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Dear Mr Dempster,

Gas Outage and Contingency Management Arrangements

Introduction

1. Mighty River Power welcomes the opportunity to comment on the Gas Industry Co's (GIC's) Statement of Proposal "Gas Outage and Contingency Management Arrangements", August 2007. We regret that temporary staffing constraints meant we were unable to submit on the due date.
2. No part of our submission is confidential and we are happy for it to be made publicly available.

Opening comments

3. Mighty River Power has previously expressed the view that the current voluntary NGOCP arrangements are inadequate for dealing with gas outage contingencies. We have expressed a preference that the GIC attempt to reach a pan-industry agreement for alternative arrangements. We also have recognised the potential practical difficulties with reaching pan-industry agreement and that if it is not possible regulations should be put in place.
4. We were consequently pleased to see the GIC progress this matter with the release of the "Gas Outage and Contingency Management Arrangements" paper. We also acknowledge the GIC's proposals to create a hybrid between mandatory Outage and Contingency Management Regulations, and a requirement for industry participants to develop detailed planning and arrangements to apply during a gas contingency.
5. Responses to the specific questions contained in the "Gas Outage and Contingency Management Arrangements" paper are contained in the Appendix to this submission. However, we have concerns about key aspects of the GIC's policy development. The responses to the GIC's questions are qualified by these concerns. We raise them here as constructive criticism aimed at ensuring the GIC maintain a high standard of policy development. None of the comments below are unique to the GIC. They are concerns we

have expressed with the Electricity Commission from time to time in its policy development.

Regulatory objectives and problem definition

6. We are concerned that the GIC's regulatory objective confuses the objectives with the solution. Likewise, we are concerned that the GIC's problem definition confuses the problem with the solution.
7. The regulatory objective is "that arrangements are in place to achieve handling of a national or regional gas contingency without compromising long-term security of supply." This is not an objective. Rather it is the specification of the means (the solution) to achievement of some (unspecified) objective. That is, if the objective is to have arrangements in place to handle national or regional gas contingencies the solution is to put arrangements in place to handle national or regional gas contingencies. This is the case, regardless of whether it is desirable to put such arrangements in place, and regardless of whether such arrangements would promote the Government's overall policy objective for the gas industry.¹
8. Likewise, for example, one of the problems the GIC has identified with the current arrangements is that they are not mandatory. It is axiomatic that if the problem is that the current arrangements are not mandatory the solution is to make them mandatory. The problem definition does not permit any other solution. This, however, begs the question of why mandatory arrangements need to be put in place i.e., what is the REAL problem? In answering this question, the GIC needs to consider whether durable market failures exist that mean the market (unregulated) may not be able to be relied on to deal with gas outages and contingencies. The market failures may relate to the common good element of the solutions to gas outages and contingencies, and the consequent potential for individual participants to free-ride on any solution (given the common usage of the gas transmission network). We are disappointed that we could find no reference to market failure in the problem definition.
9. While there seems to be general agreement that mandatory arrangements should be put in place this does not abrogate the need for a proper specification of the problem definition (identification of market failures). The appropriate solution, even if it is mandatory, will likely be one that directly addresses the market failures, rather than just the symptoms of the market failures. This is less likely to be achieved, and the optimal solution less likely to be found, if the problem definition is not properly and explicitly specified.

Development of policy and implementation

10. The other principle concern we have with the "Gas Outage and Contingency Management Arrangements" paper is the bundling of specification of the policy options that the GIC

¹ The Government's overall policy objective for the gas industry is:

"To ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner."

considers to be practicable and identification of the GIC's preferred policy option, with full specification (draft Regulations etc) of the GIC's preferred option for implementation.

11. Mighty River Power considers that full specification of the GIC's preferred option for implementation is premature at this stage of the policy development.
12. The GIC should first determine that it has properly specified the problem, and identified all of the policy options that should be considered. The GIC should then determine whether its preferred option is the appropriate option to pursue.
13. Once the GIC has completed this consultation and established a preferred option it should then move into an implementation phase (including specification of draft Regulations etc).
14. The problems the GIC may face by merging these consultation phases into a single step include:
 - a. A lot of time and resources may be wasted by the GIC on implementation if it becomes apparent that the GIC's preferred option is not appropriate (or should be substantially amended). Likewise, stakeholders may waste a lot of time and resources commenting on the detailed proposals for implementation of an option that may not be introduced.
 - b. Worst still, the time expended on developing the preferred policy option may paint the GIC in a corner, as the GIC may consequently find that it does not have sufficient time to materially change its proposed approach.
15. It has been Mighty River Power's general experience that merging policy development with implementation can create an element of predetermination in the policy development process, and at least makes it more difficult for the regulator to change its intended approach.

Compensation issues

16. Mighty River Power believes the compensation process needs a lot more thought prior to implementation. Below are some issues that should be worked through:
 - a. The medium sized industrial consumer who is required to turn off plant and bears this cost is unlikely to be the same party who is the holder of the mismatch position (and the receiver of compensation). The retailer will likely hold the mismatch position. Has the GIC considered how the funds flow to the party that bears the cost of shutting down?
 - b. Is the mismatch position used for compensation the running mismatch position at the end of the contingency or the change in the mismatch position during the contingency? There are arguments for both positions. It does not seem efficient for contingency pricing to apply to mismatch positions that were created outside of a contingency event (especially for the retail mass market who will almost certainly not be aware of their mismatch position at the time of a contingency), yet the threat of contingency pricing may encourage behaviour that limits the size of the contingency, especially for those that have control over their load.

- c. If there is a producer outage, the aggregate mismatch position will depend on the reduction (if any) in the producer re-nomination, which will affect the amount of compensation available. Will the producer be required to re-nominate under in a contingency event? Will the producer be liable for operational imbalance under contingency pricing if it does not renominate?

17. The answers to these questions need to be clear in the mind of the GIC and market participants to assure consistent actions of the GCO and to avoid disputes. Working through scenarios would be of significant value.

Concluding remarks

18. If you have any queries regarding this submission please do not hesitate to contact me (on 09 308 8259 or robert.allen@mightyriver.co.nz) or Duncan Jared, Mighty River Power's Gas Portfolio Manager (on 09 308 8290 or duncan.jared@mightyriver.co.nz).

Yours sincerely,

Robert Allen

Regulatory Manager

Appendix: Responses to the GIC's questions

| QUESTION | COMMENT |
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| <p>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?</p> | <p>Mighty River Power has concerns about the GIC's problem specification.</p> <p>We are concerned that three of the four problems the GIC has identified confuse the problem with the solution.</p> <p>For example, one of the problems the GIC specifies with the current arrangements is that they are not mandatory. It is axiomatic that if the problem is that the current arrangements are not mandatory the solution is to make them mandatory. This problem definition does not permit any other solution.</p> <p>Likewise, if a problem is that the current arrangements lack legal clarity to manage contingencies the solution would be to introduce arrangements that have legal clarity.</p> <p>This, however, begs the question of why mandatory arrangements (with legal clarity to manage contingencies) should be put in place i.e., what is the REAL problem?</p> <p>Another problem the GIC identified is inadequate commercial arrangements during contingencies. This begs the question of why there are inadequate commercial arrangements. Again what is the REAL problem?</p> <p>In answering these questions, the GIC needs to consider what durable market failures may prevent the market (unregulated) from adequately dealing with gas outages and contingencies. The market failures may relate to the common good element of the solutions to gas outages and contingencies, and the consequent potential for individual participants to free-ride on any solution (given the common usage of the gas transmission network). We are disappointed that we could find no reference to market failure in the problem definition.</p> <p>While there seems to be general agreement that mandatory arrangements should be put in place this does not abrogate the need for a proper specification of the problem definition (identification of market failures). The appropriate solution – even if it is mandatory – will likely be one that directly addresses the market failures, rather than just the symptoms of the market failures. This is less likely to be achieved, and the optimal solution less likely to be found, if the problem definition is not properly and explicitly specified.</p> |

| QUESTION | COMMENT |
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| | <p>Another of the problems that are claimed to exist is that the “NGOCP is not suited to the post-Maui era”. The GIC notes that Maui gas supply is becoming less important, new gas supplied may be less flexible than Maui and more diverse, and that gas fired electricity generation is becoming a higher proportion of total electricity supply. What the GIC does not do is explain why any of this means that the NGOCP may be less suitable, than currently, in a post-Maui era.</p> |
| <p>Q2: Are there other key problems with the current arrangements which also need to be addressed?</p> | <p>Yes.</p> <p>There is little or no consideration given to the flow on effects to the electricity market of curtailing power stations ahead of all other load groups. The EO needs to communicate effectively with the electricity industry operator to ensure their decisions don’t increase the likelihood of a cascading failure in the electricity market.</p> |
| <p>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?</p> | <p>Yes.</p> |
| <p>Q4: Do you agree with the proposed regulatory objective?</p> | <p>No.</p> <p>We are concerned that the GIC’s regulatory objective confuses the objective with the solution.</p> <p>The regulatory objective is “that arrangements are in place to achieve handling of a national or regional gas contingency without compromising long-term security of supply.” This is not an objective. Rather it is the specification of the means (the solution) to achievement of some (unspecified) objective.</p> <p>Further, gas contingencies are short term in nature and only very indirectly affect long term security of supply which is about the development of new gas supplies and maintenance of infrastructure.</p> |

| QUESTION | COMMENT |
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| Q5: Do you agree that the net benefits of the proposal are materially higher than the net benefits of the counterfactual? | Mighty River Power cannot conclude with certainty that the benefits are material due to the difficulty in assessing the options in a quantitative manner. |
| Q6: Do you agree that the proposal has the potential to address the key problems identified with the current arrangements? | Potentially, subject to comments in response to Questions 1 and 2. |
| Q7: Do you agree with the proposed definition of a Gas Contingency? If not, what would you propose? | No. The current definition is subjective and therefore provides market participants with no certainty as to when a gas contingency will be called. The ability of industry participants to react to an impending contingency will be minimal with such a definition. A gas contingency should be defined as when the quantity of gas in the transmission system falls, or is likely to fall, below a level (or a band if the level is variable), which is measurable and reportable. |
| Q8: Do you agree with the list of responsibilities given to the GCO? | Yes. |
| 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? | Yes. It is difficult to foresee every possible contingency scenario and to this extent the GCO should be provided with flexibility to take action. |
| 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? | Yes to the extent that the GCO cannot achieve it alone or there is a need for independence in the planning process. |

| QUESTION | COMMENT |
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| <p>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?</p> | <p>a) Yes - large consumers supplied from transmission systems that have alternative fuel supplies should be curtailed first.</p> <p>b) Bands B to D should be combined.</p> <p>c) Mighty River Power supports the concept of a minimum load consumer, but notes that the additional load group may prove impractical and difficult to manage if linepack is falling quickly.</p> <p>Essential services should not be reliant on gas and should have alternative supplies (although it may be appropriate to keep the band anyway).</p> |
| <p>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?</p> | <p>See comments above</p> <p>Instead of imposing a time limit, industrial parties should provide evidence from the manufacturer of the gas consuming unit that the ramp-down rate is appropriate for a safe shutdown. This suggestion is designed to ensure that industrial gas consumers do not abuse any benefit provided to them of being in this category.</p> <p>9.40 suggests that commercial gas supply arrangements between parties may need to be modified to ensure additional gas supplies are available at short notice. Mighty River Power is strongly against this requirement being included in rules and regulations if that is the intention. Natural market forces should alone encourage commercial decision making.</p> <p>If market forces are not sufficient, then the Gas Contingency Operator should contract with gas suppliers.</p> |
| <p>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?</p> | <p>The wholesale gas price should be a "buy price" (as apposed to a mid-point between the buy and sell price) to create incentives on parties to correct mismatch positions. The UK's Uniform Network Code recognises this by increasing the buy price for pipeline balancing above market clearing prices.</p> |

| QUESTION | COMMENT |
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| 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? | No. Mighty River Power believes that the GIC needs to do a lot more work before a firm view could be formed on this matter. |
| Q15: Do you agree that the proposed scheme to calculate imbalances using existing industry processes is workable? If not, what adjustment would be required? | The proposed scheme is not clear from the document. The wording "will use the standard industry processes modified to take account of the extent and duration of the actual curtailment" in 9.50 makes the intent of the proposal unclear. It is also unclear in 9.52 whether the proposal allocates costs based on the change in mismatch positions during the contingency period or based on the running mismatch position at the end of the outage (including prior to the outage), which is consistent with standard industry processes. Standard industry processes may not be suitable for reasons outlined earlier. |
| 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. Payments on the 20 th of the month following. |
| Q17: Do you agree with the proposed communications process shown in Figure 2? | The GCO should post on OATIS the directions and timing of those directions provided to the TNO to avoid miscommunication between the GCO and large consumers and retailers |

| QUESTION | COMMENT |
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| <p>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?</p> | <p>Vector has declared it will be the GCO on its pipeline and this is unlikely to change in the future. It is Mighty River Power's view that curtailment of gas transmission services during a contingency event is part of Vector's core business and competency, for which they are compensated through the tariffs they charge. Liability provisions between Vector and Mighty River Power are currently governed by the transmission services agreement between the parties. The proposal as it stands, adds cost to shippers to compensate Vector for what is already a core business operation and limits liabilities below that currently agreed through commercial arrangements between Vector and Mighty River Power (and shippers in general).</p> <p>This will allow Vector to hide behind the GCO role in order to limit liability in cases of negligence or wilful default.</p> <p>Where Vector is the GCO then for parties who hold a Transmission Services Agreement with Vector, liabilities should be governed by the commercial agreements between them and not limited by regulation.</p> |
| <p>Q19: Do you agree with the proposed approach to allocating the costs associated with administering the outage and contingency management arrangements?</p> | <p>Costs should only apply to the extent that the GCO is not Vector and/or Vector is required to take actions outside their normal business activity (which excludes curtailment under contingency events).</p> |