

8 November 2004



Manager, Energy Market Reform Team  
National Energy Market Branch  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra, ACT 2601

Dear Sir/Madam

### **National Gas Emergency Response Protocol Issues Paper**

ENERGEX Retail (ENERGEX) welcomes this opportunity to participate in the development of a National Gas Emergency Response Protocol in consultation with the Ministerial Council on Energy (MCE).

#### **1. Introductory comments**

ENERGEX supports the establishment of a National Gas Emergency Response Protocol that is aimed at providing increased certainty and understanding of the functions of governments and industry in an emergency and the mechanisms by which these functions will be executed and that provides for the management and protection of market participants' commercial rights.

Notwithstanding the interrelatedness of the issues concerning wholesale gas market development and emergency response protocols, ENERGEX believes that the establishment of a National Gas Emergency Response Protocol should be considered independently of development of a wholesale gas market. It is recognised that a wholesale gas market could facilitate the economic allocation of gas during supply shortages by establishing pricing signals that reflect the value of gas. However, until the market reaches a level of maturity sufficient to support a framework for short-term trading, ENERGEX considers that the focus should be on establishing a protocol to deal with emergencies that arise within the current market context. While ENERGEX does not advocate government imposition of a wholesale gas market, it is supportive of government initiation of the establishment of a gas emergency protocol.

The remainder of our submission responds specifically to the following issues raised in the MCE's Issues Paper<sup>1</sup>:

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<sup>1</sup> National Gas Emergency Response Protocol Issues Paper, Ministerial Council on Energy Gas Emergency Protocol Working Group, October 2004.

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- How effective is the market in managing a gas shortfall (3.1);
- How should demand for gas-fired power generation be managed during an emergency (3.5); and
- How can market participants' commercial rights be better recognised (3.6).

## **2. How effective is the market in managing a gas shortfall (3.1)?**

During the 1998 Longford incident and the 2004 Moomba incident, ENERGEX was not directly affected and is not therefore in a position to offer any comprehensive opinions in relation to how effective the market and governments managed these shortfalls.

However, there is a general view that the Moomba incident in January 2004 demonstrated the ability of governments and industry participants in the affected jurisdictions to respond in an appropriate way to minimise the impact of the supply disruptions (and in NSW to preclude the need for government intervention). Nevertheless, greater preparedness with respect to an understanding by the market of the roles and responsibilities of industry and governments during an emergency, and the mechanisms by which these roles and responsibilities will be executed, may be desirable to ensure that gas emergencies are managed effectively and efficiently.

The MCE's Issues Paper recognises that an important role of governments during an emergency is ensuring that all potential additional supply options are explored, and that the most economically efficient options are exploited.

ENERGEX considers that in order for governments to fulfil this role, there needs to be a set of pre defined communication processes through which relevant information can be exchanged between government and industry during an emergency. A national gas emergency response protocol should therefore seek to deliver a transparent mechanism by which governments (or the relevant emergency management body) are able to:

- identify participants (including those in other jurisdictions) who can potentially assist in providing additional short-term supply to the affected markets;
- call upon such participants (through the jurisdiction's government) for assistance; and
- define and communicate the needs of the market experiencing a supply disruption to wider industry (beyond the affected jurisdiction).

In recognition that information flows will be imperfect, such a protocol should also provide a means by which participants with additional supply will be able to identify themselves to governments and offer their services to the affected markets. However, care should be taken to encourage parties to act cooperatively rather than compelling a party to act against its commercial interest.

## **3. How should demand for gas-fired power generation be managed during an emergency?**

The penetration of gas-fired generation in Queensland is expected to increase significantly over the coming years as a result of the Queensland Government's 13%

gas scheme to encourage cleaner fuels and gas fired generation to cover peak requirements. As both the proportion of gas fired generation and the demand for electricity increase, the impact of curtailing the use of gas in electricity generation will have a growing impact on customers.

In making a decision on whether or not demand by gas fired generators should be curtailed in a supply scarcity, consideration should be given to the following factors:

- the reliance on gas by residential customers – will customers undergo more hardship through an outage in electricity or gas;
- the long-term price impact on electricity and GEC charges – the withdrawal of gas-fired generation has the potential to substantially affect the supply and therefore the price of electricity and GECs resulting in continuing price impacts. GEC impacts could be managed by reducing retailers GEC liabilities during periods of gas generation curtailment; and
- the long-term impact on investment in gas fired generation due to uncertainty in fuel supply and returns – a reduction in investment in the gas generation area will impact both future end user energy prices and the move to cleaner fuels.

#### **4. How can market participants' commercial rights be better recognised (3.6)**

##### **(a) Proposed principle of rewarding more “secure” supply arrangements and penalising “less secure” arrangements**

The MCE's Issues Paper contains a proposition that it is important to improve the allocation of costs to participants to ensure that “more secure” supply arrangements are rewarded and “less secure” arrangements are penalized. This is intended to provide incentives for investment in more secure supply options.

ENERGEX has concerns with this approach, particularly because there has been no criteria presented alongside this proposal that could be used to enable an assessment to be made on the extent to which a particular supply arrangement is “secure” or “insecure”.

ENERGEX believes that such an assessment is not straightforward and is unconvinced that the protection of commercial rights should be driven by such a principle. The main reasons why such a principle is considered to be unnecessary and inappropriate are discussed below.

##### ***Sufficient market incentives currently exist for parties to ensure minimal disruption to supply***

ENERGEX considers that there already exist sufficient incentives at each level of the supply chain (including production, transmission, distribution and retail), for the responsible parties at each link to ensure that supply remains undisrupted. No supplier, transmitter, distributor or retailer would benefit from having a disruption to their supply. From a retailer perspective, there is minimal commercial incentive to invest in a supply arrangement that has a high risk of supply disruption. Although a retailer may be protected from a supply disruption by force majeure provisions in its customer contracts, a retailer that has to utilize force majeure provisions on more than one occasion as a result of supply disruptions stemming from an “insecure” supply arrangement, will be unattractive to customers. This applies to all links in the supply

chain – for example, producers should not have any incentive to risk disruptions to their supply and rely on protection from FM provisions, as those customers who are adversely impacted will simply move to find other producers.

***Difficulty in defining the criteria for assessing whether or not a particular supply arrangement is “secure”***

Experience of past supply disruptions highlights the difficulty in making an assessment about whether or not a particular supply arrangement is “secure”. The two most recent and major supply disruptions, that is, the Esso gas plant explosion at Longford in September 1998 and the fire at Santos’ gas plant at Moomba in January 2004, occurred at two of the most significant supply sources in Australia, both of which have been processing gas for more than 30 years. It would be incorrect to conclude from these events that these supply sources are in fact “insecure”.

***Issues regarding compensation from one retailer to another retailer***

The Issues Paper raises issues regarding the curtailment of customers and the possibility of requiring compensation payments from retailers whose supply fails to those retailers whose customers are curtailed as a result of that loss of supply. This is tied to the proposition that more “secure” supply arrangements should be rewarded and the “less secure” ones penalised.

ENERGEX has concerns with this proposition. The very reason for the existence of force majeure provisions, found in the majority of energy legislation and contracts, is to recognize the fact that certain events, beyond control of the responsible party, can occur, and that in such situations, the responsible party should not be penalized. The imposition of financial penalties on retailers whose supply fails due to an event beyond the control of the retailer is contradictory to this principle. Furthermore, the financial risks created for retailers may inhibit retailer participation in the market. Again, ENERGEX emphasizes that there are sufficient commercial based incentives currently in place to encourage retailers to enter into supply arrangements that they consider reliable.

**(b) Issues regarding pain and reward sharing**

With the increasing interconnection between jurisdictions, there is an increased potential for an emergency in one jurisdiction to have an impact on another. A shortage in one jurisdiction could result in supply from another jurisdiction being diverted to address the shortfall. Customers in the jurisdiction providing assistance may be affected. Under any protocol to be considered the issue is how will parties' commercial rights be protected and who should wear the pain.

The following principles could be considered when determining the sharing of reward/pain:

- Jurisdictions, and the parties in it, who assist another jurisdiction at the cost of diverting their own gas supply, should be rewarded. Such a reward could be in the form of a defined premium in the price of gas at the time.
- This reward should flow to retailers, with the difference between any premium received and the costs of diverting supply, being passed through to customers who suffer curtailment.

- Retailers who are able to make additional gas available under the flexibility of their gas supply contracts should be incentivised to make such gas available ie they should be able to charge a reasonable premium for such gas.
- Customers who are not curtailed, including customers under a regulated retail tariff, should pay a premium for being last off/essential service customers. Retailers could be formally allowed to charge such a premium (perhaps in accordance with a pre-defined methodology or cap) under the Protocol.
- An option is to have a central fund into which the total net premiums are pooled. Payments to retailers and curtailed customers could be made from this pool.
- As gas transporters within a region could lose gas throughput within their transmission pipelines or distribution systems as a result of a diversion of supply, it may also be appropriate for such parties to be compensated accordingly.

However, ENERGEX recognises that the difficulties that would be faced in defining a system that would fairly manage all parties' rights under a national compensation fund concept, may render such a concept impractical.

## **5. Concluding comments**

Overall, ENERGEX supports the development of a National Gas Emergency Response Protocol and appreciates the opportunity to provide its input into its development.

We believe that the development of such a Protocol is critical for ensuring that governments and industry participants are knowledgeable about their roles in an emergency situation and are empowered to execute those roles by having the necessary infrastructure available. While we are cognisant of the fact that a wholesale gas market that enables short-term trading could facilitate the direction of gas flow during a major supply constraint, thereby potentially postponing the need for government intervention, our view is that the development of an emergency response protocol should be considered independently of the development of a wholesale gas market to ensure that industry and governments are adequately prepared in their responses should an emergency arise in the near term. Should a wholesale gas market be developed in the future, emergency protocols should then be modified to utilise the mechanisms offered by the market to manage emergencies.

ENERGEX looks forward to the release of the Ministerial Council on Energy's Options Paper later this month.

Please do not hesitate to contact me or Sarah Kok on (07) 3407 4092 or [sarahkok@energex.com.au](mailto:sarahkok@energex.com.au) should you wish to discuss our submission or have any questions.

Yours sincerely

[SIGNED]

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