GAS INDUSTRY
COMPANY LIMITED

Retail Competition under Pipeline Constraint

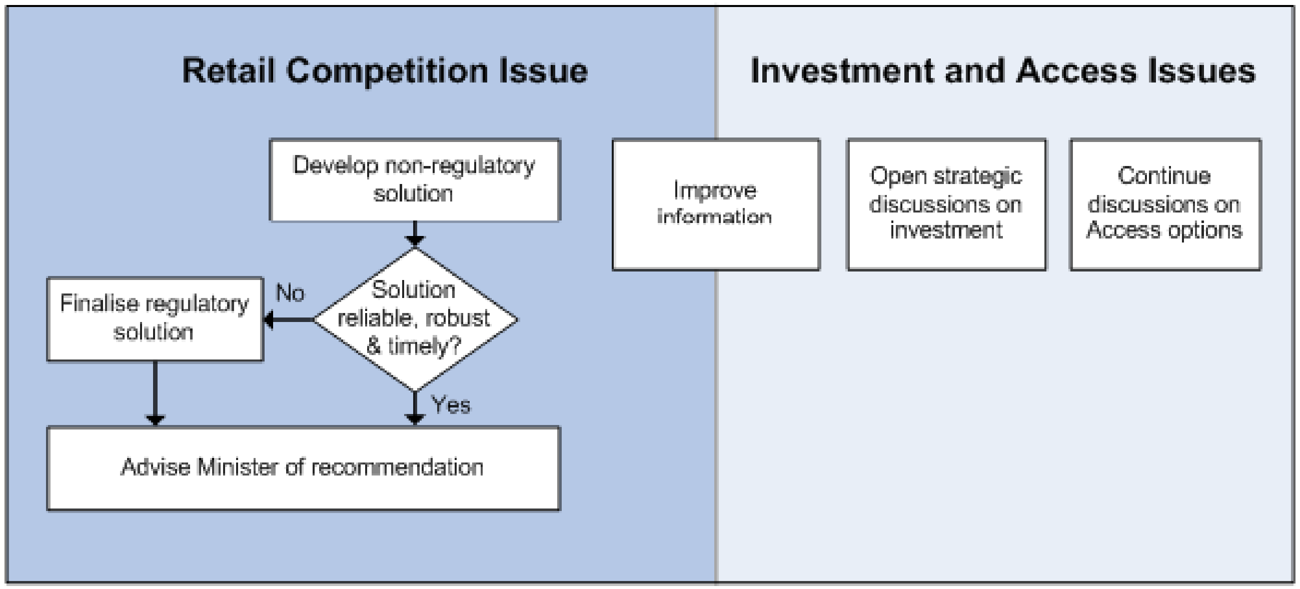
14 April 2011

Agenda

Time	Item
9am to 9.15am	Background & Objective
9.15am to 9.30am	Review of Submissions Analysis and Next Steps paper
9.30am to 10am	Identification of non-regulatory solutions to be considered
10am to 11.30am	Discussion of non-regulatory options
11.30am to noon	Next steps

Morning workshop: Short term focus

Afternoon workshop: Longer term focus



BACKGROUND AND OBJECTIVE

Background: history

2009	Q1	January: Research paper on access issues
	Q2	
	Q3	June: Vector declares North Pipeline constrained
	Q4	
2010	Q1	Reduced competition reported by large end users
	Q2	May: Options paper on access issues
	Q3	June/August/September: Workshops
	Q4	November: Retail Competition Statement of Proposal
2011	Q1	
	Q2	April: Submissions Analysis and Next Steps paper
	Q3	
	Q4	

Background: strategic context

We need to maximise the long term potential for gas in NZ, by:

- Providing efficient, competitive markets
- Giving investment confidence
  - Exploration/production
  - Transport/infrastructure
  - Consumers
- Historical arrangements may need review when constraints arise

Overarching objectives

What do we need to ensure a reasonably efficient market?

- Gas Industry Co is required to ensure:
  - barriers to competition are minimised
  - access to essential infrastructure & competitive market arrangements
  - downward pressure on gas costs and prices

The Gas Act and GPS objectives provide a framework for thinking about how to improve capacity arrangements.

Objective

Proposals will need to:

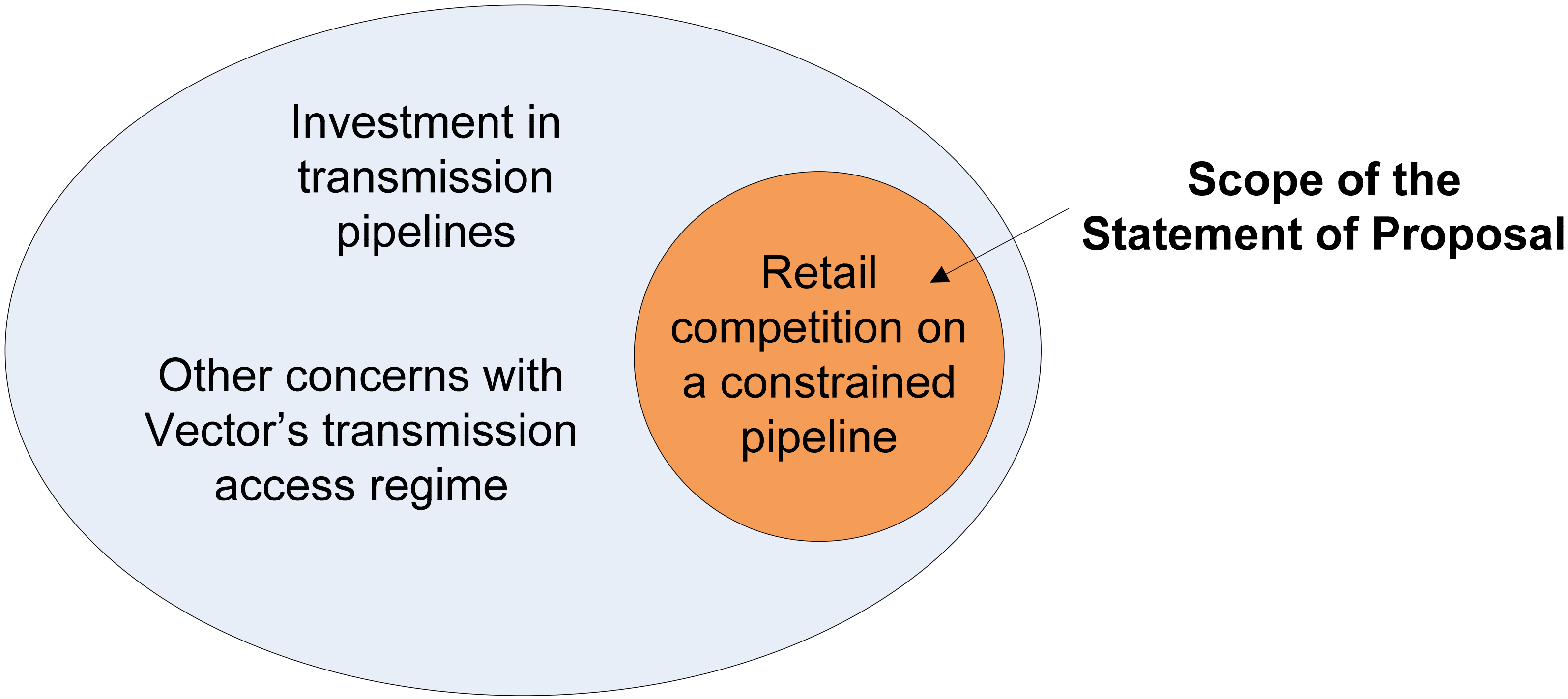
- Ensure that, in the short term, end users who are able to be supplied by existing pipeline capacity are not prevented from having an effective choice of supplier. The solution should not compromise achieving the Gas Act and GPS objectives in the longer term.

This workshop will explore whether the objective will be achieved by non-regulated means that are timely and effective.

REVIEW OF SUBMISSIONS ANALYSIS AND NEXT STEPS PAPER

Review: Statement of Proposal

Gas Industry Co published a Statement of Proposal to deal with the immediate retail competition issue



Review: Statement of Proposal

The retail competition issue is:

- large end users experiencing reduction in bids
- an unintended consequence of constraint and access arrangements
- at conflict with Gas Act/GPS objectives

We identified and assessed reasonably practicable options. Capacity follows end user (CFEU) identified as Gas Industry Co's preferred option.

Review: What submissions said

Key concerns were that Gas Industry Co should have:

- tested whether a constraint actually exists
- provided more evidence of extent of problem
- given more weight to contractual rights
- considered ‘real’ issue - investment in new capacity
- more fully explored non-regulatory solutions

Review: Does a constraint exist?

Declaring a pipeline 'constrained' has major market consequences… yet:

- Vector did not support its declaration with detailed information

We are encouraging Vector to:

- present full information, including:
  - 'capacity queues'
  - security of supply standard
  - demand forecasts and modelling assumptions

- Rules designed to only apply if there is a constraint

Review: Extent of problem

Covec re-assessed evidence:

- 'there has definitely been a lessening of competition for large gas users' - Covec Report
- Effect on $75m sales to large end users on the North Pipeline is significant

Effect on delivered gas prices	9% - 22% increase
Net public benefit of intervention	$1.1 - 3.2 m / year
Net consumer benefit of intervention	$ 6.1 - 14.9 m / year

Review: Contractual rights

Rights should not be overridden lightly… however:

- capacity rights under the VTC are not enduring, long-term contractual entitlements – the VTC terminates each year

The proposed rules are targeted:

- only require capacity to be relinquished where an end user wishes to change supplier
- less intrusive than eliminating ‘grandfathering rights’ (as Vector had proposed)

Review: Investment in new capacity

Progress needs to be made in short term and long term:

- Submissions focus on importance of long term
- We agree, but believe current competition concerns are also important

Afternoon workshop 'Investment and Access' will consider long term work programme

Review: Non-regulatory solutions

Submitters say a non-regulated solution is preferred… however:

- must be timely and effective
- none is currently being progressed
- otherwise, need to revert to proposed rules

We will provide a forum for the industry to discuss a non-regulatory solution

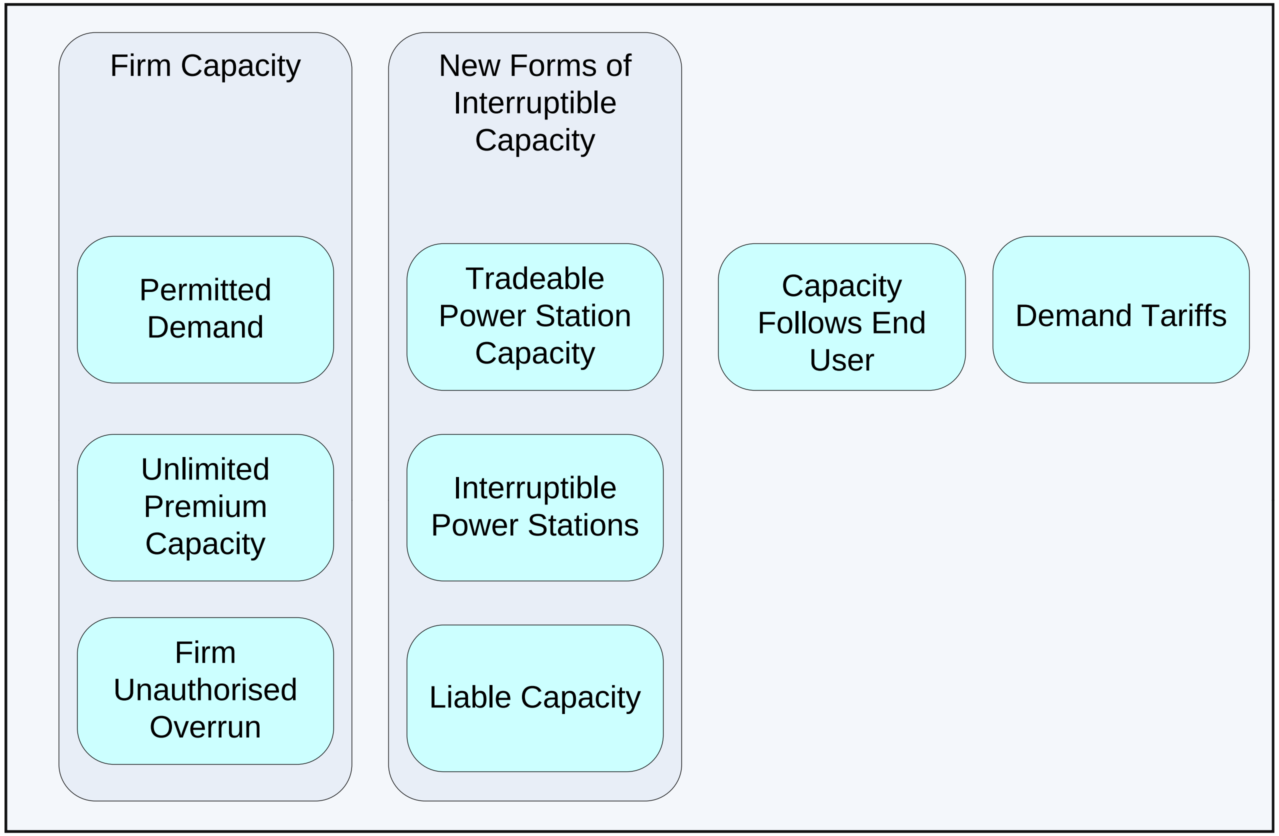
NON-REGULATORY SOLUTIONS

Quick test for suitability of proposals

The best solution will:

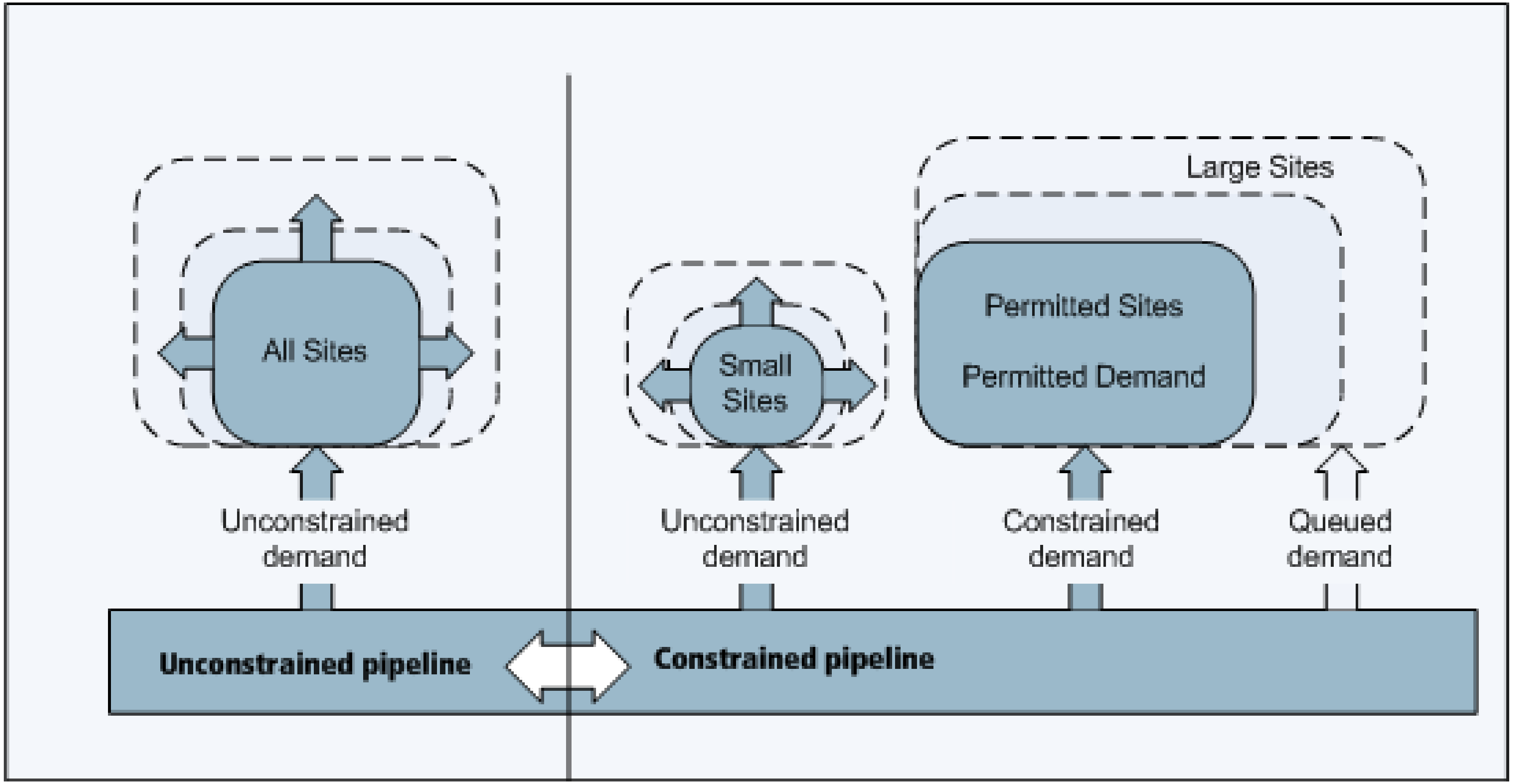
- Give existing end users an effective choice of supplier
- Be quick/simple to implement
- Not compromise long term options

Reasonably practicable options

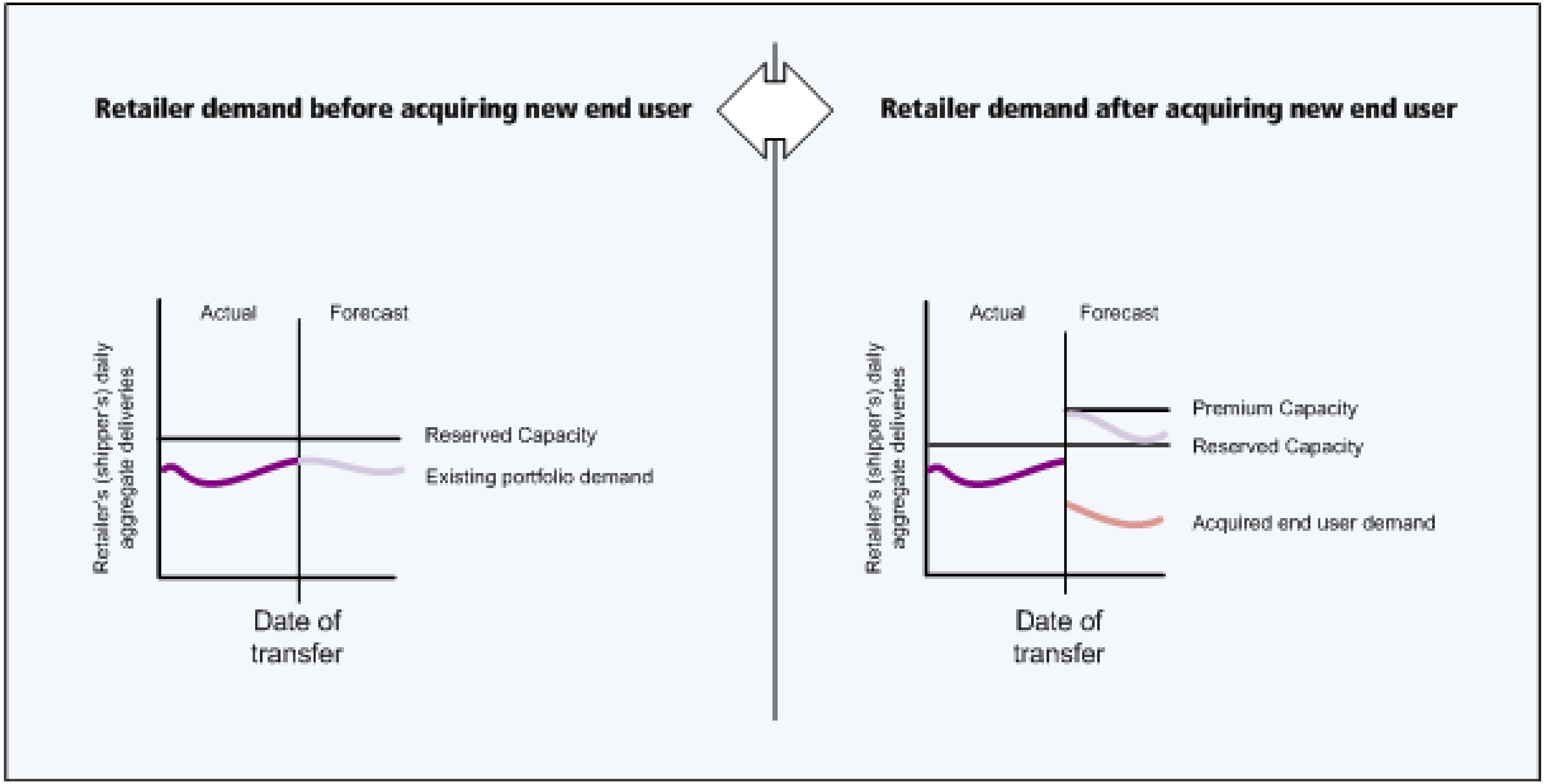


Criteria	Firm capacity options			Interruptible capacity options				
	Permitted Demand	Unlimited Premium Capacity	Firm Unauthorised Overrun	Tradeable PS Capacity	Interruptible PS	Liable Capacity	Capacity Follows End User	Demand Tariff
Competition	✓✓	✓	×	××	××	××	✓	✓✓
Consistency	×	✓	✓	✓	✓	××	×	✓
Timeliness	✓	×	✓✓	✓	××	××	✓✓	××
Existing contractual rights	××	✓	✓	✓✓	✓✓	✓✓	×	×
Shock	✓	×	×	✓	✓	✓	✓	××
Curtailment	✓✓	×	×	✓✓	✓✓	××	✓✓	✓✓
×× **Poor** × **Moderate** ✓ **Good** ✓✓ **Very good**								

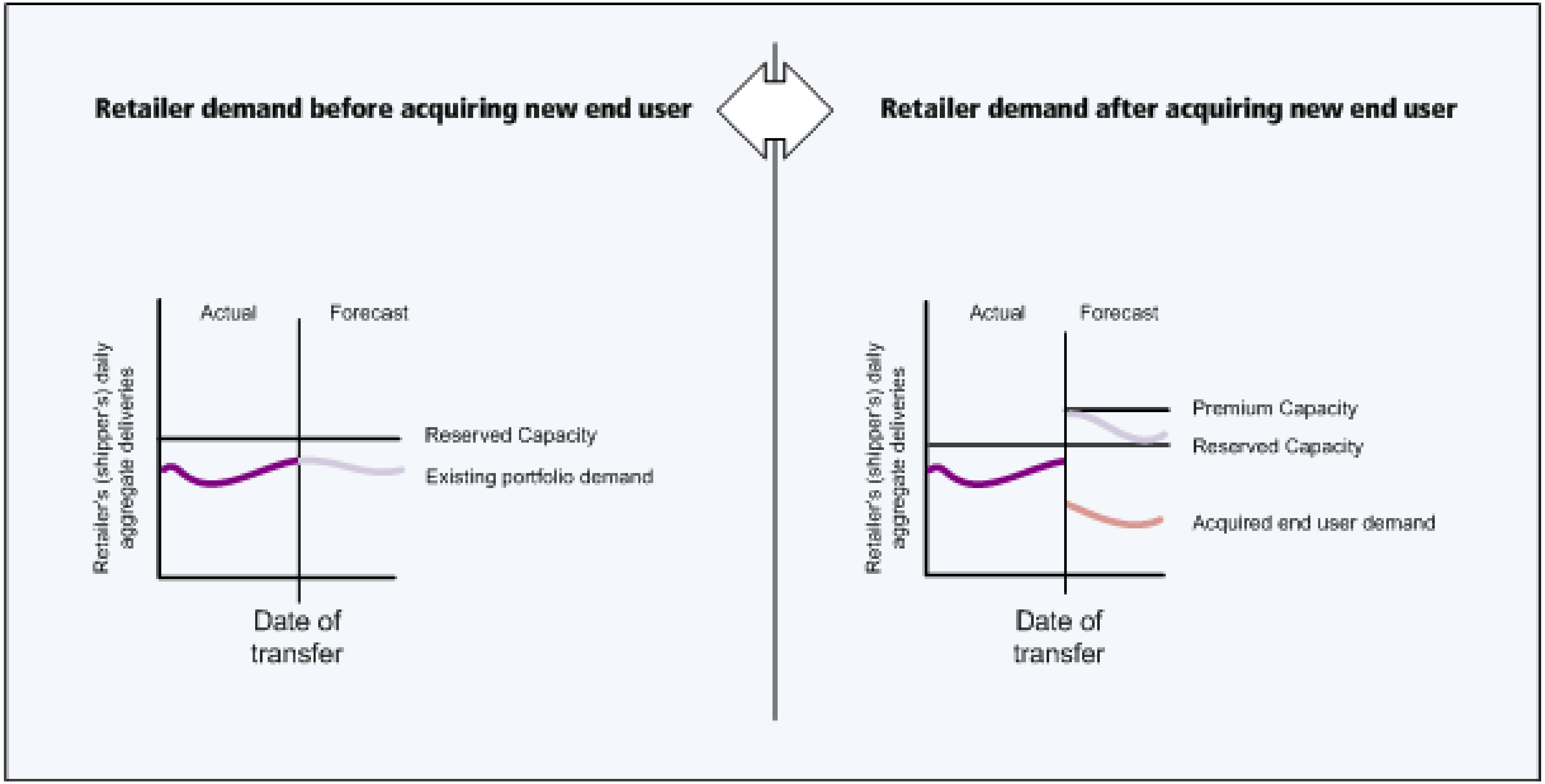
Permitted Demand



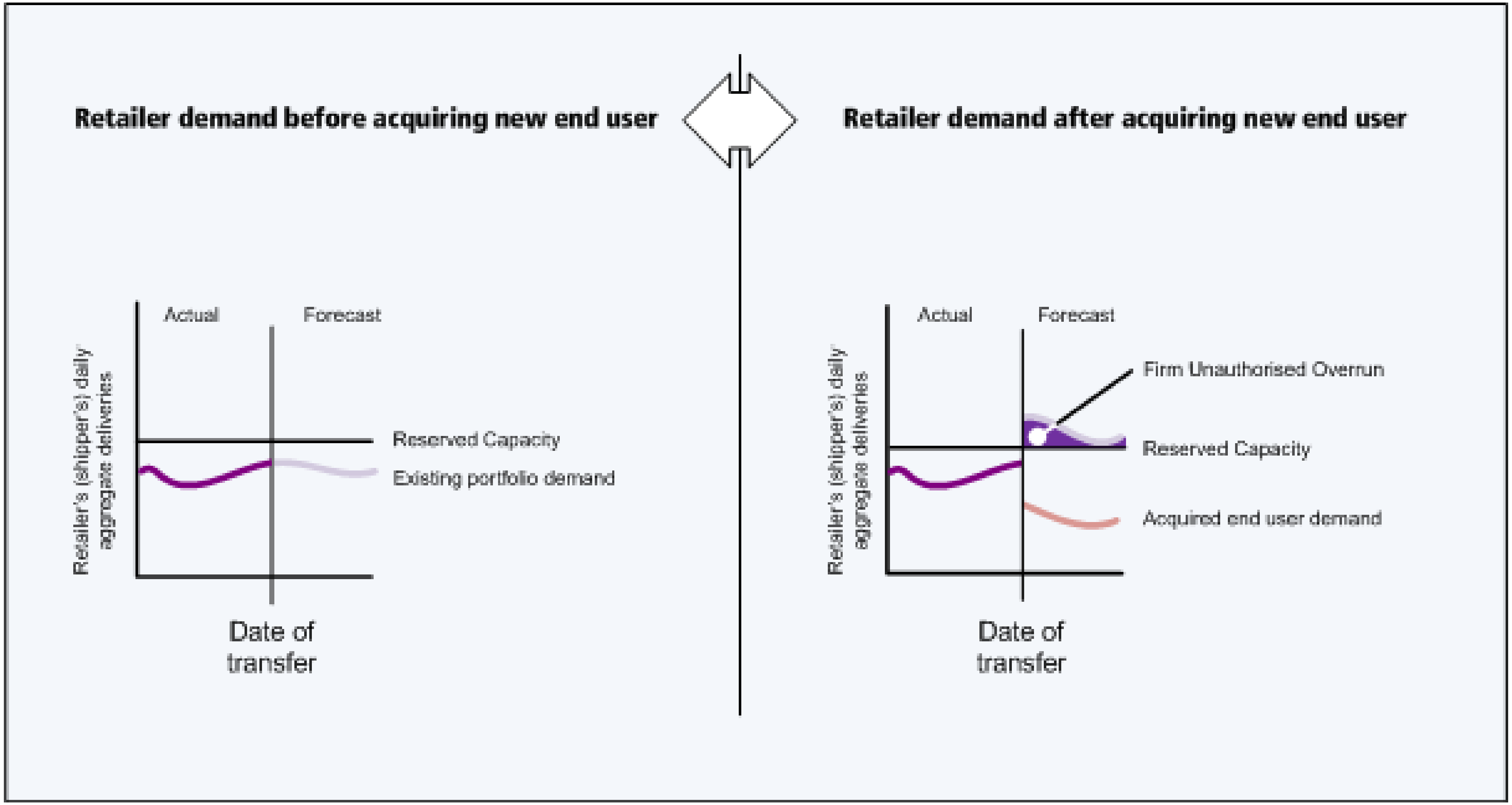
Unlimited Premium Capacity



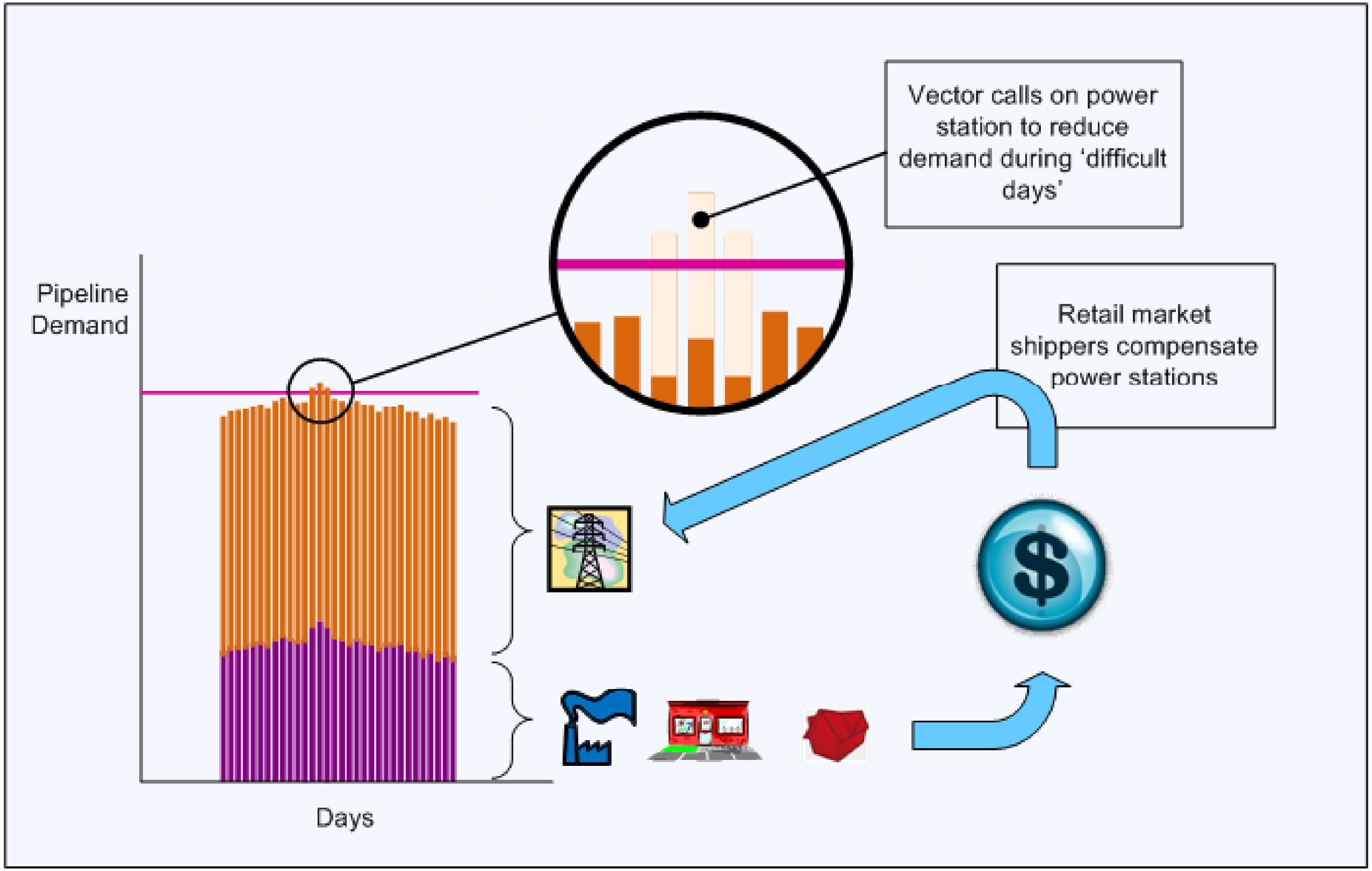
Unlimited Premium Capacity



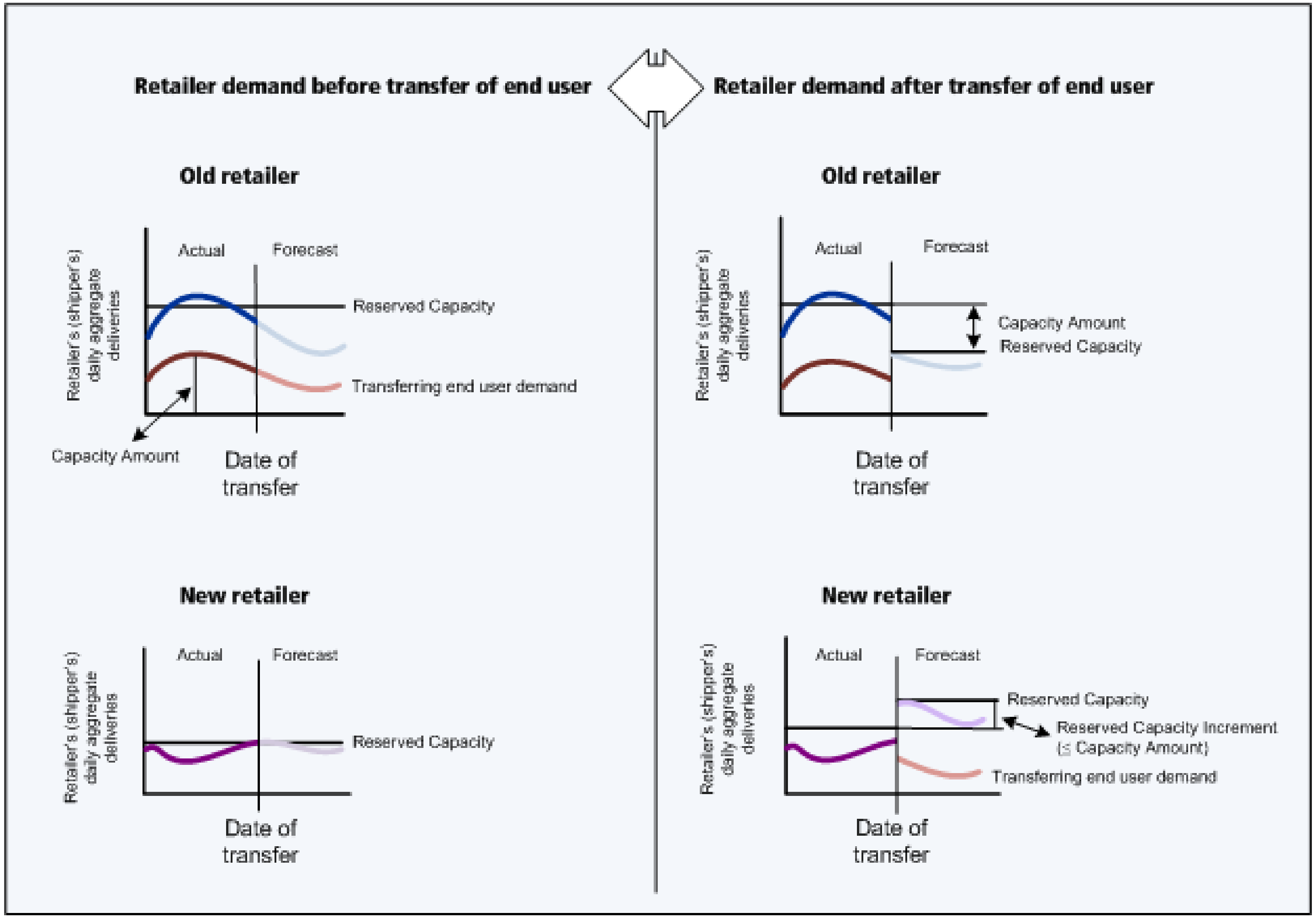
Firm Unauthorised Overrun



Interruptible Power Stations



Capacity Follows End User

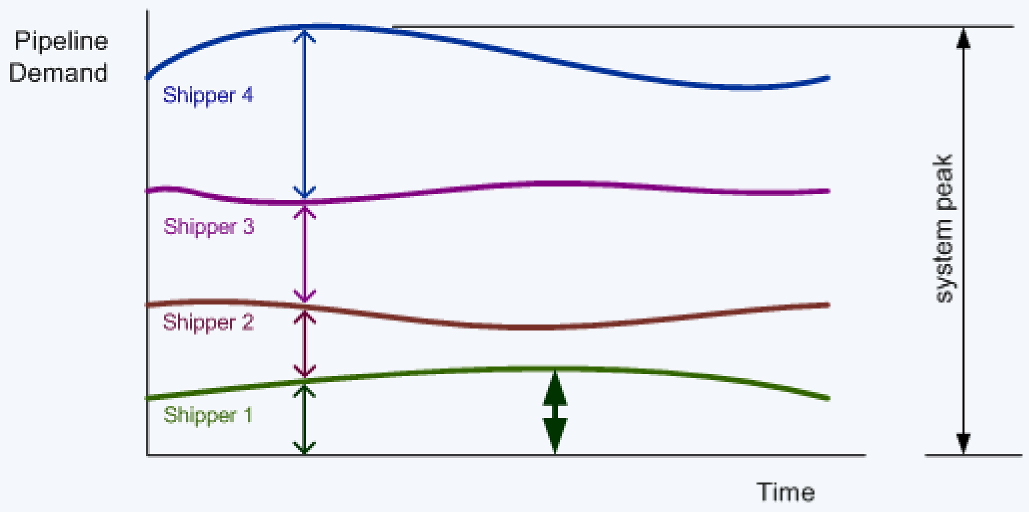


Demand Tariff

Shippers (Retailers) currently reserve based on their individual peak demand.

Under demand tariffs they would not reserve capacity but would be billed retrospectively for their actual demand during the system peak.

For example, Shipper 1 would be billed based on this demand ↕ not this individual demand peak ↕



A few possible non-regulatory solutions

Option	Main features	How to implement
Capacity Follows End User	Old retailer required to transfer capacity to new retailer an posted price	The VTC would be changed to provide for an old retailer relinquishing capacity where a large end user selects a new supplier, and for the new supplier to be issued capacity

A few possible non-regulatory solutions

Option	Main features	How to implement
Transfer provisions in retail contracts	End user contracts would contain a provision requiring its supplier to transfer an amount of capacity to another shipper, nominated by the end user, on termination	• Standard wording for a provision to require the transfer of capacity would be developed and notified to large end users • Some mean of committing retailer to include this provision in contracts they offer to large end users would need to be developed

THE DRAFT RULES

The ‘capacity follows end user’ option

- The capacity follows end user option (CFEU) is GIC’s **preferred regulatory option**
- Option implemented through the Gas Governance (Constrained Transmission Pipeline) Rules

Main feature of CFEU: when a large end user on a constrained pipeline changes retailer the old retailer is required to relinquish capacity to TSO who makes it available to new retailer.

The ‘capacity follows end user’ option

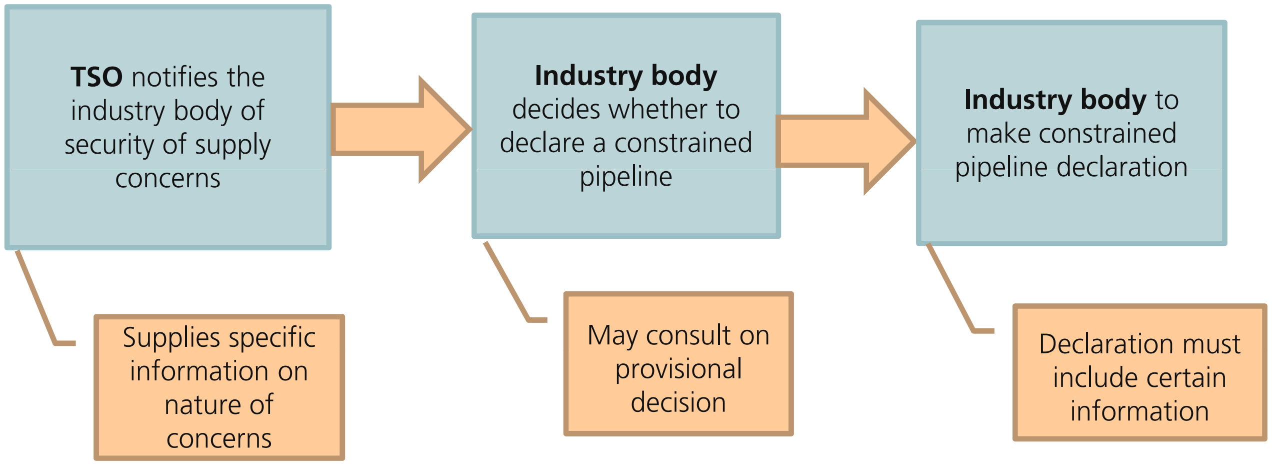
- The purpose of the rules is to:

  Facilitate competition by providing for a terms and conditions of access to ensure retailers have access to transmission capacity on any part of the transmission system where capacity is constrained.

- Rules apply to:
  - All transmission pipelines (Vector and Maui) but only take effect when a pipeline or section of a pipeline is declared constrained
  - Major end users (allocation groups 1 and 2) on a constrained pipeline
- We see the Rules being revoked or superseded when capacity arrangements are revised as part of a longer term revision

Constrained pipeline declaration

- Process for declaring a pipeline or section of a pipeline constrained



Transferring capacity

- Process for transferring capacity