

27 June 2024

The Ministry of Business, Innovation and Employment
Gas Security Response Group
15 Stout Street,
Wellington, 6011

To whom it may concern,

The BusinessNZ Energy Council welcomes the Government's formation of the Gas Security Response Group. This has occurred at a critical period for the sector. The issues discussed and solutions advised by the Group will have a lasting impact on the energy system and New Zealand's business community more broadly. This letter aims to provide a whole-of-system perspective, reflecting our wide membership across the energy sector from user to producer.

Gas demand is declining, and fields are entering their decline phase. But natural gas will still play a vital role during the transition to a less carbon intensive economy. Deliverability must continue to avoid a disorderly transition. Gas supply constraints, experienced over the last few years, are rapidly becoming severe. Available supply is less than anticipated and businesses have found it difficult to source sufficient gas to meet demand. Scarcity is disrupting production, applying serious pressures to the commercial viability of operating in New Zealand.

Beyond immediate scarcity, there is a serious risk that forecasted resources will not be delivered, especially if the needed investment required to maintain deliverability is not initiated. The current shortfall and worsening supply outlook have exacerbated risks to gas users, the electricity market, and the wider economy to a point where we believe the gas supply problem needs to be addressed swiftly.

In the electricity system, there are currently no arrangements that provide gas supply beyond what is contracted. Tight gas supply underscores the threat to security of supply, and as a result, to the proper functioning of the economy and every-day life. Such threats of disruption are both economically and socially unacceptable. In the absence of arrangements that address this unmanaged risk, there is a real possibility that events could cause energy security problems. This could be a costly and disruptive endeavor. Resolving a shortage after-the-fact would be difficult and likely to be inefficient.

Market solutions should be allowed to be agreed upon preemptively. To allow for a market solution, signals that facilitate contractual arrangements must be present and clear. We support an industry and market-led solution that encompasses contractual arrangements, for example swaptions, that would provide the electricity market with supply if necessary. Those providing solutions such as storage or demand response for already contracted gas to the electricity system would be sufficiently compensated.

It would provide more certainty and an incentive for contracted parties to underwrite investment in field development or alternative sources to gas, such as methanol, biogas, biofuels, hydrogen, LPG, the importation of liquified natural gas (LNG) or similar. This would mean gas or other fuels that provide energy security are available. A market initiated contractual approach would ensure peak capacity is appropriately awarded to those providing it, when and if it is needed.

Following and allowing for an industry and market-led contractual approach is important, reducing the risk of a heavy-handed, disruptive, and suboptimal intervention in the future. We believe that such

intervention would undermine market fundamentals, distort price signals, and discourage investment in much needed new generation at this critical juncture.

Managing the immediate gas availability issues in the electricity system is one side of the equation. The other side relates to some concerns about the electricity system's level of peaking capacity to meet growing peak demand. The issue is compounded by aging thermal assets. Stress is being applied to thermal kit not designed to operate flexibly and cope with expected but unplanned outages.

Multiple energy models, including the New Zealand Energy System Model: TIMES-NZ, show New Zealand needs more demand response and fast start peaking capacity to manage a successful transition. We support the Electricity Authority's work on adopting an integrated standby ancillary service to incentivise more flexible resources. But there is uncertainty to whether the service would adequately address the problem or whether the service would be ready in time. Uncertainty extends to the service's need as more grid scale batteries are deployed, and renewable capacity comes online.

Given some concerns about peaking capacity, a market mechanism aimed at incentivising its delivery becomes more warranted as such capacity would run in short durations and would be unable to make a payback over its lifetime. The Group could investigate this option.

Such option has uncertainty however about the type of fuel it would use, the availability of such fuel, how it would function and its cost upon the system. It could risk creating additional costs and adverse consequences to the system. Therefore, if the Group decides to assess market mechanisms to incentivise peaking capacity it should also consider other options like incentivising demand response or the option to retain current arrangements as they stand.

Despite all possible options assessed by the Group, its preference should be driven by the principle of following the least regrets, least unintended consequences, and least cost options. Least cost includes avoiding disruption to economic output in the event of outages. It's important that we do not act for acting sake.

Beyond measures to mitigate near term supply risks to the electricity sector, New Zealand's depleting gas reserves will continue to impact gas users across the country. The Government's legislative changes could help promote some investment by way of reducing prohibitive costs. However, the underlying deliverability problem of not enough gas supply remains pertinent.

Addressing wider supply constraints is a pressing issue, highlighting the need for an Energy Strategy developed in tandem with industry, which encompasses the role of gas in the sector. We hope to see the Group assess and recommend additional options that would improve optionality and investment as New Zealand faces declining reserves. This is important because a sudden and accelerated decline in gas supply, without available and economic alternatives, would unleash a disorderly transition. This would have broad and deep economic and social costs across society.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Tina Schirr', is positioned above the typed name and title.

Tina Schirr
Executive Director
BusinessNZ Energy Council