

8 September 2010

Hon Pansy Wong  
Associate Minister of Energy and Resources  
Parliament Buildings  
Wellington

Dear Minister

### **Recommendation on Transmission Pipeline Balancing**

The Strategic Plan for FY2010-2012 provided for the Company to make a recommendation to you on transmission pipeline balancing by December 2009. In October 2009, we published the *Statement of Proposal on Transmission Pipeline Balancing* (Statement of Proposal), which proposed the 'participative regulatory option'. In December 2009, we advised you that we had considered submissions on the Statement of Proposal and assessed alternative industry efforts to improve balancing. We found that our analysis in the Statement of Proposal was still valid; however, we deferred sending you a formal recommendation on balancing until the industry had properly considered the draft balancing rules contained in the Statement of Proposal (Draft Rules).

In January 2010, you acknowledged our advice but advised: '...given the stated preference of most industry participants for a contractual solution in this area, any regulatory proposal would need to be supported by a robust quantifiable cost benefit analysis that has been made available for consultation with industry stakeholders...'. Accordingly we engaged economists who worked with industry participants to identify and quantify the costs and benefits of the balancing proposal.

In April 2010 we consulted on a supplement to the Statement of Proposal, which contained:

- the quantitative cost-benefit analysis of the Draft Rules;
- a description of key changes made to the Draft Rules following further industry discussions; and
- implementation plans for the Draft Rules, which were determined with industry input.

In July 2010 we published an analysis of submissions and cross-submissions on the supplement to the Statement of Proposal, and made minor changes to the Draft Rules in response to specific concerns raised in the submissions.

Having now completed our assessment of balancing arrangements in line with section 43N of the Gas Act, Gas Industry Co remains of the view that the the optimal option to achieve efficient, unified balancing of transmission pipelines is the 'participative regulatory option'. Our experience indicates that further progress to improve the industry codes will be challenging. Commercial interests (including those of the two owners of the transmission system, whose operating codes are strongly interdependent) can delay improvements that are most efficient for the overall gas market. The 'participative regulatory solution' resolves the balancing issues by:

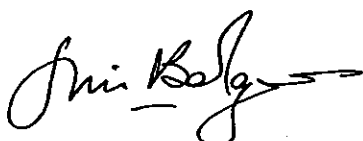
- providing for a single Balancing Operator and a unified balancing regime;
- increasing transparency of balancing actions and costs;
- ensuring the cost of a balancing action goes to the causer;
- providing for an open and competitive balancing market;
- allowing for appropriate governance and dispute resolution; and
- ensuring roles and responsibilities are clear and transparent.

In its analysis, the Company has acknowledged and taken account of the ongoing industry efforts to revise the Maui Pipeline Operating Code to improve balancing arrangements, recent improvements in balancing behaviour and reductions in balancing costs.

We are aware officials consider that a more focused, and potentially less costly regulatory solution is preferable. We understand that they would prefer to give the industry more time to improve their balancing arrangements by aligning the codes with international best practice before considering such regulation.

Taking into account these factors it may be appropriate for Gas Industry Co to defer making a final recommendation on balancing at present and instead adopt a 'wait and watch' approach. Industry balancing arrangements can then be reviewed again at an interval of, say, one year. We seek your agreement to this approach and your acknowledgement that it is appropriate to defer our work in this area. As this course of action is different from that set out in our published work programme, we would also appreciate formal advice from you suggesting an amended milestone and approach.

Yours faithfully



**Rt Hon Jim Bolger, ONZ**  
*Chair*

cc: Carolyn van Leuven, MED