



17 December 2009 MPOC Change Request

**Submission on GIC Draft Final
Recommendation**

16 July 2010



A. Introduction

Maui Development Limited, (MDL), welcomes the opportunity to make this submission on the Gas Industry Company's, (GIC's), Draft Final Recommendation, (Recommendation), dated July 2010 concerning its 17 December 2009 MPOC Change Request, (Change Request).

MDL is disappointed that the GIC has chosen to reverse its earlier draft recommendation in support of the Change Request. It has serious concerns, detailed in this submission, about whether the GIC has acted in the best interests of the gas transmission industry and in particular whether its Recommendation assists the resolution of balancing issues. MDL strongly encourages the GIC to reconsider its position and revert to supporting the Change Request when it issues the final version of its recommendation.

In examining the GIC's decision, MDL is particularly concerned to that:

- international best practice and principles do not appear to have been given due weight and consideration or that certain decisions do not appear to be in accord with them.
- an analytical framework has been adopted that MDL considers to be flawed.
- there appears to have been a failure to distinguish between public and private benefits in making what is essentially a regulatory decision.

These are discussed below and in **Annex 1**.

MDL is also concerned to find that there are suggestions of detrimental actions that MDL might take, (but which it has never considered), which are expressed in a way that implies MDL will attempt to take unfair advantage of its pipeline customers. MDL is particularly disappointed by this and believes that it should be sufficient to judge MDL by its actions since the introduction of Open Access on the Maui Pipeline, noting that these have often been in difficult circumstances and occasions.

MDL is concerned that little consideration appears to have been given to the level of responsibility MDL is prepared to accept for the operation of the Maui Pipeline. MDL's Change Request does not seek to remove MDL's legal responsibility for matters under its control but if MDL's control over crucial aspects of its pipeline operation is removed, this begs the question as to who is going to take legal responsibility as MDL cannot. For example, MDL has completed an early assessment of the MPOC changes that would be required if the GIC's proposed Rules were to be adopted. This is set out in **Annex 2**.

MDL believes further consideration of these points provides a compelling case for a reversal of the GIC's draft decision in the Recommendation. The current process has seen a total lack of progress in improving the current balancing arrangements and has come at great cost. Conversely, MDL has been able to make significant progress on improving balancing arrangements within its current contractual framework.

MDL notes that if all the objections considered, (and given weight by the GIC in the Recommendation), are taken seriously, no progress towards back to back balancing or any improvement in current systems is possible – even for changes apparently supported by the GIC in the past. This is an unacceptable situation.

It is important that progress continues to be made on resolving balancing issues given the time and money already expended on them. Accordingly, MDL has given consideration to the alternative options available to it that it may take and the principles it will follow in the event the GIC does not agree to the Change Request. These are also set out below.

B. The background to MDL's Change Request

MDL submitted its Change Request in order to provide a basis for further progress on a contract based solution to industry balancing issues. While it was aware that an MPOC Change Request could not solve every outstanding issue, MDL was aware that the absence of a carefully considered text for the necessary MPOC changes made consideration of any contract-based solution much more difficult. This point was made by a number of parties including the GIC.

In lodging the Change Request at the time and in the form it did, it was suggested that MDL:

- Commenced a process in determining the Change Request that was too hurried and lacked consultation, (although many of the matters were considered as part of the ICD process).
- Included too many changes, including so-called “non-balancing changes” in the Change Request lodged.

The period available for development of the Change Request was determined by the period taken up by the ICD process, which provided some useful input, and the pre Christmas deadline set by the GIC for the consideration of its Rules. As matters have developed, the pre-Christmas deadline was irrelevant as the Rules are still under consideration by the GIC, but MDL and other industry members did not know this at the time.

The Change Request covered a number of matters aside from the mechanics involved with introducing a back to back process for allocating balancing costs. Some of these were in the nature of tidy-ups, such as the removal of references to contracts that have expired. The others are related directly to the process of balancing cost allocation as they are concerned with the collection of the balancing charges. They were included because the process of allocating and collecting balancing charges has to be looked at as a whole. There is no point in a system for allocating balancing charges if they can be avoided and/or are not paid.

Consideration was given to handling the changes required through a number of different MPOC Change Requests. They were included together in one document because:

- Many of the changes required were interdependent – that is change in one area required change in another.
- Consideration of simultaneous but independent changes to a large complex document like the MPOC can become very complicated as it becomes difficult to obtain a clear picture of the final form of the document after all the changes have been resolved. Some may proceed, others may not, and alterations to one can affect others.
- Sequential changes will be very slow as it takes a minimum of five months to process an MPOC change. The Change Request being considered here has taken seven months so far.

These factors are equally relevant today.

C. Principles behind MDL's views

C.1. Adherence to international best practice

In performing its obligations under the MPOC, MDL is required to be a Reasonable and Prudent Operator. In particular, MDL is required to be “*an operator of a high pressure gas transmission system whose standard of performance is equal to or better than good gas transmission operating practice as determined by reference to proper and prudent practices recognised internationally as applying to the operation of such systems*”.

Gas transmission pipeline balancing is an issue in many jurisdictions. In Europe the European Regulators' Group for Electricity and Gas, (EREG), has published the EREG Guidelines of Good Practice for Gas Balancing¹. These set out guidelines for the development of Gas Transmission Pipeline balancing regimes and pay particular attention to balancing requirements when different pipelines are interconnected. There are also other bodies working on the same problem². MDL strongly believes that the EREG principles are an excellent guide to best international practice and can and should be followed in the implementation of any systems put into practice in the New Zealand context. These, together with the requirements of the Gas Act and the government's Gas Policy Statement, (GPS), determine the stance that MDL will take on balancing issues.

C.2. The significance of OBA

MDL's agreement to the Open Access principle was based on the premise that Operational Balancing Agreement, (OBA), principles would be observed between the Maui Pipeline and the interconnected parties, including the interconnected Vector pipelines. The OBA principles follow best international practice in that they allow pipelines with very different operating regimes to be joined by specifying the relationships that occur at the pipeline interconnection point. An important objective of them is to ensure that under normal conditions a Shipper may nominate a given quantity of gas to an interconnection point with another pipeline and be assured that the same quantity of gas will be available for shipment on the interconnected pipeline even though there will be inevitable flow variations. The use of OBA principles to manage imbalance was supported by all parties, including the Natural Gas Corporation³, at the time Open Access was introduced.

Where balancing charges are concerned the OBA principle as it is applied in the MPOC is quite simple. Balancing charges that have been incurred at the TP Welded Point are charged to the TSO of the interconnected pipeline, which is in turn responsible for collecting them from its customers. The MPOC does not have to specify how other TSO's should levy and collect balancing charges; it merely states that they are required to pay them. As far as balancing charges are concerned, the different contractual and operating regimes used by each pipeline are not required to be identical.

Departure from OBA principles causes contractual problems occurring on one pipeline to wash over into the operations of the other. MDL has pointed out that attempts by Vector to apply limited recourse, (i.e. pay when paid), to balancing charges levied by MDL on Vector as the interconnected party, have had a number of perverse effects. In essence, disputes between Vector and its customers

¹ Available at http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_EREG_PAPERS/Gas/2006/E06-GFG-17-04_GGPGGB_2006-12-06.pdf

² For example ENTSOE (http://www.entsog.eu/publications/index_balancing.html); The European Gas Regulatory Forum (<http://www.cre.eu/en/content/download/3566/65823/file/GuidelinesGas.pdf>); GDF Suez (<http://www.grjm.net/documents/AAgenda/LdP-David.pdf>); The NAESB (<http://www.naesb.org/>); and COPAS (<http://www.copas.org/node/176>)

³ See the submission from Andrew Knight, General Manager Corporate Development, NGC dated 20 May 2005.



are being used as an excuse to withhold payments to MDL even though MDL has no direct contractual relationship with Vector's customers and no direct knowledge of, or participation in, the disputes involved. The result is that MDL is not paid for balancing services it has performed and Maui Pipeline customers, who are not involved, bear the burden of the unpaid charges.

This situation contravenes the OBA principles underlying Open Access and is contrary to the GPS, which requires that "*the full costs of producing and transporting gas are signalled to consumers*". In this case costs that are unpaid by one class of consumers are being imposed on another. It is no answer that some members of each of those classes are the same.

In its Change Request, MDL proposed changes which would make the payment responsibilities under the OBA agreement clearer and would have allowed the currently disputed amounts to be cleared over time without being added to. Various parties have suggested these changes are an attempt to transfer risk from MDL to Vector. However, in MDL's view the limited recourse stance taken by Vector wrongfully transfers these risks to it in the first place. The fact that some parties apparently condone this risk transfer to MDL may mean that MDL has to consider alternative options to clarify the situation and recover the money owing to it.

The GIC's treatment of both systems as a whole and implicitly allows Vector to remove itself from responsibility for collecting balancing charges which in turn allows:

- Difficulties in collecting balancing charges to replicate themselves upstream,
- Difficulties in amending downstream codes to comply with a changed Maui Pipeline charging regime to veto progress upstream.

None of these matters should be MDL's concern. As currently administered, they allow disputes, (over which MDL has no control or input), to effectively be financed from MDL's balance sheet and ultimately be paid for by MDL's customers.

Without recognition of OBA principles any analysis of MDL's Change Request is flawed. These are discussed in more detail in Section D of this submission.

C.3. Residual Balancing

There are apparently differing views on the precise meaning and extent of the balancing function on a gas transmission pipeline. International best practice is based around primary balancing, which is the responsibility of pipeline users and residual balancing, which is the responsibility of the TSO. The ERGEG principles refer to these as follows:

- **For pipeline users:** "It shall be the primary responsibility of network users to balance their own inputs and off-takes over the relevant period according to the rules and incentives of the respective balancing regime".
- **For the TSO:** "Each TSO retains the overall responsibility for the economic and efficient operation of its system and therefore should retain a residual role to maintain physical balance to ensure the safe, secure, efficient and reliable operation of its system, subject to the incentives, information and flexibility and tools provided to shippers to balance their individual portfolio".

These principles make it clear that responsibility for balancing devolves first of all on the users with the TSO taking a residual role primarily to support the safe and efficient operation of the pipeline. For the Maui Pipeline, where Shipper nominations are required, the nominations system does not

allow the entry of unbalanced nominations, so receipt and delivery nominations must always balance. All nominations of gas into or out of the pipeline system must be made in good faith⁴.

It appears that GIC has a different view of the extent of the balancing function required of TSO's and this is a matter of concern for MDL. For instance the following quotations are of note:

- “We consider that balancing costs include the cost of individual users self-balancing, and the cost of the Balancing Operator taking balancing actions”.(p.13)
- “The increase in user risks may incline users to self-balance rather than offer gas into the balancing market (through which balancing would occur at least cost)” (p.14)

Best international practice as set out in the ERGEG principles emphasises pipeline users' primary obligation to balance. This obligation still applies when imbalance positions can be traded⁵ and where tolerance services are provided⁶. The TSO's residual activity should be minimised⁷. Self-balancing is not an optional activity to be carried out only if the user feels there is no better deal elsewhere but an obligation at both the nomination stage and subsequently. MDL provides pipeline flexibility sufficient to cope with the normal daily fluctuations of demand and the inevitable errors in estimation. It does not provide this free flexibility to give users a source of gas to be used as an alternative to self-balancing. Pipelines that provide a specific flexibility or tolerance service to their users generally charge for it.

D. The Analytical Framework

MDL submits that the GIC has chosen, and applied, the wrong analytical framework in assessing the Change Request. Adopting this analytical framework affects the GIC's understanding of the treatment of operational imbalances under an OBA system, of the relevant provisions of MPOC, and of the Change Request.

The analytical framework adopted by the GIC has the following characteristics:

- the idea that the codes and operations of inter-connected pipelines should be mutually inter-dependent rather than mutually tolerant;
- in particular, the idea that *the inter-relationship between the [MPOC and VTC] Regimes is clearly a relevant factor* – especially when that is anything but clear;
- the ideas that benefits achieved on one system must also be achieved on the other and that disbenefits on one system are disbenefits on the other;
- in particular, the idea that *the realisation of net benefits* depends in part on the rights and obligations of users on the Vector transmission system, as such, (“Vector users”) because, for example, *balancing costs may not pass fully through to causers until VTC changes are made*; or because *efficiency benefits intended through the introduction of back-to-back balancing in the MPOC are dependent upon corresponding changes to the VTC*;
- the idea that the Change Request can *result in misallocations of balancing costs in downstream pipelines*;

⁴ MPOC Section 8.3

⁵ ERGEG balancing principle 1.18.

⁶ ERGEG balancing principle 1.21.

⁷ ERGEG balancing principle 1.26



The GIC itself prefers a unified balancing model. Despite noting that *it cannot reject a change request because it believes there might be a better alternative* the GIC appears to have nevertheless adopted an analytical framework based on, and which assumes, an integrated or unified model.

The GIC says that it *considers the merit of a Change Request against the status quo*. However we are concerned the status quo has not been correctly identified and are also concerned the characteristics of the GIC's analytical framework do not actually exist in the current operational environment. MPOC provides, and has always provided for, inter-connection not inter-dependence.

Nonetheless the GIC has treated the users of the Maui Pipeline, as such, ("Maui users") and Vector users as a single group of users, when they are not. The GIC has treated deficiencies in VTC – for example, in respect of allocation, collection of balancing costs, and the change process – as being deficiencies in MPOC, when they are not. The GIC makes Vector users' rent-seeking behaviour a hurdle for MDL, rather than for Vector with whom they have a relationship. (One of the problems which the Change Request seeks to remedy is the way in which, currently, Maui users pay for imbalances on the Vector transmission system: costs which are transferred by Vector users to Maui users.) The GIC implies that the Balancing Agent/Operator has some duty to balance the Vector transmission system, as well as towards Vector users, when that is not the case. The GIC assumes that MDL is in some way implicated in disputes among Vector and Vector users about allocations and costs on the Vector transmission system, when that is not the case. MDL submits that the GIC's analytical framework is wrong in that it purports to make mutually interdependent and integrated, what is, actually, simply inter-connected and mutually tolerant.

MDL believes that the GIC should have adopted and applied an analytical framework limited to the effect of the Change Request on the operation of the Maui Pipeline and on MDL and Maui Users. This is the correct analytical framework for reasons which include the following:

- the balancing function currently undertaken by the Balancing Agent, (and which would be undertaken by the Balancing Operator under the Change Request), is only, and is limited to, the balancing of gas flows on the Maui Pipeline. The Balancing Agent/Operator offers no transmission services (and therefore no balancing services) to Vector users. The Balancing Agent/Operator has no contractual or other relationship with Vector users;
- under the MPOC OBA structure those who "cause" operational imbalances, from a responsibility and cost perspective, are always and only Welded Parties – of which Vector is one for the purposes of Welded Points where the Vector transmission system interconnects with the Maui Pipeline. Consistently, MPOC provides Welded Parties with tools to manage that exposure. The Change Request adds to them;
- OBA principles, as given effect by MPOC:
 - provide a boundary to the transmission service, including any balancing services, provided for on a pipeline;
 - allow inter-connected systems to be mutually tolerant without requiring them to operate on the same basis or creating opportunities for rent-seeking;
 - ensure that each inter-connected system can operate on principles, terms and conditions chosen by their respective owners and users without imposing costs on the owners and users of other systems (including by compromising the adaptability of their contracts);
 - allow for the relevant terms and conditions to evolve and innovate as required by the owners and users of those systems;



- Welded Parties are responsible for managing operational imbalance at Welded Points, and for the costs of balancing, irrespective of whether they are also the, or a, Shipper. This is subject to the proviso (in the case of a TP Welded Party) that a Shipper making a nomination on the Maui Pipeline under MPOC has a transmission services agreement and/or gas transfer agreement in respect of the Vector transmission system of the kind described in section 2.14(c), including the principles in Schedule 9. Only the TP Welded Party can possibly know whether the proviso is satisfied. Only the TP Welded Party can manage its risk and protect itself and other users of its pipelines. The TP Welded Party has tools to manage the risk. If the proviso is not satisfied the TP Welded Party can remove the Shipper's name from the Vector website and/or decline its nominations under sections 9.3, 9.6 or 9.8; quite apart from preventing that Shipper from using the Vector transmission system. MDL cannot know whether or not the proviso is satisfied: accordingly MDL can only rely upon information posted on Vector's internet site – see section 2.16.

The adoption of the correct analytical framework is critical. However, by adopting an integrated framework the GIC:

- does not give sufficient weight and consideration to existing contractual relationships – the ICAs and TSAs based on MPOC – because it takes into account the views and positions of entities who are strangers to that code. Regulatory bodies will generally avoid interfering with, or overriding, existing contracts except in compelling cases of public benefit because to interfere with or override a contract is to confiscate a property right. Here the GIC has selected an analytical framework which has that effect;
- creates the opportunity for strangers to MPOC (including Vector and Vector users in respect of VTC) to, in effect, hold out or veto changes to it, notwithstanding that section 29.4 was designed to avoid hold out or veto as between parties to contracts based on MPOC;
- creates the opportunity for Vector to seek to avoid and renegotiate its obligations as a TP Welded Party under MPOC by virtue of being party to both MPOC and VTC;
- makes relevant, in considering the enforcement of MPOC provisions, matters which are outside the scope of that code, beyond the physical Maui Pipeline, and (it follows) beyond the control of MDL and of the Maui users;
- tends to imply that the Balancing Agent/Operator of the Maui Pipeline has a duty to balance gas flows attributable to Vector users when that is plainly intended not to be the case and there is no relevant contract;
- will dampen: the incentive for an existing TSO to invest in its pipeline; the incentive for a TSO to allow inter-connection with other transmission systems; and the incentive to build new pipelines which might be classified as transmission systems (and thus subject to open access or to inter-connection), because, in each case, the parties cannot rely upon their codes being enforced in accordance with their terms.
- restricts the autonomy of, and dampens incentives for pipeline users, because as well as having to plan for the pipeline code they have signed, they then have to plan for the effects under other pipeline codes.

The GIC notes that some submitters considered *it would be more efficient if Vector Transmission Code (VTC) and MPOC changes were considered together*. The GIC has then adopted an analytical framework which has that effect even though Vector has shown no willingness to make alterations to the VTC. MDL doubts there is any economic or other benefit to be achieved by stymieing or restricting innovation, choice and adaptability or by creating mutual vetoes – certainly none has been



proven in this case. Nor, in MDL's view, is there any economic or other benefit in removing practical options for code change by applying an integrated framework. MDL submits that by doing so it hastens regulation and potentially undermines the statutory provisions by ensuring there are fewer practicable alternatives. Even if that would be consistent with the GIC's views in respect of balancing, it would destroy the co-regulatory model.

These effects are inconsistent with the GPS and inconsistent with the Gas Act.

Annex 1 provides a more detailed list of MDL's responses to GIC's analytical framework and the potential consequences of it.

E. Public and private benefit

MDL submits that the GIC should only take account of public benefits and benefits in detriments in accessing the Change Request.

MDL believes the GIC has taken account of issues which are purely private. There are number of examples in the draft recommendation, including:

- for Vector, the alleged risk that Vector's balancing costs attributable to Vector as TP Welded Point may not be recoverable under VTC because of the choices made by Vector and Vector users in drafting that document (disregarding both that the existing VTC expires on 30 September and that Vector is in a position to manage those costs);
- for Vector, the alleged risk involved in shippers who do not have compliant transmission services agreements and or gas transfer agreements on the Vector Transmission System nominating gas to Welded Points at which Vector is the TP Welded Party (despite Vector being in a position to manage that risk);
- for Vector, the alleged risk of it being unable to comply with its service obligations (despite entering into an ICA including the change process, automatically confirming, rather than controlling, its own TP Welded Points and the back-to-back balancing scheme operating on a daily basis);
- for Contact, the removal of the legacy provisions (despite this point never having been raised before and now being raised in private discussions with the GIC).

In the case of Vector the alleged risks are really inter-party transfers. In the case of Contact, the alleged risk is not publicly known and is untested. However the alleged risks appear highly contentious and we are concerned whether the GIC is the appropriate forum to test them. Accordingly MDL believes they should be disregarded.

F. Further comments on the GIC analysis

F.1. The obligation to trend ROI towards zero

The GIC has expressed concern about the wording in the Change Request that requires a Welded Parties *"to use its reasonable endeavours to manage the flow of gas at each of its Welded Points so that its Running Operational Imbalance at each such Welded Point tends towards zero at all times"*. It states that this may cause users to "balance more than is efficient". The GIC has also stated that it accepts that a strict application of the *"at all times"* obligation could require Vector to manage flows to Scheduled Quantities and that this would reduce supply security for its users.

We find these arguments difficult to comprehend. The obligation to self –balance is clear in both the MPOC and by reference to best international practice. We also note that the balancing period proposed in the Change Request which will determine whether any balancing charges are payable is one day and that users will have this period to self-balance. MDL does not accept the proposition that ROI at Vector Welded Points should be managed in any way other than to use reasonable endeavours to reduce the ROI at those points nor does it believe that a Shipper’s failure to order sufficient gas, which is really what is being talked about here, can be inflated to the point where it is presented as a security of supply issue.

MDL believes the GIC’s concern is misplaced.

F.2. The prohibition on profiting (or losing) from balancing actions

The GIC has expressed concern about the removal of provisions that sought to prevent MDL from making a profit, or loss, from its balancing operations. This provision made some sense originally because income from ILONs and cash outs was not directly related to expenditure on balancing gas. The adoption of back to back balancing elsewhere in the Change Request changed this situation because it requires that:

- Balancing charges are directly related to and cannot exceed expenditure on balancing gas – hence there cannot be any profit.
- Balancing charges in some restricted circumstances may be less than expenditure on balancing gas – hence there may be a loss. (It should be noted that the changes to the Incentives Pool mechanism proposed in the Change Request were to reduce the possibility of a loss).

There was little point in keeping an MPOC provision that was both unnecessary and inaccurate. The GIC has argued that removal of this provision may allow Balancing Operator behaviour that will increase costs to users. It is difficult to see how this deletion can have the effect claimed. In fact, the Change Request as a whole makes it impossible for balancing charges levied on pipeline users to exceed the amount spent on balancing gas. Rather than being a matter for concern it should be treated as an improvement on the current situation. MDL notes that the GIC is not equally concerned about the prospect of loss.

F.3. MDL retaining the right to amend its SOP

MDL has determined that it will retain direct control over areas where it has responsibilities or liabilities. The SOPs and in particular, the balancing SOPs, govern matters that are critical to the operation of the Maui pipeline, including its ability to transmit gas and its operational safety. These are matters for which MDL accepts direct responsibility in the current version of the MPOC and in the Change Request.

As it has pointed out previously, MDL believes that it must have discretion alter its SOPs at short notice in response to any changes in operational and safety requirements, without having to go through a drawn out modification process and in that regard it must have a final say on the procedures adopted. However MDL has accepted that it should be subject to an obligation to consult with the industry in relation to SOP changes before they come into effect. In this respect MDL is quite aware of the obligations it assumes in agreeing to consult.

Parties seeking to dispute MDL's control over its Standard Operating Procedures, (SOPs), have to recognise that any such abrogation must inevitably result in changes to the liabilities and responsibilities that MDL can accept.

Last year MDL reviewed the balancing thresholds in force on the Maui Pipeline with the object of providing as much flexibility to users as was safe and prudent. MDL currently has no intention of narrowing these thresholds as a consequence of the implementation of its Change Request. The GIC's comment to the effect that "MDL retaining the right to amend the SOP may result in balancing thresholds being tighter than necessary" does not appear to be factually based. Accordingly, it should not be taken into consideration in the evaluation.

Some parties have commented on the ability to distinguish between "operational" gas such as UFG handled by the SOPs and balancing gas resulting from pipeline user's operational imbalance. MDL has been making this distinction under its current balancing regime for some months now and has not experienced any particular difficulty with the concept. However it recognises that the fears expressed by the GIC and other parties might be alleviated if further information on its daily handling of "operational" gas matters was published. Work to provide this information through the BGX is under way. A proposed amendment to the SOP's to provide more information on the procedures used can also be expected in due course.

F.4. Effect of Tolerances on line pack flexibility

The GIC has stated that the removal of tolerances would provide an incentive for MDL to provide line pack flexibility. In fact, large tolerances might dispose a pipeline operator to impose tighter thresholds as pipeline users will be able to create imbalance within their tolerance levels without any fear of being cashed out as the thresholds are exceeded. Removal of tolerances will have the opposite effect, if any. We think this objection should be removed.

F.5. The Incentives Pool mechanism and linked nominations

The GIC has stated that it finds itself in agreement with Vector in that:

- Retaining the Incentives Pool mechanism for residual cost recovery means cash out prices will not always reflect cash out costs.
- The absence of linked nominations may result in mis-allocation of costs in downstream pipelines.

The first of these points is true as far as it goes. The Incentives Pool mechanism is designed to ensure that cash out income matches cash out costs in circumstances where there is insufficient operational imbalance to recover all the cost of the balancing gas purchased. This difference would otherwise be socialised and not charged to a causer of the imbalance. In these circumstances cash out prices are only part of the balancing charge collection mechanism and they will not and should not reflect cash out costs on their own. We consider this objection results from a misunderstanding of the mechanism proposed.

We are puzzled by the reference to linked nominations. The errors arising from GIC consideration of this complaint are set out in Annex 1. The GIC is also surely aware that Vector does not currently run a nominations system on its pipelines and to our knowledge has no specific plans to do so. MDL



has no influence over whether Vector takes this step or not. The question of linked nominations does not arise and should not be considered until a nominations system on Vector pipelines is introduced.

F.6. Vector and Vector customers' access to balancing gas

Two issues have been mentioned here:

- That MDL should be offering participation in the balancing market to Vector pipeline users.
- That by removing the TP Welded Party balancing mechanism, MDL has “closed off” an option for Vector to manage its own pipeline imbalance.

MDL strongly disagrees with these points. On 17 September 2009, MDL copied a letter to all industry members outlining the terms on which it would provide access to the balancing market for participants connected to Vector pipelines. No response to this letter has been received.

In looking at the TP Welded Point balancing mechanism, MDL assessed whether post intra day nominations should be generally used for balancing purposes by both Vector and MDL as they could lead to a reduction in lead times for the supply of balancing gas. It was concluded that post intra day nominations should not be used as they were incompatible with the requirement to provide speedy and accurate information on Welded Point ROI positions under a back to back balancing system. It was decided that MDL's standard ID cycle nomination procedure should be used for balancing nominations and MDL has proceeded on that basis since. Vector has never used the TP Welded Point balancing facility but if it does require the ability to nominate balancing gas it can do so on the same basis as is used by MDL by using the standard intra day nomination cycles. The issue is simply whether a post intra day nomination facility should be provided, and MDL believes it should not, rather than whether an option for Vector to balance has been removed.

G. Next Steps

MDL does not believe the reasons given by the GIC for rejecting its 17 December Change request are valid and strongly urges the GIC to reconsider its position.

Failing this, given the wide scope of the objections taken into consideration by the GIC in evaluating its Change Request, MDL does not believe that any reform of balancing or payment arrangements on the Maui Pipeline system will be possible unless:

- There is an explicit decoupling between any problems experienced with amending the VTC and the decisions on any balancing regime. It is not acceptable to have problems in this area affect the balancing issues the Change Request sought to address.
- There also needs to be explicit recognition that balancing charges incurred by MDL, (or Vector), should be paid and not be subject to disputes by persons who are not party to the relevant pipeline code. This is consistent with international best practice and an exception should not be made in New Zealand.

MDL notes the GIC's preference for a unified pipeline system. However if movement in this direction is to succeed it has to be backed up with a movement towards compatible pipeline operating codes. There has been recognition in the past that progress had to be made in introducing a nominations based balancing regime on Vector's pipeline, but no progress has been made and none seems imminent. Without substantial progress in this area, a strict adherence to OBA principles is the best solution.



There is a definite need for change. MDL is now convinced that only strict adherence to international best practice is going to provide an efficient long term solution. It is still prepared to engage with the industry to find better solutions by working on further Change Requests as part of an incremental process of improvement. However this will have to be based on adherence to OBA principles and best international practice. MDL does not expect unanimous support throughout this process, but will endeavour to take into account industry views that do not infringe upon these principles.



Annex 1: Summary of Errors in GIC Analysis

<i>Location in the Draft Final Recommendation</i>	<i>GIC comment/analysis</i>	<i>MDL response</i>
<p>Page 4, VTC, 2nd paragraph</p>	<p>“While there is no absolute requirement for consistency between MPOC and VTC regimes, the inter-relationship between the regimes is clearly a relevant factor for Gas Industry Co to take into account when determining the overall benefit (or otherwise) of the Change Request.”</p>	<ol style="list-style-type: none"> 1. There is no requirement at all for there to be consistency between the MPOC and VTC regimes. Nor, given that MPOC operates on OBA principles, is it proper to consider the Change Request beyond a Welded Point. What is required is that transmission pipelines inter-connect on a mutually tolerant basis. This, among other things, allows each of them to operate, and be managed, upon the terms and conditions which the TSO and the users consider relevant and gives investors and users confidence in their property rights. 2. The requirements which relate to the inter-connection of the systems are set out in MPOC and have not been amended in any way which is material by the Change Request. It is and always has been Vector’s obligation, as TP Welded Party, to determine whether or not the arrangements which it has made with the Vector users meet the requirements set out in section 2.14(c), including Schedule 9. (The principles in Schedule 9 include daily balancing, recovery of costs and expenses and the allocation of costs and expenses.) 3. These provisions apply irrespective of a Change Request since, to state the obvious, a Welded Party’s ICA includes section 29 and, thus, can be amended in accordance with section 29 at any time. The GIC takes the same view saying, on page 20, <i>while Vector negotiated the MPOC as part of the package, it also agreed to the change process.</i> 4. Vector and Vector users can and have chosen their own operational system and terms and conditions. But



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		<p>those choices cannot impose costs on MDL and Maui users, including the loss of adaptability which would result from the use of the integrated framework.</p>
<p>Page 4, VTC, 3rd paragraph</p>	<p>“In this regard, Vector’s submission is helpful in highlighting that, without changes to the VTC, the realisation of net benefits is uncertain. However Gas Industry Co considers it appropriate to make its own assessment of the likelihood of changes to the VTC, and the effect on net benefits associated with the Change Request.”</p>	<ol style="list-style-type: none"> 1. The Change Request relates to MPOC. The question for the GIC’s consideration is whether the Change Request is of benefit to MDL and Maui users not whether or not it is of benefit to Vector and Vector users or both TSOs, and for both sets of users. 2. Table 1 from the draft recommendation (see p 7) illustrates MDL’s point. Under the headings <i>Current Arrangements (Efficiency, Productive, Allocative and User Risks)</i> there are listed problems of the kind addressed by the Change Request. All of those problems relate wholly and solely to MPOC, to MDL and to Maui users. 3. MPOC and the Maui Pipeline cannot resolve the problems with VTC and on the Vector transmission system. The work and costs of resolving those problems should fall upon Vector and Vector users. 4. The likelihood of changes being made to VTC is irrelevant. This is not something over which MDL or MPOC have any control or influence. Under OBA principles an operational imbalance (and its associated costs) will be allocated to a Welded Party at a Welded Point under the Change Request just as it is now. These are a costs associated with a benefit taken and the behaviour of the TP Welded Party and one which the TP Welded Party is required to pay. How that cost is defrayed is not a matter for MPOC.
<p>Page 13,</p>	<p>“Several submitters</p>	<ol style="list-style-type: none"> 1. It is plain that these submissions are irrelevant and should be treated as such (see p 4 <i>Improvements to the</i>



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1 st paragraph	considered productive efficiency should be given a lower score because the balancing market is not open to parties connected to the Vector transmission system ... Nevertheless, we agree it would be beneficial to promote competition in the balancing market by allowing Vector-connected parties to offer a balancing service.”	<p>Change Request) – there is no change to the status quo. It is not clear whether the GIC has in fact excluded them from its qualitative assessment.</p> <ol style="list-style-type: none"> 2. Although irrelevant, the submissions highlight the point that choices made by Vector and Vector users should not affect (and should not be allowed by the GIC to affect) the assessment of the Change Request. The fact is that, by letter of 17 September 2009 to the GIC, MDL offered Vector and certain Vector users the opportunity to participate in the balancing market for the purposes of balancing the Maui Pipeline. MDL has had no response, no response whatever, to that offer. 3. MDL is surprised that submitters should raise the matter now despite not responding to that offer.
Page 15, 2 nd (full) paragraph, 2 nd bullet	“• the absence of linked nominations may result in misallocations of balancing costs in	<ol style="list-style-type: none"> 1. The GIC directly links a potential reduction in the effectiveness of the Change Request with the misallocation of balancing costs on downstream pipelines. The choice of allocation methodology for Vector and users of its transmission system as such is a matter for them, provided that the methodology complies with section 2.14(c) (including Schedule 9). 2. Vector, as TP Welded Party, is the causer responsible for imbalances on its transmission system, to the



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point	<p>downstream pipelines. (Vector gives the example of a major user on its pipeline who is curtailed or suffering a force majeure event, and causes Maui Pipeline imbalance and associated balancing costs, but does not incur the balancing cost.)</p> <p>We accept that the second point [that above] is not within MDL’s control, however it potentially reduces the effectiveness</p>	<p>extent they are manifested as an operational imbalance at a Maui Pipeline Welded Point. That is so whether the imbalance consists of UFG, Vector’s own use or Vector users’ imbalances. There is no change to the status quo.</p> <ol style="list-style-type: none"> 3. Expanded to its logical end, Vector’s submission would have the Maui Pipeline Balancing Agent/Operator responsible for balancing the Vector transmission system despite having no relationship contractual or otherwise with the users on that transmission system. 4. This is also another example of choices made by Vector and Vector users being allowed by the GIC to affect the rights and obligations of MDL and MDL users in respect of the Maui Pipeline. Here Vector and Vector users have, apparently, decided that the costs associated with imbalances on the Vector transmission system which result from curtailment or force majeure events under the VTC are to be socialised. They may, as between themselves, to make that choice but they cannot, by doing so, affect Vector’s responsibility and liability as TP Welded Party for any associated operational imbalance on the Maui Pipeline. If Vector and Vector users wish to socialise imbalance costs which arise in particular circumstances, they should include an effective socialised allocation and recovery methodology in VTC. MDL is entitled to assume that they have done so given section 2.14(c) (including Schedule 9). 5. MDL notes that, were allocation on downstream pipelines actually a relevant issue, then the GIC would have to start by analysing those mechanisms. However MDL does not believe that the GIC has done that. 6. The GIC refers to <i>the absence of linked nominations</i>. This suggests that the GIC is comparing the Change Request with what with the GIC may consider is a better solution (although MDL submits that such a solution has not been tested).



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	of the Change Request.”	7. As noted above, it is not the absence of linked nominations that is the issue but rather the choices which appear to have been made by Vector and Vector users (in the example, socialising costs arising from curtailments and force majeure).
Page 15 4 th (full) paragraph	“Another matter not considered in the Draft Recommendation was the mis-alignment between MPOC and VTC that the Change Request would create. In respect of allocative efficiency we note that the VTC is currently drafted to recognise the MPOC ILON process. ... balancing costs may not pass fully through to causers until VTC changes are made.”	<ol style="list-style-type: none"> 1. The GIC assumes that the Change Request would result in mis-alignment (or a form of incompatibility under the final draft) between the MPOC and VTC. However, no justification appears to have been given for this assumption. MDL is concerned that the GIC has accepted Vector’s submission to that effect without analysis or contest. 2. The point is highly contentious: MDL disputes there would be any mis-alignment for a number of reasons: <ul style="list-style-type: none"> • first, OBA principles provide a mechanism which allows systems, which operate in different ways and on different terms and conditions, to be mutually tolerant. In the case of balancing the TP Welded Party pays for the benefit it and its users receive by contributing to imbalance on the Maui Pipeline and can distribute those costs as they choose; • secondly, MDL and Maui users should not be implicated in VTC terms and conditions – they are, as such, strangers to that code; • thirdly, Vector has all the necessary tools to manage its exposure and should be incentivised to use them. These include the expiry of VTC at the end of September; • fourthly, whether and the extent to which costs can be recovered is not a mis-alignment or incompatibility; it is rather an attribution and transfer of cost and risk of a kind common in any contract. MPOC distinguishes such business risks from systemic incompatibility – see, for example,



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		<p>section 2.13.</p> <ol style="list-style-type: none"> 3. MDL submits that the GIC cannot allow choices made by Vector and Vector users to affect the rights and obligations of Maui and Maui users under MPOC. The change process set out in section 29.4 cannot be rendered ineffective by choices made by strangers to the code. That would simply transfer control of MPOC from the parties to a contract to strangers, and costs from those strangers (or a group including strangers) to the parties to the contract. 4. Moreover, the balancing costs which are the subject of the Change Requests are the costs of balancing the Maui Pipeline. Vector, as TP Welded Party, is responsible for those balancing costs at its Welded Points. It is untenable to suggest that, apart from requiring Vector as TP Welded Party to comply with section 2.14(c), MDL should be responsible for the terms and conditions (embodied in VTC) upon which Vector offers transmission services to, and balances, Vector users.
<p>Page 15 4th (full) paragraph</p>	<p>“We can, however, assess the likelihood of such a change being drafted by Vector or one of its shippers. As well as the likelihood of any such change being approved or accepted by Vector (under</p>	<ol style="list-style-type: none"> 1. For the reasons already noted these matters are irrelevant to the analysis of the Change Request. 2. We quote them for two purposes. First, VTC expires at the end of September 2010. Even if (despite MDL’s view) consideration of the existing VTC position is relevant: <ul style="list-style-type: none"> • it will at most be relevant for a very short period of time and probably not at all since MDL has suggested an implementation date of 1 October 2010. • there is no need for VTC to be changed by using a Change Request: Vector can simply offer new terms and conditions; • VTC allocation methodology from and after 1 October will be the choice of Vector and Vector users;



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	<p>either the VTC change process or gas industry codes appeal process). ... VTC shippers have no incentive to approve such a change... .”</p>	<p>3. Secondly, if <i>VTC shippers have no incentive to approve such a change</i> that is because the allocation methodology in VTC is defective and results in those Vector users accruing unjustified windfall advantage. The retention of economic rents is surely not a sound basis upon which to deny MDL and Maui users the benefits which would flow from the Change Request.</p>
<p>Page 16 1st paragraph</p>	<p>“This means that the efficiency benefits intended through the introduction of back-to-back balancing in the MPOC may be less than we originally believe them to be.”</p>	<p>The efficiency benefits intended through the introduction of back-to-back balancing are those which accrue to MDL and Maui users. Those efficiency benefits are not reduced in anyway by any deficiencies there may be in the allocation and recovery regime applicable to VTC.</p>
<p>Page 16 4th paragraph</p>	<p>“Vector believes this would result in curtailments and the breach of Vector service</p>	<p>1. Vector submits that the two open access regimes are incompatible because Vector is required to pay the balancing charges for which it is liable under MPOC. The submission is plainly wrong because:</p> <ul style="list-style-type: none"> • as a Welded Party Vector is already responsible for paying those balancing costs – there is, in that respect, no change to the status quo;



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	<p>obligation under the VTC, affecting the security of all its users.”</p>	<ul style="list-style-type: none"> • Vector is already responsible for ensuring that its transmission services agreements with Vector users include the right for Vector to recover costs which it allocates to those Vector users; • from 1 October Vector will be in a position to offer terms and conditions for transmission services on the Vector Transmission System which recover costs not currently properly allocated by VTC;
<p>Page 16. 5th paragraph</p>	<p>... Vector suggests the Change request makes the MPOC and VTC open access regimes incompatible. Vector considers it will bear the loss associated with any gas that is shipped to a Vector Welded Point that has a TSA which does not align with the amended terms of the MPOC. ... we accept incompatibility between the open access regimes could threaten security.”</p>	<ul style="list-style-type: none"> • Vector must remove from its website the names of parties whose transmission services agreements do not meet the requirements in section 2.14(c) (including those in Schedule 9); • section 2.13 clearly distinguishes incompatibility (paragraph (a)) from the recovery of costs (paragraph (b)). A similar distinction is made in section 29.4 (paragraphs (b)(iii) and (b)(v)) and in Vector’s ICA (clause 12 – paragraph (a) and paragraph (b)). MPOC and VTC and their respective regimes are not incompatible (or even mis-aligned) because Vector does not, or cannot, recover costs from causers among Vector users. This is just an attribution of business risk. Indeed, it appears Vector and Vector users have elected not to recover costs from “causers” in respect of curtailment and force majeure events – see above. <p>2. Anyway, the two open access regimes will not be inconsistent as a result of Vector being responsible, under MPOC for the behaviour of Vector users. It is Vector that has chosen: to offer services on the Vector transmission system on a demand following basis; not to introduce a nominations regime; not to allocate daily; not, itself, to balance its own system; and automatically to confirm nominations rather than exercise control over gas flows at its Welded Points. These are choices made by Vector and Vector users in respect of the Vector transmission system. They are not rights derived from MPOC or dependent upon</p>



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		MPOC. Vector did not obtain MDL’s and its users’ permission to operate in that fashion..
Page 17, 6 th (full) paragraph 1 st bullet point	“• Increased incompatibility between the MPOC and VTC may result in more disputes over the passing through of balancing costs;”	<ol style="list-style-type: none"> 1. As noted above, MDL does not consider that MPOC and VTC are incompatible now, or will be incompatible as a result of the Change Request. 2. Moreover, it is inconsistent for the GIC to take account of <i>disputes over the passing through of balancing costs</i> (emphasis added) given that the GIC appears (correctly) to have disregarded Vector’s submission on the associated point at Enforcement on page 20.
Page 21 2 nd paragraph 4 th bullet point	“• the removal of the TP Welded Party balancing gas mechanism, unilaterally closing off an option for Vector to manage its own pipeline imbalance.”	<ol style="list-style-type: none"> 1. MDL does not believe that the GIC can argue, on the one hand that VTC is relevant and that it is <i>difficult to say with any certainty that corresponding changes to the VTC will take place</i> and, on the other hand, ascribe some value to the mechanism. 2. The status quo is that the mechanism has never been used and, by virtue of the terms and conditions agreed between Vector and Vector users in VTC, cannot be used. 3. In a back-to-back balancing scheme it would be entirely inappropriate to allow one Welded Party the opportunity to avoid balancing costs by adjusting its position <i>post facto</i>. The continuation of the (unused) balancing gas mechanism is inconsistent with back-to-back balancing: it would shift costs to other Welded Parties.



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		<p>4. But the removal of the unused and inconsistent balancing gas mechanism does not mean that Vector cannot manage its own pipeline imbalance. Rather, like all Welded Parties, and like MDL as TSO, Vector would be required to balance its position using the nominations cycles.</p>
<p>Page 21 4th paragraph</p>	<p>“The removal of Vector’s protection against gas being shipped with a compliant transmission services agreement (TSA) and Gas Transfer Agreement (GTA), and the removal of MDL’s obligation to confirm shippers have appropriate contracts in place before shipping to a TP Welded Point, ...”</p>	<ol style="list-style-type: none"> 1. The point seems to go to whether or not there are compliant transmission services agreements and gas transfer agreements in place in respect of the Vector transmission system. MDL has no influence or control over whether or not Vector and Vector users enter into compliant contracts. The position under MPOC is that MDL relies upon Vector’s website – see section 2.16. There has been no change to that provision. 2. MDL does not ship gas; rather, MDL processes nominations made by Shippers. The risk that a Shipper on the Maui Pipeline does not have a compliant transmission services agreement or gas transfer agreement in respect of the Vector transmission system is one which must fall to, and can only be managed by, Vector – section 2.16 has that effect now, and will have the same effect under the Change Request. There is no change in the status quo.



Annex 2: Changes to MPOC under proposed GIC Rules

The GIC's proposed Balancing Rules remove MDL's direct control over certain aspects of the operation of the Maui Pipeline. MDL does not propose to accept any situation where it retains responsibilities and liabilities but has been deprived of the means to directly control the associated risks. The following section outlines the changes that will have to be made to the MPOC to recognise the new situation that would be created by the adoption of the Rules.

Summary of possible MPOC Changes

Rule 38.1.1(b) requires the transmission system owners (TSOs) to prepare, and give to Gas Industry Co, documents which set out the changes required to their respective transmission system codes in order to ensure consistency with a draft balancing plan. Rules 40.4.4 and 46.4.4 are to similar effect.

MDL has begun to consider what changes to MPOC would likely be required were Rules, similar to the draft Rules, to come into effect. Additional changes are likely to be required in the context of a draft balancing plan.

At this stage, MDL can do no more than indicate the kinds of change to MPOC that will be required. Some of these are briefly and generically summarised below. The summary is not, and cannot be, complete. Neither does it seek to deal with the consequential adjustments that are, and will be, inevitable.

1. MDL will have no obligation to maintain line pack or control pressure in the balancing zone comprising or including the Maui Pipeline (**Maui balancing zone**): these roles and functions will be the balancing operator's under the Rules. As a TSO MDL will be required either to rectify its TSO imbalance or pay its proportion of any cash-out amount.
2. As a result, MDL:
 - (a) will not maintain or control Target Taranaki Pressure, MAOP, or Minimum Pressure in the Maui balancing zone;
 - (b) will not maintain or control pressure at any particular point on the Maui Pipeline;
 - (c) will not have exclusive control of gas in the Maui Pipeline, which may affect either or both of (i) what MDL can promise about Shipper's gas once in the Maui Pipeline, and (ii) a Shipper's title to gas comprised in Approved Nominations;
 - (d) will not maintain or control line pack or pressure so as to deliver Approved Nominations or to provide any flexibility in the Maui balancing zone;
 - (e) will not maintain a Contingency Volume in the Maui Pipeline; and
 - (f) will have no obligation to minimise any interruption to or reduction of gas transmission through the Maui Pipeline.
3. The balancing operator, rather than MDL as TSO, will manage line pack in the Maui balancing zone, so:

- (a) MDL’s daily calculation of total Maui Pipeline capacity⁸ will be on the basis of balancing assumptions⁹ and subject to there being no balancing failure¹⁰;
 - (b) MDL’s Rolling Capacity Forecasts will be on the basis of the balancing assumptions;
 - (c) MDL’s confirmation of Approved Nominations will be on the basis of the balancing assumptions and subject to there being no balancing failure;
 - (d) MDL will not warrant available capacity for the purposes of Authorised Quantities.
4. As a TSO MDL will be obliged, on an ongoing basis, (i) to co-operate with the balancing operator and facilitate the performance of its role, (ii) to provide information, and (iii) to facilitate balancing by users. So that MDL can comply:
- (a) MPOC will require that all Shippers and Welded Parties always comply with all relevant MPOC technical and commercial requirements, including if necessary to modernise Metering and other plant and equipment at Stations and Welded Points which are presently “grandfathered”;
 - (b) where MDL does not own or control the relevant Metering or other relevant sources of information in real time, MPOC will require Shippers and Welded Parties to provide (and to be in a position to provide), on a best available information basis, all the data and information which MDL reasonably requires in order to comply with the Rules.
5. The acts and omissions of the balancing operator, and the form of the balancing plan, will affect the management and operation of the Maui Pipeline, and may affect the delivery of gas through that pipeline. Accordingly MPOC will include additional rights for MDL to interrupt gas flows, give operational flow orders, and curtail Approved Nominations. MPOC will also include additional events of default, suspension and disconnection to protect the Maui Pipeline, and its users, from operational disruption or instability or damage resulting from (or which could result from) the failure by balancing operator to perform its role and functions under the Rules, or the failure by a Maui user to perform its obligations under the Rules as and when due.
6. It will be necessary to include a number of new provisions in MPOC. These include:
- (a) a transmission regime peculiar to the balancing operator, including:
 - (i) a variable tariff;
 - (ii) priority rights, including in respect of Approved Nominations;
 - (iii) prudential assurance;
 - (iv) bespoke assignment for changes in the balancing operator;

⁸ Which is not necessarily the same as Maui balancing zone capacity.

⁹ For example that (i) on any day the upper and lower thresholds specified in the balancing plan are, in fact, adequate to deliver Approved Nominations, and (ii) the balancing operator does, in fact, manage line pack at or close to those thresholds.

¹⁰ For example that (i) the balancing operator does not, in fact, manage line pack at, or close to, the thresholds specified in the balancing plan, or (ii) despite doing so line pack is not, in fact, adequate to deliver Approved Nominations.



- (b) residual balancing and line pack management rights for MDL, including for the allocation and collection of all associated costs and charges;
 - (c) relief from liability for MDL if a balancing assumption proves to be incorrect or if there is a balancing failure;
 - (d) additional, or strengthened, rights to protect the Maui Pipeline from operational disruption or instability or damage when the Rules are ineffective. This may include legal rights, physical rights¹¹ and financial incentives.
7. The provisions for “forced” Operational Imbalance will be removed from MPOC as they will be inconsistent with the Rules.
 8. The Change Request provisions will be modified to (i) provide for relevant additions to MDL’s right to withhold consent to a Change Request, and (ii) add an immediate change right to cope with changes to the Rules, to the balancing plan, and in balancing practice¹².
 9. MDL’s Reasonable and Prudent Operator obligations as a TSO will be revised so as to take account of its changed role and function, and of the role and function being performed by the balancing operator.

¹¹ For example, controls on peaking or of unmanaged ROI.

¹² For example, changes to the terms and conditions of balancing agreements or to the structure and/or operation of the balancing market.