

Bridge Commitments: Progress Report

4 May 2012

Introduction

This paper presents Gas Industry Co's second progress report and appraisal of the Bridge Commitments, a package of measures to address perceived short-term competition issues on the North Pipeline. The Bridge Commitments were agreed by Contact, Energy Direct, Genesis, Mighty River Power (MRP), Nova, OnGas and Vector in August of last year. Further background on the Bridge Commitments can be found in the appendix of this report and on Gas Industry Co's website at <http://gasindustry.co.nz/work-programme/transmission-pipeline-capacity/short-term#fragment-2113>.

The Bridge Commitments have now been in effect for nine months. Our overall assessment follows:

There has been significant progress made on a number of the Bridge Commitments. Although no capacity has yet been traded, Gas Industry Co is pleased that incumbent Shippers are offering capacity when it is requested and that Shippers are about to test the feasibility of an electronic transmission capacity bulletin board, the Gas Transmission Exchange (GTX). We consider that the provision of capacity and gas delivery information has set an important and useful precedent for the industry. Also, we believe that the industry group charged with giving Gas Industry Co advice on longer term solutions to transmission issues - the Panel of Expert Advisers (PEA) - is making good progress in its work. Overall, it is pleasing that the industry has shown that it is capable of working together to address the complex issues that the North Pipeline capacity constraint presents.

To date, however, progress on some Bridge Commitments has been slower than targeted. Gas Industry Co considers that more effort is required to ensure the full potential of the Commitments is realised, including from the freeing up of power station capacity and the use of the GTX. At the same time, we acknowledge that some technical issues involved have proven difficult and complex. Regarding the power station capacity, we also understand that the owners of the power stations have not received any inquiries for capacity, which perhaps reflects the current flat demand situation. However, we are keen for measures for transferring capacity to be in place and operational, as we continue to believe that such measures will facilitate competition on the North Pipeline.

The crucial measure remains whether better outcomes are delivered to large end users to address short-term capacity issues arising on Vector's North Pipeline. Gas Industry Co will continue to support this work and to monitor developments.

Gas Industry Co's assessment of individual commitments follows.

Capacity offers

1. *as a Shipper supplying a large end user (end user) who obtains gas from the Northern Pipeline, where the end user tenders for future gas supply to:*
 - a. *ensure that transmission capacity (capacity) is available to the preferred retailer of the end user of gas, at a price that reasonably reflects the value of that existing capacity to the Shipper, and at a quantity that will reflect the end user's demand, to the extent practicable;*
 - b. *provide that capacity and quantity information, at the end user's or another Shipper's request, within five business days, to allow competing bidders to incorporate it into their supply proposals; and*
 - c. *provide that information in paragraph 1(b) to the Gas Industry Company Limited (GIC), together with the name of the end user, relevant ICP number and any other material terms of the capacity transfer offer at the time they are made to assist the GIC in assessing the efficiency of the arrangement set out in this paragraph.*

Signatories to the Bridge Commitments have taken the reference to "large end users" in the commitment letter to mean all end users with a time of use (ToU) meter. Responses from large end users to this commitment have been positive, and Gas Industry Co is aware that there have been tenders whose terms required the incumbent Shipper to provide capacity offers.

In assessing this commitment, Gas Industry Co has examined the following aspects of gas tendering:

- To our knowledge, there have been four offers for capacity since August 2011 by incumbent Shippers of end users who have tendered their supply. The amount of capacity offered has been for 75-80% of the gas consumers' Optimised Maximum Daily Quantity. We understand that none of these capacity offers has been accepted, although we have received no feedback from Shippers to indicate that the capacity offers have been insufficient or the terms unattractive.
- According to the gas registry, seven large end users on the North Pipeline have switched to new suppliers since August of last year. As far as Gas Industry Co is aware, only one of these

switches was the subject of a capacity offer; the others switched without competing Shippers requesting capacity offers. (As a comparison, there were 26 switches of ToU customers on the North Pipeline in the period September 2010 to March 2011, and 6 from September 2009 to March 2010.)

- Gas Industry Co is also aware of several tenders where ToU customers have chosen to stay with their incumbent retailers.

Feedback from the industry indicates that incumbents have provided competitive prices in these situations and that the tender processes have been competitive and transparent. Gas Industry Co has also been told that price offers for sites on the North Pipeline have been similar to prices offered to end users on other parts of the transmission system, suggesting that the capacity constraint on the North Pipeline is not having an impact on end-user prices.

Gas Industry Co is pleased to note that Shippers seem to be upholding their commitments to offer capacity if requested and that recent tenders have had positive outcomes. Although no capacity has been traded as a result of this commitment, the existence of the commitment and the terms of offers made to date under it are potentially market-enhancing. Gas Industry Co remains of the view that the ability of competing Shippers to access capacity is an important element of a competitive market.

Capacity price and quantity information posted on Vector OATIS

2. to ensure that within ten business days after the completion of the tender process initiated by the end user or Shipper, the information in paragraph 1(b) will be disclosed on the public version of the Vector Transmission Open Access Transmission Information System (OATIS).

Information on the capacity offers has been posted under the publications page on OATIS (www.oatis.co.nz). Gas Industry Co welcomes the publication and urges the industry to keep on top of these disclosures.

The purpose of disclosing this information is to make the price and quantity of capacity offers transparent. Gas Industry Co continues to see value in the disclosure of this information, in providing transparency in a constrained market.

Terms for the transfer of capacity under Supplementary Agreements and Non-Code Shipper agreements (ie. power station capacity)

3. to negotiate, and where practicable agree, on a set of reasonable commercial terms to govern the transfer of capacity under Supplementary Agreements and Non-Code Shipper transmission services agreements (including where relevant reasonable amendments to Supplementary Agreements and Non-Code Shipper transmission services agreements), by a target date of 1 December 2011.

Since the implementation of the Bridge Commitments, Contact Energy, MRP, and Vector Transmission ('the parties') have been negotiating to remove existing restrictions that prevent power stations trading capacity under supplementary agreements. Power station capacity accounts for around 60% of all capacity on the North Pipeline. Power station owners have been running their stations differently than in the past, which could allow them to free up some capacity to be traded (although it may need to be made available on an interruptible basis).

After six months of negotiating, the parties have to date failed to agree on a set of reasonable commercial terms that will allow spare capacity to be on-sold. While we understand there are some significant unexpected complexities, we are disappointed that agreement has not yet been reached. However, we also understand that there has not been any demand-side interest in power station capacity; if there had been, it might have expedited the parties' work on this issue.

Gas Industry Co is also aware that trading provisions have been added into other supplementary agreements as they have been rolled over, which is a welcome development.

Gas Industry Co continues to see the tradability of supplementary capacity as offering potential in terms of getting best use of existing North Pipeline capacity, particularly if demand for gas on the North Pipeline increases in coming years. We accordingly acknowledge the work to date by the parties and urge them to progress their further work in this area as a matter of priority. We also continue to urge retailers and large end users to further explore with the parties opportunities for greater use of unutilised power station capacity.

Information request

4. to disclose to the GIC such information as the GIC reasonably requires to enable it to understand and assess the extent of the Northern Pipeline capacity constraint, the efficiency of the current capacity allocation mechanism and the need for asset investment, provided the GIC only uses the information for the purposes set out in this paragraph and keeps confidential any information identified by a discloser as confidential (including not disclosing that information to any competitor).

In February, Gas Industry Co received daily capacity reservations and delivery information for all Shippers (as well as Greymouth Gas, which is not a signatory to the Bridge Commitments). Despite the Bridge Commitments only applying to the North Pipeline, we requested and received information relating to all gas gates, as such information is an important input into the supply/demand study (one of the Information Projects under the GTIP).

Gas Industry Co considers that increased transparency needs to be a feature of both short and long term solutions to transmission issues. We believe this provision of information is a good precedent for the future, both in terms of the way further information disclosure can improve market outcomes and the way industry can voluntarily aid in such processes.

Review of capacity constraint

5. to work with GIC on a review of the Northern Pipeline capacity constraint, with the results made public and presented in an open forum by a target date of 1 December 2011.

In December 2011, Vector released the report, *North Pipeline Review as at 1 October 2011*, which was well received by the industry as throwing useful light on the current issues and options for North Pipeline utilisation. It includes:

- a summary of the way in which Shippers obtain Reserved Capacity;
- a record of Shippers' transmission capacity entitlements over recent years;
- use of firm transmission capacity (ie offtake), by retail and power generation Shippers; and
- pipeline performance during August 2011 peak week.

The report shows that while overall annual demand north of Rotowaro declined by 18% over the last five years, peak daily offtake increased 7% in the same period. This presents both

opportunities and challenges: opportunities to increase annual demand on the pipeline, and challenges to facilitate more flexible peak demand arrangements. The GTIP is well positioned to address these issues, as the overall picture shows that there is significant potential for more efficient use of the North Pipeline.

In late 2011, Vector also commenced a review of the North Pipeline capacity – the Capacity Determination Project – and sought feedback from interested parties on the inputs for its modelling process. A further paper was to have been released by Vector on the outputs from the modelling process in February, but this step has not yet occurred. Gas Industry Co understands that Vector is intending to complete this work. We think it has delivered considerable value to date and we urge Vector to resume work on this important project.

More information can be found on Vector’s website: <http://vector.co.nz/gas/pipeline-capacity-consultation>

Bulletin Board

6. to work together to develop a platform (known as a Bulletin Board) to facilitate the open and transparent trading of capacity between willing buyers and sellers, by a target date of 1 December 2011.

The bulletin board trading system referred to as the Gas Transmission Exchange (GTX) (www.thegtx.co.nz), is operational. As of this writing, four of the eight Shippers on the North Pipeline have signed the Undertaking documents to participate in the market. There has not yet been any trading activity on the site.

The GTX has been designed to facilitate open and transparent trading (whether by sale or by loan) of transmission capacity rights among Shippers who hold capacity rights on Vector’s North Pipeline. Gas Industry Co acknowledges the efforts of Vector Transmission in contributing to and funding the initial stage of development of the system.

Gas Industry Co has agreed to operate and fund the GTX until 30 June 2012. After this date, Gas Industry Co expects to assess Shippers’ use of the platform and its ongoing costs, which will inform longer-term arrangements for the platform’s operation and funding.

Gas Transmission Investment Programme (GTIP)

7. to participate in a project with the objective of developing longer term market solutions; establishing the current need for gas transmission investment; and developing an effective pathway for gas transmission investment to take place, including correctly signalling the price of gas transmission capacity.

A Panel of Expert Advisers (PEA) has been created as a group of industry experts to provide technical and expert advice to Gas Industry Co in relation to the GTIP projects. The PEA has been making good progress in its first key deliverable, an assessment of current transmission access and capacity pricing arrangements and identification of preferred options. The group is due to provide its advice on these matters to Gas Industry Co in June.

A Panel of Strategic Advisers (PSA) comprising senior industry leaders has also been established to provide advice on strategic issues that may arise in relation to the GTIP. In particular, the PSA will consider the PEA's advice on various matters.

Industry participants and other stakeholders will have the opportunity to participate in the GTIP through workshops and public consultations on the PEA's work. Gas Industry Co anticipates that there will be a number of these opportunities in the upcoming 12 months. The first of these opportunities will be a forum in May, which will include an update to stakeholders on the progress of the PEA and other transmission capacity work streams.

Gas Industry Co believes the GTIP is proving to be an effective platform for developing long term transmission access solutions. The Bridge Commitments and Vector's Capacity Determination Project are key supports for this platform.

Appendix: Background on the Bridge Commitments

Following a Gas Industry Co proposal for regulation, Vector Transmission and the majority of shippers ('Shippers') on its North Pipeline (Contact, Energy Direct, Genesis, Mighty River Power (MRP), Nova and OnGas) committed to a package of measures ('Bridge Commitments') to address the perceived short-term competition issues large end users have been facing. This initiative is an industry response to Gas Industry Co concerns that, in a constrained pipeline situation, capacity can be retained by incumbent Shippers because their rights to capacity are 'grandfathered'. The consequence is that in response to tenders, large end users may only receive a bid for gas supply from the incumbent Shipper (or a few others).

The Bridge Commitments were agreed amongst Shippers and Vector in August, and comprise seven elements, including a commitment by Shippers to make capacity available to other Shippers 'at a price that reasonably reflects the value of that existing capacity to the Shipper, and at a quantity that will reflect the end user's demand, to the extent practicable'. The package of commitments creates a bridge to allow the industry to discuss how the transmission access and pricing arrangements can be developed to improve the economic allocation of capacity on the Pipeline.

Shortly after being agreed, Gas Industry Co assessed¹ the Bridge Commitments and concluded that they should:

- ensure existing large end users on the North Pipeline have an effective choice of supplier in the short term, by facilitating the transfer of capacity amongst Shippers;
- help to facilitate development of longer term access arrangements and investment; and
- materially change the market.

As a result of these conclusions, Gas Industry Co determined that intervention by way of Rules was not justified at that time. In its assessment paper, Gas Industry Co also noted that it would continuously monitor the effectiveness of the Bridge Commitments and update industry if anything occurred that might change its assessment.

¹ http://gasindustry.co.nz/sites/default/files/u254/retail_competition_when_transmission_capacity_is_constrained_-_reevaluation_of_constrained_pipeline_rules_option_171755.12_1.pdf