

21 December 2010

Hon Hekia Parata  
Associate Minister of Energy and Resources  
Parliament

Dear Minister

### **Advice on Gas Quality Arrangements**

In this letter we set out Gas Industry Co's advice following our recent review of industry arrangements for gas quality.

### **Background**

Maintaining an acceptable standard of gas quality is important for the whole gas industry. Gas quality affects combustion performance, safety, the reliability of gas supply, and the long-term integrity of the gas transport system. The NZS 5442:2008, *Specification for reticulated natural gas* (the Gas Specification) establishes the standard for gas quality. However, with the introduction of new fields the number of gas quality-related incidents appears to have increased. Such incidents have the potential to be costly for the industry and disrupt the supply of gas to end users.

Some industry participants have concerns that the parties with legislative responsibility for achieving compliance with the Gas Specification may not have sufficient influence over the parties who physically control the gas quality. The contractual linkages between those with the legislative responsibility for gas quality and those who physically control gas quality can be complex and may not provide proper incentives for good control, monitoring, reporting, and auditing of gas quality. Also, it appears that, in the event of a quality-related outage, costs may not be borne by the party who caused the gas quality problem.

### **The Gas Quality Issues Paper**

The *Gas Governance Issues in Gas Quality: Issues Paper* (the Gas Quality Issues Paper) presented the findings of our recent review of industry arrangements for managing gas quality.

There were two main matters under consideration: whether appropriate arrangements are in place to prevent gas quality incidents, and whether the costs of a gas quality incident will be met efficiently (for example, whether damages can flow through the contractual chain to the 'causer'). There is, of

course, a strong link between these two matters. If parties are likely to be held responsible for their actions, they are likely to behave appropriately and have incentives to put in place preventative measures.

## **Consultation**

Nine submissions were received on the Gas Quality Issues Paper.

Four of the nine submitters considered the existing arrangements for monitoring gas composition and contaminants are sufficient; four thought the arrangements should be strengthened.

Four submitters considered further work is justified to identify the options for more active monitoring of gas quality, and to quantify the costs and benefits of those options.

Most submitters were content that liabilities should be dealt with through the contract chain. A few submitters believed there are too many parties in the supply chain for contractual arrangements to be robust should a major event occur, and that regulation is the only way to guarantee the protection of all participants in the supply chain.

## **Analysis of submissions**

After considering submissions, Gas Industry Co responded in an Analysis of Submissions Paper. That paper outlined our conclusions and next steps.

## **Conclusions**

### ***Are appropriate arrangements in place to prevent gas quality incidents?***

Submissions confirmed that we had adequately described the current contractual arrangements between industry participants related to gas quality. However, the Gas Quality Issues Paper did not describe how the various obligations relating to gas quality were being discharged—that is, the operational arrangements. In particular, the monitoring, testing, reporting, and auditing practices of the various industry participants were not described.

Given the concerns expressed in submissions about the adequacy of current gas quality operational arrangements, we believe it is necessary for us to investigate and describe these operational arrangements.

In addition, we are also concerned about the poor visibility of gas quality incidents. There appears to be a wide range of views on what incidents have occurred, and whether these incidents raise safety or reliability concerns. We will consider the options for improving the reporting of gas quality incidents.

### ***Will the costs of a gas quality incident be met efficiently?***

In the Gas Quality Issues Paper, Gas Industry Co explained why existing contractual arrangements were unlikely to allow liabilities to flow through the contract chain to the party who causes an incident. While this was generally accepted by submitters there were different views on what should

be done about it. End users suggested strengthening RPO obligations. Retailers and TSOs were generally satisfied with current arrangements. And two of the three gas distribution companies would like to see more prescriptive arrangements to bring certainty and ensure the causer of a quality incident bears the cost.

Gas Industry Co considers some further consideration of the efficiency of current liability arrangements is justified.

### **Next steps**

Gas Industry Co concludes that further work is required to:

- investigate and describe the operational arrangements for managing gas quality (that is, monitoring, testing, reporting, and auditing practices);
- consider the options for improving quality monitoring, including an assessment of the costs and benefits;
- consider the options for introducing greater transparency on gas quality incidents (such as, a quality complaints process as suggested by users), including an assessment of the costs and benefits; and
- assess whether the efficiency loss from current contractual arrangements is likely to be significant, and whether the Ministry of Consumer Affairs analysis in respect of electricity quality may be applicable to gas.

### **Advice**

Gas Industry Co's advice on current industry gas quality arrangements is that regulation is not required at this time. We will continue to work with industry participants to improve existing arrangements by completing the work described above.

We will continue to keep you informed of our progress and any findings that may change this advice.

Yours sincerely



**Rt Hon J Bolger, ONZ**

*Chair*

CC David Buckrell  
Carolyn van Leuven