



## **GREYMOUTH GAS**

16 May 2011

Ian Wilson  
Principal Advisor – Infrastructure Access Group  
Gas Industry Company Limited  
PO Box 10 646  
Wellington 6143

Dear Ian,

### **RE: MPOC Change Request 18 April 2011 – Prudential Requirements & Information**

This letter sets out the submissions of Greymouth Gas New Zealand Limited ("Greymouth") on the 18 April 2011 MPOC Change Request (the "Change Request") application submitted by Maui Development Limited ("MDL") to the Gas Industry Company Limited ("GIC") on the same date relating primarily to prudential requirements and information.

Unless separately defined in this letter, capitalised terms used below have the same meaning as is ascribed to them in the working version of the Maui Pipeline Operating Code ("MPOC").

Greymouth congratulates MDL for providing a succinct request which, in its brevity, is a significant improvement on the 17 December 2009 MPOC change request (the "2009 Change Request"). This new form and structure (one change request for one small bundle of proposed related changes) is much improved as it provides for heightened rigour, reflection and efficiency.

However, as a preliminary point, Greymouth has two fundamental process concerns regarding the Change Request, the GIC, and the Memorandum of Understanding between the GIC and MDL dated October 2006 (the "MoU"). These concerns are as follows:

- First, that the GIC may have a conflict of interest if it is a shipper under a current interconnection agreement with MDL.
- Second, the exercise by the GIC of discretion whether or not to recommend the Change Request is not qualified by effective and appropriate considerations, where the proposed amendments relate to commercial arrangements.

### **Conflict of Interest**

MDL's letter to Maui Pipeline Shippers and Welded Parties of 23 December 2009 signals that the MPOC will be amended to allow trading hubs on 1 February 2010, and this is reflected in the current working version of the MPOC.

As part of the implementation of the trading hubs, and in accordance with the Agreement for Interconnection with the Maui Pipeline between MDL and the GIC (the "ICA"), the GIC became a Welded Party on 1 June 2010.

By becoming a Welded Party, the GIC therefore became a Party to the MPOC. It is unclear to Greymouth whether the ICA is still in force today given the GIC-run trading hub work-stream has been discontinued. If the ICA was terminated prior to 18 April 2011, then the remaining points raised below relating to a potential conflict of interest can be disregarded.

However, if the ICA is still in force, then the GIC is both a Party to the MPOC and is the decision making body that rules on changes to the MPOC. If this is the case, Greymouth considers that GIC has an actual or potential conflict of interest<sup>1</sup> between its interests as a party to the MPOC and its role as independent arbiter of proposed changes.

Greymouth's concerns about this conflict are especially acute in relation to the Change Request because the ICA has a specific clause about prudential requirements (clause 5), which is one component of the MPOC which the Change Request seeks to amend.

Regardless of the ICA not having been used, Greymouth is concerned that the presence of the conflict of interest has the potential to affect the outcome of the MoU process, and, at a minimum, it goes against a basic legal principle.

If the ICA is still in force, then (given the conflict referred to above) this work-stream must be stopped immediately in its current form. The following options will need to be considered:

- Whether to formally cancel the ICA, with the GIC's process for assessing the Change Request starting again following that cancellation,
- Whether to keep the ICA, with the GIC's process for assessing the Change Request starting again but passed to an independent party,
- Whether the MPOC and/or MoU allow an independent party to assess MPOC change requests when the GIC is conflicted.

### **Gap in MoU**

Greymouth's second process concern is the lack of criteria that guide the GIC's assessment of amendments to MPOC commercial arrangements that are proposed in the Change Request or other change requests.

Clause 2.2 of MoU reflects that GIC is empowered under the MPOC to assess and make recommendations on change requests. Clause 2.3 of the MoU says that GIC is to have regard to the objectives in section 43ZN of the Gas Act 1992 ("Gas Act") in performing that role.

---

<sup>1</sup> Greymouth notes that regardless of whether the ICA is in force today, it was in force on the date when the GIC made its final recommendation pertaining to the 2009 Change Request in July or August 2010. Because the final recommendation and the likely default process for dealing with this conflict of interest were the same outcomes (cessation of work-stream), Greymouth considers that no further action be taken on the conflict of interest pertaining to the above. However, we also note that because this was overlooked does not mean it sets a precedent for getting around the rule against bias; it simply means it needs to be addressed this time.

Section 43ZN of the Gas Act sets out market efficiency objectives that are appropriate where an MPOC change request relates to macro market issues. However, they do not lend themselves to an assessment of changes to MPOC commercial arrangements that have no impact on and no relationship with the market. There are no criteria, either under the MoU or the MPOC, that guide an assessment by GIC of proposed changes to commercial arrangements in a change request.

In this case, the Change Request primarily<sup>2</sup> contains commercial changes. But the MoU does not set parameters or guidelines on the GIC's assessment of changes to commercial terms and conditions. Furthermore, Greymouth is not aware of any GIC policy on the matter.

This lacuna needs to be addressed.

Interestingly, two key points provide a helpful steer on this matter:

- 1) There are at least three MDL precedents<sup>3</sup>:
  - a. the first pertains to a proposed revision to Mismatch pricing methodology in May 2010 which was implemented following unilateral support from Parties<sup>4</sup>,
  - b. the second pertains to a proposed shortening of the Nomination cycle timeframes between December 2009 and March 2010 which was not implemented following one Party not supporting shorter cycle times<sup>5</sup>,
  - c. the third pertains to the above vis-a-vis changing the Nomination cycle timeframes which was not implemented following at least one Party's opposition to it,
- 2) Commercial issues were debated at length when the MPOC was first developed and the MPOC reflects the results of those debates. The commercial terms and conditions therein were therefore unanimously supported by any Party who signed up to an Interconnection Agreement or a TSA. Ergo, any changes to the commercial terms and conditions should likewise be unanimous.

Greymouth considers that the following actions must happen:

- The GIC must formulate a policy on how to assess changes to commercial terms and conditions within the MPOC based on the precedents, especially having regard for unanimous support of non-market related items as per the intent behind clause 2.2 of the MoU which stemmed from precedent 2) above,
- The MoU must be re-written to incorporate the modus operandi vis-a-vis changes to commercial terms and conditions, including what happens when a change request includes proposed changes to both commercial and market conditions,

---

<sup>2</sup> if not completely

<sup>3</sup> which, although not MPOC change requests, these are in fact changes to concepts outlined in the MPOC which are managed under other documents as part of wider the wider MPOC umbrella but most of all which show the commercial intent of how MDL chooses to change commercial terms and conditions

<sup>4</sup> when discounting one Party's non-support which made little commercial sense

<sup>5</sup> as per MDL's 20 February 2010 letter 'Re: Consultation on MPOC Nomination Cycle Deadlines' to Shippers and Welded Parties

- As an interim step, any change request (including the Change Request) which contains both market elements and purely commercial elements, should only be approved<sup>6</sup> by the GIC where such change request is supported unanimously by all Parties submitting to the change request, and "also" passes the GIC's 'net benefit' test with regard to clauses affecting the market.

For the GIC to support proposed changes to commercial terms together with supporting proposed changes to clauses affecting the market, and/or to assess the impact of proposed changes to commercial terms as having a neutral impact on the Gas Act, then this, in Greymouth's view, is contrary to the principles in the MoU and is contrary to the development process of the MPOC.

If the GIC has a different view on this matter and applies their 'net benefit' test to all proposed changes (including to commercial terms), then it is paramount that the majority of the weighting must be on commercial terms and that there must be a maximum negative impact on the market if a particular commercial term is not supported by any Party.

### **GIC's 'Net Benefit' Test**

Greymouth is also concerned that a negative change to the market can be incorporated into the MPOC if it is part of a wider change request which, in aggregate, is deemed to have a net benefit. The GIC had similar concerns throughout the 2009 Change Request process.

Greymouth encourages the GIC to develop a policy<sup>7</sup> such that any proposed negative change to the market as part of a wider change request either triggers the change request to not be supported, or allows for the GIC to have the ability to take that particular change out of the change request.

Support or non-support in 'whole' can still be achieved but we need to address the process to close loopholes that can, in part, negatively affect what could be unrelated parts of the market which are important in their own right.

### **Comments on Change Request Application**

Comments on the specific clauses within the Change Request are in the next section of this letter.

First, MDL's comment that *"causer pays...[is] a maxim which [MDL] notes the industry as a whole (and GIC in particular) is moving towards implementing as far as possible"* is inappropriate.

Greymouth would have thought that 'causer pays' is a good guide, but that to extend this concept to its absolute extremities would have an exponentially increased negative impact on efficiency. In other words, it is likely that some cost socialisation will always be present because to eradicate this (in general cases) would likely cost more than the cost of the cost socialisation.

---

<sup>6</sup> or supported, or recommend for approval

<sup>7</sup> and associated documents to make this happen

## Comments on Change Request

Greymouth has no comment unless specifically mentioned below.

### Section 1.1 of the MPOC: Definitions

Greymouth supports the removal of the Industry Contingency Plan [and the non-replacement with references to the new critical contingency arrangements] from the definition of Force Majeure Event because not all critical contingencies lead to force majeure cover and the remaining wording does not preclude critical contingencies being a Force Majeure Event if it reasonably is. We note that this clause is a commercial term or condition only.

Greymouth does not support the proposed definition of Highest Month for reasons discussed later, and because this does not pertain to a time period but a dollar value and it is therefore confusing and misleading. We note that this clause is a commercial term or condition only.

### Section 4 of the MPOC: Information

Greymouth does not support any of the proposed changes in sections 4.1 or 4.3 of the MPOC. These proposed changes will not, as MDL suggests, make Parties better placed to balance because each Party can already see their own information, Pipeline and Line Pack information and TP Welded Point information. That's all you need to balance.

Because each Party is accountable to MDL, it doesn't matter what their individual Running Operational Imbalance is (for example), as this will be captured in existing aggregate Pipeline information. Therefore this change is purely commercial and, in our view, adds no value.

### Section 20 of the MPOC: Prudential Requirements

Greymouth supports the way that existing clauses 20.1 and 20.2 of the MPOC are managed at the moment by MDL, and the intent under the Change Request, such that if a Party is both a Shipper and a Welded Party then MDL will reasonably and without burden apply these clauses based on commercial and relationship management.

However, Greymouth does not support any of the proposed changes to section 20 of the MPOC for the following reasons:

- Prudential requirements were debated at length when the MPOC was first developed and the current MPOC reflects the result of that debate. Tariffs have been set on the basis of the risks inherent in the MPOC. One would expect that if the risks to the Pipeline Operator were to reduce, which would happen if this request were to be approved, then the tariffs should decrease. There is no indication that this will happen, but instead there is a threat that tariffs will increase if the change request isn't passed,
- The effect of this Change Request is to impose extra costs on those Pipeline users who don't have an acceptable credit rating for no incremental service benefit. Pipeline users are being penalised because of issues associated with the demise of E-Gas,
- Holding additional prudential requirements will add cost to the industry as Parties will have to service these. The Change Request will:
  - a) result in a significant barrier to entry for a new entrant, thus adding a barrier to competition, which would be contrary to section 43ZN(b)(ii) of the Gas Act, and

- b) result in additional costs of financing the increased Prudential Requirements which will eventually be passed onto end-users in the gas industry (resulting in increased pressure on gas costs and prices, contrary to section 43ZN(b)(iv) of the Gas Act), and
  - c) direct money away from exploration as an over-reaction to E-Gas, which is contrary to what appears to be a drive by the government to encourage more exploration, and
  - d) not sit with section 43ZN(b)(i) of the Gas Act as this is not a competitive market arrangement,
- Having prudential requirements based on maximum charges over a calendar year does not provide reasonable cover against risk at any point in time. The Change Request is therefore weighted in favour of MDL and this is not commercially acceptable to Greymouth,
  - Increased prudential requirements will not make the gas industry safer. It just changes money and risk. It is therefore a commercial term or condition and changes herewith should follow a robust negotiation process between the Parties and not purely reflect MDL's desire to improve their credit risk.

### Summary

The Change Request sets out numerous proposed changes to commercial terms. The industry body that has been created to assess the appropriateness of these changes (i.e., the GIC) has no criteria against which to make that assessment, other than the objectives set out in section 43ZN of the Gas Act. As stated above, these objectives have not been designed to be applied to, and are not appropriate for use in, that assessment.

Accordingly, and notwithstanding a potential conflict of interest, Greymouth cannot see how the Change Request can even begin to be assessed by the GIC given the gaps in the MoU. Greymouth encourages the GIC to address the substantial issues raised in our submission and in the interim we consider that there is no option for the GIC but not to support the Change Request.

If the GIC proceeds with an assessment of the Change Request notwithstanding the concerns set out above, then there are enough changes to the prudential requirements section that should make such an analysis fail any 'net benefit' test.

Yours sincerely,



Chris Boxall  
Commercial Manager