



Fonterra Co-operative Group

2 July 2012

Submission to the Gas Industry Company on suggested changes to the Gas Critical Contingency Management Regulations



Dairy for life

Fonterra Cooperative Group at a glance

1. Fonterra Co-operative Group (Fonterra) thanks the Gas Industry Company for the opportunity to provide input into this first stage of the review of Gas Critical Contingency Management (CCM) processes.
2. Fonterra is the world's largest processor and exporter of dairy products and is at the heart of the New Zealand dairy industry, and the dairy industry is at the heart of the New Zealand economy.
3. Natural gas is Fonterra's fuel of choice where it is economically available and Fonterra has 21 processing sites dependent on gas supply, four of those via cogeneration plants, collectively requiring around 13 PJ of gas a year.
4. Raw milk is a perishable material which must be collected from farms and processed within 48 hours. There is no tap to stop production coming off the farms, nor is there a tap to turn it back on if milking of cows ceases prematurely in a season. This means milk processing sites are absolutely dependent on an uninterrupted energy supply.

Need for Review

5. Fonterra believes the CCM processes generally worked well during the October 2011 outage but agree the event did expose some shortcomings which need to be addressed.
6. We do take some umbrage with the passage at the bottom of Page 55 of the Concept report "...the amount of milk discharged and the resulting environmental impacts were less than initially feared". While this may be strictly true in that it could have been, and for a while looked like it would be, much worse it does understate the real impact. In the first day of the crisis alone, some 30 million litres of milk had to be disposed of, worth an estimated \$20 million.

Proposed Changes

7. Fonterra has three substantive concerns regarding the changes proposed by Concept although we will reserve our position on all changes until we sight the actual wording changes proposed to the regulations.

Splitting of Band 5 (Essential Service Providers) into three subgroups (Recommendation 10.1, #4)

8. Fonterra supports taking Critical Care Services out of this group and elevating those consumers to a new Band 7.
9. Splitting the remaining into 5a (Avoidance of substantial economic cost) and 5b (Essential Food & environmental aspects) has some appeal but we cannot see how one could adequately define "substantial economic cost". Is this with respect to absolute cost, cost to the economy, or cost relative to the company's size?
10. Unless "substantial economic cost" can be quantitatively defined to its satisfaction, Fonterra will not support that recommendation.
11. If an appropriate definition can be developed, Fonterra would want to see some reference in that to irrecoverable losses due to perishability of raw materials. That would reflect that if raw milk can't be processed within 48 hours it is lost forever, whereas a log, for example, can still be processed the next month, and further, the chainsaws can be stopped whereas milking must continue or output is lost for the remainder of the milking season.

Applications for ESP Status (Recommendation 10.2, #7)

12. The recommendation suggests that any consumer seeking ESP or MLC designation should “supply information on the essential nature of service, any back-up supply arrangements in place or the reasons why back-up supply arrangements are not feasible, the minimum supply necessary to maintain the service, and emergency arrangements for coping with full loss of supply (including emergency stores and other back-up arrangements necessary to survive a gas outage”.
13. Fonterra does not dispute the need for an applicant to justify its position but we are concerned about the specifics.
14. The first is the need to justify that having back-up supplies are not feasible or, as referred to elsewhere in the report, not an economic alternative. Who is to decide what is economically viable or feasible, by what criteria? Will the Gas Industry Company make an assessment as to how often an outage can be expected so that a cost benefit criteria can be set?
15. The second issue is the recommendation that the applicant provides details of emergency arrangements in case of a full gas curtailment. Contingency planning is an internal process and should be part of the company’s business continuity planning. Fonterra believes that the approving party need only receive information as to what the consequence of a complete outage would be, not the detailed emergency plan.
16. If detailed emergency plans were provided it is feared that this could lead to selective curtailment within bands based upon who is most prepared to cope with a gas outage.

Rewarding those with Back-up Options

17. The Concept report acknowledges that there is a perverse incentive in that the banding “rewards” a party which doesn’t take some back-up precautions but the impact is then downplayed and the issue is not adequately addressed.
18. It is stated that in a significant event Band 3 is unlikely to keep gas supplies much longer than Band 2. The bigger issue is for a consumer installing back-up arrangements who would otherwise be eligible for ESP status, such as most milk processing sites. Here the disincentive is much more pronounced as such a party prudently installing back-up options would presumably be relegated from Band 5 to Band 2.
19. While the advantage of being in a higher band might be fleeting during the curtailment phase, it could be much more long-lived in the restoration process if only partial gas supply is restored.
20. Fonterra believes the best way to address this is through a pricing mechanism perhaps with the Contingency Pricing arrangement including an element of balancing of costs between those able to remain on gas, albeit at a higher price during the contingency, and parties forced to run on even more expensive fuel such as diesel.
21. Such an arrangement would still not recompense the party with back up options for the capital spent but at least it does avoid inequitable treatment during the contingency itself.
22. The exact pricing mechanism will need further development but the need to solve this problem is a view strongly held by Fonterra. Fonterra would be prepared to take part in a small Technical Advisory Group (TAG) tasked with designing such a pricing mechanism.