

2 March 2012

Hon Phil Heatley
Minister of Energy and Resources
Parliament Buildings
Wellington

Dear Minister

Update on Gas transmission pipeline balancing

This letter provides an update on issues relating to gas pipeline balancing, as requested by the Hon Pansy Wong as the (then) Associate Minister of Energy in September 2010. In summary, balancing is still viewed by key industry participants as an issue that needs to be addressed. Although the amount/value of balancing gas purchased in the last few years has significantly reduced¹, underlying problems remain. However, there has been significant recent progress aimed at improving balancing arrangements, led by the industry and supported by Gas Industry Co. We have also developed a 12-month programme of action that should see remaining balancing issues largely addressed; and without need for targeted regulatory intervention. In addition, this work is expected to mesh with Gas Industry Co's parallel work programme on wider gas transmission access and investment.

Transmission pipeline balancing is the management of the inventory of gas in a pipeline to keep gas pressures within safe operating limits. Effective balancing is necessary for the reliable transportation of gas and, although balancing arrangements have been a cause of concern since the commencement of open access to the Maui Pipeline in 2005, improvements have been hard to achieve. This is because balancing arrangements are intimately bound with other arrangements in the industry, such as gas trading, contracts for transportation, and regulations for allocating gas quantities, which are difficult to unravel.

Options to resolve these concerns have ranged from a regulated solution to the preference of the majority of industry participants for it to lead initiatives for non-regulated solutions. Under the co-regulatory governance model for the gas industry, we have encouraged participants to develop a contractual solution, providing it can meet Gas Act objectives in a reasonable timeframe.

We can report significant industry initiatives are in train which we believe will improve balancing arrangements. The initiative that most directly addresses balancing is a change to the Maui Pipeline Operating Code (MPOC) proposed by Maui Development Limited (MDL) in October 2011. The principal objective of that proposal is to make the 'causers' of pipeline balancing actions more accountable for their costs. Gas Industry Co has a contractual role under the MPOC to consider proposed changes, consult on them, and recommend to MDL

¹ The total value of all gas transported is of the order of \$800m, but the Maui pipeline balancing agent bought only about \$1.4m of balancing gas in 2011. This quantity of balancing gas is only about 11% of the amount purchased in 2008. This downward trend should be viewed as an indicator of balancing behaviour. It indicates that individual pipeline users are managing to balance their own receipts and deliveries more effectively, leaving less 'residual' balancing to be done by the pipeline operator.
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whether we support the proposal. This process is underway and on 23 February 2011 we released a Draft Recommendation supporting the proposed change.

Our analysis of the proposed change concludes that it will make pipeline users more accountable for their individual balance positions and better meet the objectives of the Gas Act. In submissions, pipeline users have argued that other improvements, to allow them to better manage their balance positions, should complement the MPOC change. In particular, they are seeking improved access to the balancing gas market, more timely downstream allocation of delivery quantities, and extended pipeline nomination arrangements. In addition, Vector Limited (Vector), the owner of the transmission system interconnected with the Maui pipeline, believes that flow-on effects of implementing the proposal could have significant consequences for it, and is working through that issue with MDL under the terms of their interconnection contract. We have reached agreement with MDL that, should our Final Recommendation also support its proposed change, MDL will not implement the MPOC change until 1 June 2013.

In the meantime, Gas Industry Co will work with industry participants to help realise the complementary improvements they argue for in their submissions, and with MDL and Vector to address impacts that changes to the MPOC (if confirmed) would have on Vector's gas transmission system and arrangements.

Another significant Gas Industry Co initiative relates to broader aspects of gas transportation which, given the interconnected nature of industry arrangements, also has relevance to pipeline balancing. This initiative is the Gas Transmission Investment Programme (GTIP), launched in September 2011. The impetus for this programme was market concerns about transmission capacity availability through Auckland. The programme is expected to last 18-24 months and aims to:

- Ensure that existing and future gas transmission assets are used efficiently;
- Establish the need for gas transmission investment; and
- Develop an effective pathway for efficient investment to occur.

This Programme has widespread support from industry participants and is already producing positive outcomes such as improved information on pipeline operations. We would welcome the opportunity to give you a full briefing on the how the programme is developing once this work is further advanced.

Given the high level of activity within the industry on gas transmission-related matters, we think it is appropriate to allow the current initiatives to run their course before determining the next step. In relation to balancing, we expect to be able to provide you with a further update after 1 June 2013; at which time we believe we will be able to report further significant improvements. In the meantime, we believe that current balancing arrangements, while inefficient, do not pose a threat to the safe operation of the transmission pipelines or represent a substantial issue for consumers.

Yours faithfully



Steve Bielby

Chief Executive

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