14 September 2007

Ian Dempster
Gas Industry Co
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1 Willis Street
Wellington

Dear Ian,

Statement of Proposal - Gas Outage and Contingency Management Arrangements

Thank you for the invitation to make a submission on the Gas Industry Co's (GIC) Statement of Proposal – Gas Outage and Contingency Management Arrangements, dated August 2007. Contact regards the development of the Gas Outage and Contingency Management Arrangements as a high priority for the gas industry and the GIC.

Contact's response to the questions contained in the Statement of Proposal is attached.

Contact has not been able to review the draft Regulations in the time available and believes it is inappropriate to undertake the necessary detailed review until the principles of the arrangements are clearly settled.

From our responses to the questions in the Statement of Proposal you will see that Contact believes a number of matters require further consideration or have not been addressed in the Statement of Proposal. Settlement of those issues is likely to require significant redrafting of the regulations. Leaving those issues unresolved will create uncertainty as to how the arrangements work in practice.

The criteria to determine the Gas Contingency Price should demonstrate the true value of gas *during* a Gas Contingency. Contact's view is that in the absence of a wholesale gas spot market, the most appropriate determination of the value of gas during a Gas Contingency is to impute the gas price using wholesale electricity market prices prevailing during a Gas Contingency. The shortage of supply of gas will be reflected in the prices for wholesale electricity due to the shortage or lack or gas-fired generation. Contact does not agree that prices in the wholesale market for gas prior to or after a Gas Contingency demonstrate the true value of gas during a Gas Contingency.

In determining payment for Contract Imbalances under provisions 67 and 69 of the Draft Gas (Outage and Contingency Management) Regulations 2008, parties with Positive Contract Imbalances are over-compensated and parties with Negative Contract Imbalances are required to make excessive payments. The amount of money in the contingency cash pool is determined by the Negative Contract Imbalance multiplied by the Gas Contingency Price. Parties that have a Negative Contract Imbalance must pay into the pool regardless of whether the gas that was consumed came from linepack or from parties with Positive Contract Imbalances. Parties with Positive Contract Imbalances are entitled to all monies paid into the contingency cash pool and so will unfairly reap the value of the linepack consumed during the Gas Contingency. Contact believes the same mechanisms must be used to determine Gas Contingency Prices to those used in the Open Access Codes to address imbalances.

It is not clear how gas quantities related to a contingency will be determined unless the contingency starts and ends at the end of a day. Contact believes it will prove impractical to

create contingency arrangements that employ different mechanisms to determine imbalances from those used in the pipeline operating codes.

It is Contact's view that independent oversight is required for the development of the Outage and Contingency Management Plans (OCMPs) produced by the Transmission Network Owners (TNOs). This is to ensure that all submissions made by industry participants are given due consideration and the final OCMPs developed and submitted to the Gas Contingency Operator (GCO) and the independent Expert Adviser for approval are consistent with the views of the industry participants. In addition, independent oversight should help ensure best practice is captured in the Contingency Arrangements. Contact suggests that the independent Expert Adviser is the appropriate person to facilitate discussions between the TNOs and the industry participants.

Ownership of any new systems developed for the Gas Outage and Contingency Management Arrangements need to be held by industry participants or the GIC. This will help ensure these systems are not captured by a particular organisation so that it becomes difficult to appoint a new GCO.

Contact is happy to agree that the GIC publishes this letter and the attachment. Contact is also happy to further explain the points made in the attachment if that would assist the GIC.

Yours sincerely,

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Contact Energy Submission on Gas Industry Company Statement of Proposal "Gas Outage and Contingency Management Arrangements, August 2007"

Submission prepared by: Contact Energy, Roopal Gandhi & Alex Love

QUESTION	COMMENT
Q1: Do you agree the four problems described in this section are key issues needing to be addressed in any new arrangements for outage and contingency management?	Yes but there are other key issues, listed in the response to question 2, that must also be addressed.

Q2: Are there other key problems with the current arrangements which also need to be addressed?	Yes. • Arrangements must ensure that conflicting instructions or advice are not issued by the Gas Contingency Operator and Transpower. For example, under the current National Gas Outage Contingency Plan (NGOCP), thermal generators may be requested by Transpower to continue operation of plant for frequency stabilisation purposes. Industry participants require assurance that if they act in accordance with any such notice from Transpower or GCO that they will not incur legal liability under the Outage and Contingency Management Regulations (OCMRs). • Electricity security of supply is important and should be maintained as far as possible despite a gas contingency. Currently the NGOCP requires Major Plant to shed load from the initiation of phase 2. The required rate of load shedding is unclear. In some circumstances complete load shedding may be unnecessary. Contingencies in the gas industry should not lead to a contingency in the electricity industry or unnecessary loss of other production through overreaction. • Arrangements are required to ensure that during a gas contingency gas users are not curtailed when spare gas deliverability is available. • There are no mechanisms that allow the determination of the impact of the Contingency Management Arrangements on the injection and offtake of gas during the contingency. • There is a lack of technical information which enables efficient and properly controlled management of contingent events. Instead current contingency management is often hit and miss in nature resulting in over reaction and unnecessary curtailment. To avoid this additional technical information is required such as: a. information on the quantity of gas and the time required to undertake an orderly shut down of Major Plant and industrial plant without risking serious damage to plant, operator and public safety and environmental damage; and b. clear specification of the circumstances in which Contingency Management Arrangements should be implemented. c. capability of gas production stations and fields.

Q3: Given the difficulties in assigning penalties for non-compliance under a pan-industry agreement and, therefore, the inability to ensure a high-level of compliance, do you agree that the only reasonably practicable alternative to the proposal is a more fully prescribed regime incorporating the detailed arrangements for contingencies in regulations and/or rules?	Yes. The proposed approach has more merit than the counter-factual; however, the requirement for Transmission Network Owners (TNOs) to develop Outage and Contingency Management Plans (OCMPs) under the OCMRs in consultation with affected stakeholders may lead to the same difficulties in reaching consensus as under the pan industry approach. Independent oversight needs to be provided during the development of the OCMPs in order to reach an appropriate and timely outcome. Constructing Contingency Management Arrangements distinct from transmission pipeline open access regimes does present a number of complex and fundamental technical difficulties such as determination of the point in time from when the Contingency Management Arrangements apply and when the open access regime applies. We note that both the MPOC and VTC include arrangements that with some further specification of operating arrangements such as the circumstances in which Operational Flow Orders could be issued and the liability for failure to act in accordance with those orders should meet most of the requirements of efficient and effective Contingency Management Arrangements. In designing the regime another consideration is that the OCMRs and the OCMPs need to be consistent with the Electricity Governance Rules (EGRs) where applicable.
Q4: Do you agree with the proposed regulatory objective?	Contact believes that the proposed regulatory objective requires further consideration. The proposed regulatory objective refers to long term security of supply, when surely the issue is more about short term security of supply. There is no mention of efficiency or delivery of gas in a safe and reliable manner. Contact suggests the following objective would be more consistent with Government policy and would better meet the needs of gas industry stakeholders: *"that arrangements are in place to achieve efficient and effective handling of a national or regional gas contingency so that security of supply is maintained and gas is delivered in a safe and reliable manner."*

Q5: Do you agree that the net benefits of the proposal are materially higher than the net benefits of the counterfactual?	Yes. Industry participants with the relevant expertise can potentially develop OCMPs more effectively, but only if appropriate parameters are set for achieving this in the OCMRs. In addition, it will be easier to incorporate changing industry needs and developments into the OCMPs. The GIC will need to carefully design the regulations to ensure there is sufficient scope within the regulations to allow TNOs to develop practical OCMPs. For example, it appears extremely difficult to design an OCMP that would have a regime distinct from the open access arrangements simply because of the difficulty of determining gas quantities that are delivered under the open access regime and the quantities delivered under the OCMP. Contact suggests that the open access regime should continue to apply during contingencies but be reinforced by any missing elements of an effective OCMP such as when operational flow orders could be issued and the liability for failing to act on accordance with those orders. There is the risk that a TNO will submit an OCMP that is inconsistent with the submissions made under Regulation 25 of the Draft Gas (Outage and Contingency Management) Regulations 2008. An independent expert advisor needs to be made available to facilitate the process required under Regulation 25. GIC should reserve the option for more direct intervention, if OCMPs are not implemented in a satisfactory manner or timeframe.
Q6: Do you agree that the proposal has the potential to address the key problems identified with the current arrangements?	Yes, but with recognition of the following: • that the regulations are designed to relate to open access arrangements so that practical OCMPS are produced; • that the regulations require gas suppliers to make spare deliverability available, preferably prior to any request to shut down plant; and • that the open access arrangements should not contain provisions that create or exacerbate contingencies or make it difficult to manage contingencies. For example, the MPOC should encourage re-nomination of gas requirements rather than prevent re-nomination.

Q7: Do you agree with the proposed definition of a Gas Contingency? If not, what would you propose?	Contact does not agree with the definition of a Gas Contingency proposed in section 9.3 of the Statement of Proposal. Contact proposes the following: *"when remaining linepack reaches a stage of depletion so that if gas offtake remains unchanged that offtake can only be maintained for less than [number to be inserted] hours, and in the reasonable opinion of the Gas Contingency Operator the situation can only be managed by invoking the Outage and Contingency Management Plans".* Gas Contingency as defined in the Draft Gas (Outage and Contingency Management) Regulations 2008 is not the same as section 9.3 of the Statement of Proposal. The Regulations state that Gas Contingency: *"means a gas contingency as determined by the gas contingency operator in accordance with regulation 44".* Regulation 44 states that the GCO must make a determination that there is a Gas Contingency if either one or more thresholds included in the OCMPs is breached, or that one or more thresholds is likely to be breached.
Q8: Do you agree with the list of responsibilities given to the GCO?	Yes providing the Gas Contingency Operator (GCO) is the system operator. It is impractical for the GCO to not be the System Operator. The Gas Contingency Operator (GCO) should act independently of the TNOs to ensure that there is no conflict between its system operator role and its GCO role. The employment contract of the GCO should be published to help ensure this. The appointment by the industry body of an expert adviser to recommend the OCMPs or recommend any changes to the OCMPs to the industry body, will help avoid such conflicts. GIC should reserve the option for more direct intervention, if OCMPs are not implemented in a satisfactory manner or timeframe.
Q9: Do you agree that the GCO should be provided with some flexibility to take action that it considers necessary to ensure the effective management of a gas contingency?	It is highly unlikely that Outage and Contingency Management Plans can be developed to provide sufficient prescription to address all situations that may arise. It seems inevitable that the GCO will need some flexibility to exercise judgement to address contingent events. The developers of the OCMP and the approvers of those plans will need to exercise considerable judgement as to whether the OCMPs contain the appropriate balance of prescription and flexibility to ensure efficient and certain outcomes.

Q10: Do you agree with the split between the planning role for the TNO and the communications plan role for the GCO? Do you agree that an industry expert should assist the GCO in the process to approve the plans?	Contact agrees with the split of the planning role for the TNO and the communications plan role for the GCO. Contact agrees that the expert adviser should assist the GCO in the process to approve the plans. If Vector plays the role of both TNO and GCO, then an expert advisor is required to ensure that Vector as the GCO properly assesses the OCMP it has prepared as the TNO. Independent oversight will also help ensure that the IT systems developed by TNOs and the GCO are in a form readily transferable to a replacement GCO in the event Vector decides or a determination is made that Vector is not able to continue to be the GCO. In addition, an appropriately experienced expert, perhaps with international experience, will help ensure that OCMPs incorporate best international practice rather than being based on the more limited local experience.
Q11: Do you agree that the existing NGOCP curtailment bands should be updated: a) To distinguish large consumers supplied from the transmission system that have an alternative fuel capability, from those that do not have an alternative fuel capability? b) To combine the existing NGOCP bands B, C and D into a single band? c) To establish the category of minimal load consumer?	Contact agrees the existing NGOCP curtailment bands should be updated. Contact agrees that large consumers with alternative fuel capability should be distinguished from those without alternative fuel capability. Contact does not agree that bands B, C and D should be combined into a single band. Curtailment of these categories does seem to have significantly different impact on net public cost to the economy. In any event, net public cost to the economy is not the only factor that should be taken into account. Risk of plant damage, safety impact and environmental risk are other matters that should be considered. Furthermore, the greater number of categories will allow for a curtailment process that is more tiered and therefore more efficient and effective. Curtailing customers in the bands B and C may be sufficient to stabilise the transmission networks and customers in band D need not be affected unnecessarily. Contact agrees that the minimum gas requirements of all significant consumers should be registered. Contact believes that most consumers require a certain minimum quantity of gas to avoid the risk of plant damage and unsafe practices. This information should be incorporated into the proposed curtailment profiles. Some independent audit of minimum gas requirements will be required. As well as protecting the interests of consumers this information will allow the GCO to efficiently control and manage the shut down process and to help avoid over reaction.

Q12: If you agree with the provision for the category of minimal load consumer, do you consider these arrangements should be designed in such a way as to encourage such consumers to make alternative arrangements wherever practicable, for example by making the classification for a consumer time-limited?	Contact agrees, that for each significant consumer and for the purposes of curtailment, information will be required on the quantity of gas and the time period over which that gas will be taken. Contact does not agree with imposition of the same fixed time on all customers. There are other ways to encourage consumers to make alternative fuel arrangements such as through the level of compensation payable for gas taken during a contingency. The regulations should require each consumer to limit its gas take to the quantity determined by its curtailment profile in the event that consumer is directed by the GCO to shut down.
Q13: Do you agree that the proposed contingency cash-out price will provide incentives for commercial arrangements to be put in place to maximise upstream production during a GC?	That is unclear. Determination of the contingency price ex-post will create uncertainty and may discourage commercial arrangements to maximise up-stream production. Contact believes the basis for determining the contingency price should be clearly specified before any contingency occurs. The price used should be determined from market conditions prevailing during the contingency. Given the absence of a gas spot market, the wholesale electricity market should be used to impute the gas contingency price. This is the approach taken in the MPOC and the draft VTC. It seems inappropriate for a different approach to be used for in contingency management to that used to manage balancing arrangements under open access codes. Prices determined from market conditions prevailing outside the period of the contingency such as prices in the wholesale gas market 7 days prior to or immediately prior to the gas contingency are inappropriate. In the event of a gas supply contingency, upstream gas producers should be required to make available spare deliverability. Preferably this should occur before large consumers are curtailed. Contact can discern little difference between curtailment and an obligation to make spare deliverability available. Both actions impact across contractual obligations.

Q14: Do you agree with the proposed criteria for setting the contingency price? Are there any other prices that the expert could usefully reference to determine the contingency price?	Contact does not agree with the proposed criteria for setting the contingency price. The gas contingency price should be determined in order of a) to d) below, with the most weight placed on a): a) prices during the gas contingency in the wholesale gas spot market (when such a market exists); b) imputed gas prices determined from wholesale electricity market prices prevailing during the contingency; c) the economic cost of the loss of gas supply to those consumers who had their gas supply curtailed; d) prices in the wholesale market for gas immediately prior to the gas contingency and immediately after the gas contingency. The criteria to determine the gas contingency price should be sufficiently robust so that there is no scope for industry participants to manipulate the pricing regime. Prices must also be set at a level so that there is no incentive to precipitate a contingency. Contact believes because of that prices should be set in the same manner that the equivalent prices are set under the MPOC and VTC. That would mean that there is no need to determine a separate contingency price. In any event it appears impractical to impose specific prices to apply during a contingency because of the difficulty of determining the gas quantities to which those prices should apply.
Q15: Do you agree that the proposed scheme to calculate imbalances using existing industry processes is workable? If not, what adjustment would be required?	No, these arrangements are not workable. This is an aspect of the gas contingency arrangements that requires further consideration. If a gas contingency commences or ends sometime during a day, rather than at the start of a day, it is unclear how the gas supply and gas take quantities relevant to the contingency will be determined. Largely for this reason Contact believes there is no option but to employ the mechanisms used for determining imbalances in the MPOC and VTC. These are determined on a daily basis.

Q16: Do you agree with the proposal to have the contingency cash-out pool administered by the GIC? What period should be given to parties for payment of invoices issued by the contingency cash-out pool?	Yes, providing it is managed in an open and transparent manner and records are made available for audit. 20th of the month following the issue of invoices is reasonable.
Q17: Do you agree with the proposed communications process shown in Figure 2?	There should be information flows and directives from the GCO to Gas producers, to Retailers and to Large consumers. Most of the information flows should be two-way rather than one-way as shown on the diagram. There should also be information flows from Gas Producers to the TNOs, because the operators of upstream gas production facilities can also provide information on whether they will supply gas to meet any shortages.
Q18: Given that any exposure under a service provider agreement is likely to be reflected in the price, do you agree that GCO liability under the service provider contract should be limited in the manner proposed?	Yes. The GCO will demand increased fees for increased exposure.
Q19: Do you agree with the proposed approach to allocating the costs associated with administering the outage and contingency management arrangements?	The development fee should not be a lump sum payable by the industry participants soon after the commencement date of the gas contingency and the outage management arrangements. Instead, the development fee should be payable monthly by industry participants and spread over the initial 5 year term of the Service Provider Agreement with the GCO. This would better ensure the development fee is recovered from the beneficiaries of the arrangements. To avoid unnecessary costs the ongoing fees and the development fee as suggested above should be allocated to each industry participant through an increase in the Wholesale Levy payable to the Gas Industry Company.