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**Changing Energy Sector – a
Co-regulatory perspective**

10 March 2008

Agenda

- Our role and work stream update
- Changes to policy environment
- Implications for industry and for us as regulator

Key features of co-regulation

- Minister has powers to pass rules or regulations
- On some matters Minister's powers are restricted
- Gas Industry Co also has restrictions:
 - Process requirements
 - Specific objectives
- Process requirements relate to considering options, cost benefit analysis, and consultation

Gas Act objectives

- **Apply to regulatory recommendations**
- **Overall objective is:**

“To ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner.”

Other objectives relate to:

- Infrastructure access and investment incentives
- Market competition and downward price pressure
- Managing security risks and maintaining gas safety

- Sets out additional objectives-fairness and environmental sustainability
- Lists tasks for co-regulator
 - Access to infrastructure
 - Efficiency of the wholesale and retail gas markets
 - Optimal outcomes for consumers
- Work required for transition to fully competitive markets

Access to processing facilities: recommendation made to Minister in February

Benefit: Improved transparency of information on surplus processing capacity

Transmission access: extensive work underway recommendation expected early next year

Benefit: Transmission access on reasonable terms and conditions

Short-term gas trading: standard contract released, trial trading platform underway

Benefit: Reduced transaction costs, improved information transparency and efficiency

Contingency management: regulations being developed for June recommendation

Benefit: Certainty in contingency events and improved interface with new transmission codes

Switching: Rules in place, preparing for “Go live” 1 March 2009

Benefit: Timely and accurate switching of customers

Reconciliation: Recommendation this week with aim of “Go live” on 1 October 2008

Benefit: Efficient downstream reconciliation processes

Consumer outcomes: Variety of work streams

Benefit: Safe, fair, efficient and reliable supply to consumers

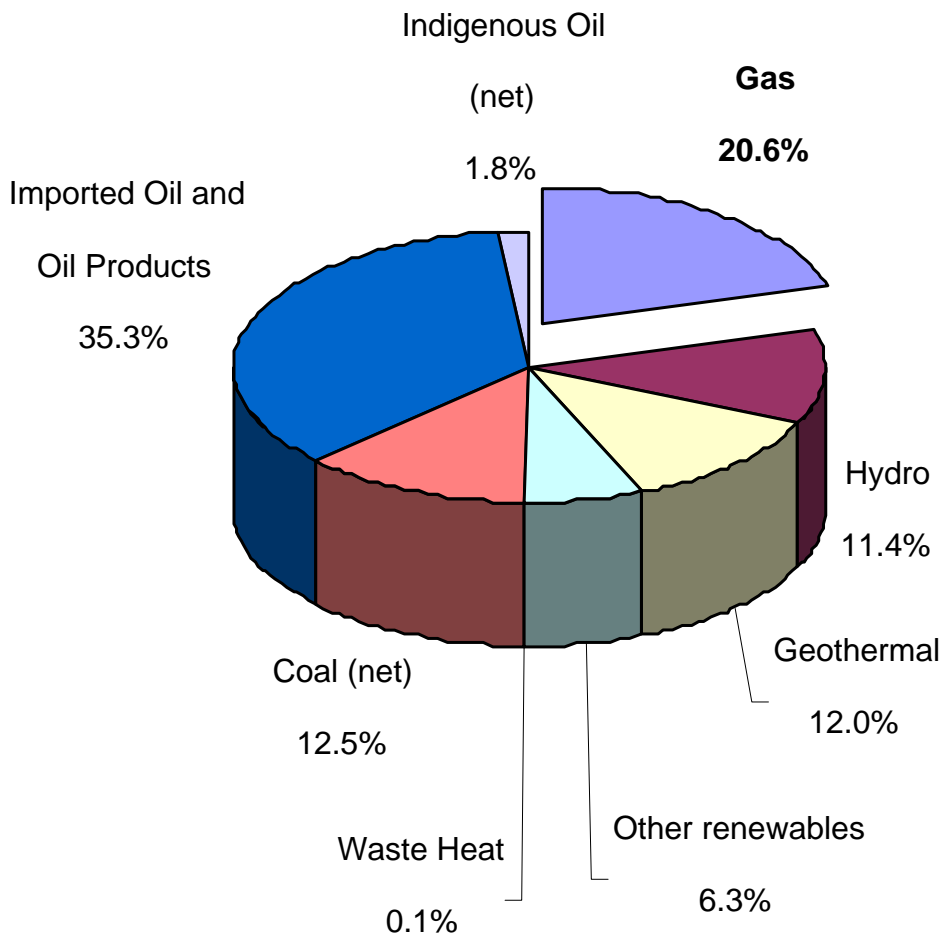
Summary of progress

- Well advanced on current GPS
- Policy development work complete mid 2009
 - Access arrangements, trading platforms, contingency requirements, switching and reconciliation systems, standards contracts all help markets
- Focus will then turn to implementation and oversight
- New GPS next month

Wider energy policy framework

- In parallel with our market development work, Government considering the wider energy policy framework
- Appropriate to discuss
 - Current energy mix
 - NZES and
 - Implications

Current energy mix



- Gas supplies a fifth of primary energy supply
- Contributes more than solar, wind, biogas, wood, and geothermal combined
- Largest indigenous source of energy ahead of coal and hydro

How did this come about?

Partnership with Government

- Historically industry faced a number of unique physical challenges
- Resulted in direct and indirect government assistance
- Examples:
 - Establishment of NGC in 1967
 - Underwriting of Maui and “Think-Big” projects
 - Petroleum Programme of Action

Economic policy objectives

- Government involvement motivated by economic imperatives
- Successful partnership with industry
 - Significant contribution to primary energy supply
 - Range of specialist NZ companies supporting exploration, production, treatment and utilisation of gas

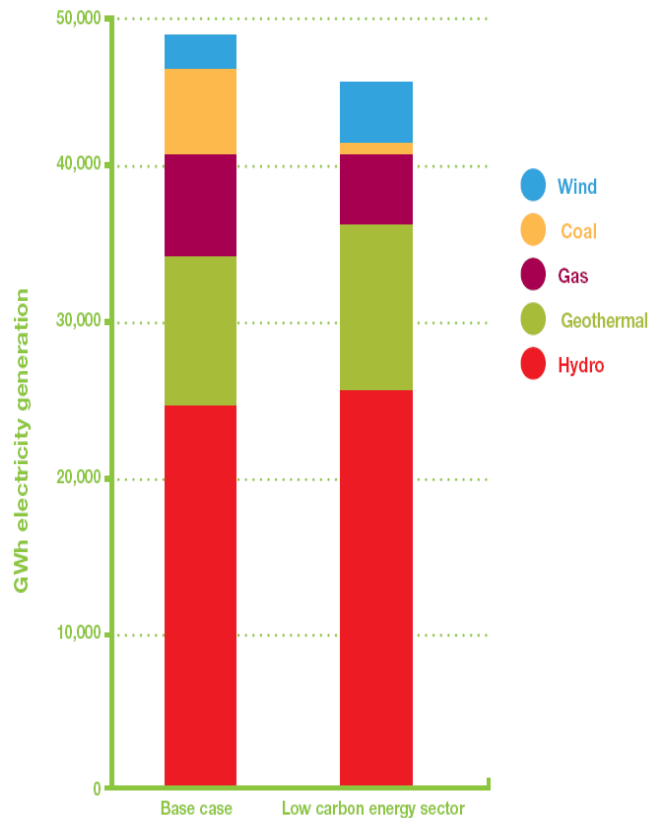
- Natural barriers continue but are mitigated by liquid fuel prices and rising demand
- New Zealand relatively under-explored
- Economics looks good for government and the industry
- In 2005, the baseline projection was for gas to grow 35% by 2025
- Many were expecting the partnership to continue

- Super-layered on economic policy objectives are new policy goals relating to:
 - Security of supply
 - Fair consumer outcomes
 - Environmental protection
- Not unique to New Zealand...
- Government's now seeking more active role in determining energy mix
- Creates uncertainty for stakeholders (and regulators)

- NZES provides strategic direction
 - 90% renewables target by 2025
- Proposed policy instruments include
 - Ban on thermal generation
 - Emissions trading scheme
 - Use of call-in powers

NZES vision- 90% renewables

Figure 5.4: Electricity generation in 2025 under emissions pricing and efficiency measures



- Gas-fired generation will decrease 25% by 2025 as compared with the base case
- Difference will be picked up by wind generation and decrease in demand

Is gas a sunset industry?

Source: Ministry of Economic Development

Underlying demand for gas

- **Domestic and commercial use**
 - 220,000 residential and 3,000 commercial users of gas
- **Industrial use**
 - Fuel of choice for range of industrial applications
 - Forestry and dairy sectors two of the largest users
 - ETS improves competitiveness of gas against coal
- **Petrochemical production**
 - Methanex announcement to reopen Motunui

Use of gas for power generation

- NZES vision is not for gas not to be used in electricity generation, but for growth not to be as large as some forecast
- This was recently confirmed by the Minister

“We do not shrink away from the reality that in the electricity sector a greater emphasis on renewables means demand for gas will not grow as it might otherwise have. This is axiomatic. But nor do we accept some of the rhetoric being put about that the gas market will fail. The gas for electricity market is not going to disappear. Other uses for gas also exist.”

2008 National Power Conference

- Other scenarios possible in long journey
- Security standards and costs will change over time
- Need a transition to low emissions future
- Gas well placed to assist transition
 - New peaking plant
 - Gas storage

Concluding remarks

- Innovation and technology will be required for gas to make significant contribution to low emissions future
- Regulatory regime needs to support that innovation
- Gas industry will continue its cornerstone role