



SUBMISSION BY

GENESIS POWER LIMITED

trading as Genesis Energy

ON

**Transmission Access Framework – Statement
of Proposal**

21 December 2007

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Transmission Access Framework Statement of Proposal

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Introduction

1. Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to comment on the Gas Industry Company's statement of proposal for a Gas Transmission Framework ("the proposal paper"). Genesis Energy has previously submitted on the 'Gas Transmission Access Issues Review' consultation paper ("the issues paper") and on the 'Analysis of Options for an Access Framework for Governance of Gas Transmission' consultation paper ("the options paper").
2. Genesis Energy has interests both upstream and downstream of transmission access. Upstream interests include exploration and production activities in the Taranaki region. Downstream interests include use of gas

for electricity generation in the Waikato region, plus retail of reticulated natural gas throughout the North Island. Genesis Energy operates up to 1450 MW of gas-fired generation and has over 700,000 electricity and gas customers.

3. Genesis Energy is committed to providing a reliable supply of energy to New Zealand at least cost into the future and believes that gas transmission arrangements are of fundamental importance to achieving this objective. As such, Genesis Energy takes a keen interest in the Gas Industry Company's work on regulating transmission access.

Executive Summary

4. In many ways, Genesis Energy is impressed with the work that the Gas Industry Company has produced and with the lengths that the Gas Industry Company has gone to in describing its thinking. The statement of proposal clearly reflects a great depth of understanding of gas transmission pipeline operation and governance.
5. Genesis Energy has however found it to difficult to assess the merits of the Gas Industry Company's proposal as presented. The proposal provides a great deal of detail, but does not provide a clear analytic and evaluative basis from which to move forward with implementation or to consider alternative ways forward.
6. Genesis Energy recommends that the nature of the problem and the objectives should be examined more thoroughly and in the context of market development scenarios plus a strategic vision. Genesis Energy also recommends that, having settled on 'light regulation' as a preferred approach, the Gas Industry Company now needs to explore a range of options and evaluate them side-by-side.
7. In this submission, Genesis Energy provides an illustration of an alternative option for improving pipeline codes and managing multi-party arrangements. This option is described and contrasted with the Gas Industry Company's developed option.
8. Without clear options for comparison plus a meaningful evaluation, Genesis Energy does not believe that the Gas Industry Company proposal should proceed any further. Although the Gas Industry Company option clearly has some strengths, it also has a number of weaknesses and risks. In particular, the option opens the existing codes up to a potentially intense transmission system owner (TSO) led transition with the risk of much disruption for little real gain. Genesis Energy sees merit in an approach that would avoid regulatory inflexibility, while nonetheless providing a strong counter to TSO market power.

Opening Comments

9. While the Gas Industry Company's statement of proposal is a thorough and detailed paper that reflects a great deal of understanding of gas transmission pipeline operation and governance, Genesis Energy has found it to difficult to assess the merits of the Gas Industry Company's proposal as presented. The proposal in Genesis Energy's view does not provide a clear analytic and evaluative basis from which to move forward with implementation.
10. To provide a base that allows for an analytic comparison of options, and thus a base from which to move to implementation, Genesis Energy believes that the Gas Industry Company's work should be complemented by more policy-oriented work around developing, analysing, and evaluating options. In Genesis Energy's view, this should ultimately allow for a clearer, more concise and complete formulation and exposition of possible ways forward together with their strengths, weaknesses and risks.
11. Genesis Energy recommends that the Gas Industry Company should not press ahead with the proposal as it stands. Genesis Energy believes that the benefits of more in-depth policy analysis and clear identification of the preferred solution outweigh the risks that further delay may bring. Genesis Energy recommends that the Gas Industry Company should consider pressing ahead with policy work to complement the work to date. Genesis Energy believes that if the complementary work were to make use of working parties then there will not be any significant delay in implementation.

How this Submission is Structured

12. Having expressed our overall view in the opening comments above, the remainder of this submission covers several areas.
 - a. Firstly, we attempt to illustrate the policy work that we believe is needed to complement the analysis done to date.
 - b. Secondly, we have some comments on the risks, strengths, and weaknesses of the proposal.
 - c. Thirdly, we have some specific comments on the draft regulations.
13. The proposal paper brings together all levels of the Gas Industry Company's plans for a new transmission access framework – from high level policy analysis and evaluation, through detailed policy design and on to draft regulations. This submission similarly pulls together Genesis Energy's response to the proposal at all those levels.

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Complementary Analysis

14. This section describes the policy work that Genesis Energy suggests should provide an essential complement to the work that the Gas Industry Company has already completed. This section builds on Genesis Energy's submission on the issues paper, but attempts to provide a more in-depth discussion. This is in large part made possible by the additional work that the Gas Industry Company has completed since the issues paper.
15. In this section Genesis Energy adopts an illustrative approach (albeit at the level of a sketch rather than a detailed portrait). This section can be thought of as illustrating our suggestions for further work that would:
 - a. assist us (and we suspect others) to fully understand the merits of the proposal;
 - b. satisfy the business need to be able to meaningfully compare the proposal against a truly representative array of reasonably practicable options;
 - c. fulfil the Gas Industry Company's legislative obligations before recommending regulations;
 - d. provide opportunities to refine and improve (where possible) the proposal; and
 - e. establish an excellent base for the Ministry of Economic Development's consideration of the Gas Industry Company's proposal.
16. We have structured this part of the submission along similar lines to our earlier submission on the issues paper¹. We cover the dynamic context for policy work on transmission access, thinking about the nature of the problem and the objective, developing an array of options, and evaluating their relative merits.

Thinking about the future

17. In our submission on the issues paper, Genesis Energy urged the Gas Industry Company to turn its thoughts to the future direction of gas industry policy and the gas industry itself.

¹ Genesis Energy, "Submission to the Gas Industry Company on Gas Transmission Access Issues Review", 26 July 2006.

Strategic vision

18. Genesis Energy recommended in its issues paper submission that the Gas Industry Company should develop a strategic vision – meaning a consistent view of how industry relations, governance and business practices may fit together and evolve. Genesis Energy did not suggest what that vision should be, but illustrated some alternatives.
19. In its subsequent submissions analysis paper, the Gas Industry Company expressed the view that there is a strategic vision inherent in the Gas Act 1992 (the Act) and the Government Policy Statement on Gas Governance (GPS) and that this essentially boils down to:

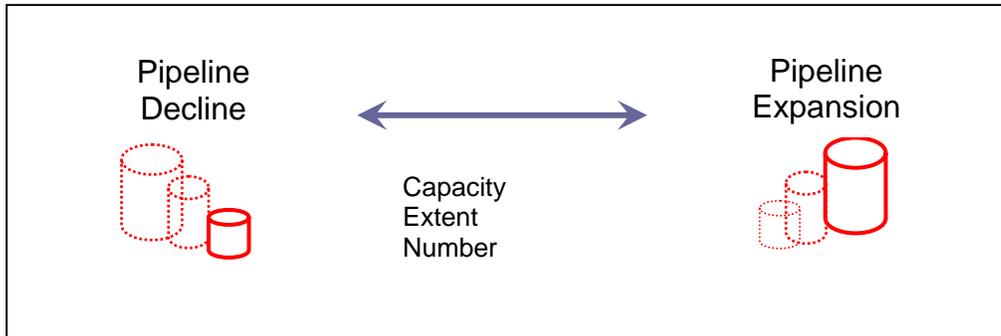
“developing competitive markets, low barriers to entry, access to essential infrastructure, and the appropriate level of regulation required to achieve these.”²
20. Genesis Energy maintains that it would be useful for the Gas Industry Company to continue to work on fleshing out this strategic vision. In our view this work would assist the Gas Industry Company with its policy development, as well as assisting industry participants to better understand the direction and end point of the Gas Industry Company’s regulatory proposals.
21. In Appendix One to this document, Genesis Energy sketches out a possible timeline of how industry regulation could evolve in the mid-term. In Genesis Energy’s view, this type of timeline could be a useful tool for thinking about the strategic vision and especially for thinking about linkages between regulatory proposals in different segments of the gas industry.

Market development scenarios

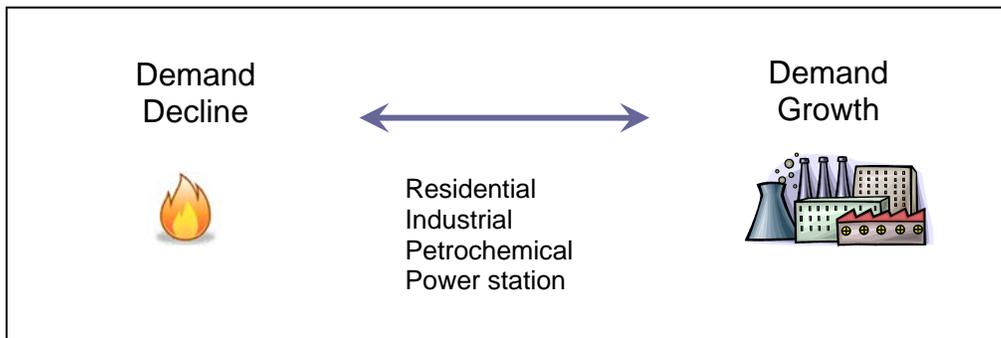
22. Genesis Energy recommended in its issues paper submission that the Gas Industry Company should develop a set of gas industry development scenarios. These would help the Gas Industry Company and industry participants to think about the industry context when evaluating policy options. The Gas Industry Company has not picked up this suggestion at all.
23. Given Genesis Energy’s view of the importance of having a view of the future, in order to develop a sustainable policy, Genesis Energy has made a (necessarily cursory) attempt to demonstrate what market development scenarios might look like. Later in this submission these scenarios are used to add context to discussion on the evaluation of policy options.

² Gas Industry Company, “Transmission Access Issues Review: Submission Analysis and Work Programme”, October 2006, para 2.26.

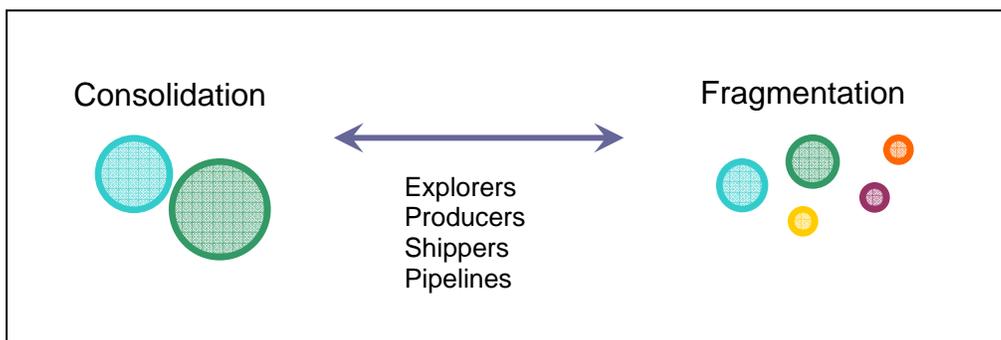
24. In thinking about market development scenarios, it is useful to consider some relevant 'dimensions'. Three important dimensions are illustrated below:



With capital investment, pipelines could be extended geographically, their capacity could be increased, or additional pipelines could be constructed. Alternatively, pipeline infrastructure could be maintained or could decline. The two existing transmission pipelines could be consolidated to one pipeline, or possibly further segmented to create multiple pipelines.



Demand for delivered gas could grow, decline, or remain stable. Growth could be across sectors, or vary from sector to sector.



The number of industry participants could increase or decrease. Changes in structure could be across industry, or vary along the production chain.

25. It may also be useful to think about some of the 'events' that may occur. Some of these are:

- a. LNG import or export;
- b. Storage facilities constructed³; and
- c. Discovery of gas in new regions.

26. The dimensions and events illustrated above go some way to providing a foundation for thinking about credible industry development scenarios, as well as for describing the current market context. The following examples illustrate some development scenarios (at a sketch level). The first example is elaborated on slightly, while the other scenario would require significant additional work:

- a. Rapid expansion/new infrastructure scenario.

New fields are discovered on a scale that does not warrant export (via LNG facilities). The fields are developed nonetheless (due to condensate value) and the demand-side of the market is stimulated by the volumes of gas available.

Expansion of electricity generation, industrial, commercial and residential gas use is stimulated by a favourable shift in the price of gas relative to electricity and other alternative fuels. A mixture of new pipeline construction, expansion to capacity of the existing Vector pipeline, and construction of storage facilities is contemplated by various investors to bring gas to expanded markets.

The diversity of uses (and users and shippers) provides depth on the demand side to support wholesale gas trading and this is supported by flexible contracts on the supply side.

Under this scenario:

1. there is significant investment in transmission infrastructure (new and existing);
2. transportation becomes a larger proportion of the delivered cost of gas for many consumers;
3. the market is more fragmented, and hence there is more pressure on management of multi-party arrangements;

³ We note that there is reference to gas storage in the recently released draft revision to the GPS and we also note the recent media release from Contact Energy regarding gas storage.

4. conditions are suitable for significant wholesale gas trading activity;
5. there is increased pipeline access seeking activity; and
6. complexity of pipeline services increases.

b. Decline scenario.

The moratorium on thermal generation or reduction in petrochemical sector activity effectively halts growth of the demand-side of the market, which instead declines as older plant is closed, mothballed or moved into a reserve role. The lack of a market for gas dissuades supply-side investment beyond development of small fields needed to meet residential and other remaining load.

Pipeline utilisation declines, as does the number of shippers and number of active welded points. For a time this results in higher transportation costs per unit of gas, though eventually some spur lines are decommissioned and dismantled. Eventually, the remaining pipelines are sold into ownership of the remaining major users.

27. The value of industry development scenarios is that policy options can be tested against the scenarios to assess the durability of the policy option. In particular, well-developed scenarios should be invaluable when it comes to extending cost benefit analysis from consideration of static efficiency to dynamic efficiency. For example, the optimal design for a code change process is probably strongly dependent on the degree of industry consolidation or fragmentation. As another example, the optimal approach to managing vertical integration risks is probably strongly dependent on whether pipeline expansion is, or is not, likely.
28. The evaluation process should include an examination of each policy option against each development scenario as a way of drawing out the strengths, weaknesses and risks of policy options in a dynamic setting.

Understanding the nature of the problem

29. Earlier submissions from Genesis Energy and others have stressed the need for the regulator to clearly identify the nature of the problem that makes intervention necessary. Understanding the nature of the problem is closely related to understanding the objective that regulation is trying to contribute to.
30. The Gas Industry Company has certainly heeded this call for problem definition, and has included a description of the problem right up front in

the proposal. Genesis Energy is heartened by efforts the Gas Industry Company has made to improve analytical clarity in this way.

31. The problem definition is described in the proposal in economic terms as an "access issue" stemming from the natural monopoly characteristics of gas pipelines. The proposal distinguishes this from a "market power issue" (also stemming from the same cause). The market power issue is set to one side as it is assumed to be dealt with in its entirety through the Commerce Commission's economic regulation under the Commerce Act.
32. While this is a good start, Genesis Energy believes that the Gas Industry Company's work on problem definition could be extended or clarified to aid option development and evaluation. It may be useful to examine alternative dissections of the problem and to link the conceptual problem to the known issues to create a more "concrete" basis for policy development. The following sections treat refining the problem and moving to more concrete problems in turn.

Refining the problem definition

33. There appear to be two distinct characteristics of gas transmission that are of interest to the Gas Industry Company. The first is the natural monopoly nature of transmission pipelines; the second is cross-ownership of pipeline and energy businesses (that is, vertical integration). Vertical integration is of interest here only because it involves cross-ownership between competitive and natural monopoly sections of the market. As such, vertical integration wouldn't necessarily be a problem without the prior problem of natural monopoly. Nonetheless, it is worth considering vertical integration as a distinct market characteristic.
34. In general terms, the problems of interest stemming from natural monopolies are that price and quality of service are likely to diverge from what would be the case if the business were fully exposed to competitive pressures. This is only a problem where divergence is likely to be to the detriment of consumers. These problems are made possible by the market power that natural monopolies can exert. The proposal correctly identifies the price problem and labels this the "market power issue", but does not discuss quality of service as a problem also stemming from market power.
35. Vertical integration is not discussed directly in the proposal's description of the problem. Instead, motivation to favour affiliates is given as an example of why a pipeline owner might offer access terms that impede upstream or downstream competition. The general ability of pipelines to influence upstream and downstream competition is referred to in the proposal as the "access issue".
36. The proposal puts the "market power" issue to one side, assuming that it was dealt with by the Commerce Commission's 2004 gas control inquiry.

Genesis Energy suggests that this issue would more easily be placed to one side if it were considered instead as an “excess pricing” issue. The Gas Industry Company’s “access issue” then actually relates to both market power and vertical integration.

37. However, this may not tell the full story. The other potentially distinct problem that Gas Industry Company appears to be interested in is the governance of multi-party arrangements. Presumably, this is because the Gas Industry Company believes that poor governance of multi-party arrangements is so detrimental to consumers that regulatory intervention may be warranted. This problem seems to be related to the market power problem and could possibly also be considered an aspect of poor service quality (in that in a hypothetical competitive market, pipeline owners might compete on the basis of the quality of their governance arrangements). It is not clear whether the Gas Industry Company would still be interested in governance of multi-party arrangements in the absence of natural monopoly.
38. Figure 1 illustrates the problem components discussed above. Pricing risks are set aside at the bottom of the diagram as these fall reasonably squarely within the ambit of the Commerce Commission’s regulatory activity. Poor service quality is illustrated as a risk within the interest of the Gas Industry Company. Poor service quality stems from the market power and lack of competitive pressures that pipeline companies enjoy, which are in turn consequences of natural monopoly. Poor governance is a potentially distinct and also possibly related risk. Vertical integration and its attendant consequences and risk are separated out from the natural monopoly components of the problem.

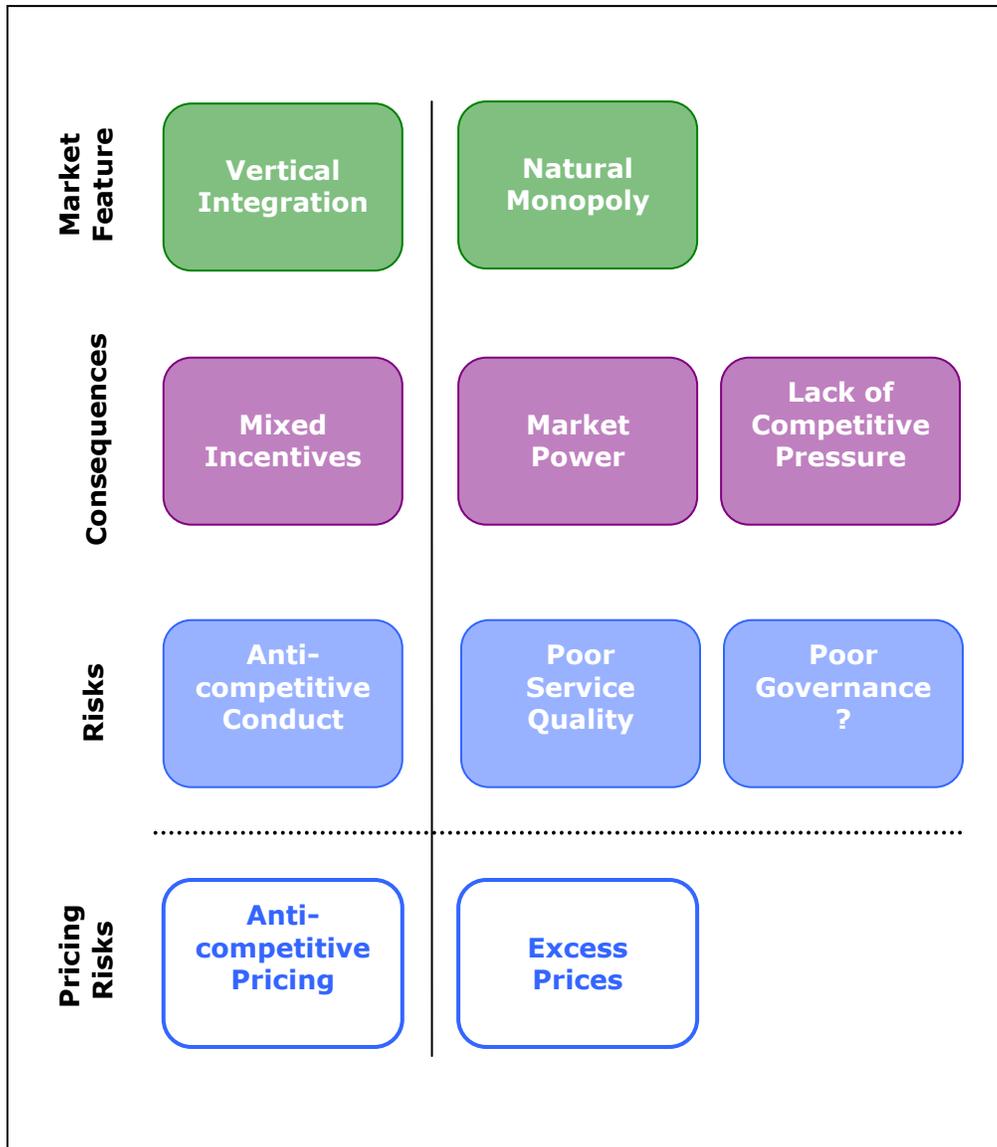


Figure 1 - Natural monopoly and vertical integration characteristics and the resulting risks

39. The Commerce Commission’s regulatory ambit under the Commerce Act extends beyond price to include quality of service risks arising from market power. However, Genesis Energy would argue that this does not exclude quality of service from the Gas Industry Company’s consideration. The Commerce Commission’s regulatory activity at best deals only with gross measures of service quality⁴. In Genesis Energy’s view, the specialist regulator (in this case the Gas Industry Company) has the potential to add

⁴ This is illustrated by the Commerce Commission’s regulation of lines companies where regulation of service quality is focused on gross measures such as frequency and duration of service interruption.

value in the regulation of a natural monopoly's ability to exercise market power to degrade service quality to the detriment of consumers⁵.

40. There is possibly also a question of whether pricing *structures* may be of interest to the Gas Industry Company, as the Commerce Commission is more interested in total returns than the intricacies of pricing.
41. In the alternative dissection of the problem described above, the relevant "issues" could be re-framed as a "poor service quality" problem and an "anti-competitive conduct" problem (or alternatively this could be called a "favouring affiliates" problem). "Poor multi-party governance" could possibly be added as a separate problem, or could be wrapped into the service quality problem. In the remainder of this submission, Genesis Energy has taken the latter approach.
42. It could also be useful to break each of the service quality issues down into separate consideration of the written terms under which pipelines are operated and the actual conduct of the pipeline owner. Written terms are more tangible than conduct, hence different regulatory approaches may be warranted.

Moving to more concrete problems

43. The discussion above re-frames the problem somewhat but, as with the discussion in the statement of proposal, leaves the analysis at a very generic level. The problem as described is generic to virtually any vertically integrated natural monopoly. The next step then is to link the generic problem description to real problems.
44. The statement of proposal does this by describing two themes and three specific issues that were developed in earlier Gas Industry Company papers as follows:
 - a. Theme 1: Third party access rights – new physical connections are complex and there is no automatic right of access to the Maui pipeline.
 - b. Theme 2: Governance issues – many aspects of gas transmission are intrinsically multilateral and existing mechanisms are patchy.
 - c. Specific Issue 1: new entrant rights of access for physical connection and for transportation services.

⁵ For example, balancing services is a key area where there is potential for the transmission owner to degrade the level of service by either reducing tolerances or by not matching cash out prices to prevailing market conditions.

- d. Specific Issue 2: 'management' of common terms for transmission services.
 - e. Specific Issue 3: cross-ownership conflicts of interest.
45. The statement of proposal also mentions several other specific issues as follows:
- a. balancing arrangements – lack of clarity;
 - b. "legacy-related" pipeline imbalance issues;
 - c. impact of monthly reconciliation on imbalance management for pipeline users;
 - d. "lack of leverage" for pipeline users; and
 - e. lack of leverage for the Gas Industry Company.
46. From this collection of themes and issues, it seems that the Gas Industry Company's objectives are to:
- a. ensure access to new physical connections are available on reasonable terms (Access to connections);
 - b. ensure access to transmission services are available on reasonable terms (Access to services);
 - c. improve the quality of service provided by transmission system owners (TSOs) to better reflect consumer needs⁶ (Improvement to services).
47. The statement of proposal doesn't seem to link its generic problem definition to the specific issues or themes. The following table provides a starting point for such an analysis by looking at each of the above objectives against the two problems (poor service quality and favouring affiliates) described earlier in this submission.

⁶ Quality of service here could include governance of multi-party arrangements.

Table 1 - Firming up the problem definition by linking identified objectives to the generic description of the problem.

Objective	Poor Service Quality Problem	Favouring Affiliates Problem
Access to connections	<p>Quality of connection services could be less than would be expected from a hypothetical competitive TSO.</p> <p>For example, the TSO may provide poor information for connection seekers, have poor responsiveness to requests for access, and may be unwilling to accommodate the needs of access seekers.</p> <p>In addition, TSOs could use their market power to shift risks and costs to access seekers.</p> <p>Gas Industry Company suggests that some of these problems may be in evidence for both the Maui and the Vector pipelines.</p>	<p>There are potentially anti-competitive motivations for frustrating access to pipelines.</p> <p>This may be more of a risk on the upstream side than on the downstream side.</p>
Access to services	<p>TSOs could make it difficult to new shippers to gain access to transmission services.</p> <p>It is not clear that there is any evidence of this being a problem.</p>	<p>TSOs could frustrate access to shippers that seek to compete with the TSO's affiliates.</p> <p>TSOs could offer favourable access terms to affiliates.</p> <p>For example, prudential requirements may be relaxed for affiliates, TSOs may be more willing to expand capacity for affiliates, affiliates may get first call on available capacity, affiliates may gain access to services not available to others, and affiliates may not have the same incentive to optimise capacity reservations.</p>

Objective	Poor Service Quality Problem	Favouring Affiliates Problem
Improvement to services	<p>TSOs may be more reluctant to meet consumer demand for service improvements than would be the case for a hypothetical competitive TSO.</p> <p>At present, this seems to be illustrated by concerns around balancing arrangements, monthly reconciliation, poor information provision, the 'lack of leverage' issue.</p> <p>It is also possibly also illustrated by inefficient governance of multi-party arrangements.</p>	<p>Incentive to favour affiliates could (theoretically at least) conflict with incentive to meet needs of other pipeline users.</p> <p>TSO conduct could favour affiliates (even if codes are even-handed).</p>

48. There is undoubtedly considerable scope for extending the above analysis. In particular, Table 1 provides a base from which to look for evidence, to examine the justification for intervention, to examine the logic of a proposed intervention (intervention logic), and to consider evaluation indicators. Also, problem definitions should always be revisited as understanding of the options and their evaluation evolves.

What are the reasonably practicable options?

49. The Act places a clear onus on the Gas Industry Company to identify and assess all reasonably practicable options. If an extremely literal interpretation of this requirement were adopted, then the Gas Industry Company would have to identify and assess a near limitless array of options. Sensibly, the Gas Industry Company has addressed this potential problem by limiting its consideration to a finite number of representative points along a spectrum of options – from 'minimal change' at one end to 'full regulation' at the other.
50. While agreeing in principle with this pragmatic approach, Genesis Energy believes that the Gas Industry Company's options development falls short of the rigor required by the Act. There are two ways in which Genesis Energy suggests that this pragmatic approach could be extended to meet the requirements of the Act. These are summarised below.

- a. Develop options in a series of consecutive stages.

The spectrum of options used by the Gas Industry Company only deals with a very high-level question of 'how "heavy-handed" should regulatory intervention be?' Assuming that this is indeed a useful question to ask, there still remains a host of options to be examined within the category of 'light regulation'.

- b. Dissect the options to illustrate the key design variables.

The Gas Industry Company has presented 'bundles' of options. These don't allow the reader to clearly see what the actual design features (or variables) are. Similarly, dissecting the options should help to understand the problem and with subsequent analysis of benefits and costs.

51. The following sections discuss each of these two concepts in turn.

Consecutive stages

52. The Gas Industry Company's options paper focuses on developing a range of 'governance framework' options and uses a regulatory strength concept to illustrate a spectrum of possible options. The options paper introduces the concept of 'retained elements' as a way of excluding options that the Gas Industry Company considers not to be reasonably practicable. Finally, a concept of 'three tiers of governance' is introduced as a means of structuring all of the options. Given these analytical constraints, option development becomes simply a question of 'what regulatory strength at what tier of governance?'
53. Genesis Energy believes that this approach to developing options is too narrow to satisfy the requirements of the Act.
54. Nonetheless, there may be some value to considering 'regulatory strength' as a first-stage options filter. Even so, 'regulatory strength' can only give a first order of magnitude indication of the optimum option. If the analysis does support 'light regulation', there remain a number of further design elements to consider.
55. To illustrate the idea of consecutive stages of options, consider the "favouring affiliates" problem. A first cut spectrum of options may look something like the figure below.

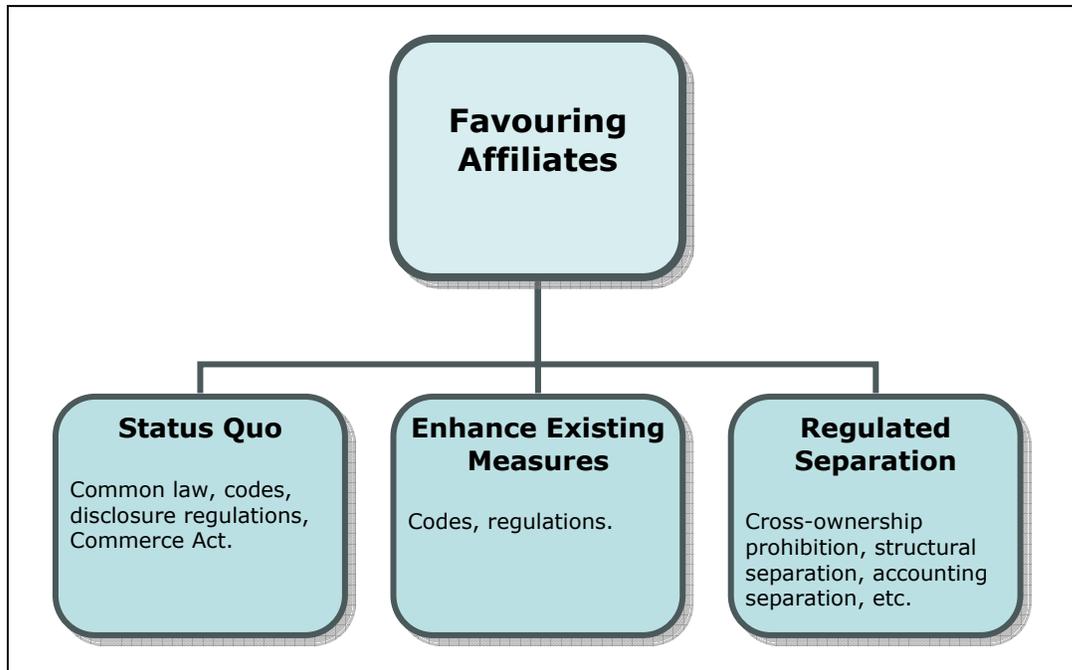


Figure 2 - Range of options for 'favouring affiliates' problem.

56. This range of options is representative of a spectrum from doing nothing to “heavy-handed” intervention aimed at eliminating the source of the risk directly (and probably creating other risks). If the options at either end of the spectrum can be discounted relatively quickly⁷ because either they are ineffective or effective but at too great a cost, then the next stage would be to look at options within the ‘enhance existing measures’ box⁸.
57. In any event the nature of the status quo option should also be dissected further to allow its use as a counterfactual (including for cost benefit analysis). This should also assist understanding of the other options, as the status quo already contains a relatively comprehensive set of measures under a range of jurisdictions. The issues paper provides a starting point for this analysis, though it focuses on the content of the codes to the exclusion of other aspects of the status quo⁹. . Also, it is important to evaluate options (including the status quo) with reference to market development scenarios. For example, a prominent weakness of intervening to prohibit

⁷ As seems to have been the case.

⁸ Of course, two of the options within this category may be to improve the provisions in the codes, or to improve TSO conduct – both of which could also be features of the preferred option for tackling the service quality problem.

⁹ Other aspects of the current environment include the common law system, generic competition legislation, and the disclosure regulations under the Gas Act 1992. The discussion also omits examination of the set of incentives facing the relevant parties.

cross-ownership of production and pipelines would be the deterrent effect on new pipeline (and possibly other gas infrastructure) investment. As another example, one of the strengths of the status quo could be the ability to cope with rapidly evolving industry structures.

Dissecting the options

58. In the context of the 'poor quality of service' problem, Genesis Energy presents a simple model for thinking about several option design variables. The following figure illustrates a generic version of this model.

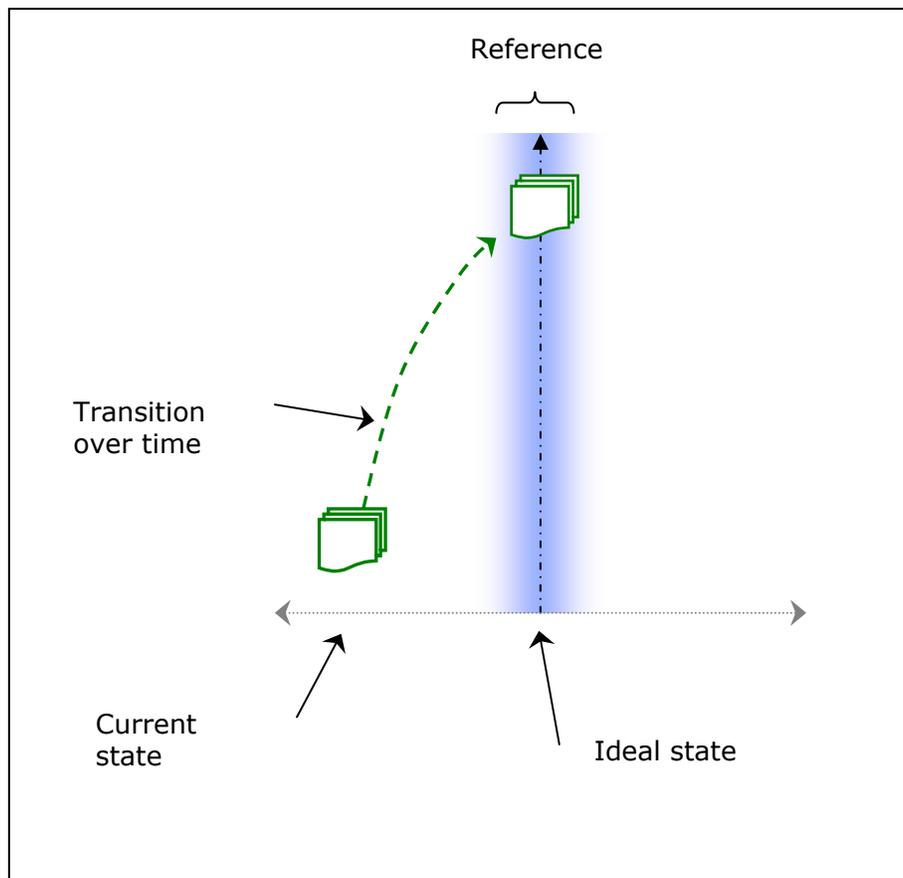
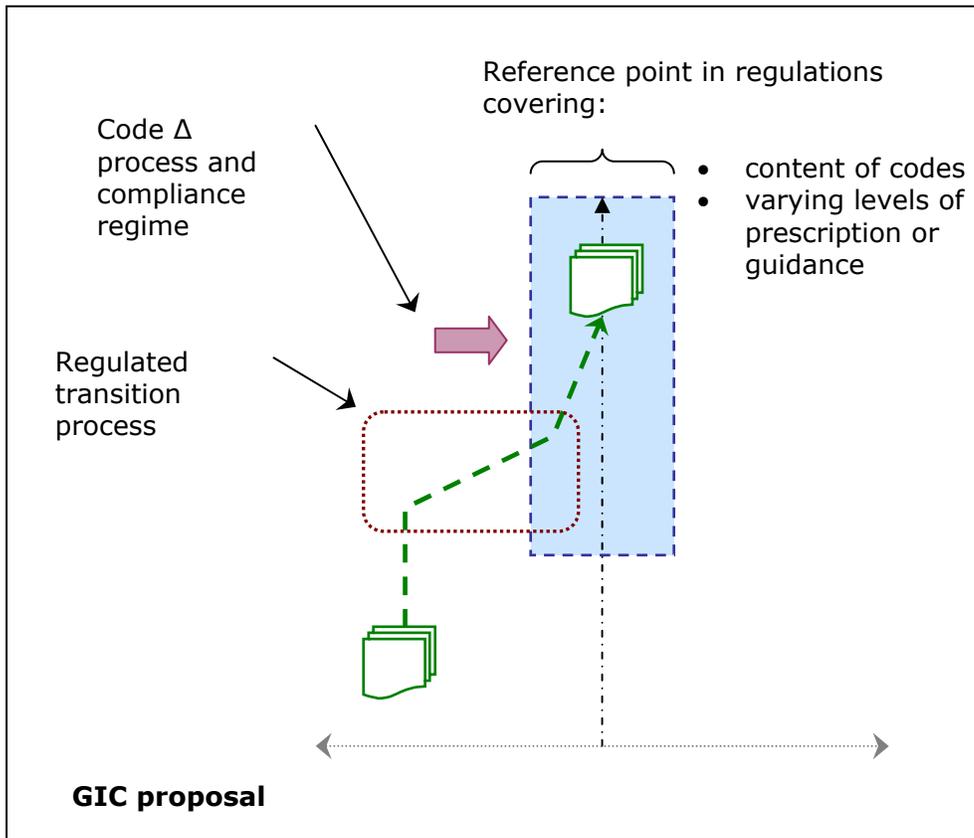


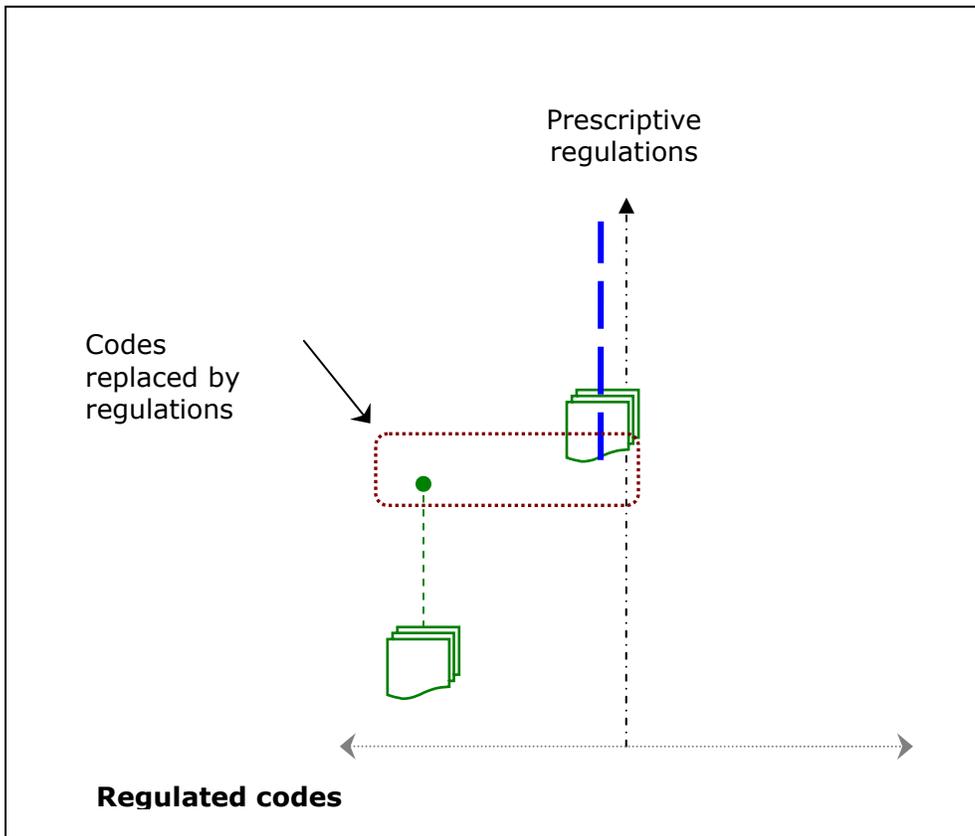
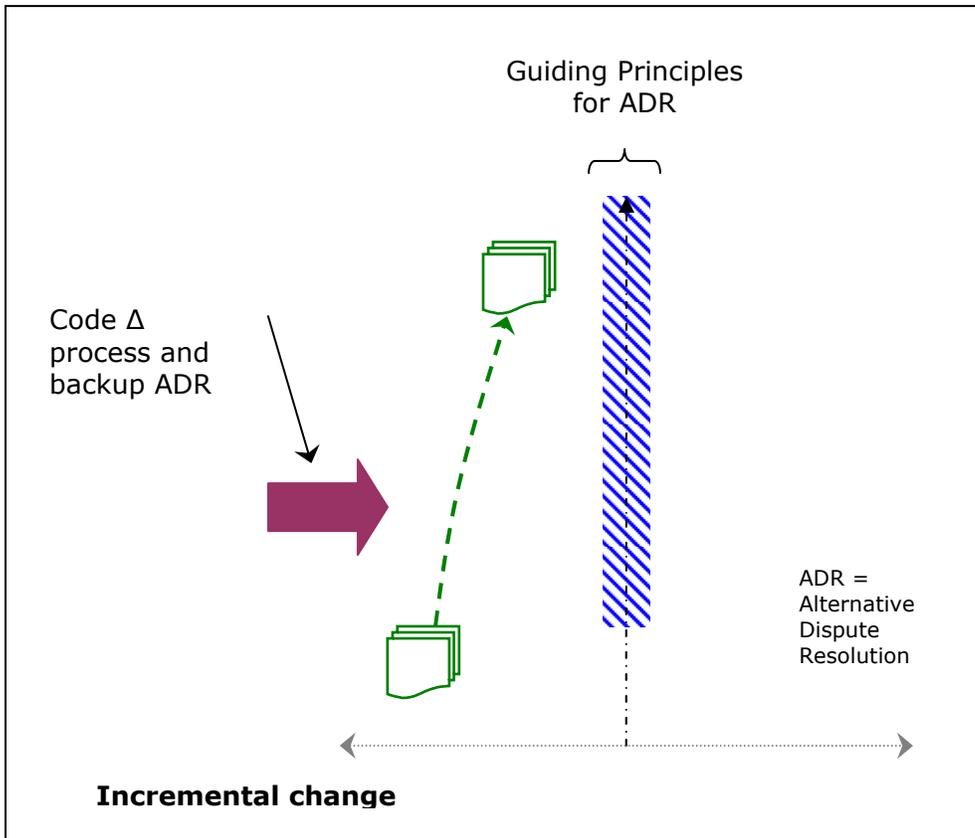
Figure 3 – A generic model for thinking about option design variables.

59. The diagram illustrates the Gas Industry Company's desire to improve codes (and perhaps conduct) from their current state towards some 'ideal state'. The state of the codes is represented by the horizontal axis, while the vertical axis represents time. Transition is represented by the 'trajectory' of the codes. While this model is extremely simplistic, it nonetheless provides a prompt for thinking about policy design variables such as:

- a. What is the 'ideal state'?
- b. Can/should we attempt to define the ideal state, or some proxy reference point?
- c. How do we compel/manage transition from the current state towards the ideal state?

60. As a further illustration, the following figures apply the model to three possible policy options for improving transmission services codes. Each adopts a different approach to answering the above questions.





61. The analysis above is in no way complete. It does however start to illustrate how options could be developed and communicated in a way that draws out the range of possibilities and the key design variables. This model operates on the assumption that (at least one) objective of any option will be to improve transmission codes – there could be other options (and other components).
62. To amplify this illustration, Genesis Energy has developed an illustrative option in more depth. This builds on the ‘incremental change’ option shown above and adds a separate treatment for access seekers.

Developed option – Incremental change plus reference offers

63. This section illustrates an ‘incremental change plus reference offers’ (ICRO) option, as an alternative to the transmission access framework proposed by the Gas Industry Company. The ICRO option is displayed in Figure 4 below.

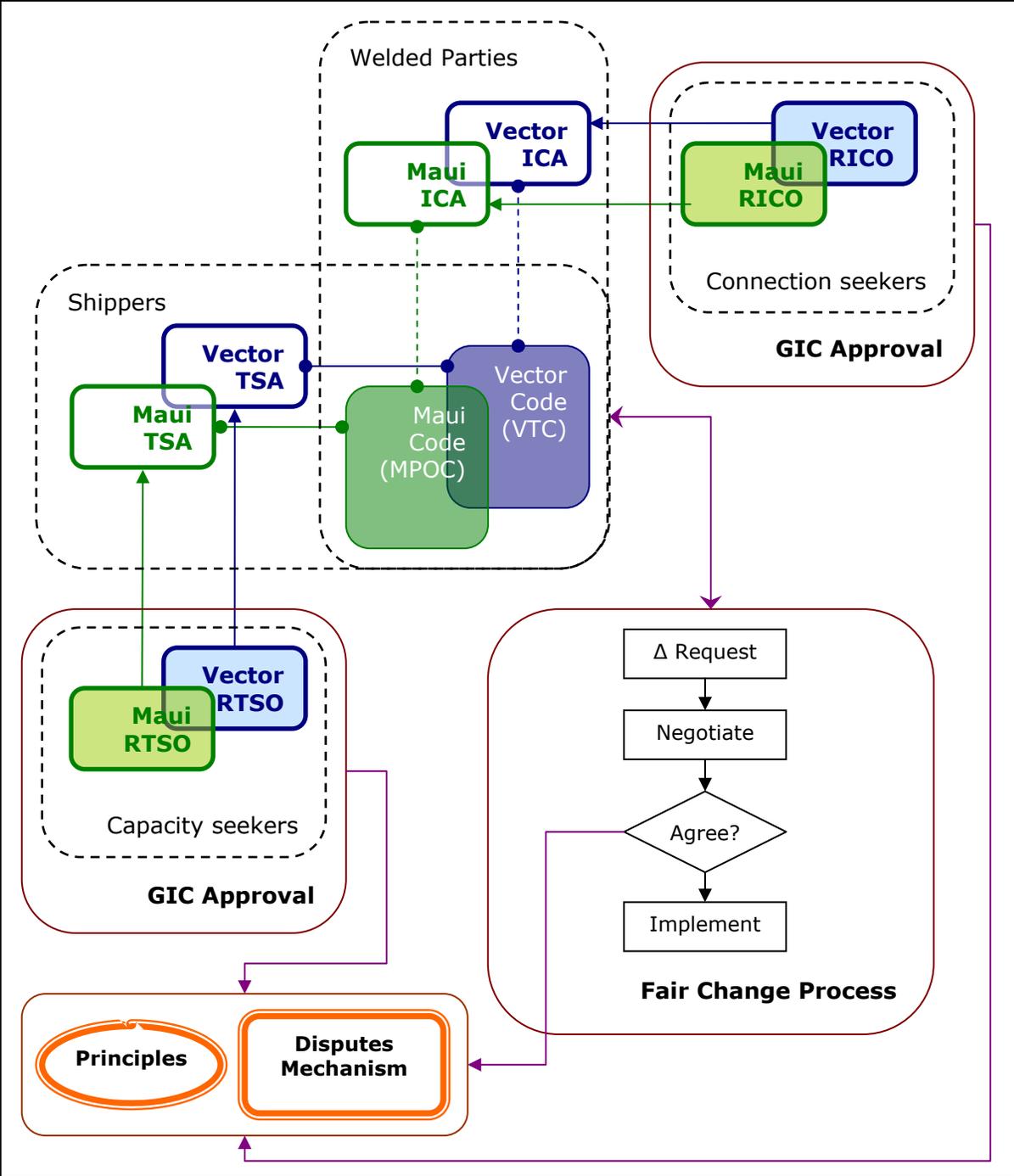


Figure 4 - Schematic of the incremental change plus reference offers (ICRO) option.

64. The essential features of this option are:

- a. TSOs must make 'reference transmission service offers' and 'reference interconnection offers' (reference offers) available to new industry entrants. The Gas Industry Company must review

these reference offers for fairness and approve them once compliant;

- b. The current Vector and Maui codes (“the codes”) are recognised by the Gas Industry Company;
- c. A ‘fair change process’ is established that allows industry players and the Gas Industry Company to seek amendment to the codes. This change process is similar to the Vector Transmission Code (VTC) change process but improves on it by:
 - i. allowing industry participants to take disputes arising from industry contracts, the reference offers or the fair change process to a binding alternative disputes resolution mechanism (“the disputes mechanism”); and
 - ii. asking the Gas Industry Company to establish a set of code principles that will guide the disputes mechanism. These principles follow the Act and may build on the GPS.

65. Potential advantages of the ICRO option include:

- a. reference offers guarantee access on fair terms;
- b. the industry effort behind the current structure of contracts and codes is supported and left largely intact;
- c. both players and the Gas Industry Company can initiate changes to the codes through the change process. This permits a mix of industry-led and regulator-led development; and
- d. the codes are left to evolve ‘organically’ through the change process and a potentially painful transition process is avoided.

66. The ICRO option recognises the difference between providing for access and governing the rules of multi-party arrangements. Particularly:

- a. new entrants are offered regulated access on fair terms to protect them from being excluded by existing participants; and
- b. existing participants are free to negotiate the operation of the network, and can initiate the change process (with the disputes mechanism) in the event that negotiation alone is not enough.

67. The ICRO option is described in more detail in Appendix Two of this submission.

Pulling it all together and making a recommendation

68. In this submission, Genesis Energy is advocating development of several policy options in parallel to a greater depth than was contained in the Gas Industry Company's options paper. Genesis Energy believes that this will be in line with the Act requirements and, as importantly, will also improve the policy development process.
69. It seems quite likely that Gas Industry Company has already done much of the thinking that Genesis Energy would like to see, but that this has simply not been conveyed to stakeholders in a complete but concise form. The Gas Industry Company's "progress" paper¹⁰ and "international review" report¹¹ in particular show the seeds of some good option development work. However, it also seems to be the case that there is work that could improve the policy development process but has simply not been carried out. This observation is perhaps most clearly reinforced by the cost benefit analysis ("the CBA") contained in the statement of proposal.
70. The CBA appears to suffer from a lack of policy analysis on which to find good purchase. The CBA does not have the raw policy material available from which to consider in any detail the economic costs and benefits of policy options. Instead, the CBA can only focus on relatively trivial direct costs. The CBA omits consideration of the 'do nothing' counter-factual and explores instead only two options. The CBA does not consider the proposals against scenarios for industry evolution.
71. It would be useful for the development of options to include, at an early stage, consideration of jurisdiction. This is not to say that options should be immediately discounted on the basis of jurisdiction. Instead, jurisdiction is an important part of the overall picture – particularly given the unique institutional arrangements under which the Gas Industry Company operates.
72. The Gas Industry Company has used the 'regulatory strength spectrum' as a pragmatic means of achieving a first-order narrowing-down of an otherwise limitless range of options. Genesis Energy supports such a measure as a sensible way of making the policy development process meaningful, but cautions that a one-step use of the spectrum approach is unlikely to equate to a sufficiently fulsome examination of reasonably practicable options.
73. Genesis Energy recommends that working parties would also be a pragmatic means of making the policy development process more

¹⁰ Gas Industry Company, "Transmission Access Framework Progress Towards a Statement of Proposal", August 2007.

¹¹ Appendix 5 of the Gas Industry Company's statement of proposal paper.

manageable. Well run working parties should offer a means to both enrich and to streamline the policy development process compared to a counter-factual of 'behind closed doors' policy development punctuated by periodic formal consultation. Working party development should of course still be complemented by information sessions and formal consultation, but the 'gap' between consultation steps should be less jarring for stakeholders.

74. Genesis Energy reiterates comments made in previous submissions to the Gas Industry Company that consultation on draft regulations prior to settling matters of policy is neither appropriate nor helpful.

The Proposal – Strengths, Weaknesses, Risks

75. The statement of proposal describes the Gas Industry Company's proposed transmission access framework. The Gas Industry Company intends to give effect to this proposal by recommending a set of regulations — namely, the Gas (Transmission Access) Regulations 2008 and the Draft Gas (Compliance) Regulations 2007. The comprehensive draft regulations included in the statement of proposal clearly shows that the Gas Industry Company has put considerable effort into developing the details of its preferred option.
76. Notwithstanding the above, if the Gas Industry Company should proceed on the basis of the proposed regulations (as set out in the statement of proposal), Genesis Energy has a number of concerns which it believes require further consultation and consideration by the Gas Industry Company, including:
 - a. the risks and costs of the transition process may outweigh any benefits;
 - b. coverage of the proposed regulations is incomplete;
 - c. the change process may not adequately counter TSO bargaining power;
 - d. linkages between other work streams and the regulations are not fully apparent;
 - e. the proposal does not improve interoperability between the Maui and Vector pipelines;
 - f. the proposal may provide too much scope for bilateral negotiation of terms impacting multiple parties;
 - g. the transition process may exclude industry involvement;

- h. the proposal sits between extremes of industry-led or regulation-led approaches, possibly capturing weakness from each approach; and
- i. for all their bulk, the regulations don't provide much guidance for the amendment process to derive compliant codes.

77. The remainder of this section discusses each of these concerns in turn.

The transition process

78. The proposal takes a forced approach to transitioning existing codes to a new improved state, placing a regulated time constraint on transition. The transition process requires each TSO to take the lead developing new compliant codes. Once compliant, these TSO-drafted codes will have the force of law.¹² This approach certainly has the advantage of rapid and comprehensive change, however the approach also brings considerable risk.
79. The transition process allows the TSOs to introduce new terms into the codes, to amend the current terms or to replace the codes behind closed doors. In Genesis Energy's view, this could be an open invitation for retrograde steps by the TSOs. Many aspects of the existing codes have already been the subject of lengthy negotiation between industry participants. Any process that then allows for changes to the codes without full industry participation risks losing some of the progress that has been painfully won. This could result in a significant loss of benefit and flexibility for shippers.
80. As one example, TSOs may choose to include new terms that price balancing gas at a level that favours the pipeline owner to the detriment of shippers. Setting such a price at non-market levels could ultimately detract from consumer outcomes.
81. Any forced transition process would create uncertainty for users (and place a steep burden on TSOs). A forced transition coupled with a loose set of regulatory constraints and no regulatory approval process simply heightens the uncertainty for shippers. If the new codes placed shippers in a substantially worse position than they currently enjoy, then there could be a lengthy process through the compliance regime to return to a more balanced position (let alone an advance on the status quo).

Gaps in coverage

82. The proposed regulations cover many important aspects of transmission and interconnection services, but at varying levels of detail. In many areas

¹² Under regulation 13 of the Gas (Transmission Access) Regulations 2008, each TSO and transmission system user must comply with the codes.

the regulations do not go into a great deal of detail.. For example, although the regulations ask TSOs to offer a balancing service and to set a price and tolerance levels for this service¹³, the TSOs are free to set this price and these levels as they wish. There are yet other aspects of transmission services that are not covered at all.

83. Genesis Energy understands that this is an intentional design feature, however this approach does appear to carry some risk. In particular, TSOs are likely to have an incentive to draft their new codes as close to the line as possible. That is, TSOs are likely to seek advantage in areas where the regulations are silent. One response to such 'gap seeking' behaviour could be to ensure that the codes are as extensive as possible. However, this becomes a 'slippery slope' argument whereby the logical conclusion is comprehensive regulation.
84. The 'gap seeking' risk is illustrated in Figure 5. The horizontal axis shows the aspects that the regulations or the codes could cover, while the vertical axis shows the level of service that the TSOs provide. This figure illustrates that where there is a gap in regulatory cover, there could be a tendency for the TSOs to reduce the level of service they provide.

¹³ See regulation 50 of the Gas (Transmission Access) Regulations 2008.

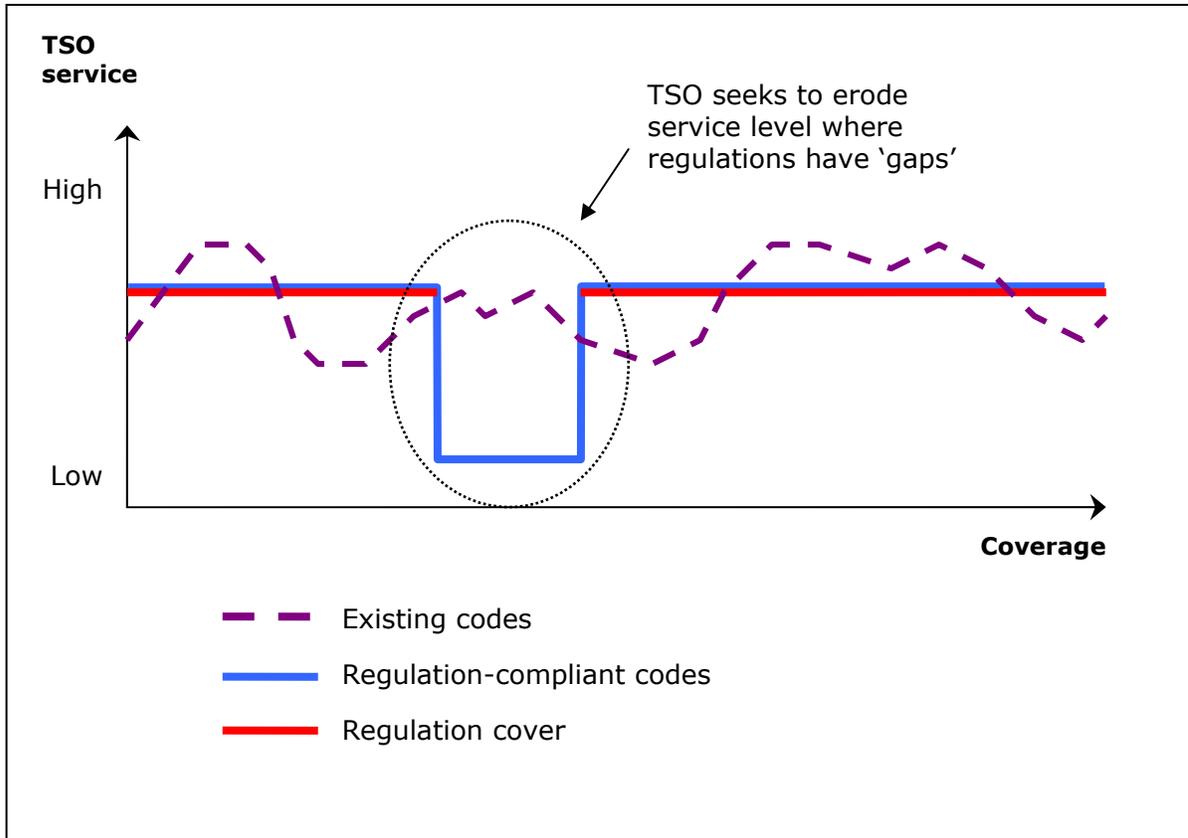


Figure 5 - The proposed approach could create a 'gap seeking' risk.

Change process may not adequately counter TSO bargaining power

85. The Gas Industry Company clearly recognise the value of a robust code change process for dealing with multi-party arrangements and provide a good model in their proposed regulations. When one party wields substantial market power, it is particularly important that any change process should fairly balance the bargaining power of all industry participants. Genesis Energy considers that the Gas Industry Company proposal may not adequately achieve this difficult balance.
86. Under the proposal, TSOs have the freedom to decline a code change request from any person (including the Gas Industry Company) provided they have regard to a number of objectives. Once these objectives have been considered by a TSO, a decision can only be appealed on grounds that the change process (or other term of the code) was breached by the TSO. The merits of that decision cannot be appealed. There is a risk that TSOs will use this change process to only allow amendments that are in their favour and to frustrate other changes that would benefit the industry as a whole.

Missing linkages with other work streams

87. Given the nascent state of gas sector regulation, there are a number of important work streams still at their early stages. Some examples include:
- a. the wholesale market work stream — the aim is to develop a voluntary wholesale market for the trading of short-term forward contracts for gas supply;
 - b. the gas balancing work stream — this aims to develop an appropriate mechanism for pricing gas that is supplied outside of the imbalance tolerance. The industry can avoid unnecessary costs in the transmission system by getting this mechanism right; and
 - c. the outage and contingency management work stream — this addresses the process for dealing with severe gas supply contingencies.
88. It is important to ensure that the results of these work streams can be implemented smoothly under whatever framework governs gas transmission. It is not clear that this will be the case under the Gas Industry Company's transmission access proposal. For example, it is not clear how transportation arrangements would be modified under the proposal to facilitate wholesale market trading. It would be useful to see a clear road map for how this could occur.
89. The proposal could create a risk that work streams not supported by TSOs would face considerable impediments to their implementation. This would in turn give TSOs considerable 'hold-out' power over industry development work streams.

Interoperability between the Maui and Vector codes

90. Of necessity, shippers use the transmission systems of different TSOs as a single physical system. Interoperability of the Maui and Vector pipelines is therefore an important requirement to support development of the gas market. The Gas Industry Company proposal does not appear to explicitly consider this need. Genesis Energy considers the following interoperability issues to be important for efficient market operation:
- a. technical consistency between the two pipelines (including gas composition and pipeline pressure);
 - b. tracking of gas title through both pipelines to help ensure that commercial arrangements can adequately deal with:
 - i. ownership of gas as it passes between the two pipelines;

- ii. payment for gas transmission and balancing of gas supply on the two systems; and
- iii. liability issues across pipelines;
- c. common trading conditions so that gas markets can coordinate transactions across both pipelines;
- d. the need for a balancing system that operates across both pipelines to help maximise overall line-pack capacity; and
- e. consistent force majeure provisions across pipelines to help balance the effects of force majeure events between customers and suppliers on each pipeline and to avoid creating an operating imbalance.

Scope for bilateral negotiation of multi-party arrangements

91. The proposed regulations provide that each transmission system code may comprise both negotiable and non-negotiable terms¹⁴. The non-negotiable terms are extremely limited, relating to nominations policy, interruptions and mismatch caused by interruptions¹⁵. The balance of the requirements for transmission system codes comprise negotiable terms. Regulations 11(4) and 16(1) provide that these are able to be agreed between the transmission system owner and each individual user.
92. Under this structure, provisions relating to all other matters including the provision of standard transportation services, interconnection and balancing services are able to be negotiated by individual users with the transmission system operator. This ability is constrained only by the requirement under regulation 16(2) for the TSO to consider certain matters. Negotiated agreements then form part of the user's individual agreement with the TSO. The proposed regulations seem to codify a basis on which TSOs are able to discriminate between users by agreeing different negotiable terms.
93. Genesis Energy considers this to be a significant and surprising departure from the current 'code' structure and has serious concerns in relation to users being able to negotiate independent and user-specific terms in relation to the shared pipeline services. Genesis Energy considers that to date, in establishing industry codes, gas industry participants have been particularly concerned to ensure that all participants using the shared services of a pipeline are governed by the same (or substantially the same

¹⁴ Draft Gas (Transmission Access) Regulations 2008, regulation 15, 16, and 17.

¹⁵ Regulations 38, 39 and 40.

provisions) with respect to critical services issues such as balancing, interconnection and transportation.

94. Genesis Energy considers that it is fundamental to the operation of the pipelines as a shared service that all shippers are treated on an equivalent basis for the services offered and operated by the relevant transmission pipeline owner. Examples include:
- a. it should not be possible for a single user to negotiate an interconnection agreement that allows for non-specification gas to be injected into the pipeline and blended with existing gas streams even where the blended gas meets the NZS 5442 specification;
 - b. allocation of any balancing gas (whether acquired or resulting from a Maui Code 'cash-out') must be done on an equivalent basis for all shippers, including the price at which such gas is transferred;
 - c. allocation of tolerances at welded points (which equates to access to line pack tolerance and pipeline flexibility) must be on an equivalent basis for all parties.
95. Similarly Genesis Energy is concerned that the effect of regulation 19(2) is that certain users will be able to negotiate individual services. Genesis Energy has two concerns in this regard:
- a. offering a new service to an individual user may give that user an advantage over other users in upstream or downstream markets. For example, agreeing to offer one user a storage service in the pipeline will give that user an advantage in managing its take-or-pay obligations in upstream gas contracts; and
 - b. the services that may be offered by a TSO in relation to the operation of the pipeline are inextricably linked and should not be a menu of options for individual users. To use the above example, offering one user a storage service in the pipeline reduces the flexibility able to be offered to other users. Another example is that nominations, balancing and contingency management are operationally inextricably linked and all users should, in Genesis Energy's view, be subject to the same terms of use.

Transition process may exclude effective industry involvement

96. The Gas Industry Company's proposal places TSOs in charge of developing compliant codes. This approach could be supported by the principle of

subsidiarity – that is, the decision making is in the hands of those closest to the action. However, the flip side is that this approach is weak on countering the TSO bargaining power that is the source of the problem in the first place.

97. Even without a desire to improve their position at the expense of shippers, TSOs may inadvertently make changes that are detrimental to other parties if shipper participation is not a strong feature of the code development process.
98. There is also the risk that using regulations to impose a tight deadline on the code writing process may stretch industry resources and preclude full consideration of the impacts of any changes.
99. The recent Vector code negotiations indicate both that the industry can work together, and that code negotiation can take considerable time and resources. These lessons should be taken on board in considering how the codes could evolve under a regulatory framework.

The worst of both worlds?

100. The Gas Industry Company proposal seems to seek a middle ground between an industry-led model at one end and a regulation-led model at the other. While this approach has obvious attractions, it also carries a risk of capturing bad features from either end of the spectrum.
101. In an industry-led model, changes would be developed and agreed to largely through a process of negotiation by and between industry participants, with the Gas Industry Company largely playing a facilitative role and perhaps providing a regulatory backstop. The ICRO option described elsewhere in this submission (see Appendix Two) largely follows this model.
102. In a regulatory-led model, the Gas Industry Company as regulator would seek to set out a complete prescriptive set of regulations for the industry. While the Gas Industry Company would consult industry participants, code development would nonetheless be largely driven by the Gas Industry Company itself. The Gas Industry Company would seek to achieve outcomes that promote the public benefit and would need to develop considerable technical competence to fulfil its role.
103. The Gas Industry Company's actual proposal seems to fall between these two models. Pipeline users appear to be excluded from a good deal of real input and control over code development, but the Gas Industry Company does not play an approval role either. The proposal gives the Gas Industry Company a role in code development, but it is not clear that this role is strong enough to adequately counter the bargaining power of TSOs.

104. A more fulsome policy development process would draw out the features of these three models (and possibly others) and place them side-by-side for comparison against a range of market development scenarios.

Limited constraints on the code transition process

105. Currently the regulations provide some positive guidance on a number of issues important to the industry, including the following:

- a. the need for disclosure of information;
- b. the need to include a change process;
- c. provision of transmission, interconnection and balancing services;
- d. distinction between negotiable and non-negotiable terms of service; and
- e. ring-fencing.

106. However, this guidance appears to be largely at such a high level as to not be particularly meaningful. As such it may not provide a great deal of assistance to, or constraint on, TSOs as they develop their compliant codes. It may also fail to require (or even prompt) any material improvement to the existing codes.

Too much, too fast, for too little gain?

107. The proposal has positive features and some of the weaknesses could possibly be reduced by tweaking the proposal. However, other weaknesses and risks are likely to be intractable features of the Gas Industry Company's proposed option.

108. Genesis Energy's overall impression of the proposal is that it may be too much change in too short a time period for too little real gain. This is particularly true given the divergence of plausible market development scenarios, and the looming presence of several very significant market changes in the near term. The transition process potentially throws current arrangements into the air, creating uncertainty for pipeline users.

109. Genesis Energy sees merit in an approach that would avoid regulatory inflexibility, while nonetheless providing a strong counter to TSO market power. Genesis Energy sees merit in a more participative approach that allows codes to evolve issue by issue.

The Law

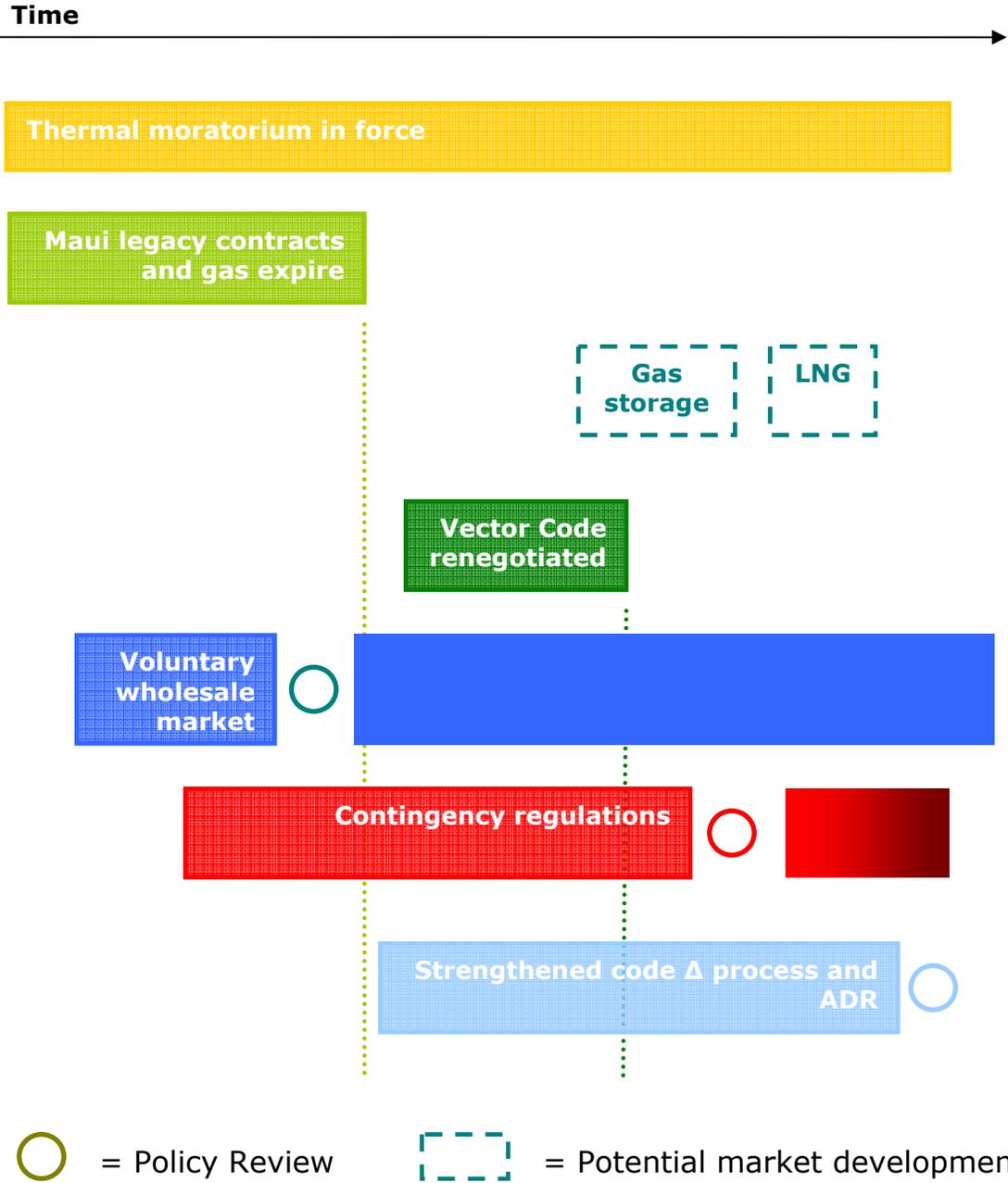
110. Detailed comments on the proposed regulations are set out in Appendix Three.
111. For the sake of completeness, Genesis Energy also sets out in this section a comment on the scope of the regulation-making powers in the Act and the possibility that the proposed transmission access regulations do not fall within those regulation making powers.
112. In paragraphs 4.1 and 4.3 of the statement of proposal, the Gas Industry Company correctly sets out the powers in sections 43F(2)(c) and section 43S of the Act, under which any regulations or rules relating to transmission pipelines need to be made.
113. Genesis Energy is cognisant of the view that a number of the draft regulations are beyond the scope of the regulation-making powers in the Act and in particular that the draft regulations relating to the process of setting terms and conditions for access to transmission pipelines and the imposition of fees on participants to cover the ongoing costs of the transmission access framework are not authorised by the Act.
114. Genesis Energy wishes to reserve its position in relation to these matters pending further discussions with the Gas Industry Company.

Summary

115. Without clear options for comparison plus a meaningful evaluation, Genesis Energy does not believe that the Gas Industry Company proposal should proceed any further.
116. Although the Gas Industry Company option clearly has some strengths, it also has a number of weaknesses and risks. In particular, the option opens the existing codes up to a potentially intense TSO-led transition with the risk of much disruption for little real gain.
117. Genesis Energy sees merit in an approach that would avoid regulatory inflexibility, while nonetheless providing a strong counter to TSO market power.
118. Genesis Energy believes that a number of complementary analytical and evaluative steps could be developed to take the Gas Industry Company's work forward. These are described and illustrated in this submission.
119. Genesis Energy recommends that industry working parties should be used to progress work on gas transmission access.

Appendix One: Timeline for Regulation

The following figure illustrates one possible timeline of how industry regulation could evolve in the mid-term. In Genesis Energy’s view, this could be a useful tool for thinking about a strategic vision. In particular, such a timeline should be useful for thinking about linkages between regulatory proposals in different segments of the gas industry.



Appendix Two: Incremental Change and Reference Offers Option

1. This section describes the five elements of incremental change and reference offers (ICRO) option introduced in this submission. The ICRO option is illustrated in Figure 6 below and includes the following elements:
 - a. reference offers;
 - b. core codes;
 - c. change process;
 - d. disputes mechanism; and
 - e. code principles.

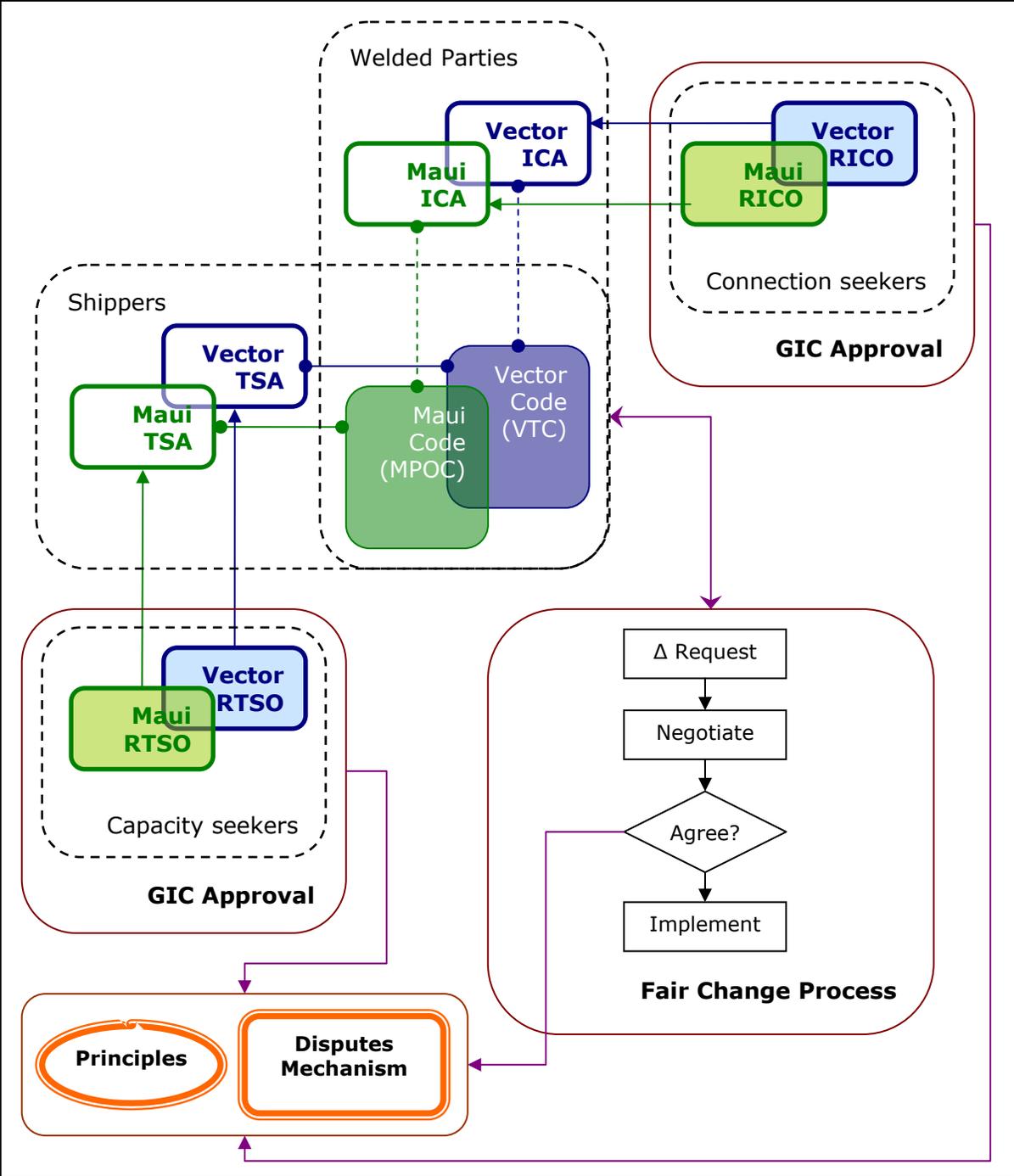


Figure 6 - Schematic of the incremental change plus reference offers (ICRO) option.

2. In this section, the phrase 'core codes' refers to the existing codes that have had their negotiable terms removed and placed into reference offers. These core codes can then only have their terms amended through a multi-party change process.

Reference offers

3. The reference offers are like the current TSAs and ICAs. They provide the bilateral terms to transmission service and interconnection agreements. They also incorporate (by reference) the core code to ensure consistency between the existing contracts (that already refer to the codes) and any new contracts.
4. The two types of offer discussed below are:
 - a. reference transmission service offers; and
 - b. reference interconnection offers.
5. These offers are termed 'reference offers' because they are standing offers that can be taken up by any new entrant. These offers must have their terms approved by the Gas Industry Company before they are offered. This means that new entrants are ensured entry into the industry on fair terms. However, parties are still free to negotiate something different in permitted areas. Only the 'core code' cannot be changed bilaterally.
6. The reference offers also include terms covering matters of process. These terms cover both the prudential standards of new entrants and the process for reaching agreement. These terms help to ensure the process of contracting is fair to both new entrants and the TSOs by:
 - a. placing restrictions on who is eligible to enter the gas industry;
 - b. ensuring that agreements are reached in a timely manner; and
 - c. ensuring that existing participants cannot exclude others from entering the industry.

Reference transmission service offers

7. Each TSO must make a reference transmission service offer available to new entrants who wish to ship gas through its transmission pipelines. The Gas Industry Company review and approval process helps ensure that the terms of this offer are fair for new shippers and the TSO.
8. Figure 6 shows these offers within a box labelled 'capacity seekers'. Referencing back to the core codes is symbolised by the lines connecting the TSAs to the codes. The GIC review and approval process is represented by the encompassing 'GIC approval box' and the right of appeal is highlighted by the line connecting this box to the 'disputes mechanism' and 'principles' boxes. An entrant can appeal to the disputes mechanism if they believe that the TSO has not followed the terms and processes in the reference offer.

Reference interconnection offers

9. Similarly, each TSO must also make a reference interconnection offer available to new entrants who wish to connect pipelines to its transmission pipelines. Again, the Gas Industry Company review and approval process ensures new interconnected parties can enter the industry on fair terms. Figure 6 shows these offers within a box labelled 'connection seekers'.
10. The ICRO option could be expanded to provide for additional types of reference offer in future. New reference offers could be developed to cover additional services. For example, a spot capacity offer may be needed to support wholesale trading. Any new reference offer would be subject to review and approval from the Gas Industry Company.

Core codes

11. The existing VTC and MPOC would remain largely the same as they are at present. The only differences between these codes and the core codes are that they must:
 - a. have all bilaterally negotiable terms removed and placed in the reference offers; and
 - b. incorporate a new change process to be backed up by the disputes mechanism.
12. The Gas Industry Company would 'recognise' the existing codes once these changes are made. Once recognised, the core codes would remain unchanged unless a successful change application is made.

Fair change process

13. The change process would provide an opportunity for any participant to seek amendment to a core code. This process could be modelled on the VTC change process (refer section 25 of that code), with a few improvements and modification to suit the altered regulatory environment. Like the VTC, the change process would:
 - a. give participants the right to request changes to the codes and to have these requests considered by the other participants; and
 - b. allow participants to appeal a change request to a binding rulings body if the request is not agreed to by the other parties (this process is shown in Figure 6 within the box labelled 'fair change process').

14. Unlike the VTC, the change process could be modelled as a bilateral negotiation between the shippers on one side and the TSO on the other. Agreement would be reached on the shippers' side when 75 percent of the shippers agree. But in the event that the shippers and the TSO cannot agree, either side (as opposed to any participant) can appeal the change request to the disputes mechanism (that is, the shippers would only have recourse to the disputes mechanism if 75 percent agreed).
15. This change process would improve on the VTC by:
 - a. giving the Gas Industry Company a right to make code change requests – this could be used for work stream implementation; and
 - b. providing for appeal to a rulings body operating independently of the Gas Industry Company¹.

Dispute resolution mechanism

16. The disputes mechanism would apply to disputes arising from:
 - a. the code change process;
 - b. review and approval of reference offers; and
 - c. conduct of participants party to the core codes, the TSAs and the ICAs.
17. The dispute resolution mechanism could generally follow the compliance scheme proposed by the Gas Industry Company in its Draft Gas (Compliance) Regulations 2007. The dispute mechanism is indicated in Figure 6 together with a set of principles. These are linked to the change process and the Gas Industry Company review and approval processes.
18. An important additional use of the disputes mechanism could be as a means of resolving conduct-based disputes. The mechanism would give parties to TSAs, ICAs and core codes recourse to relatively low-cost dispute resolution. This could help to create a stable contractual environment within the industry.

¹ Independence from the Gas Industry Company would allow the Gas Industry Company to avoid conflicts of interest with its industry development role and its access to the change process.

Code principles

19. The final element of the ICRO option would be promulgation by the Gas Industry Company of a minimal set of 'code principles' designed to guide operation of the disputes mechanism. Because the disputes mechanism oversees the change process, the code principles would also help to guide the evolution of the codes. These principles could include some of the objectives already developed by the Gas Industry Company in regulation 62(5) of the proposed Gas (Transmission Access) Regulations 2008. For example, some principles could be:
 - a. pipeline interoperability must be maintained;
 - b. access to, and provision of, standard services must be transparent to users;
 - c. all users must be treated equally irrespective of their affiliations;
and
 - d. economic efficiency should be favoured.
20. More principles could also be developed by drawing on common law principles, on the Act, and possibly the on the GPS.
21. An important design consideration would be the level of detail needed to guide the disputes mechanism. This would to some extent depend in turn on the nature of the disputes mechanism. In any event, the disputes mechanism should develop a specialist a body of precedent over time. Genesis Energy expects that it should be possible to develop a set of principles operating at a higher level than the detail contained in the Gas Industry Company's proposed regulations.

Pros and cons of ICRO option

22. Genesis Energy presents the ICRO option because it provides a point for comparison with the single option developed by the Gas Industry Company. The ICRO is likely to have advantages and disadvantages compared with the Gas Industry Company proposal.
23. Some of the fundamental differences are:
 - a. the ICRO option leaves the existing codes large unaltered;
 - b. transition occurs on an issue-by-issue basis rather than on a set timetable;
 - c. participative multi-party commercial negotiation is relied on as the primary mechanism for altering the codes;

- d. access seekers are provided offers that are subject directly to Gas Industry Company approval.
24. The ICRO option avoids the upheaval that a timetabled transition could entail, but may forgo some of the benefits of a more rapid changeover.
 25. The 'organic' nature of the ICRO option should favour changes that are clearly wealth-creating, and minimise the risk of 'government failure'. However, the transaction costs could be larger over the long term.
 26. The ICRO provides stronger intervention for the benefit of access seekers, but may be slower to adapt to the need for new types of service and connection (such as storage facilities or LNG plant) due to the need for regulatory approval.
 27. A high-level principles approach to guiding the disputes mechanism may be more robust and flexible in the long run, but may also entail greater uncertainty and risk of 'rulings error'.
 28. Of course, much further work could be carried out on developing this option to a fine level of detail. However, not too much extra work should be required to allow a meaningful evaluation against other viable options.

Appendix Three: Detailed Legal Comments

1. Genesis Energy sets out below a number of comments on the draft regulations at a greater level of detail than those contained in the body of this submission.

Incorporation by reference of standard

2. The definition of “specification” in the draft regulations provides that it means “NZS 5442:1999 as amended or replaced from time to time”. The inclusion of the words “amended or replaced from time to time” is problematic.
3. Section 22 of the Standards Act 1988 authorises references in regulations to New Zealand standards. However, section 23 provides that the citation of a New Zealand Standard in the regulation is deemed to include and refer to the latest New Zealand standard with that citation before the regulation is made (unless the context otherwise requires). That is, in the usual case, amendments to the standard after the regulations are made would not be included in the regulations.
4. The default position in section 23 (that subsequent amendments are not incorporated) preserves some important constitutional principles, including the principles that the power to make regulations cannot be sub-delegated; that obligations imposed by legislation should be certain as well as understandable by those affected by it; and that legislation should be published in a form and manner that enables ready access by those affected.
5. In order to preserve those principles as far as possible, it is not appropriate that the regulations incorporate any changes to NZS 5442:1999 that may be made after the date on which regulations are made.
6. There are a number of sources of guidance on incorporation by reference, including publications of the Regulations Review Committee¹ and Legislation Advisory Committee.² The Regulations Review Committee report sets out standard provisions for the incorporation of material by reference. However, those provisions do not allow the incorporation of amendments to material incorporated by reference.

¹ See *Inquiry into material incorporated by reference – Report of the Regulations Review Committee* (July 2004). The Committee is currently conducting a further inquiry into incorporation by reference.

² See the Legislation Advisory Committee’s *Guidelines on the Process and Content of Legislation* (available at www.justice.govt.nz/lac/index.html), in particular, part 6 of chapter 10 and Appendix 4.

Definitions

7. The definition of “industry body” in the draft regulations contains a number of ambiguities. We suggest that the definition be amended to read as follows:

industry body means:

- (a) *the industry body for the time being approved by the Governor-General by order in Council under section 43ZL of the Act; or*
- (b) *if no industry body is approved, the Commission.*

8. The definition of “transmission system” in the draft regulations is as follows:

...a system comprising those high pressure transmission pipelines depicted in the map published by the industry body in accordance with regulation 5.

9. Regulation 5(1) provides that the industry body must publish a map depicting transmission systems on the commencement date. The problem is that, because regulation 5(1) uses the term “transmission system” and the definition of that term in turn refers to regulation 5(1), the regulations do not adequately specify what a transmission system is.
10. The Gas Industry Company needs to reconsider the definition to remove the circularity.³
11. Parts 3 and 4 of the draft regulations have their own ‘definitions’ sections. We think the clarity of the drafting would be improved if the definitions in those sections were included in the interpretation provision in regulation 4.

Further issues

12. Regulation 12 defines a ‘reasonable and prudent operator’ for the purpose of the regulations. Genesis Energy considers that the reference in regulation 12(1)(b) is problematic and should reference the capacity to which the RPO obligations apply.
13. Genesis Energy considers that regulation 12(4) is unnecessary and can be deleted.

³ Genesis Energy also considers this mechanism for extending coverage to be inappropriate in a policy sense. The decision to subject a pipeline to access regulations has considerable consequences for the pipeline owner and for those seeking access. As such, this decision should be subject to appropriate checks and balances such as would be provided by a requirement to alter the regulations to achieve any change in coverage.

14. Regulation 22(3)(b) is stated to be subject to regulation 57. This creates a circularity when read with regulation 57(1)(a).
15. Genesis Energy considers it inappropriate that a TSO can provide for confidentiality provisions to be effectively overridden by negotiated code provisions, which is the effect of regulation 57. The confidentiality provisions should be strengthened by removing regulation 57(1)(b) and the deletion of the words "and the transmission system owner's code" in regulation 57(2).
16. Regulation 58 refers to arms' length regulations applying to standard services. Genesis Energy is of the view that this should also apply to the various policies developed in the codes.