18 October 2010

Gas Industry Company
PO Box 10-646
WELLINGTON 6143

Dear Sir/ Madam

Submission: Gas Governance Issues in Gas Quality

1. This submission is being made by Hale and Twomey and Aretê Consulting Ltd on behalf of the following Major Gas Users:

    a) Fonterra Cooperative Ltd

    b) Carter Holt Harvey Ltd

    c) New Zealand Steel Ltd

    d) New Zealand Refining Company Ltd

2. Our overall comment is that the issues paper correctly identifies the three main matters for further investigation. We've addressed our responses to the specific questions in the attached submission form. Summarising our key submission points:

    a) A significant portion of gas demand in New Zealand (15%) is for use in gas as a feedstock to industrial processes. For these users, gas contaminants and stability of gas composition are important quality parameters only recognised to a limited degree, or not at all by NZS5442:2008. This is a limitation of the gas quality specification, nevertheless the TSO can often have an unwitting impact on quality performance under a GSA to which it is not a party. For the volume of demand that appears to be sensitive to composition changes we think that the TSO has some scope to go beyond NZS5442 to act reasonably and prudently with respect to these sensitive users.

    b) The TSOs should warrant that it will deliver specification gas and assume liability when it doesn't. The TSO should also warrant that it will act as an RPO under a strong definition of the term.

    c) A quality complaints process should be provided for under the pipeline codes and complaints should be reported under a disclosure regime to provide transparency to the industry.

    d) The suggested provisions should ideally be incorporated in MPOC and VTC but given that both MDL and Vector would not volunteer to incorporate these, regulation may ultimately be required.

Yours sincerely,

Len Houwers and Richard Hale

Gas Quality submissions template

To assist the Gas Industry Co in consider stakeholders' responses, below is a suggested format for submissions. The questions are the same as those contained in the body of this document.

Respondents are also free to include other material in their responses.

QUESTION	COMMENT
Question 1: Are there any other significant effects of non-specification gas, other than those identified in section 2.3, that Gas Industry Co should consider?	For certain customers such as petrochemical producers an important parameter is managing the rate of change of CV or composition. The acceptable rate of change would be identified within a GSA but the control effectively resides with the TSO. Excessive CV swings cause Plant to become unstable which leads to heightened risks for environmental consent breaches, equipment damage, and personnel safety. In NZ Steel's case, a gas stream is used in the steel making process with a chemical reaction by-product that protects equipment from overheating. Stability of gas composition is a key quality parameter. It is accepted that NZS5442 specifically excludes gas transformation processes. Nevertheless gas is used for more than just energy by a number of significant users (approximately 15% of total New Zealand gas demand in 2009 was for non-energy use). If their concerns aren't recognised within the gas specifications, they should at least be understood and reasonably accommodated by the TSO .
Question 2: Do you agree with the assessment of types of non-specification gas and potential causer, as set out in Table 3?	Table 3 excludes rate of change of CV. Potential causer is a producer but can also result as a decision by the TSO in terms of managing comingling of gas streams.

QUESTION	COMMENT
Question 3: Do you agree with the proposed regulatory objective? If you disagree please explain why and/or provide an alternative.	Generally the proposed regulatory objective is consistent with other obligations around the Gas Act including the GPS. The definitions around "safety, reliability, and efficiency" help provide some objective assessment around those terms. Nevertheless we note the restrictive use of "composition" as a reference to the *burning* characteristics of the gas does not suit the issue perhaps unique to gas transformation which requires that composition be stable or controlled in terms of rate of change of composition.
Question 4: Do you agree we have interpreted the provisions contained within the transmission codes and contracts correctly? Are there additional contracts or provisions that should be considered?	We agree that the provisions are as described. However we would note that the provision alone does not necessarily imply that they are also being followed. For example the ICA requiring continuous monitoring of O_2 content. We are not convinced that this provision is actively adopted by producers in spite of it being a requirement under their ICA. Even issues such as continuous monitoring of composition may not be enforced as GCs or mass specs may be taken off line for maintenance whilst gas continues to be injected into the transmission system. Furthermore it's not clear how or if the TSO actually enforces or audits compliance with ICA provisions, or indeed whether it takes any action when non-compliance is discovered. We think that the TSO has an enforceable obligation to ensure compliance with ICA provisions.
Question 5: Are there any aspects of the discussion in section 6.1 that you believe to be inaccurate or misleading? If so, please explain what these are.	We are generally happy with the discussion.

QUESTION	COMMENT
Question 6: Do you consider that liability for quality issues is best addressed through contractual arrangements or regulation? Please explain why.	The current issue with liabilities is that the rights of retailers and other end users to sue for damages are being undermined by lack of acceptance of accountability for delivery of non-spec gas by the TSO. The TSO should not be allowed to absolve itself of its fundamental duty to provide a transmission service that includes delivery of gas that meets the requirements under NZS 5442. In the first instance liability for non-specification gas delivered through the transmission system should lie with the TSO and damages should be claimed against the TSO. It should be up to the TSO to recover its own damages through its ICAs. This is the only effective control on injecting parties who contract their ICA with the TSO. MPOC and VTC should warrant the delivery of specification gas and also warrant that the TSO will act as a Reasonable and Prudent Operator (RPO) without the use of exculpatory clauses. In our experience liability is often negated by the use of unsatisfactory definitions of RPO (such as those with vague references such as "good oilfield practice", and/or use of exculpatory clauses like "*..no liability as a result of gross negligence or wilful misconduct*" – i.e. even if RPO obligation is acknowledged it is then immediately exempted by the higher standards of proof for gross negligence or *wilful* misconduct. We have tried in the past to tighten up these definitions under contract but have been unsuccessful in getting it past the counterparty legal advice. We suggest that this resistance is unreasonable in light of where accountability for negligence should lie and that regulation may be required to readdress the risk sharing balance. i.e a reasonable definition of RPO should be (as used elsewhere): **Reasonable and Prudent Operator**" shall mean a person seeking in good faith to perform its contractual obligations and in so doing and in the general conduct of its undertaking exercising that degree of skill, diligence prudence *and foresight* which would reasonably and ordinarily be expected from a skilled and experienced operator complying with applicable law engaged in the same type of undertaking in the same or similar circumstances and conditions and any reference to the standard of Reasonable and Prudent Operator or "**RPO**" shall be construed accordingly.

QUESTION	COMMENT
Question 6: Continued	Regulation should also prevent RPO accountability being undermined by use of exculpatory clauses. Although it is generally unsatisfactory to regulate terms within commercial agreements the balance of power clearly lies with the monopoly provider who will act unreasonably to transfer its own risks as much as possible to the counterparty. Regulation may be the only solution to readdressing this imbalance of power.
Question 7: Do you think the proposed regulatory objective would be better achieved with more prescriptive arrangements for the monitoring of gas composition and contaminants?	We suggest that more prescriptive arrangements for monitoring of gas and contaminants shouldn't be required under regulation if a broad RPO obligation and quality warranty incorporated under the various pipeline codes. It would be particularly important that a strong RPO definition includes the expectation of foresight being exercised as it strikes us that quality issues such as filter/ regulator blockages/ oil carryovers etc from routine maintenance operations are reasonably foreseeable by a competent operator and therefore able to be prevented.
Question 8: Do you think further work to identify the options for more active gas quality monitoring, and to quantify the costs and benefits of those options, is justified?	No. We think adjustments to MPOC or VTC as suggested above provides sufficient incentive for TSOs to place tight obligations on injecting parties under ICAs.
Question 9: Do you think TSOs should monitor gas quality more actively (for example, by continuously monitoring the water content in the transmission system to manage the risk of hydrate formation)?	TSOs should act as Reasonable and Prudent Operators rather than prescribing what they need to do to be Reasonable and Prudent. However it would be useful if there was transparency around quality complaints under additional disclosure requirements. MPOC and VTC should clarify process for notifying quality complaints and transparency under disclosure regime should alert industry where the TSO may not be acting as a RPO.

QUESTION	COMMENT
Question 10: Currently, the TSOs audit producers' monitoring of gas composition. Do you think this arrangement provides sufficient assurance against the delivery of non-specification gas?	As noted in the issues paper, non specification gas is wider than just composition and hence monitoring of composition does not provide assurance against the delivery of non-specification gas. However as noted above, the best form of assurance is a warranty by the TSO to deliver gas that meets the gas specification with limited room to manoeuvre out of this obligation.