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**TXU Comments on MCE GEPWG Consultation:
National Gas Emergency Response Protocol – Issues Paper**

Thank you for providing us with the opportunity to comment on the Issues Paper. We believe the Gas Emergency Protocol Working Group has demonstrated an appreciation of the issues surrounding the management of supply disruptions in its paper, and trust that our responses below will assist the working group in developing its options.

We believe there are 3 key issues in the management of supply disruptions that must be addressed:

- Current emergency allocation procedures are complex, lack transparency and are not able to be predicted
- There are no commercial incentives to voluntarily ration gas
- Governments provide limited recognition of commercial arrangements at times of system constraint and intervention.

In addressing these issues and defining a protocol for the management of constraint events, TXU has identified the following objectives which we believe need to be satisfied:

- Recognition of market capabilities in emergencies
- Clear definition of the intervention criteria
- Clear definition of the roles and communication protocols
- Clear methodology for physically allocating gas
- Methodology for notionally allocating gas. That is, defining “whose gas was burnt by whom”

- A mechanism for valuing the gas and compensating those parties disadvantaged by the intervention by not being able to physically access gas which was commercially theirs.

The benefits of addressing these points will be significant. Firstly, clarity around intervention and allocation roles and procedures will provide for a smoother process at the time and more predictable outcomes. This will be a significant improvement over current practices for industry participants, governments, regulators and ultimately customers alike.

Secondly, and perhaps more importantly, recognising the greater value of gas during an emergency will provide incentives to participants to (a) voluntarily act to ration gas usage during any incident and (b) invest, or establish commercial arrangements, which increase supply reliability and resilience against constraint events.

The importance of such commercial signals cannot be over-stated. Without such signals, as the Issues Paper rightly points out, there are disincentives for participants to assist voluntarily, and fewer incentives for investment in more secure supply or demand options.

Our comments in response to the detailed points in the Issues Paper are predicated upon these principles and objectives, and are included in the attachment below.

For further discussion on these matters, please contact me on (03) 8628 1244.

Yours Sincerely

Peter Carruthers
Regulatory Manager, Policy

SPECIFIC CONSULTATION ISSUES

Below are TXU's comments on the specific issues identified in the Issues Paper. We have used the numbering convention adopted by the Issues Paper for convenience of cross-referencing our responses to the issues.

3.1 How effective is the market in managing a gas shortfall?

There is now a greatly enhanced physical capacity to manage gas shortfalls in the south-eastern Australian states, due to the greater pipeline inter-connection and supply diversity. This was shown by the role of the SEA Gas pipeline in the Moomba incident earlier in 2004. TXU contends that this demonstrates the importance of a positive investment and competitive environment that promotes upstream and pipeline investment.

While the physical capacity to manage gas shortfalls has improved dramatically since the Longford incident in 1998, the capacity of the market to manage shortfalls commercially is still evolving and requires improvement.

As we stated in our introductory remarks, the main improvements required are:

- Clear intervention criteria, with intervention powers only to be invoked on the basis it is clear the market is unable to resolve the situation commercially
- Clear roles and procedures to provide predictable processes and outcomes in the management of the physical arrangements
- Mechanisms that value the gas during the constraint event and settle it out based on that gas value.

3.2 How can information on supply and demand be shared?

TXU believes an industry body should be established to manage a short-term wholesale gas spot market, with associated transparency of information required to effectively manage such a market. Supply/demand information would be part of this, and rules could be established to safeguard the confidentiality of such information but at the same time provide the necessary information to governments in the event of a supply shortfall incident. Information sharing precedents exist, such as the Victorian arrangements where information is supplied to VENCORP on a confidential basis and is released in aggregated form.

3.3 What are the options for timing of Government involvement under a protocol?

TXU considers that industry, through an industry governed body, should manage gas shortfall events in the first instance. TXU recognises that Governments will require confidence in the industry's capabilities under this approach, and therefore proposes that

industry works co-operatively with governments to define principles and processes that fulfil the required objectives.

TXU understands there can be situations where it is essential governments do become involved – particularly in the event of very significant emergencies – and recommends that a joint government/industry committee be convened to work above the industry body.

The timing of escalation and government intervention should be set out clearly, but would be based on a criteria of failure of commercial arrangements to resolve the shortfall situation, significant property damage or a threat to personal safety in the event of emergency situations.

3.4 What are appropriate principles for gas sharing between jurisdictions?

TXU notes the Issues Paper highlights the issue of economic losses suffered by users who have their gas curtailed. TXU considers this is a fundamental issue that requires resolution in a fair and even-handed manner, regardless of the curtailment procedures to be adopted. The value of the economic loss suffered will be different for different consumer types, and it is essential that no single consumer type carries an undue burden. This either requires some form of rotational curtailment approach across user types or, perhaps more effectively, a commercial approach which effectively values gas under the constraint. If the value of gas is recognised, then those curtailed involuntarily can expect to be compensated fairly and there will be incentives for the voluntary rationing of gas.

3.5 How should demand for gas-fired power generation be managed during an emergency?

A market-based approach and absence or minimisation of government intervention is essential.

The electricity market provides clear signals which value the product (electricity) being produced. Gas-fired generators respond to this market accordingly, and this market continues to operate even if not all generators are available. It is essential then, that governments do not intervene in the allocation of gas and over-ride commercial rights to gas-fired generators as it has the flow-on effect of distorting the electricity market and not treating participants equally. For example, governments or regulators have a tendency to curtail gas-fired generators before any other user, simply because this is historical practice or is seen as the most convenient response. This ignores the economic losses incurred, and if energy is in high demand then the value of the product being produced may be substantially greater than other manufactured products. This is effectively a cross-subsidy between consumer types. A second example is that governments or regulators have a tendency to re-allocate gas from parties with alternative fuel supplies to parties who have not invested in alternative fuel supplies. While this may be seen as a practical short-term

measure in the event of a supply shortfall, when done without associated compensation between the parties, the value of supply reliability is being distorted and the party without back-up arrangements will continue to avoid investment on the basis that they always receive someone else's entitlement of gas in emergency circumstances.

TXU therefore contends that the market should be allowed to operate for as long as possible. If intervention and curtailment are unavoidable and a market is not operating or cannot continue operating, then a compensation mechanism, which values the gas under the constraint situation, is required.

3.6 How can market participants' commercial rights be better recognised?

Presently jurisdictions have the ability to over-ride commercial or contractual rights of participants. While TXU recognises that this may be required at times of emergency, it is important to recognise the inter-connected nature of the current gas market. Participants have diverse portfolios with varying contractual arrangements across several regions.

It is therefore essential that decisions that are made recognise this impact and that solutions are put in place to ensure equitable outcomes for all participants.

TXU envisages that where trading arrangements provide a transparent market price (or prices) for gas, then that market price would provide a basis for the market to manage scarce supply at the lower levels of the escalation procedures. Where such a transparent price is not available, or in any case at the higher level of the escalation procedures, TXU envisages that a default value of gas will need to be established to reflect the cost of alternative supply and transportation arrangements.

3.7 Are current jurisdiction powers effective?

TXU has concerns with the adequacy of jurisdictional powers at present, particularly in cross-border situations. We see opportunity for conflict between jurisdictions if their powers are exercised in a non-coordinated fashion. This has the potential to result in confusion and lessens the predictability of outcomes. TXU recommends that jurisdictional powers be made compatible and that the rights of participants to be compensated based on some value of gas be enshrined in the legislation.

3.8 What is the most appropriate scope for a Protocol?

TXU believes the scope identified in the Issues paper is a reasonable starting point.

3.9 What is the most appropriate form for a Protocol?

TXU supports an approach that is consistent with the electricity industry. The risk of a non-legally binding MOU between jurisdictions however, is that jurisdictions may not follow the protocol. If the MOU-approach is adopted, TXU considers that jurisdictions should not only commit to the MOU, but also ensure they have appropriate procedures, training and allocation of responsibilities to ensure the procedures specified in the MOU can be implemented at any time.

3.10 What is the most appropriate content for a Protocol?

TXU wishes to raise the issue of a default value of gas as a possible item to be addressed by the Protocol. In TXU's view, it is essential there is a mechanism which values gas under a constraint situation and provides a mechanism to settle out gas re-allocated under direction based on this default value.

This mechanism must be legally enforceable.

If spot market mechanisms are in place (TXU advocates an industry controlled market), then participants involved in the market will be bound by the market rules, which would be expected to have such a settlement mechanism.

However, if market mechanisms that provide transparent price(s) for gas do not exist, then an alternate method for defining and enforcing settlements based on a default value of gas will be required. If the Protocol is defined using an enforceable instrument, then the mechanism can be documented in the Protocol. However, if the Protocol is defined using a non-enforceable mechanism (such as a MOU), then an alternate mechanism will be necessary.

3.11 What are the most appropriate/effective emergency communication protocols?

TXU considers that the detailed work required to answer this question is left to an industry convened group with responsibility for managing gas emergencies, working co-operatively with jurisdictions to ensure jurisdictional objectives are satisfied.

3.12 What support mechanisms are necessary?

Again, TXU recommends that the work required to answer this is allocated to the industry body. TXU cautions against progressing far down the path alluded to in the Issues Paper without a joint process.