,000).

## 14. Commitments

### (a) Capital commitments

The Company has no material capital commitments (2016: $Nil)

### (b) Operating lease commitments

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| *Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:* | | |
| Within one year | 282,188 | 303,123 |
| Later than one year but not later than five years | 1,269,084 | 114,852 |
| Later than five years | 104,721 | – |
| **TOTAL** | **1,655,993** | **417,975** |

### (c) Service provider commitments

| | ACTUAL 2017 $ | ACTUAL 2016 $ |
|---|---|---|
| *Service provider agreements for the Downstream Reconciliation, Switching and Registry and Critical Contingency Management Rules payable as follows:* | | |
| Within one year | 1,113,387 | 1,199,153 |
| Later than one year but not later than five years | 536,696 | 1,612,496 |
| Later than five years | – | – |
| **TOTAL** | **1,650,083** | **2,811,649** |

## 15. Subsequent events

No significant events, which would materially affect the financial statements, have occurred subsequent to year end that require disclosure or adjustment to the carrying value of assets or liabilities in this set of financial statements.

## GLOSSARY

| | |
|---|---|
| **ALLOCATION AGENT** | Appointed pursuant to the Reconciliation Rules to apportion downstream gas quantities and allocate daily gas quantities to retailers. The Allocation Agent is currently Energy Market Services (EMS) |
| **CCM REGULATIONS** | Gas Governance (Critical Contingency Management) Regulations 2008 |
| **CCO** | Critical Contingency Operator. The CCO is currently Core Group |
| **COMPLIANCE REGULATIONS** | Gas Governance (Compliance) Regulations 2008 |
| **DAWG** | Daily Allocation Working Group |
| **D+1** | The day-after delivery (D+1) allocation methodology for downstream reconciliation processes |
| **DISTRIBUTION SCHEME** | Gas Distribution Contracts Oversight Scheme |
| **GAS ACT** | Gas Act 1992 |
| **GAS REGISTRY** | The customer switching platform which facilitates customer switching between retailers and provides a database of information about consumer installations. The Gas Registry Operator is currently Jade Software Corporation (NZ) Limited |
| **GJ** | Gigajoule ($10^9$ joules). The average residential gas consumption is 23 GJ/year |
| **GPS** | Government Policy Statement on Gas Governance (April 2008) |
| **ICP** | Installation Control Point |
| **MBB** | Market-Based Balancing |
| **MDL** | Maui Development Limited |
| **MINISTER** | The Minister of Energy and Resources (unless indicated otherwise) |
| **MPOC** | Maui Pipeline Operating Code |
| **PEPANZ** | Petroleum Exploration and Production Association of New Zealand |
| **RECONCILIATION RULES** | Gas (Downstream Reconciliation) Rules 2008 |
| **RETAIL SCHEME** | Retail Gas Contracts Oversight Scheme |
| **SWITCHING RULES** | Gas (Switching Arrangements) Rules 2008 |
| **TRANSMISSION SYSTEM** | A system of pipelines transporting gas at high pressure from production and processing facilities to delivery points supplying end users and lower pressure local area gas distribution networks |
| **UFG** | Unaccounted-for gas |
| **VTC** | Vector Transmission Code |

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