



14 September 2007

Ian Dempster  
Gas Industry Co  
PO Box 10 646  
Wellington

Dear Ian,

**Submission re Gas Outage and Contingency Management Arrangements Proposal**

Please find attached a submission from Nova Gas regarding the GIC's proposal management of contingent events.

To summarise Novas views:

- Nova agrees that current voluntary arrangements are insufficient to manage contingent events where demand rationing is required;
- Nova agrees with much of the practical detail surrounding planning for and implementation of curtailments in response to a contingent event;
- The current Maui Legacy Gas arrangements contribute to uncertainty and inadequacy of current balancing arrangements;
- Nova does not agree with the proposition that a second price determination, gas allocation and settlement regime is necessary;
- Current industry arrangements embodied within the Maui Pipeline Operating Code should be sufficient. Duplication of those arrangements will lead to conflict, uncertainty, additional costs and potentially perverse outcomes.

Please contact me if you would like to discuss our submission.

Regards

Charles Teichert  
Nova Gas

Nova Gas submission on Gas Outage and Contingency Management Arrangements. September 2007.

QUESTION	COMMENT
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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?

No.

The Proposal states that the problems with the current arrangements are:

- “inadequate commercial arrangements during contingencies”; and
- current arrangements provide no recognition of the premium value of gas at the time of a contingency.

Nova agrees that the commercial arrangements are not satisfactory when it comes down to enforcement of operational flow orders and curtailment orders required to maintain pipeline balance.

Nova does not agree with the second proposition that commercial arrangements do not cater for contingent events and the settlement of imbalances created by curtailments.

Under the MPOC arrangements, welded parties are subject to cashout of excess running imbalances as well as the incentives pool regime where daily imbalances are outside stated tolerances. Since the inception of open access on the Maui pipeline, the negative mismatch price has been linked through an escalation clause to the electricity price. In addition the premium fuel value which forms the basis of the liquidated damages regime through the incentives pool is also directly linked to electricity prices.

These mechanisms were designed to enable linepack to be managed and to pre-estimate loss in the event that a party did not receive their gas entitlements due to the actions of other parties using the Maui pipeline.

The main reason for these mechanism not being able to deployed as intended has been the treatment of Maui legacy gas volumes and the associated restrictions that result such as the inability to issue Imbalance Limit Overrun Notices at welded points through which Maui legacy gas is injected and received.

Removing or suspending Section 3 of the code will have a significant impact on how the pipeline is balanced on a day to day basis and how contingent events are managed.

<p>Q2: Are there other key problems with the current arrangements which also need to be addressed?</p>	<p>1) Treatment of Maui legacy gas during contingent events.</p> <p>Currently there is residual risk from parties to the legacy Maui gas contract who may lay claim to line pack during a contingent event that may affect their decisions re curtailment of load in response to a contingent event.</p> <p>2) Lack of ability of Vector Transmission at its welded points where multiple parties trade, to directly curtail demand during contingent events.</p> <p>Other welded parties who are single users at their welded points are subject to contractual requirements to comply with Operational Flow Orders (OFO). Consequences of a party failing to comply with an OFO can be significant given the discretion of MDL in such an instance. The nature of Vector welded points and the multiple shipper issue make OFO's problematic due to the diverse and disaggregated nature of load behind those welded points.</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, although we believe that the proposal goes further than necessary, particularly in relation to the post event reconciliation, pricing and settlement process.</p> <p>Commercial outcomes from curtailments are catered for through the MPOC incentives pool scheme which is in effect a liquidated damages regime. Introducing a second reconciliation, pricing and settlement process to industry arrangements will give rise to conflicts between the two.</p> <p>Nova Gas prefers one regime.</p> <p>If the GIC believes that the third party expert regime leads to a better outcome when curtailments occur than the current liquidated damages regime, then perhaps it is simply better to amend the MPOC through the S29 process.</p>
<p>Q4: Do you agree with the proposed regulatory objective?</p>	<p>Yes</p>

<p>Q5: Do you agree that the net benefits of the proposal are materially higher than the net benefits of the counterfactual?</p>	<p>Yes although the proposal goes further than necessary and fails the test of efficiency: ie What regulations are required to deliver the desired outcome.</p> <p>As mentioned above, Nova believes that the proposal goes one step too far in regulating the reconciliation, pricing and settlement outcomes that are already provided for by the MPOC.</p>
<p>Q6: Do you agree that the proposal has the potential to address the key problems identified with the current arrangements?</p>	<p>Yes although it can also be said that the proposal is far more comprehensive than necessary and can be likened to using a sledge hammer to crack a nut.</p>
<p>Q7: Do you agree with the proposed definition of a Gas Contingency? If not, what would you propose?</p>	<p>He problem with the definition proposed is that is very broad. While that be useful in terms of regulations, the practical and operational application of such a broad definition will give a very wide discretion to the pipeline operator.</p> <p>From a practical perspective, the definition of a contingent event should include unambiguous and objective trigger points such as:</p> <ul style="list-style-type: none"> <li>- pipeline pressure,</li> <li>- hours of linepack remaining.</li> </ul> <p>These should also be subject to amendment from time to time through a suitable change process</p>
<p>Q8: Do you agree with the list of responsibilities given to the GCO?</p>	<p>Yes</p>
<p>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?</p>	<p>Yes</p>

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 if the GCO wasn't the TNO
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?	Yes
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?	Yes

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?

The incentives:

- for upstream producers to maximise production during a contingent event and
- for retailers who have had customer load curtailed and as a result have excess supplies,

depends on the prospect of receiving prices for excess gas over an above the price they have paid for that gas or the price that they are willing to accept for the gas as a producer.

A retailer may have post contingent event but prior to curtailments being announced by the GCO, procured additional gas at high prices to meet their customers needs only to find that their load is curtailed in which case they are forced to sell that gas to another retailer at an uncertain price;

A producer may over inject gas into the pipeline without the surety that they will receive value for that gas. The over injected quantity potentially is in breach of the MPOC and after the contingent event has been terminated, is potentially subject to cashout at a low price.

Ex ante pricing is more likely to stimulate the supply of additional gas than ex post pricing as ex-post pricing by the independent third party will be subject to pressure from purchasers to form a view that a low price is appropriate.

The benefit of the electricity price escalator is that not only is it a pre-estimate of loss and value of gas, it is also a price that is observable in real time.

Ex post pricing could disincentivise parties trading prior to an event if the ex post price could be lower than the price at which gas could be purchased at prior to curtailments.

The appropriate price for gas in constraint situations should be calculated on the basis that if trading of gas was used to ration demand to available supplies, which trades would be completed and at what price. A key determining factor of what trades would occur in a perfectly competitive market is what a gas users alternatives are.

It is rational to expect that consumers who use gas to fire electricity generation plant (50 of the gas market) has the alternative of procuring electricity from the electricity spot market or switching to an alternative fuel in the electricity market such as hydro or coal. It would also be true that if there were non electricity generation gas consumers were willing to trade their gas entitlements, the price that the electricity generator can afford to pay would be their alternative – ie the electricity spot price. If the gas price were above the electricity price equivalent, then the gas trade would not occur.

This suggests that the electricity spot price should be a good approximation of the value of gas during a gas contingency event.

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.

The order of prices used in consideration of any ex post pricing regime should be:

1) the **higher** of:

- a) Gas wholesale market price post contingent event but prior to the GCO announcing curtailments and;
- b) Wholesale electricity market prices post the contingent event leading to curtailment actions;
- c) Valid gas supply offered to the market but not accepted – ie no trade took place.

2) Economic cost to end users who have had their gas supplies curtailed.

Item 2 on the proposals list – wholesale market prices in the seven days leading up to the curtailment of demand is not considered important as those prices are highly likely to be in steady state and not reflective of the need for economic rationing of gas.

The ex post price should be the higher of wholesale gas traded, not traded or electricity prices for three reasons:

- a) to strike a price sufficiently high enough to avoid perverse incentives on parties with deficit gas positions from not trading out of their position;
- b) it is an economically efficient (pareto efficiency) representation in that all trades that should have occurred are deemed to have occurred.
- c) the observable nature of some these transactions – in particular the electricity market will provide a close to ex-ante pricing result as is feasible.



<p>Q15: Do you agree that the proposed scheme to calculate imbalances using existing industry processes is workable? If not, what adjustment would be required?</p>	<p>Yes. Daily allocations should be sufficient for allocation purposes.</p> <p>While use of hourly data to attempt more precisely calculate intraday and part day imbalances we note the following:</p> <ul style="list-style-type: none"> <li>- such calculations will heavily rely on allocations as hourly data availability will be limited</li> <li>- daily allocations were deemed to be the lowest level of allocation required at the outset of open access on the basis that Maui pipeline linepack was sufficient to deal with part day events and that imbalances caused by events have a larger impact would be dealt adequately through the provisions of the MPOC.</li> </ul>
<p>Q16: Do you agree with the proposal to have the contingency cash-out pool administered by the GIC?</p> <p>What period should be given to parties for payment of invoices issued by the contingency cash-out pool?</p>	<p>No.</p> <p>Settlement of imbalances should be managed through the existing processes provided for under the MPOC and Vector Transmission Services Agreements. In this way duplication of processes is minimised.</p> <p>Payment of cashouts should be in accordance with standard invoicing arrangements:</p> <ul style="list-style-type: none"> <li>- invoices to be rendered based on normal month end allocation processes</li> <li>- payment due on the 20<sup>th</sup> of the month</li> <li>- following future washups of allocation data (to account for consumption calculations being modified as actual meter reads are collected and used in the washups process) washups of cashouts should also be performed.</li> </ul>
<p>Q17: Do you agree with the proposed communications process shown in Figure 2?</p>	<p>Yes, currently retailers are notified by both TNO and DNO</p>

<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>Yes</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>The gas contingency arrangements primarily arise from difficulties associated with controlling gas flows on an open access transmission network following a contingent event.</p> <p>Users of non spec gas and consumers of gas who do use dedicated networks to transport gas are examples of users who do not contribute to the need for contingency arrangements or benefit from those arrangements.</p> <p>Costs should be levied on gas volumes transmitted through the open access networks of Vector and MDL. This will be a subset of total gas produced.</p>