



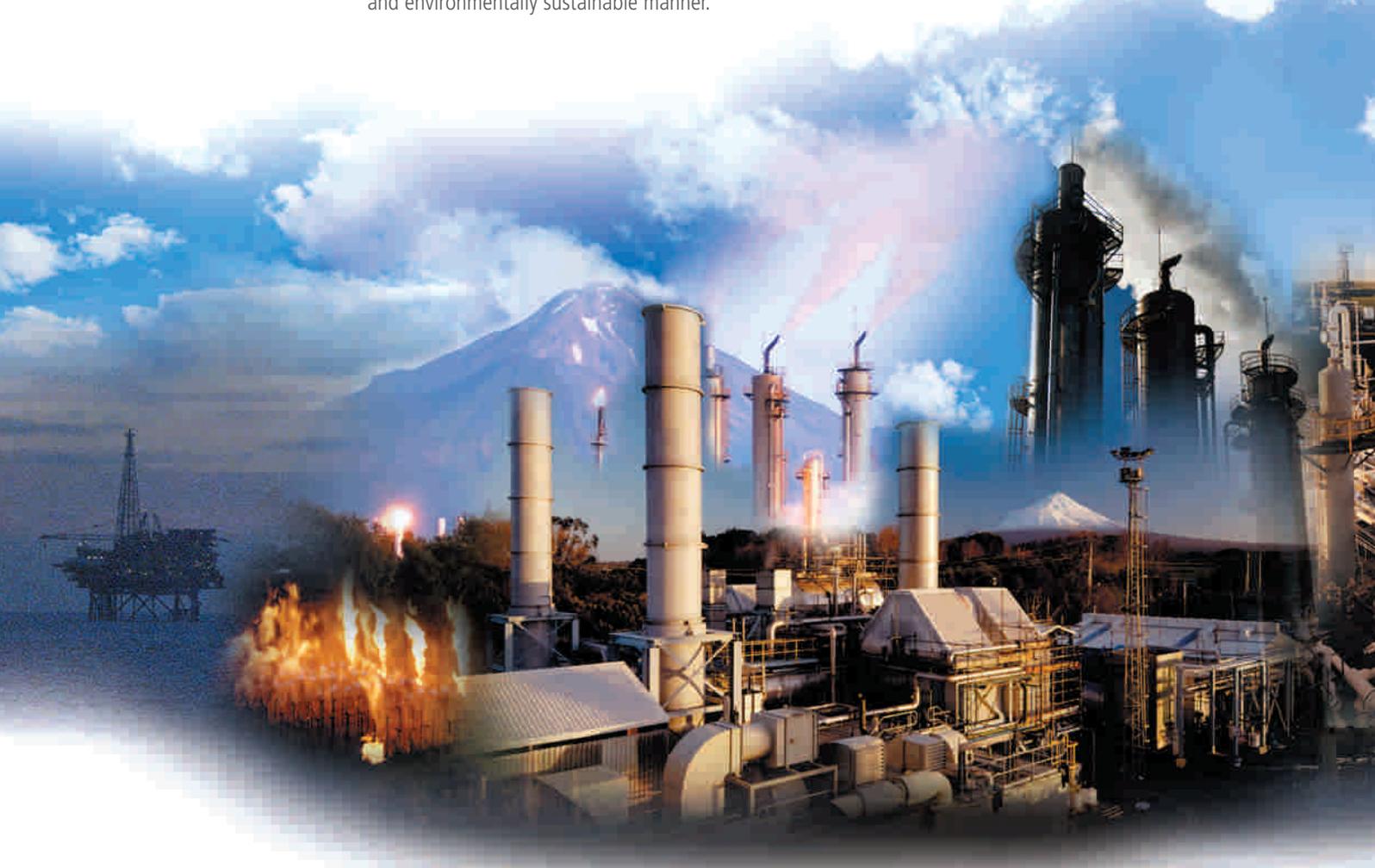
ANNUAL REPORT

05
06

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

The Gas Industry Co's role includes recommending to the Minister of Energy proposed arrangements, including regulations and rules where appropriate, for governing the gas industry.

The principal objective of the Gas Industry Co, in recommending gas governance arrangements, is to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner.



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Rt Hon James Bolger ONZ Chair
5 September 2006

Robin Hill Deputy Chair

Presented to the House of Representatives pursuant to section 43ZY of the Gas Act 1992, as amended by the Gas Amendment Act 2004.



The Gas Industry Co is a special purpose company, which was formed to be the co-regulator under the Gas Act. As such its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to key infrastructure; and
 - consumer outcomes;
- administer, oversee compliance with, and review such arrangements;
- report regularly to the Minister of Energy on the performance and present state of the New Zealand gas industry, and the achievement of the Government's policy objectives for the gas sector.

OUR PURPOSE

- to fulfil the role of the industry body under the Gas Act 1992; and
- to work with the gas industry and consumers to develop outcomes that meet the Government's policy objectives as stated in the October 2004 Government Policy Statement on Gas Governance.

OUR APPROACH

Gas Industry Co is committed to:

- clear problem definition and identification of best fit solutions based on the best available information;
- meaningful consultation with all parties likely to be substantially affected by policy reform;
- detailed development work on preferred options, including cost / benefit analysis;
- a focus on long term objectives and outcomes;
- open and transparent decision-making with clear recommendations to the Minister; and
- high standards of accountability to all its stakeholders (including consumers, industry and Government).

01

THE YEAR IN REVIEW



Rt Hon James Bolger, ONZ
Chairman



Christine Southey
Chief Executive

With the approval of the Gas Industry Co in December 2004 as the industry body under the recently amended Gas Act, the industry achieved the first step in the path to successful co-regulation. Then came the challenge of establishing the resources and systems to meet the Government's objectives and outcomes, and beginning work on the first of the tasks set out in the October 2004 Government Policy Statement on Gas Governance (the GPS).

Embarking on this challenge has been the focus of the Gas Industry Co in its first full year of operation. The Company is pleased with the significant progress which has been made in the 2005/06 financial year on both its establishment and work stream objectives.

The Company has identified six strategic priorities for the industry

Strategic Priorities

Given the significant changes occurring in the sector, it is not surprising that Government's expectations for gas industry development are quite extensive. To ensure orderly and careful development of policy reform, the Gas Industry Co believes it is important that it prioritise its policy reform activities.

Drawing together the GPS expectations, the Company's obligations under the Act, and feedback from stakeholders, the Company has identified six strategic priorities for the industry at this time:

- effective operation of the co-regulatory model;
- improving consumer arrangements;
- improvements to the retail market;
- development of wholesale market trading arrangements;
- review of infrastructure access; and
- establishing sound emergency management systems.

The Company has concluded that the diverse nature of the issues facing the industry means that there is no “one size fits all” policy instrument.

Approach to Work Programme

The Gas Industry Co has allocated the GPS tasks into work streams which reflect these strategic priorities. Each of the work streams requires a progression from issues analysis and policy option development, through to the development and implementation of the preferred options. A key aspect of the supporting analysis is a comparison of the options using qualitative and quantitative cost benefit analysis. The Gas Industry Co is committed to a high level of engagement with gas industry stakeholders as it works through its policy reform process, as evidenced by the 11 consultation papers released during the 2005/06 financial year (“Plan year”).

Policy Instruments

The Gas Industry Co has the benefit of a range of policy instruments available to it when considering how best to develop and implement gas industry reform. The choices range from voluntary arrangements such as model contracts and benchmarks, to binding bilateral or multilateral contractual arrangements, through to recommending rules or regulations be imposed by the Government under the authority of a statute.

The Company has concluded that the diverse nature of the issues facing the industry means that there is no “one size fits all” policy instrument. Therefore, the Gas Industry Co is planning to use the full range of available policy instruments in its different work streams, consulting with stakeholders early in the development process to confirm that it has chosen the most appropriate instrument for the work stream concerned.

Key Achievements

As a newly established entity, corporate accountability has been an important theme for the Company in the Plan year, its first full year of operation. This has involved design and implementation of a number of internal policies and procedures aimed at ensuring the Company meets its statutory requirements, achieves good internal governance and maintains effective relationships with its stakeholders.

In addition, the Gas Industry Co has established work streams across all of its strategic priority areas in the Plan year.

The year has seen the Gas Industry Co make recommendations to the Minister of Energy on model consumer contracts, low fixed charges, transparency of invoicing and disconnection arrangements. These recommendations were the culmination of a careful assessment of the issues and options, and consideration of stakeholder feedback.

Progressing the development of effective switching and registry arrangements has also been a key focus over the Plan year. This work has involved significant design and development activity, informed by several consultation rounds. The completion of this work in the next financial year is expected to deliver the industry and consumers timely and accurate customer switching arrangements

The Gas Industry Co would like to thank its shareholders for their continued support, and encourage any industry participant not currently a shareholder to take the important step of becoming one.



Chairman



Chief Executive

5 September 2006

and a tailor-made compliance regime. This in turn will enhance customer satisfaction and the effectiveness of retail competition in the gas sector.

The Company is also well advanced in its work in considering allocation and reconciliation arrangements, the development of new arrangements for a wholesale market, the specification for reticulated natural gas, access to pipelines and gas processing facilities and also new emergency management arrangements. Gas industry stakeholders should expect a steady stream of discussion papers on these topics in the next financial year.

Support of the Board, Shareholders, Industry and Other Stakeholders

The Company is aware of the burden its processes place on stakeholders, particularly during the Gas Industry Co's intensive development phase. The Company would like to thank those who have responded with submissions and discussions, and looks forward to your continued active dialogue and participation in the next financial year.

The Gas Industry Co is conscious that its work is funded by a levy on participants. The Board would like to acknowledge the support that the levy payers provide for the policy reform activities in the sector through their funding of the Gas Industry Co and its development work streams.

The Gas Industry Co continues to rely heavily on the strong support of its shareholders. The relationship has been strengthened in the Plan year through a series of meetings between the independent directors and each shareholder, aimed at strengthening mutual understanding of the sector and expectations of the co-regulatory model.

The 2005/06 financial year has seen the Company repay half of the funds advanced to it as shareholder loans. The Gas Industry Co would not have been able to make the progress it has over the past twelve months had it not been for the financial support of its founding shareholders.

The Gas Industry Co would like to thank its shareholders for their continued support, and encourage any industry participant not currently a shareholder to take the important step of becoming one. Maintaining a shareholding in the Gas Industry Co shows support for, and commitment to, successful co-regulation for the gas sector.

The Company is grateful for the contribution of its staff and individual Board members, and would also like to take this opportunity to thank those directors who have left the Board during the Plan year. Steve Barrett retired from the Board at the September 2005 Annual Meeting of Shareholders to return to the United States. Denis Clifford resigned in April 2006 following his appointment as a High Court Judge. Both directors made a significant contribution during their tenure on the Board.

In Conclusion

The 2005/06 financial year has seen the Gas Industry Co transition from a start-up company in the early throes of its establishment to a fully-staffed organisation making significant progress on meeting the GPS objectives. The Company has established itself as a corporate entity, identified its strategic priorities, completed some of its initial work streams, and is now well advanced in policy development activities.

02

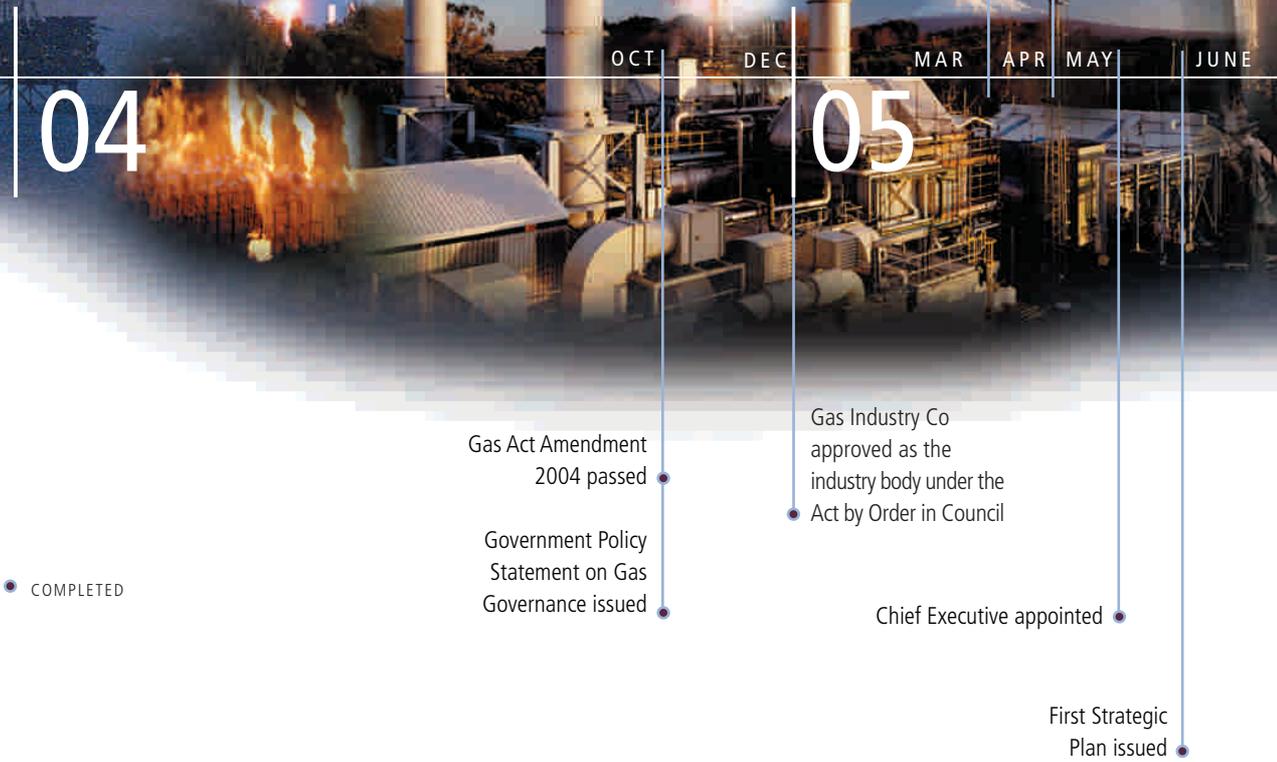
HIGHLIGHTS



Gas Complaints added to the existing Electricity Consumer Complaints Scheme

Released discussion paper Supplementary 2005/06 Levy Consultation

Released discussion paper 2005/06 Levy Consultation



● COMPLETED

Gas Act Amendment 2004 passed

Government Policy Statement on Gas Governance issued

Gas Industry Co approved as the industry body under the Act by Order in Council

Chief Executive appointed

First Strategic Plan issued

Gas Industry Co moved into its new premises at Level Nine, State Insurance Tower, 1 Willis Street, Wellington

First Annual Report issued

Senior Executives appointed

Released discussion paper Compliance and Enforcement Arrangements in the New Zealand Gas Industry

Released discussion paper 2006/07 Levy Consultation Paper

Released discussion paper Options for Amending Allocation and Reconciliation Arrangements

Recommendation to the Minister on Model Consumer Contracts

Recommendation to the Minister on Fixed Charges for Low Users and Other Consumer Issues

Consumer Issues Forum

Released issues paper Transmission Access Issues Review

Released discussion paper Mechanisms to Implement a Central Registry

2007/09 Strategic Plan Issued

OCT NOV DEC

FEB MAR APR

JUNE

SEP

06

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Industry Workshop Delivering the GPS

Released discussion paper Concept Design for Wholesale Gas Market

Released discussion paper Review of New Zealand Specification for Reticulated Natural Gas

Released discussion paper Cost Benefit Analysis of Switching and Registry Arrangements in the New Zealand Gas Industry

Released discussion paper Supplementary 2006/07 Levy Consultation Paper

Released discussion paper Options for Consumer Contracts Arrangements

Released discussion paper Options for Switching Arrangements for the New Zealand Gas Industry

03

REGULATORY AND POLICY FRAMEWORK

3.1

The co-regulatory model stems from the Government's desire for industry involvement in developing new policy settings.

CO-REGULATION

New Zealand's gas sector is governed by a co-regulatory governance arrangement. Co-regulation is not self-regulation. Co-regulation involves an industry body, the Gas Industry Co, recommending arrangements, including rules and regulations where appropriate, on a number of gas matters to the Minister of Energy following the processes set out in the Gas Act. The development of the co-regulatory model for the gas industry stems from the Government's desire for industry involvement in developing new policy settings for the industry.

The key features of the co-regulatory regime are:

- the regulatory vehicle is a special purpose entity (known as the industry body in the Gas Act), able to provide a mix of industry expertise and independent perspective to the Minister of Energy;
- the industry body is a private company, with constitutional limits on its activities, and specific obligations under the Gas Act and Companies Act;
- directors of the industry body, the majority of whom must be independent, are appointed by industry voting;
- the industry body has a range of policy instruments available to it, including recommending regulations/rules or non-regulatory arrangements where these are the most practicable option;
- the industry body has the power to levy industry participants for its costs; and
- there is an expectation of input from industry participants to the development of arrangements through working groups and consultation processes.

The combination of the Gas Act, the Government Policy Statement, and the Constitution of the Gas Industry Co collectively provides the framework within which the Gas Industry Co is required to operate in developing new gas governance arrangements.

The Government's overall policy objective for the gas industry is to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner.

3.2 THE GAS ACT

The Gas Act, as amended in late 2004, provides for the establishment of an industry body to act as the co-regulator advising the Government on arrangements to govern the gas industry. The Gas Industry Co was incorporated in July 2004 and approved as the industry body under the Act by Order in Council on 22 December 2004.

As the industry body under the Act, the Gas Industry Co is able to make recommendations to the Minister of Energy on a range of matters affecting governance of the gas sector. This range includes the wholesaling, retailing, processing, transmission and distribution of gas. The Act also sets out certain requirements for the Gas Industry Co relating to the GPS, reporting to Government, the Company constitution and funding.

3.3 THE COMPANY'S CONSTITUTION

Gas Industry Co's constitution has been designed to ensure that the Company complies with the requirements for approval as an industry body under the Act, and continues to do so over time.

The Act requires that to be approved as the industry body an entity needs to:

- be broadly inclusive of industry participants (membership is not compulsory);
- have a board with a majority of independent members, including an independent chair;
- be capable of delivering outcomes that meet the Government's objectives for the gas industry;
- have governing rules with objectives consistent with the objectives set out in section 43ZN of the Gas Act relating to developing recommendations on the wholesaling, processing, transmission, distribution and retailing of gas;
- allow all industry participants, except service providers appointed under any gas governance regulation, to become members of the industry body; and
- have rules requiring it to regularly report to the Minister on the performance and state of the gas industry, the entity's performance and achievement of its objectives and other relevant matters.

The Gas Industry Co's constitution was adopted in November 2004, and subsequently amended in May 2006 to allow for the Gas Industry Co to undertake roles wider than just those under rules and regulations, as described in the Governance Overview section of this report. A copy of the constitution is available on the Gas Industry Co's website.

3.4 THE GOVERNMENT POLICY STATEMENT ON GAS GOVERNANCE (GPS)

The Minister of Energy has set the objectives and outcomes for the Gas Industry Co, and the gas industry, by issuing a GPS. The GPS was published in the Gazette and presented to the House of Representatives in October 2004. The GPS sets out the specific outcomes that the Government expects the Gas Industry Co to pursue in the areas of wholesaling, processing, transmission, distribution and retailing of gas.

As outlined in table 1, the GPS states that the Government’s overall policy objective for the gas industry is to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner.

Consistent with this overall objective, the GPS sets out a number of specific objectives and outcomes it expects the Gas Industry Co to pursue. Significantly, the Gas Industry Co is not given “carte blanche” as to how it should attain these objectives and outcomes. Instead the GPS sets a series of tasks across a number of defined areas. These reflect the Government’s assessment of the priority areas for action. The Gas Industry Co agrees that these are the priority tasks for the industry.

TABLE 1

THE GOVERNMENT POLICY STATEMENT ON GAS GOVERNANCE

Overall Objective	"to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable,				
Specific Outcomes	The facilitation and promotion of the ongoing supply of gas to meet New Zealand’s energy needs, by providing access to essential infrastructure and competitive market arrangements	Energy and other resources are used efficiently	Barriers to competition in the gas industry are minimised to the long-term benefit of end-users	Incentives for investment in gas processing facilities, transmission and distribution, energy efficiency and demand-side management are maintained or enhanced	The full costs of producing and transporting gas are signalled to consumers
Tasks	Wholesale Markets and Processing				Transmission
	The development of protocols and standards applying to wholesale gas trading, including quality standards, balancing and reconciliation	The development of a secondary market for the trading of excess and shortfall quantities of gas	The development of capacity trading arrangements	Protocols that set reasonable terms and conditions for access to gas processing facilities	The establishment of an open access regime across transmission pipelines so that gas market participants can access transmission pipelines on reasonable terms and conditions

An assessment of the Company's progress towards delivering these tasks, and therefore meeting the Government's objectives and outcomes for the sector, is provided in the Operations Review of this Report.

3.5 IN SUMMARY

The combination of the Gas Act, GPS and the Company's constitution provides the co-regulatory framework within which the Gas Industry Co is required to operate. They set out a clear role for the Gas Industry Co that involves leading the gas sector to develop, implement and review industry arrangements. They also specify the areas which have been identified by the Government and the industry as requiring a common approach to achieving Gas Act and GPS objectives and outcomes. They are the touchstone by which the Company considers its development proposals and measures the industry's performance in meeting the expectations of Government and stakeholders.

OCTOBER 2004

and environmentally sustainable manner."

Delivered gas costs and prices are subject to sustained downward pressure	The quality of gas services and in particular trade-offs between quality and price, as far as possible, reflect customers' preferences	Risks relating to security of supply, including transport arrangements are properly and efficiently managed by all parties	Consistency with the Government's gas safety regime is maintained	The gas sector contributes to achieving the Government's climate change objectives by minimising gas losses and promoting demand-side management and energy efficiency
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and Distribution Network		Retail and Consumer Arrangements		
The establishment of consistent standards and protocols across distribution pipelines so that gas market participants can access distribution pipelines on reasonable terms and conditions	The establishment of gas flow measurement arrangements to enable effective control and management of gas	The standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised	The development of efficient and effective arrangements for the handling of consumer complaints	The development of model contract terms and conditions between consumers and retailers

04

GOVERNANCE OVERVIEW

The diversity of its shareholders across all sectors of the gas industry is a key strength for the Gas Industry Co: production, transmission, distribution, retailing and consumption are all represented.

4.1

BOARD OF DIRECTORS

At the heart of the co-regulatory governance model is the Gas Industry Co's Board. The Board is appointed by industry shareholders and comprises a mix of industry and independent directors. Under the Company's constitution, the Board of Directors must comprise not more than seven non-executive directors, four of whom (including the Chairman) must be independent of the gas industry.

The Gas Industry Co held its inaugural Annual Meeting of Shareholders on 22 September 2005. The Company's constitution requires that at every annual meeting at least a third of the directors (to the nearest whole number) must retire from office. At the meeting Dr Ajit Bansal of Shell (Petroleum Mining) Company Limited and Mr Murray Jackson of Genesis Power Limited were elected to the Board to fill vacancies created by the departure of Mr Donald Morgan of Swift Energy New Zealand Limited and Mr Stephen Barrett of Contact Energy Limited. Pursuant to the Company's rotation policy, Mr Denis Clifford, one of the independent directors retired at the meeting, and was subsequently re-elected.

Details of the Gas Industry Co's current Board of Directors are provided at Section 5 of this Report. During the Plan year the Board had a casual vacancy due to the resignation of Denis Clifford on 21 April 2006 following his appointment to the High Court.

The Board meets monthly throughout the year, to consider reports and recommendations from the senior management regarding the operation of the Company and the development of gas market arrangements. The Chair and Chief Executive also meet with the Minister on a bi-monthly basis to report on the Company's progress in meeting the GPS deliverables.

4.2

COMPANY SHAREHOLDERS

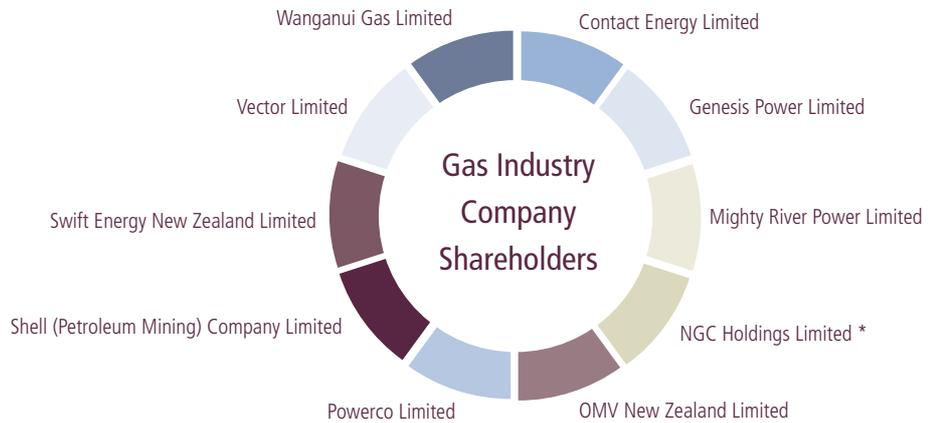
The diversity of its shareholders across all sectors of the gas industry is a key strength for the Gas Industry Co: production, transmission, distribution, retailing and consumption are all represented. The on-going support of the shareholders is key to the Company's success in delivering the GPS.

The Gas Industry Co encourages all industry participants to become shareholders in the Company. Each shareholder holds a \$1 redeemable share, redeemable at the option of the shareholder. Every shareholder is entitled to one vote on a poll at a meeting of shareholders on any resolution.

Vector and NGC Holdings were both among the ten founding shareholders of the Gas Industry Co. Under the related shareholding provisions of the Company's constitution, the voting rights attached to the shares of NGC Holdings were suspended as at 30 June 2005, as a result of Vector's ownership of NGC.

Shareholders of the Gas Industry Co

*The voting rights attached to the shares of NGC Holdings were suspended as at June 2005 under the related shareholding provisions of the Company's constitution.



4.3 COMPANY CONSTITUTION

When the Gas Industry Co's constitution was first developed, the primary focus was to ensure that the Company complied with the requirements for approval as an industry body under the Act, and continued to do so over time. In late 2005 it became apparent that the limited wording in the constitution regarding the Gas Industry Co's purpose and function created uncertainty. In particular, it cast doubt on the Company's ability to recommend non-regulatory solutions and to undertake some of the roles that had been requested of it by industry participants. This was at odds with the GPS, since the GPS clearly contemplates contractual as well as regulatory solutions.

Following shareholder discussions, suitable amendments to the constitution were proposed, and the revised constitution received the unanimous approval of shareholders in May 2006. The changes allow the Company to undertake all roles set out in the 2006/07 work programme, including the roles requested of it to date in relation to the Gas Transfer Code, Reconciliation Code, National Gas Outage Contingency Plan and Maui Pipeline Operating Code. In the event that the Company wishes to undertake additional roles in respect of existing arrangements, it needs to secure a special resolution of shareholders (75% majority).

4.4

The Gas Act provides for the Gas Industry Co to recover the cost of exercising its functions as the industry body through a levy on industry participants.

FUNDING

The Board and Executive of the Gas Industry Co place a high importance on managing the Company in a prudent and efficient manner, including appropriate cost control. The forecast statement of financial performance for the 2005/06 financial year was set out in the Strategic Plan published in June 2005.

Throughout the year the Board has monitored the financial performance of the Company, and required strong disciplines to be in place to prevent unnecessary expansion of the costs of the co-regulatory arrangements.

The Gas Industry Co has three sources of funding to meet its expenditure requirements in delivering effective co-regulation and fulfilling its GPS obligations:

- a levy on industry participants, pursuant to the Gas Act;
- an annual shareholders fee; and
- shareholder loans.

a. Levy On Industry Participants

The Gas Act provides for the Gas Industry Co to recover the cost of exercising its functions as the industry body through a levy on industry participants. The levy requirements are set out in regulations made by the Minister following a recommendation from the Gas Industry Co.

The Gas Act defines an industry participant as being any of the following: a gas retailer; a gas distributor; a gas producer; a pipeline owner; a gas wholesaler; a person who purchases gas directly from a gas producer or gas wholesaler or on any wholesale gas market; a service provider appointed under any gas governance regulations; a gas metering equipment owner; or a data administrator that provides data administration services to the gas industry.

The Gas (Levy of Industry Participants) Regulations for the 05/06 financial year were gazetted in July 2005 following widespread industry consultation. In summary:

- the wholesale gas levy applied to each quarter of the 2005/06 financial year, and was payable by three equal monthly instalments for each quarter. The rate was 1.5 cents (plus GST) for each gigajoule of gas that was purchased by an industry participant from gas producers during the quarter before each completed quarter of the financial year; and
- the retail gas levy applied to all gas retailers and was payable in 12 equal monthly instalments. It had two components. The first was 6 cents (plus GST) for each gigajoule of gas supplied by a retailer to its retail customers during the 2003/04 gas year. The second was \$4.00 (plus GST) for each network connection point at which a gas retailer has a contract to supply gas as at 30 September 2004. Both components applied only in respect of supply to end users who consumed less than 10 terajoules of gas a year.

The constitution requires all shareholders to pay an annual fee to the Gas Industry Co.

The levy is determined on an annual basis, and the Company has an obligation to consult with industry participants before making a levy recommendation to the Minister. In February 2006 the Gas Industry Co released a Levy Discussion Paper which sought the views of stakeholders on a number of possible levy design options for the 2006/07 year. Among the submissions received were some convincing arguments in favour of an alternative option – a fully fixed retail levy and a variable wholesale levy. A Supplementary Levy Discussion Paper was issued in March 2006 describing this alternative option.

Following extensive consultation a levy based on the alternative option, as described in the supplementary paper, was recommended to the Minister. The levy for the financial year ending 30 June 2007 now comprises:

- a wholesale component of 1.78 cents (plus GST) on each gigajoule (GJ) of gas purchased from a producer. The levy continues to be calculated quarterly and paid monthly, based on the party's total gas purchases in the quarter before the last completed quarter; and
- a retail component of \$6.30/year (plus GST) for each network connection point (ICP), payable in respect of every ICP (rather than only in respect of end users consuming less than 10 terajoules of gas a year as was previously the case). The levy is calculated monthly on the basis of the number of ICPs supplied by each retailer at the end of the previous month.

b. Annual Shareholder Fee

The constitution requires all shareholders to pay an annual fee to the Gas Industry Co, set annually by the Board. The fee funds a portion of the general operating expenses of the Company.

The Board set the annual fee for the 2005/06 financial year at \$10,000 (plus GST) per shareholder.

c. Shareholder Loans

In its establishment phase, the Gas Industry Co was predominantly funded from limited recourse loans from its shareholders. In the period to 30 June 2005, these totalled \$1.6 million. The shareholder loan arrangements require the loans to be repaid over the two years following the implementation of the levy, or by 31 December 2007, whichever is the earlier. Over the Plan year the Company has repaid half of these loans.

Detailed financial accounts for the 2005/06 financial year are contained in Section 9 of this Report.

05

THE BOARD OF DIRECTORS



Left to right: Mr Denis Clifford (resigned as a Director effective 21 April 2006),
Dr Ajit Bansal, Mr Mark Franklin, Mr Murray Jackson, Rt Hon Jim Bolger (Chair),
Mr Mark Verbiest, Ms Christine Southey (Chief Executive), Mr Robin Hill (Deputy Chair)

Rt Hon James B Bolger, ONZ,
Chairman
and Independent Director

Jim has had a distinguished career in politics, which includes being Prime Minister of New Zealand from October 1990 to December 1997, holding ministerial positions for 16 years and leading the National Party for 12 years. He was New Zealand's Ambassador to the United States of America from June 1998 to January 2002. Jim is currently Chairman of several organisations in addition to the Gas Industry Co, including New Zealand Post and its subsidiary Kiwibank, Express Couriers Limited, the Advisory Board of the World Agricultural Forum and the Ian Axford Fellowships in Public Policy. He is also a Trustee of the Rutherford Trust and President of the NZ/US Council.

Robin G Hill,
Deputy Chairman and Independent
Director, B Comm, FCA Fellow of
New Zealand Institute of Chartered
Accountants

Robin has an extensive background in financial and business management. He was Chairman and Chief Executive of PricewaterhouseCoopers New Zealand from 1992 to 2003. He was also a member of the firm's Global Board from 1992 to 1995 and the Executive Advisory Group from 1999 to 2000. Robin has provided a wide range of advisory services to a number of large corporates, including several energy companies.

Denis K Clifford,
Independent Director BA, LLB (Hons)

In April 2006, Denis was appointed as a Judge of the High Court and immediately resigned from his position on the Board.

Denis has significant experience in the areas of commercial law (particularly banking, company and securities) and public law. Denis was a Senior Partner at Buddle Finlay and held the positions of Senior Banking and Commercial Partner, 1990 to 2001, Managing Partner, 1991 to 1993, and Board Member, 1990 to 2001. As an independent barrister, Denis undertook work on a range of commercial and public law matters.

Mark J Verbiest,
Independent Director LLB

Mark has extensive experience of regulatory structures and competition law, as well as previous involvement in the energy sector. Mark is Group General Counsel for Telecom Corporation of New Zealand and is a member of the Telecom Senior Executive Committee. Prior to joining Telecom in 2000, he was a senior partner at Simpson Grierson specialising in corporate, securities, competition and energy-related law.

Ajit Bansal,
PhD, BSc (Hons), DipM

Ajit is the Commercial Manager for Shell's Exploration and Production activity in New Zealand and is currently the Country Chairman for Shell New Zealand. He is also Chairman of Maui Development Limited, which is the services company for the Maui Joint Venture. Ajit has 20 years industry experience, and has worked on various Shell projects based in Thailand, The Hague, China and Singapore.

Mark X Franklin,
Bachelor of Electrical Engineering

Mark is the Chief Executive Officer of Vector Limited. He has experience in the energy and technology sectors in New Zealand, Australia and Japan. He has held a number of leadership roles including Chief Executive of Orion Energy in the Hunter Valley, NSW, and Asia Pacific general manager of IBM Global Services Australia for utilities. Mark also spent ten years with the Electricity Commission of NSW and three years with Pacific Power Australia. He was also previously general manager of WELNet, a subsidiary of the WEL Energy Group.

Murray E Jackson,
MBA, BEc, FTSE, FIEAust

Murray is the Chief Executive of Genesis Energy after establishing it as a state owned enterprise in 1999. Murray's engineering career has included the commissioning of 200MW, 500MW and 660MW coal fired power plants in Victoria and New South Wales. Prior to establishing Genesis Energy, Murray was the Commissioner of the Snowy Mountains Hydro-Electric Authority, a dual electricity generation and irrigation scheme located within Australia's high alpine Kosciuszko National Park. Murray is a guarantor member of the Mt Eliza Business School in Melbourne, Chairman of the Genesis Oncology Trust and Chairman of Energy Online, a wholly owned subsidiary of Genesis Energy.

06

THE MANAGEMENT TEAM



To support the Chief Executive in delivering the company's work programme the Gas Industry Co has a small internal staff divided into two teams.

Corporate Accountability team which has overall responsibility for the delivery of the work programme, financial management, human resource issues, strategic issues, stakeholder liaison, and the relationship with Government.

Work Stream Leaders team which is comprised of experienced senior executives with responsibility for managing each of the policy development work streams.

The Company also relies on expert external advisors, working groups and project teams to support its core internal staff resources.



Chief Executive
Christine Southey
BA (Hons), LLB

Christine was appointed in May 2005. She was most recently a Commissioner on the Electricity Commission from 2003 to immediately prior to joining the Gas Industry Co. Christine has an extensive background in the energy sector. She was formerly a partner in a national law firm, the Legal Services Director at Contact Energy during its establishment phase, Corporate Services Director for Genesis Power during its establishment phase and a Director and Shareholder in Concept Consulting Group between 1999 and 2003. Christine was also a Director of Solid Energy from 1999 to 2004.

07

OPERATIONS REVIEW

Overview

The Gas Industry Co has concentrated its objectives, outcomes and expectations into six priority areas for action. The following table sets out the Gas Industry Co's work streams over the Plan year and shows how these relate to the Company's strategic priority areas.

STRATEGIC PRIORITIES	WORK STREAMS
Effective Operation of the Co-regulatory Model	<ul style="list-style-type: none"> • Corporate Accountability
Improving Consumer Arrangements	<ul style="list-style-type: none"> • Consumer Issues <ul style="list-style-type: none"> • Consumer Complaints • Model Contracts • Low Fixed Charges and other Consumer Issues
Improvements to the Retail Market	<ul style="list-style-type: none"> • Switching and Registry • Downstream Reconciliation
Development of Wholesale Market Trading Arrangements	<ul style="list-style-type: none"> • Wholesale Market • Upstream Reconciliation • Quality Standards
Review of Infrastructure Access Arrangements	<ul style="list-style-type: none"> • Access to Transmission Pipelines • Access to Gas Processing Facilities • Distribution Contracts
The Development of Sound Emergency Management Systems	<ul style="list-style-type: none"> • Gas Outage Emergency Management Plan

7.1

EFFECTIVE OPERATION OF THE CO-REGULATORY MODEL

a. Corporate Accountability

Establishment

The 2005/06 financial year has seen the Company establish itself as a stand alone entity. The Company is now fully staffed and has moved into its refurbished offices in the State Insurance Tower. It has also established systems and processes required to support its work programme.

2005/6 discussion papers

Options for Consumer Contract Arrangements

Options for Switching Arrangements for the New Zealand Gas Industry

2006/07 Levy Consultation Paper

Concept Design for Wholesale Gas Market

Review of New Zealand Specification for Reticulated Natural Gas

Cost Benefit Analysis of Switching Arrangements in the New Zealand Gas Industry

Supplementary 2006/07 Levy Consultation Paper

Compliance and Enforcement Arrangements in the New Zealand Gas Industry

Options for Amending Allocation and Reconciliation Arrangements

Transmission Access Issues Review

Mechanisms to Implement a Central Registry

These include project and financial management systems, board reporting processes and systems to support clear communication with all its stakeholders.

Reporting

In addition to monthly Board reports and quarterly reports to the Minister, the Plan year has also produced a range of external reports. These include 11 papers for consultation, three formal recommendations to the Minister of Energy, the Company's Annual Report 2004-05 and the Company's Strategic Plan 2007-09.

Levy Development Process

A precondition of the Company's entitlement to levy industry participants to cover its costs is an annual consultation process. This process, combined with normal Government processes for the development of regulations, means the development of the annual levy is a significant aspect of the corporate work stream.

Communication

The Gas Industry Co has invested considerable effort over the year in ensuring its communications with shareholders and other industry participants are effective in supporting its work streams. The Company's two principal tools of communication are stakeholder newsletters and regular website updates.

Gas Industry Co executives have also continued to maintain a high profile at industry conferences and forums. These forums provide a valuable opportunity for the Company to communicate its goals and progress with delivering the GPS outcomes, and to hear directly from stakeholders. A particular highlight was the workshop for stakeholders hosted by the Gas Industry Co in December 2005 titled "Delivering the GPS".

The Company also presents at appropriate conference events. In particular, the Chief Executive presented at the Gas Conference in September 2005, the New Zealand Institute of Gas Engineers Seminar in October 2005 and the National Power Conference in March 2006. The Chairman also made a presentation to the Petroleum Conference in March 2006.

7.2

IMPROVING CONSUMER ARRANGEMENTS

While over the long term consumers will benefit from many of the Company's work streams, the Government also has specific expectations for action to improve consumer outcomes. The GPS requests the Gas Industry Co to develop proposals for:

- efficient and effective arrangements for the proper handling of consumer complaints; and
- model contract terms and conditions between consumers and retailers.

Also, in November 2005 the Minister of Energy asked the Gas Industry Co to examine certain consumer concerns in relation to the level of fixed charges for low users, the transparency of charges on consumer bills and different practices for meter removal.

The Company has also taken a proactive approach to seeking consumers' views on gas policy reform and arrangements which ensure that consumers can readily participate in the consultation processes.

Achieving improvements to consumer arrangements has been a key focus for the Gas Industry Co over the Plan year.

Achieving improvements to consumer arrangements has been a key focus for the Gas Industry Co over the Plan year.

Consumer Complaints

In April 2005, gas was added to the electricity complaints scheme creating the Electricity and Gas Complaints Commission ("EGCC"). Over the past year a joint project team (the Land Code Working Group) between the Gas Industry Co, Transpower and the Electricity Networks Association has been looking at extending the scheme to include landowner / occupier disputes. The project team has developed a proposal for the scheme to be expanded and has undertaken three rounds of consultation on this proposal. It is anticipated that landowner / occupier disputes will be added to the EGCC scheme in the next financial year.

Model Contracts

In November 2005 the Gas Industry Co issued a consultation paper titled **Options for Consumer Contract Arrangements**. The paper explored the broad options to ensure effective outcomes for consumers in respect of their contracts with gas retailers. This included an analysis of existing contractual arrangements, a consideration of governance and compliance issues, and a review of other industry organisations that have a role in consumer protection issues arising from gas consumer contracts.

The Gas Industry Co concluded that improvements to the governance around the existing code of practice administered by the Electricity and Gas Complaints Commission are the best solution to achieve the Government's policy objectives in this area. The rationale for this conclusion is that the code provides benchmark protection for consumers, whilst avoiding the inefficiencies and contractual roles associated with the Gas Industry Co developing a "rival" model contract.

The Gas Industry Co made its recommendation to the Minister on Model Contracts in May 2006.

Fixed Charges for Low Users and Other Consumer Issues

On 27 June 2006 the Gas Industry Co made its Recommendation to the Minister of Energy on Fixed Charges for Low Users and Other Consumer Issues. The recommendation was the product of a review of current practices and numerous discussions with industry participants.

The Gas Industry Co concluded:

- that the level of fixed charges faced by retailers supported a high fixed charge being imposed on end users, and that regulation to reduce the maximum fixed component would be economically inefficient;
- that the disclosure of price components on a retailer's invoices would be expensive for retailers and potentially confusing to customers, and would not necessarily improve consumer outcomes particularly as the EGCC scheme already requires price disclosure of component charges at the time of any price changes; and
- that the arrangements relating to meter removal practices require review to facilitate greater standardisation and the minimisation of inefficient meter removal.

The Gas Industry Co has made significant progress over the Plan year in developing arrangements for the timely and accurate switching of customers between retailers and distributors.

7.3

Consumer Issues Forum

In June 2006 the Gas Industry Co held a Consumer Issues Forum, chaired by the Chief Executive of the Consumers' Institute. By maintaining open relationships with consumers and consumer representatives the Company hopes to encourage more communication on consumer issues. Also, since the forum allows an exchange of information on industry developments and how these are impacting consumers, the quality of communication on consumer issues should improve.

The feedback on this forum has been very positive and the Company will continue to explore ways of maintaining open, well informed communication with consumers.

IMPROVEMENTS TO THE RETAIL MARKET

With the removal of franchise boundaries in the early 1990's the retail gas market became fully contestable. However, competition has not been as lively as many had hoped. This is partly because of issues relating to the supply of gas and also because the systems for effective competition between multiple industry participants are not fully developed. For example, arrangements for transferring customers between retailers and for calculating and recording the quantities of gas bought and sold do not currently operate efficiently. Improving these systems has been another focus of the Company in the Plan year.

a. Switching and Registry

The GPS expects the Gas Industry Co to propose arrangements for

- the standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised.

The Gas Industry Co has made significant progress over the Plan year in developing arrangements for the timely and accurate switching of customers between retailers and distributors. The process followed in the development of these arrangements provides a tangible example of the co-regulatory model in action. A case study of the switching and registry work stream is outlined in Section 8 of this Report.

b. Allocation and Reconciliation

Efficient markets require a system to allocate the various quantities of gas being injected, transported and delivered by industry participants to consumers. This process is referred to as allocation and reconciliation. The GPS includes two expectations for the Gas Industry Co which relate to allocation and reconciliation arrangements:

- the development of protocols and standards applying to wholesale gas trading, including quality standards, balancing and reconciliation; and
- the establishment of gas flow measurement arrangements to enable effective control and management of gas.

Stakeholders identified improving allocation and reconciliation arrangements as a priority area for

7.4
The underlying driver for the development of more sophisticated arrangements for the trading of gas at the wholesale level is a change to the market circumstances which prevail.

the Gas Industry Co. Accordingly, during the Plan year the Company established two project teams to assist it review current allocation and reconciliation arrangements. These project teams were the Gas Allocation and Reconciliation Team (GART) which focussed on downstream reconciliation, and the Gas Transfer Code Team (GTCT) which focussed on upstream reconciliation.

In June 2006 the Gas Industry Co released a consultation paper titled **Options for Amending Allocation and Reconciliation Arrangements**. The paper reviewed the current arrangements for downstream and upstream allocation and reconciliation, identified a number of issues with each set of arrangements, and outlined some preliminary proposals on the direction in which arrangements could be developed.

DEVELOPMENT OF WHOLESALE MARKET TRADING ARRANGEMENTS

a. Wholesale Market

The underlying driver for the development of more sophisticated arrangements for the trading of gas at the wholesale level is a change to the market circumstances which prevail. These include:

- the transition from the Maui legacy era dominated by single field supply, to a new environment characterised by supply from a wider range of smaller sources – which requires interactions among a greater number of parties;
- the need to cover the upfront costs of field development with stable long term contracts;
- the likely increase in the variability of physical gas demand from gas-fired power stations as penetration of wind generation and other ‘must run’ generation expands; and
- growing competition in the retail gas market – which increases the variability of individual gas retailers’ needs.

The Gas Act provides that the Gas Industry Co has the power to recommend regulations or rules for the establishment and operation of wholesale markets for gas. Further the GPS expects the Gas Industry Co to propose arrangements for:

- the development of protocols and standards applying to wholesale gas trading, including quality standards, balancing and reconciliation; and
- the development of a secondary market for the trading of excess and shortfall quantities of gas.

Taken together, the Gas Industry Co considers that the GPS and Gas Act tasks the Company with ensuring there are efficient arrangements for the trading of long term, short term and balancing gas quantities. As an initial step towards this task the Gas Industry Co has been looking at the ease of trading.

In March 2006, the Gas Industry Co released a consultation paper titled **Concept Design for Wholesale Gas Market**. The paper noted that there does not appear to be any benefit in seeking to organise trading of long term gas contracts which are negotiated on an infrequent basis and are highly tailored to specific circumstances. However there may be benefits in facilitating short term

The Gas Industry Co is also tasked with addressing the arrangements which apply to access key infrastructure in the gas sector.

7.5

trading. The paper set out five options for improving short term trading arrangements. Following submissions the Gas Industry Co is now taking a modular approach to this work stream and further developing options for the short term trading of gas quantities.

b. Quality Standards

Gas Industry Co also considered whether the current gas specification continues to be adequate in the light of potential new gas fields coming on stream. There can often be a tension between gas producers who seek a wide specification, large gas users who seek strict control on the gas specification to maximise plant performance, and retail consumers who have an installed appliance base which requires a particular specification to ensure safe and reliable operation.

In March 2006 the Gas Industry Co released a consultation paper titled **Review of New Zealand Specification for Reticulated Natural Gas**. The paper presented a technical review of the current Standard NZS 5442:1999 undertaken by an independent consultant. Industry submissions on the paper strongly supported the recommendation that the current limits defined in NZS 5442:1999 are adequate and do not need to be changed. The Gas Industry Co intends to make a recommendation to the Minister to this effect early in the next financial year.

REVIEW OF INFRASTRUCTURE ACCESS ARRANGEMENTS

In addition to improving outcomes for consumers and developing the arrangements for the wholesale and retail trading of gas, the Gas Industry Co is also tasked with addressing the arrangements which apply to access key infrastructure in the gas sector: namely transmission and distribution pipelines and access to gas processing facilities. This is to ensure there are no barriers to the growth of competition in the wholesale and retail markets. During the Plan year the Gas Industry Co embarked on extensive "problem definition" analysis with its stakeholders to assist it to identify the appropriate arrangements for access to each of these different types of infrastructure.

a. Access to Transmission Pipelines

In relation to transport arrangements on New Zealand's high pressure transmission pipelines, the GPS expects the Gas Industry Co to propose arrangements for:

- the establishment of an open access regime across transmission pipelines so that gas market participants can access transmission pipelines on reasonable terms and conditions.

A series of stakeholder interviews was held during March, April and May 2006. On the basis of these interviews an issues report was developed and released in June as a consultation paper titled **Transmission Access Issues Review**. The consultation paper categorised the matters raised by stakeholders into a number of themes. Following a description and exploration of each theme, some preliminary conclusions were drawn and suggestions made as to how the issues might be addressed. These are now being progressed.

Gas industry participants requested that the Gas Industry Co review current arrangements for managing emergency and contingency situations.

b. Access to Gas Processing Facilities

The GPS expects the Gas Industry Co to propose arrangements for:

- protocols that set reasonable terms and conditions for access to gas processing facilities.

During the Plan year the Gas Industry Co commissioned a technical analysis of gas processing to establish whether gas processing facilities exhibit economies of scale sufficient to warrant regulatory intervention and whether the magnitude of gas processing costs is significant in the context of all of the costs along the value chain from exploration to delivering gas to market.

The Company also undertook a series of industry interviews aimed at identifying any inefficiencies that may have occurred with regard to parties attempting to have their raw gas processed by plants owned by other parties. The Gas Industry Co anticipates releasing a discussion paper on this analysis early in the next financial year.

c. Distribution Contracts

The GPS expects the Gas Industry Co to propose arrangements for:

- the establishment of consistent standards and protocols across distribution pipelines so that gas market participants can access distribution pipelines on reasonable terms and conditions.

During the Plan year the Gas Industry Co met with industry participants to discuss existing distribution contracts. The Company is now in the process of analysing feedback from these discussions and also the implications of recently released Commerce Commission work in this area.

7.6

THE DEVELOPMENT OF SOUND EMERGENCY MANAGEMENT SYSTEMS

During the Plan year, gas industry participants requested that the Gas Industry Co review current arrangements for managing emergency and contingency situations. The current National Gas Outage Contingency Plan (NGOCP) is a voluntary industry-based arrangement which is not fully supported by all industry participants.

In response to this request, and the GPS requirement that risks relating to security of supply, including transport arrangements, are properly and efficiently handled by all parties, the Gas Industry Co has reviewed arrangements for managing gas emergency and contingency situations. The Gas Industry Co expects to release a discussion paper on this analysis early in the next financial year.

08

CO-REGULATION IN ACTION

A key focus for the Gas Industry Co over the Plan year has been the development of new switching arrangements for retail customers. The process followed in the development of these arrangements - from GPS expectation through to a "Statement of Proposal" under the Gas Act - provides a tangible example of the co-regulatory model in action.

The GPS expects the Gas Industry Co to propose arrangements for:

- the standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised.

In response to that expectation, Gas Industry Co formed the Switching & Registry Working Group. The task of the Switching & Registry Working Group was to consider policy solutions to facilitate effective and accurate switching of retail customers. The Switching & Registry Working Group included industry and consumer representatives and had an independent Chair.

Over the Plan year the Gas Industry Co released four consultation papers on developing efficient arrangements for the switching of customers.

In November 2005 the Gas Industry Co released a consultation paper titled **Options for Switching Arrangements for the New Zealand Gas Industry**. The paper identified 4 options for discussion and feedback, being:

- do nothing – status quo;
- amend Reconciliation Code Part B (which contains the current switching process) to include enforcement/dispute resolution provisions and standard communications protocols;
- develop a central registry for switching; and
- develop a central registry as above with further functionality to include allocation mechanisms.

The paper recommended that establishing a central registry would best meet the objectives of the GPS. Submissions were received from 10 parties which indicated industry support for development of a central registry as the preferred approach.

In March 2006 the Gas Industry Co issued a paper titled **Cost Benefit Analysis of Options for Switching Arrangements in the New Zealand Gas Industry**. The cost benefit analysis was based on information provided by the industry and indicative quotations received from potential software suppliers. Submissions were received from 8 parties in response to the paper which confirmed continued industry support for development of a mandatory central registry.

In parallel with the development of new arrangements for the efficient switching of customers the Gas Industry Co progressed the development of a compliance and enforcement regime.

In April 2006 the Gas Industry Co released a consultation paper titled **Options for Compliance and Enforcement Arrangements in the New Zealand Gas Industry**. The paper considered a full range of compliance requirements, from minimal compliance with enforcement of contractual terms at the election of the parties, through to a comprehensive compliance regime including monitoring and surveillance. The paper proposed a compliance and enforcement regime to support the implementation of switching and registry rules and any future arrangements recommended by the Gas Industry Co. In response to industry submissions, the proposed compliance model was modified and is now designed solely to support switching rules.

In June 2006 the Gas Industry Co issued a paper titled **Mechanisms to Implement a Central Registry**. The purpose of the paper was to seek input from the industry on the Company's analysis of the alternatives available to implement a central registry. Submissions were received from 8 parties and indicated strong industry support that the central registry be implemented by rules.

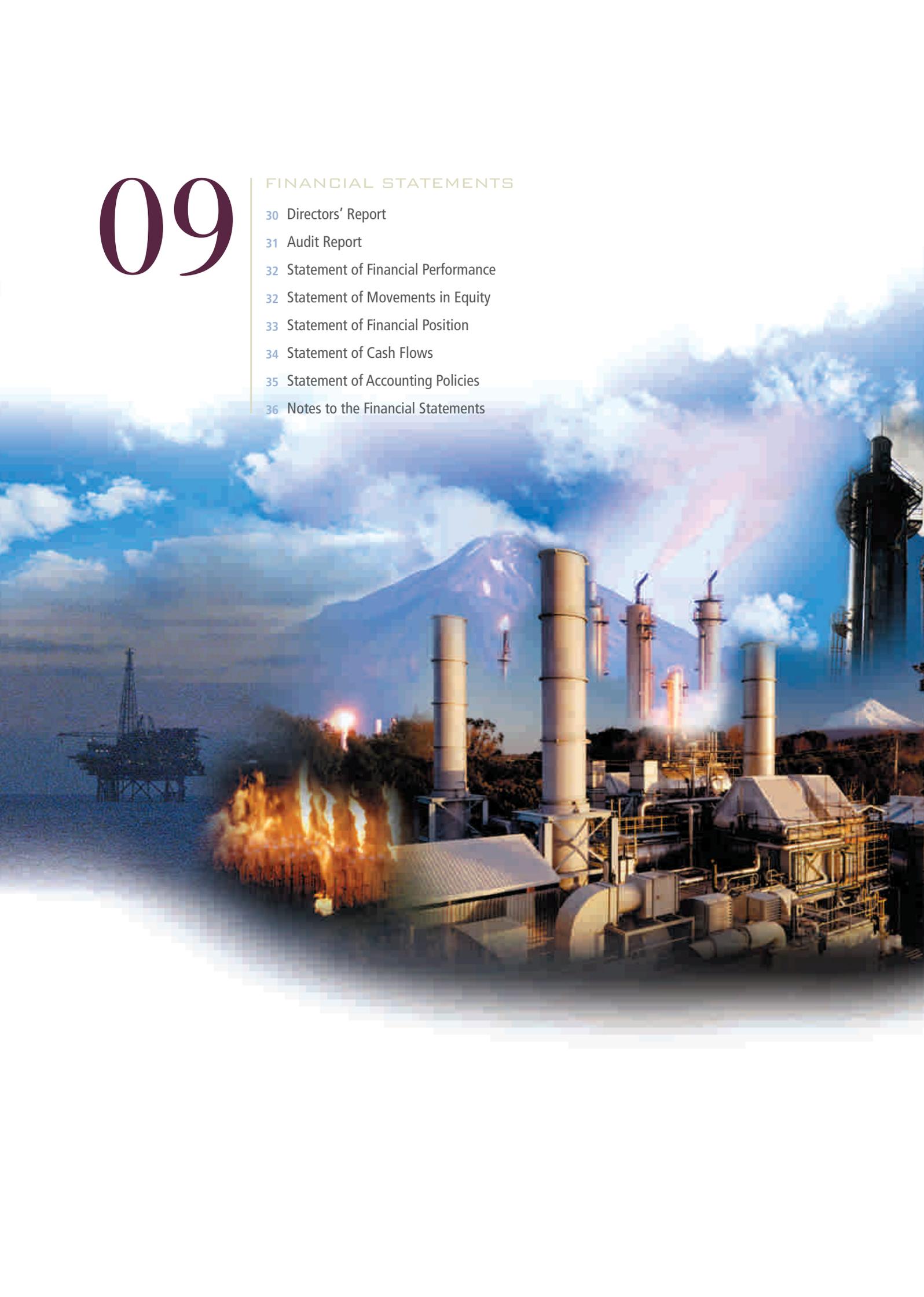
Going Forward

The Gas Industry Co is currently preparing two "Statements of Proposal" under the Gas Act for release early in the next financial year. The first proposes the development of a central registry implemented by rules. The second proposes a tailor-made compliance regime implemented by regulations to support the new switching arrangements.

09

FINANCIAL STATEMENTS

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DIRECTORS' REPORT

Interests register

The Gas Industry Company Limited ("Company") is required to maintain an interests register in which the particulars of certain transactions and matters involving the directors must be recorded. The interests register for the Company is available for inspection at its registered office. The following entries were made in the interests register in relation to the directors who held office during the period:

- **M X Franklin:** That he is an officer of Vector Limited and subsidiaries.
- **S P Barrett:** That he is an officer of Contact Energy Limited.
- **M J Verbiest:** That he is an officer of Telecom Corporation of New Zealand Limited.
- **A Bansal:** That he is an officer of Shell (Petroleum Mining) New Zealand Limited.
- **M E Jackson:** That he is an officer of Genesis Energy Limited.
- **Messrs Bolger, Hill, Verbiest and Clifford:** Their interest with respect to their remuneration.
- All directors noted their interest with respect to the Directors and Officers insurance purchased by the Company.

Where a director has declared an interest in a particular entity, as a shareholder and/or director, the declaration serves as notice that the director may benefit from any transactions between the Company and the identified entities.

Information used by directors

No member of the Board of the Company issued a notice requesting to use information received in their capacity as directors which would not otherwise have been available to them.

Indemnification and insurance of current officers and directors

The Company indemnifies all current directors named in this report and officers of the Company against all liabilities (other than that to the Company) which arise out of the performance of their normal duties as director or executive officer, unless the liability relates to conduct involving lack of good faith. To manage this risk, the Company has indemnity insurance. The total cost of this insurance during the financial period was \$15,500. (2005:\$15,500). The annual cost of this insurance is \$15,500.

Directors of the Gas Industry Company Limited

	Directors' Fees	
	2006 \$	2005 (8 months) \$
Rt Hon J B Bolger (Chairperson)	85,000	56,667
R G Hill (Deputy Chairperson)	70,800	32,000
M J Verbiest	48,000	32,000
D K Clifford (resigned 21 April 2006)*	40,000	32,000
M X Franklin	-	-
S P Barrett (resigned 22 September 2005)	-	-
A Bansal (from 22 September 2005)	-	-
M E Jackson (from 22 September 2005)	-	-
Total	243,800	152,667

* At the end of the financial year the Board had a casual vacancy for an independent director, following the resignation of Denis Clifford on 21 April 2006 to take up a position at the High Court.

The fees and remuneration have been entered into the interests register.

Auditors

The auditor for the Company is Grant Thornton. Grant Thornton did not provide any additional services to the Company other than audit services.

Donations

The Company did not make any donations during the period covered by this report.

The annual report and the financial statements presented on pages 32 to 38 are signed for and on behalf of the Board and were authorised for issue on the date set out below.

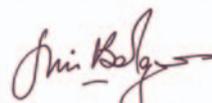
Directors' Responsibility Statement

The directors are responsible for ensuring that the financial statements give a true and fair view of the financial position of the Company as at 30 June 2006 and its financial performance and cash flows for the period ended on that date.

The directors consider that the financial statements of the Company have been prepared using appropriate accounting policies, consistently applied and supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed. The directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Company and facilitate compliance of the financial statements with the Financial Reporting Act 1993 and the Companies Act 1993.

The directors consider they have taken adequate steps to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

For and on behalf of the Board.



Rt Hon J B Bolger Chairman



R G Hill Deputy Chairman

Date: 5 September 2006

To the Shareholders of Gas Industry Company Limited

We have audited the financial report on pages 32 to 38. The financial report provides information about the past financial performance of Gas Industry Company Limited and its financial position as at 30 June 2006. This information is stated in accordance with the accounting policies set out on page 35.

Directors' Responsibilities

The Directors are responsible for the preparation of a financial report, which gives a true and fair view of the financial position of Gas Industry Company Limited as at 30 June 2006 and of the results of its operations and cashflow for the year ended on that date.

Auditors' Responsibilities

It is our responsibility to express to you an independent opinion on the financial report presented by the Directors.

Basis of Opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial report. It also includes assessing:

- The significant estimates and judgements made by the Directors in the preparation of the financial report, and
- Whether the accounting policies are appropriate to Gas Industry Company Limited's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial report is free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial report.

Other than in our capacity as auditors we have no relationship with or interests in Gas Industry Company Limited.

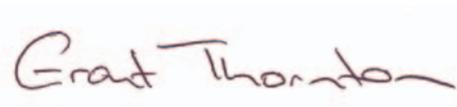
Unqualified Opinion

We have obtained all the information and explanations that we have required.

In our opinion:

- proper accounting records have been kept by Gas Industry Company Limited as far as appears from our examination of those records; and
- the financial report on pages 32 to 38:
 - complies with generally accepted accounting practice in New Zealand;
 - gives a true and fair view of the financial position of Gas Industry Company Limited as at 30 June 2006 and the results of its operations and cashflow for the year ended on that date.

Our audit was completed on 5 September 2006 and our unqualified opinion is expressed as at that date.



GRANT THORNTON
WELLINGTON

Gas Industry Company Limited

STATEMENT OF FINANCIAL PERFORMANCE

For the year ended 30 June 2006	Notes	2006 \$	2005 (8 months) \$
Operating revenue	1	4,283,748	115,792
Operating expenses	2	(3,500,122)	(1,205,894)
Operating surplus/(deficit) before income tax		783,626	(1,090,102)
Income tax	6	(20,109)	(5,211)
Net surplus / (deficit) after taxation		763,517	(1,095,313)

STATEMENT OF MOVEMENTS IN EQUITY

For the year ended 30 June 2006	Notes	Share Capital \$	Accumulated Losses \$	Total \$
Balance at 24 July 2004 (date of incorporation)		11	-	11
Share redeemed		(1)	-	(1)
Net deficit for the year		-	(1,095,313)	(1,095,313)
Balance at 30 June 2005		10	(1,095,313)	(1,095,303)
Share redeemed		-	-	-
Net surplus for the year		-	763,517	763,517
Balance as at 30 June 2006	4,5	10	(331,796)	(331,786)

The above statements should be read in conjunction with the accompanying notes

Gas Industry Company Limited

STATEMENT OF FINANCIAL POSITION

As at 30 June 2006	Notes	2006 \$	2005 \$
Equity			
Share capital	4	10	10
Accumulated losses	5	(331,796)	(1,095,313)
Total equity		(331,786)	(1,095,303)
Liabilities			
Non-current Liabilities			
Unsecured shareholder loans	3	800,000	1,600,000
Total non-current liabilities		800,000	1,600,000
Current liabilities			
Payables and accruals	7	524,152	279,809
Employee entitlements	8	19,253	3,329
Total current liabilities		543,405	283,138
Total liabilities		1,343,405	1,883,138
Assets			
Non-current assets			
Property, plant and equipment	9	246,282	16,180
Total non-current assets		246,282	16,180
Current assets			
Cash and bank balances		743,642	284,154
Accounts receivable	11	21,695	487,501
Total current assets		765,337	771,655
Total assets		1,011,619	787,835
Net assets		(331,786)	(1,095,303)

STATEMENT OF CASH FLOWS

For the year ended 30 June 2006	2006 \$	2005 (8 months) \$
Operating activities		
Cash was provided from		
Levy revenue	3,940,349	-
Other income	175,000	-
Annual fees	100,000	100,000
Interest received	38,837	15,792
Net GST refund	26,034	-
Income tax refund	925	-
	4,281,145	115,792
Cash was applied to		
Payments to suppliers	(1,983,158)	(804,104)
Payments to employees	(916,300)	(21,013)
Payments to directors	(250,098)	(146,369)
Net GST paid	-	(37,800)
Income tax paid	-	(6,136)
	(3,149,556)	(1,015,422)
Net cash provided by / (used in) operating activities	1,131,589	(899,630)
Investment activities		
Purchase of property plant and equipment	(272,101)	(16,226)
	(272,101)	(16,226)
Net cash used in investment activities	(272,101)	(16,226)
Financing activities		
Cash was provided from		
Proceeds from shareholder loans	400,000	1,200,000
Issue of redeemable shares	-	11
	400,000	1,200,011
Cash was applied to		
Repay shareholder loans	(800,000)	-
Shares redeemed	-	(1)
	(800,000)	(1)
Net cash (used in) / provided by financing activities	(400,000)	1,200,010
Net increase in cash held	459,488	284,154
Cash at beginning of period	284,154	-
Cash at end of period	743,642	284,154
Reconciliation with operating surplus		
Reported surplus / (deficit) after tax	763,517	(1,095,313)
Items not involving cash flows		
Depreciation expense	46,103	46
Impact of changes in working capital items		
Prepayments	28,548	(28,936)
Accounts payable	273,846	201,550
Accruals	(33,608)	78,259
Employee entitlements	15,924	3,329
Debtors	(7,462)	-
GST receivable	45,874	(57,640)
Other receivables	(88)	-
Tax provision	(1,065)	(925)
	321,969	195,637
Net cash provided by / (used in) operating activities	1,131,589	(899,630)

The above statements should be read in conjunction with the accompanying notes

STATEMENT OF ACCOUNTING POLICIES

Reporting entity

The financial statements are for the Gas Industry Company Limited, ("Company") as a separate legal entity. The Company is a limited liability company registered under the Companies Act 1993. It was approved as the industry body under part 4A of the Gas Act on 22 December 2004 by the Gas (Approval of Industry Body) Order 2004. The Company was incorporated on 27 July 2004.

Statutory base

These financial statements have been prepared in accordance with section 43ZW to 43ZY of the Gas Act 1992 and in accordance with the requirements of the Financial Reporting Act 1993 and the Companies Act 1993.

The financial statements have been prepared on a going concern basis. The Company is able to meet the solvency test because of the revenues it receives under the Gas (Levy of Industry Participants) Regulations 2006 and the terms of the limited recourse shareholder loans.

Measurement base

The financial statements have been prepared on the historical cost basis.

Accounting policies

The financial statements are prepared in accordance with New Zealand generally accepted accounting practice. The accounting policies that materially affect the measurement of financial performance, financial position and cash flows are set out below.

Revenue

Goods and services

Revenue comprises the levy income received and receivable in accordance with the Gas (Levy of Industry Participants) Regulations 2005.

Investment income

Interest income is accounted for as earned.

Income Tax

The income tax expense recognised for the year is based on the accounting surplus, adjusted for permanent differences between accounting and tax rules.

The impact of all timing differences between accounting and taxable income is recognised as a deferred tax liability or asset. This is the comprehensive basis for the calculation of deferred tax under the liability method. A deferred tax asset, or the effect of losses carried forward that exceed the deferred tax liability, is recognised in the financial statements only where there is virtual certainty that the benefit of the timing differences, or losses, will be utilised.

Goods and Services Tax (GST)

The Statement of Financial Performance and Statement of Cash Flows have been prepared so that all components are stated exclusive of GST. All items in the Statement of Financial Position are stated net of GST, with the exception of receivables and payables, which include GST invoiced.

Property, plant and equipment

Initial recording

The cost of purchased property, plant and equipment is the value of the consideration given to acquire the assets, and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

Depreciation

Depreciation is calculated on a straight line basis so as to expense the cost of the assets, or the revalued amounts, to their residual values over their useful lives as follows:

Category	Estimated useful life
Office Equipment (computers and related equipment)	4 years
Office Equipment (other)	10 years
Leasehold Improvements	Amortised over period of lease

Leased assets

As lessee

Operating leases

Leases that are not finance leases are classified as operating leases. Operating lease payments are recognised as an expense in the periods the amounts are payable.

Accounts receivable

Accounts receivable are carried at estimated realisable value after providing against debts where collection is doubtful.

Employee entitlements

Employee entitlements to salaries and wages, annual leave and other benefits are recognised when they accrue to employees.

Financial instruments

Recognised

Financial instruments carried on the Statement of Financial Position include cash and bank balances, investments, receivables, trade creditors and borrowings. Except for those items covered by a separate accounting policy all financial instruments are shown at their estimated fair value.

Statement of Cash Flows

The following are the definitions of the terms used in the Statement of Cash Flows:

- Operating activities include all transactions and other events that are not investing or financing activities.
- Investing activities are those activities relating to the acquisition, holding and disposal of non-current assets.
- Financing activities comprise changes in the capital structure.
- Cash is considered to be cash on hand and current accounts in banks, net of bank overdrafts.

Changes in accounting policies

There are no changes in the accounting policy. All policies are consistent with those applied in previous years.

NOTES TO THE FINANCIAL STATEMENTS

1. Operating revenue

	2006/\$	2005/\$ (8 months)
Operating revenue		
Wholesale levy revenue	2,175,520	-
Retail levy revenue	1,772,291	-
Annual fees	100,000	100,000
Other income	175,000	-
Interest received	60,937	15,792
Total operating revenue	4,283,748	115,792

The Company received a payment from the Council of the Electricity and Gas Complaints Commission of \$175,000 (plus GST) towards the costs incurred in establishing the gas consumer complaints scheme. \$71,038 (plus GST) of those costs were recognised in 2004/05 financial statements. The remainder of the costs were incurred by the Gas Industry Steering Group, the predecessor group to the Company.

2. Operating expenses

	2006/\$	2005/\$ (8 months)
Operating expenses		
Depreciation	46,103	46
Office Equipment Lease	9,992	-
Auditor remuneration	5,000	5,000
Premises	86,577	-
Other expenses	3,352,450	1,200,848
Total expenses	3,500,122	1,205,894

To assist with the interpretation of the operating expenses for the period ended 30 June 2006, the following expense breakdown is provided:

	2006/\$	2005/\$ (8 months)
Accounting and taxation advice	16,890	29,380
Consumer Complaints Scheme development	-	71,038
Directors' fees	243,800	152,667
General expenses	137,334	13,068
Recruitment expenses	192,401	86,311
Secretariat and establishment fees	160,915	324,470
Technical, economic and legal advice	1,628,931	436,143
Wages and salaries	910,537	35,700
Working Group expenses	61,642	52,071
Total other expenses	3,352,450	1,200,848

3. Shareholder loans

	2006/\$	2005/\$
Shareholder loans	800,000	1,600,000
Total	800,000	1,600,000

The Company has entered into limited recourse loans with the following shareholders:

	2006/\$	2005/\$
Contact Energy Limited	125,000	250,000
NGC Holdings Limited	125,000	250,000
Genesis Power Limited	125,000	250,000
Vector Limited	125,000	250,000
Energy Finance NZ Limited (related party to Shell (Petroleum Mining) Company Limited)	125,000	250,000
Mighty River Power Limited	75,000	150,000
Powerco Limited	75,000	150,000
Wanganui Gas Limited	25,000	50,000

The terms of the shareholder loans recognise that the loans have been made to fund the establishment of the Company and provide for the loans to be of a limited recourse, repayable only if the Company has sufficient cash resources to make repayment. All loans are to be repaid proportionately. The loans are due for repayment the earlier of two years after the commencement of the levy on industry participants or 30 December 2007. No liability to repay the loans (in part or in full) exists unless the Company would meet the solvency test immediately after making the repayment.

4. Share capital

	2006/\$	2005/\$
Issued and Paid up Capital		
Redeemable shares		
Shares issued	10	11
Shares redeemed	-	(1)
Balance at 30 June	10	10

On incorporation Mr R S Clarke QC subscribed for a redeemable share which was redeemed following the first issuance of shares to industry participants. As at 30 June 2006 there were 10 redeemable shares on issue. The shares are redeemable at any time for the consideration of \$1 payable by the Company on redemption. The redeemable shares confer on the shareholders the rights set out in section 36(1) of the Companies Act 1993.

5. Accumulated losses

	2006/\$	2005/\$ (8 months)
At the beginning of the year	(1,095,313)	0
Net surplus / (deficit) for the year	763,517	(1,095,313)
At the end of year	(331,796)	(1,095,313)

6. Income tax

	2006/\$	2005/\$ (8 months)
Operating surplus/(deficit) before tax	783,626	(1,090,102)
Permanent differences		
Non taxable (surplus)/deficit	(722,689)	1,105,894
Income subject to tax	60,937	15,792
Tax at 33%	20,109	5,211
Income tax recognised in the Statement of Financial Performance	20,109	5,211

7. Payables and accruals

	2006/\$	2005/\$
Unsecured		
Accounts payable	475,396	201,550
Finance Lease	4,105	-
Accruals	44,651	78,259
Total	524,152	279,809

8. Employee Entitlements

	2006/\$	2005/\$
Annual Leave	19,253	3,329
Total Employee Entitlements	19,253	3,329

9. Property, plant and equipment

2006				
	Opening Book Value \$	Additions \$	Depreciation \$	Closing Book value \$
Office equipment	4,104	24,177	(4,778)	23,503
Leasehold improvements	12,076	122,523	(24,281)	110,318
Furniture & fittings	-	79,192	(8,984)	70,208
Computer equipment	-	50,313	(8,060)	42,253
Total	16,180	276,205	(46,103)	246,282

Accumulated Depreciation 2006			
	Opening Acc Depr \$	Depreciation \$	Closing Acc Depr \$
Office equipment	(46)	(4,778)	(4,824)
Leasehold improvements	-	(24,281)	(24,281)
Furniture and fittings	-	(8,984)	(8,984)
Computer equipment	-	(8,060)	(8,060)
Total	(46)	(46,103)	(46,149)

2005			
	Cost \$	Acc depn \$	Closing Book value \$
Office equipment	4,150	(46)	4,104
Leasehold improvements	12,076	-	12,076
Furniture and fittings	-	-	-
Computer equipment	-	-	-
Total	16,226	(46)	16,180

10. Commitments

	2006/\$	2005/\$
Operating leases		
Within one year	82,680	82,680
One to two years	82,680	82,680
Two to five years	75,955	165,360
Total operating lease commitments	241,315	330,720
Other commitments		
Within one year	21,268	-
One to two years	19,366	-
Two to five years	2,906	-
Total other commitments	43,540	-

The Company leases premises. The lease does not provide the Company with a right of renewal.

11. Accounts receivable

	2006/\$	2005/\$
Levy Debtors	7,462	-
Goods and services tax (GST) refundable	11,766	57,640
Prepayments	388	28,936
Provision for taxation	1,990	925
Other Receivables	89	400,000
Current receivables	21,695	487,501

Levy Debtors represent unpaid levies as at 30 June 2006. Levies are invoiced and due each month for the liability arising in that month.

12. Financial instruments

The Company is subject to a number of financial instrument arrangements as part of its everyday operations. These financial instruments include bank accounts, accounts receivable and accounts payable. As at balance date the Company's bank balances were held in an interest bearing current account.

Interest rate risk

Interest rate risk is the risk that the Company return on any funds it has invested and the cost of borrowed funds will fluctuate due to changes in market interest rates. The shareholder loans provide for interest to be paid on those loans if requested by the lender. The interest rate applicable is determined by reference to the deposit rates of registered banks for a deposit equivalent to the value of the loan amount and for an 18 month duration. As at 30 June 2006 no shareholder requested interest be paid on their loan to the Company and consequently no interest expense has been recognised.

Credit risk

Credit risk is the risk that a third party will default on its obligations to the Company causing the Company to incur a loss. In the normal course of business, the Company incurs credit risk from financial institutions. The Company does not require collateral or other security to support financial instruments with credit risk, as the Company deals with financial institutions that have high credit ratings. The Company does not have any significant concentrations of credit risk.

Fair values

The fair value of all financial instruments is equivalent to the carrying amount disclosed in the statement of financial position.

Currency risk

Currency risk is the risk that debtors and creditors due in foreign currency will fluctuate because of changes in foreign exchange rates. The Company is exposed to currency risk on its dealings with consultants in Australia.

13. Contingent liabilities

As at 30 June 2006 the Company had no contingent liabilities. (2005:nil)

14. Related party information

Other than the shareholder loans detailed in Note 3, the Company has no related party transactions. Various shareholders have from time to time provided administrative assistance to the Company at no cost.

15. Remuneration

Salary Band	2006/\$		2005/\$	
	Actual	Annualised Full Time Equivalent	Actual	Annualised Full Time Equivalent
\$110,001 - \$120,000	-	1	-	-
\$120,001 - \$130,000	1	-	-	-
\$130,001 - \$140,000	-	2	-	-
\$140,001 - \$150,000	1	-	-	-
\$190,001 - \$200,000	-	2	-	-
\$290,001 - \$300,000	1	1	-	1

No employees received remuneration and benefits of \$100,000 or more in the 2005 comparative financial year. The Chief Executive commenced in the last quarter of the 2005 financial year. The comparative figures for 2005 represent the remuneration for the Chief Executive on an annualised basis. In the 2006 financial year the majority of staff commenced employment with the Company during the second quarter of the financial year. The Annualised Full Time Equivalent is provided to reflect the number of staff who would have received remuneration of \$100,000 or more on an annualised basis. The difference between the two columns reflect the timing of the commencement of particular employees and also the extent to which work is full time or part time. The total full time equivalent staff for the 2006 year was 7.

16. Subsequent events

No significant events, which would materially affect the financial statements, have occurred between 30 June 2006 and the date of signing the financial statements.

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SCHEDULE 1

The following table sets out an assessment of the Gas Industry Co's performance against the targets and measures outlined in the Company's Strategic Plan 2006-08

WORK STREAM	ACTIVITY	2005/06 PERFORMANCE MEASURE	TARGET	COMMENT
Establishment	Recruitment of internal resources	Establish small internal team	September 2005	Achieved – Core team commenced in October 2005
	Prepare best practice procedures for regulatory body	Prepare and publish procedures	November 2005	Partially Achieved - Internal procedures prepared and circulated
	Develop comprehensive communication strategy	Comprehensive Gas Industry Co website developed	August 2005	Achieved
Corporate Accountability	Regular reporting to Minister	Quarterly Reports	July 2005 October 2005 January 2006 April 2006	Achieved
	Regular reporting to industry	Quarterly Reports	July 2005 October 2005 January 2006 April 2006	Achieved – Newsletters sent bi-monthly
	Liaison with industry	Hold briefing day Regular meetings with CEO's and regulatory officers	August 2005 At least two per annum	Achieved – Industry seminar held in December 2005, numerous meetings with industry participants in Plan year
Finance	Gas Industry Co operates within budget	Gas Industry Co operates within its budget	30 June 2006	Achieved
	Gas Industry Co meets terms of loans from shareholders	The Gas Industry Co achieves repayment of 50% of its shareholder establishment loans	30 June 2006	Achieved
	The Gas Industry Co establishes 2007 levy	Levy implemented	30 June 2006	Achieved – Levy gazetted on 29 June 2006
Gas Standards	Review gas specification issues and advise the Gas Industry Co board on issues relating to market efficiency	Report to Gas Industry Co	September 2005	Achieved at a later date – <ul style="list-style-type: none"> • Technical report received in October 2005 • Consultation paper released in March 2006 • Recommendation to Minister made in July 2006
	Consult on proposed arrangements and options and analyse submissions	Consultation undertaken	31 December 2005	
	Final report to Gas Industry Co	Final report submitted	28 February 2006	

WORK STREAM	ACTIVITY	2005/06 PERFORMANCE MEASURE	TARGET	COMMENT
Wholesale Markets Development	Review of issues and report to Gas Industry Co board on matters associated with: - balancing and reconciliation; - current and potential future wholesale trading in the New Zealand gas market; - current and potential future capacity trading arrangements	Initial scoping report completed and presented to Gas Industry Co board	30 November 2005	Achieved at a later date – • Report on wholesale market trading released for consultation in March 2006 • Balancing and capacity trading were addressed in Transmission Access Report released in June 2006
Gas Outage Emergency Management	Investigate issues in relation to security of supply and gas outage contingency plans	Report to Gas Industry Co board on issues completed	By 30 September 2005	Not Achieved in Plan year - Board received report in July 2006
Allocation and Reconciliation	Review existing gas flow measurement arrangements and issues relating to gas flow inhibiting competition	Report to Gas Industry Co board	31 December 2005	Achieved at a later date – Consultation paper released in June 2006
Model Contracts	Research retail contract issues and design guidelines and model contracts	Complete report on retail contract issues and develop guidelines and model contract arrangements	31 August 2005	Achieved at a later date - • Report to Board in October 2005 • Consultation paper released in November 2005 • Recommendation to Minister made in May 2006
	Consult on proposed new arrangements and analyse submissions	Complete consultation and report on preferred arrangement	1 November 2005	
Distribution Contracts	Research distribution contract issues and design guidelines and model contracts	Complete report on distribution contract issues and develop guidelines and model contract arrangements	31 October 2005	Not Achieved – work stream deferred due to resource constraints and related Commerce Commission work in this area.
	Consult on proposed new arrangements and analyse submissions	Complete consultation and report on preferred arrangement	1 March 2006	
Switching and Registry	Design scope and functionality of appropriate registry for gas customer switching	Complete industry consultation on scope and functionality	31 August 2005	Partially Achieved – Four consultation papers on new switching arrangements for retail customers released in Plan year.
	Appoint service provider to advise on registry solutions and evaluate proposals	Recommendations on preferred registry solution	30 October 2005	
	Design rules and protocols for operation of registry arrangements and implement	Completed rules and registry function established	1 February 2006	
Consumer Complaints	Incorporation of land owner / occupier disputes in disputes scheme	Recommendation of expanded scheme to Minister for approval	December 2005	Not Achieved – There have been delays in finalising amendments to the Scheme relating to land access for electricity lines companies
		Implementation of Scheme	April 2006	

DIRECTORY

Gas Industry Company Limited

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DIRECTORS

Right Honourable James (Jim) Bolger, ONZ, Chairman

Robin Hill, B Comm, FCA, Deputy Chairman, Independent Director

Mark Verbiest, LLB, Independent Director

Mark Franklin, BE (Electrical)

Ajit Bansal, PhD, BSc (Hons), DipM

Murray E Jackson, MBA, BEc, FTSE, FIEAust

EXECUTIVES

Christine Southey, Chief Executive

Helen Brown, Senior Adviser Finance

Ian Dempster, Senior Adviser Wholesale Markets

Ian Wilson, Senior Adviser Pipelines

Nicki Lau-Young, Senior Adviser Legal

Paul Mitchell, Senior Adviser Retail & Distribution

Mark Soper, Adviser Strategy and Corporate

Auditors: Grant Thornton, Wellington

Bankers: Westpac Banking Corporation Limited

SHAREHOLDERS

Contact Energy Limited

Powerco Limited

Genesis Power Limited

Shell (Petroleum Mining) Company Limited

Mighty River Power Limited

Swift Energy New Zealand Limited

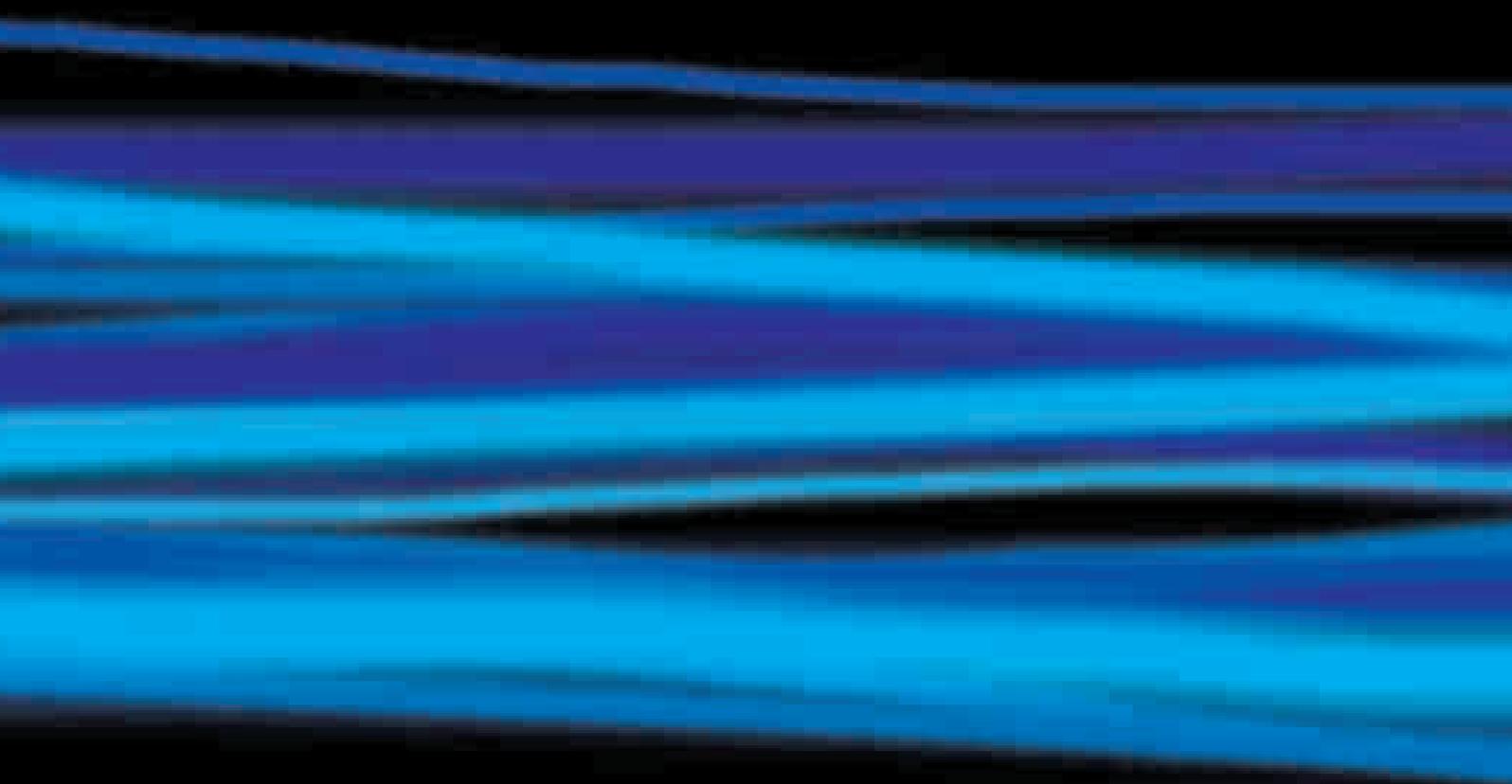
NGC Holdings Limited

Vector Limited

OMV New Zealand Limited

Wanganui Gas Limited





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