

**APPLICATION FOR GAS INDUSTRY COMPANY'S RECOMMENDATION ON
PROPOSED AMENDMENTS TO THE MAUI PIPELINE OPERATING CODE ("MPOC")**

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Applicant: Maui Development Limited

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1. Introduction

1.1 In accordance with the standard "Recommendation Request form" issued by Gas Industry Company Limited (**GIC**), this application by Maui Development Limited (the **Applicant**) includes the following information:

- (a) details of the amendments to the MPOC proposed by the Applicant; and
- (b) the reasons for the proposed amendments.

1.2 Please also find enclosed with this application a marked up copy of MPOC showing the Applicant's proposed amendments in full.

1.3 In this application, unless the context requires otherwise:

- (a) each capitalised term used has the meaning given to it in the MPOC; and
- (b) each section reference refers to a section of the MPOC.

1.4 In making this application, the Applicant has taken into account:

- (a) the (unsuccessful) MPOC change request dated 17 December 2009 submitted by the Applicant (**2009 Change Request**);
- (b) submissions lodged by industry participants on the 2009 Change Request, including the GIC Status Update dated 12 March 2010 (**Status Update**) and submissions lodged on the Status Update;

- (c) the Applicant’s recent experience in relation to the liquidation of the E-Gas group; and
 - (d) the Vector Transmission Code (**VTC**), specifically the prudential requirements set out in section 14 of the VTC.
- 1.5 The Applicant considers the proposed amendments to mark an incremental improvement in the operation of the MPOC regime. The changes proposed to section 20 (“Prudential Requirements”) are intended to remove uncertainty in the application of ambiguous provisions (or, in some cases, correct manifest errors) and to recognise that the Applicant is currently over-exposed to credit risk – a lesson learned in the recent liquidation of E-Gas. Further explanation of these proposed changes is set out in section 2 below.
- 1.6 The proposed amendments to section 4 (“MDL IX”) are directed at making more information generally available to participants. In particular, Shippers and Welded Parties will be provided with a greater amount of real time information on pipeline conditions and Operational Imbalances at all Welded Points. As such all parties will be better placed to make more informed decisions in relation to their primary balancing obligation under MPOC, and to reduce their exposure to costs incurred when residual balancing actions are taken.
- 1.7 Minor amendments are proposed to section 1.1 (“Definitions”). One of these reflects a change that has occurred outside MPOC – retirement of the National Gas Outage Contingency Plan – while the others are new terms tied to substantive amendments proposed in this change request (“Highest Month” and “Initial Period”, which relate to the prudential requirements on Shippers under section 20.6).

2. **Prudential requirements**

- 2.1 The proposed amendments to the prudential requirements in section 20.6 will impact on the existing obligations of Shippers, which may be required to increase their Cash Deposits and/or third party securities provided to the Applicant. The Applicant notes however that the following points should be taken into account in assessing the impact of the increased compliance burden:

(a) If a Shipper does not pay a Throughput Charge in accordance with section 21, then:

(i) the Applicant bears a credit risk in respect of:

(aa) the previous Month, being the Month in respect of which the Throughput Charge was incurred (invoiced but unpaid);

(bb) the current Month (services provided but not yet invoiced);
and

(cc) the following Month (during which the notice period under section 22 continues),

before it is entitled to terminate its TSA with the relevant Shipper and prevent further losses; and

(ii) the Applicant's resulting losses will be passed on to all Shippers in the form of higher Throughput Charges in subsequent periods. It is preferable that the "causer pays" for such losses, a maxim which the Applicant notes the industry as a whole (and GIC in particular) is moving towards implementing as far as possible.

(b) Under the VTC, Vector's shippers are required to provide security equal to Vector's reasonable estimate of three months of their transmission charges. Industry participants are therefore already accustomed to providing this level of comfort to a Transmission Pipeline owner. The proposed amendment then would signify nothing new, and would align both the VTC and MPOC on this matter.

2.2 The Applicant does not consider the proposed amendments to section 20.3(b) and 20.4 will impact materially on the existing rights and obligations of Shippers or Welded Parties. Rather their aim is to clarify the originally intended purpose of those sections which, as currently drafted, create significant ambiguity. Despite the existing words, it is clear:

(a) that section 20.4 is intended to set out what an acceptable credit rating is in the context of a third party service provider, not a Shipper or Welded

Party as currently specified (section 20.3 is the relevant provision in that context); and

- (b) in both section 20.3(b) and 20.4(b), that the absence of a negative credit watch – rather than the opposite – is the criterion that would contribute towards a Shipper’s, Welded Party’s or third party security provider’s credit rating (as applicable) being “acceptable”. Notably, the negative credit watch trigger would only render a credit rating no longer “acceptable” if the credit rating in question is of the minimum level permitted under section 20.3(a) or 20.4(a) (as applicable).

2.3 The proposed amendment to section 20.3(a) rectifies a clerical error and clarifies that the independent auditor providing confirmation need not be the same independent auditor that audits the Incentives Pool pursuant to section 14.8. The Applicant notes that:

- (a) making this change would align section 20.3(a) with its counterpart section 20.4(a); and
- (b) this amendment was proposed in the 2009 Change Request and, to the extent submissions were received, they were supportive.

2.4 Similar changes are also proposed to section 20.4(a), to align the required Moody’s credit rating and “other reference” terminology with section 20.3(a). And in section 20.1(d), it is proposed that the cross reference be amended to clarify that it is a Cash Deposit and third party securities that can be provided in combination, in order to demonstrate creditworthiness – rather than a credit rating and a Cash Deposit, as is currently (and in the Applicant’s view, mistakenly) the case. For consistency, the Applicant proposes that section 20.1(d)’s counterpart in section 20.2 be removed (given Welded Parties do not have the option of providing a Cash Deposit).

2.5 The proposed amendment to section 20.7(a) rectifies a clerical error, in that – analogous to section 20.7(c) – it is changes to a Shipper’s or Welded Party’s credit rating (or reference, as appropriate) of which MDL should be informed (where those changes result in the Shipper or Welded Party no longer holding an acceptable credit rating in terms of section 20.3).

3. **General**

3.1 The Applicant:

- (a) considers that all of the proposed amendments comply with the Commerce Act 1986 and all other relevant laws;
- (b) acknowledges that the parties to ICAs and TSAs have the right to make submissions to GIC in relation the proposed amendments;
- (c) will give consideration to the proposed amendments in light of the submissions that are received by GIC; and
- (d) reserves the right to withhold its consent required under section 29.4 of the MPOC for the Operating Code and each affected TSA and ICA to be amended.

Schedule: Summary of Proposed Amendments

Section	Issue	Proposed Change	Rationale for Proposed Change
1.1	New and deleted definitions	Amendments to section 1.1: <ul style="list-style-type: none"> • new definitions for “Highest Month” and “Initial Period” • deletion of “Industry Contingency Plan” 	<p>The introduction of “Highest Month” and “Initial Period” definitions is consequential to the proposed amendments to section 20.6.</p> <p>The deletion of “Industry Contingency Plan” reflects the retirement of the NGOCP following introduction of the Gas Governance (Critical Contingency Management) Regulations 2008.</p>
4	MDL IX	Making certain information previously restricted to each Welded Point available to all participants	The proposed amendments seek to provide all Shippers and Welded Parties with a greater amount of real time information on the pipeline conditions and operational imbalances at all Welded Points. The objective is to ensure that all parties are better placed to make more informed decisions in relation to their primary balancing obligation under MPOC, and reduce exposure to costs associated with residual balancing actions being taken.
20	Prudential requirements	Amend section 20.1(d) to cross refer to sections 20.1(b) and (c) rather than sections 20.1(a) and (b)	In the Applicant’s view, section 20.1(d) was intended to permit Shippers to provide a Cash Deposit in combination with third party securities, in order to demonstrate creditworthiness. The status quo is

Section	Issue	Proposed Change	Rationale for Proposed Change
			somewhat non-sensical.
		Delete section 20.2(c)	For consistency with the change proposed above – and given Welded Parties do not have the option of providing a Cash Deposit – it is proposed that this subsection be removed.
		<p>Amend section 20.3 to reflect that the “Independent Auditor” referred to is not intended to be the Independent Auditor defined in section 1.1.</p> <p>Amend sections 20.3(b) and 20.4(b) to require that a Shipper, Welded Party or third party security provider that has a credit rating of the minimum level permitted under section 20.3(a) or 20.4(a) (as applicable) not be subject to negative credit watch,</p>	<p>The definition of Independent Auditor in section 1.1 relates to the auditor appointed to audit the Incentives Pool. The proposed amendment reflects that it is not necessary for the same independent auditor to certify a Welded Party’s or a Shipper’s creditworthiness. This would also align section 20.3 with its counterpart section 20.4, which relates to the creditworthiness of third party security providers.</p> <p>The Applicant notes that this amendment was proposed in the 2009 Change Request and, to the extent submissions were received, they were supportive.</p> <p>The proposed amendments are intended to capture the proper intention behind sections 20.3(b) and 20.4(b). As currently drafted there is circularity in the first line and the subsequent lines are contradictory, in that:</p>

Section	Issue	Proposed Change	Rationale for Proposed Change
		in order to have/maintain “an acceptable credit rating”.	<ul style="list-style-type: none"> • a rating of the minimum level permitted should not be subject to negative watch if it is to be acceptable, rather than vice versa; and • if the rating is subject to negative watch, it's likely that MDL would have “reasonable grounds” to consider that the party in question would be unable to maintain a credit rating that meets the requirements of paragraph (a) – rendering this limb redundant. <p>Stripping paragraph (b) of each section back to require only that a rating of the minimum level permitted not be subject to negative credit watch (or that such other reference as MDL originally considered acceptable continues to be reasonably acceptable to MDL) eliminates these ambiguities and restores what appears to have been the parties' intentions in the first place.</p>
		Amend section 20.4 to reflect that sections 20.1(c) and 20.2(b) relate to the creditworthiness of a third party security provider, not that of a Shipper or a	The proposed amendments rectify clerical errors and create consistency between sections 20.3(a) and 20.4(a) (see in particular “Baa2” and “or such other

Section	Issue	Proposed Change	Rationale for Proposed Change
		<p>Welded Party (the relevant provision in the latter context being section 20.3) and amend section 20.4(a) to mirror section 20.3(a).</p> <p>Delete the current section 20.6 and replace it with the following:</p> <p><i>Where a Shipper elects to provide a Cash Deposit and/or have a third party provide a guarantee, letter of credit and/or bond to satisfy the prudential requirements in section 20.1(b), (c) or (d), the amount of the Cash Deposit and the maximum amount which may be payable pursuant to the guarantee, letter of credit and/or bond or under any combination thereof shall be:</i></p> <p><i>(a) during the Initial Period, an amount equal to three times MDL’s reasonable estimate of the highest Throughput Charge the Shipper will incur during the Initial Period; and</i></p> <p><i>(b) after the Initial Period, an amount equal to three times the Shipper’s highest Throughput Charge incurred during the previous rolling 12 Month period (Highest</i></p>	<p>reference”).</p> <p>Given the notice periods and frequency of invoicing for Throughput Charges, the Applicant is exposed to three months’ worth of Throughput Charges if a Shipper defaults in payment, not one (as currently provided for). During the recent liquidation of E-Gas, it became apparent that this level of credit risk is unduly burdensome on MDL and discordant with the level of comfort Vector receives from its Shippers under the VTC (see section 14.5 VTC).</p> <p>Amending section 20.6 to require comfort equivalent to three months’ Throughput Charges would therefore align MPOC with the VTC in this context, and better reflect the level of credit risk the Applicant faces.</p> <p>Note that a Throughput Charge is, by definition, a Monthly Charge.</p>

Section	Issue	Proposed Change	Rationale for Proposed Change
		<p><i>Month),</i></p> <p><i>provided that, if the Shipper's Throughput Charge in respect of any Month is greater than either:</i></p> <p><i>(c) MDL's estimate under section 20.6(a); or</i></p> <p><i>(d) that payable in respect of the Highest Month under section 20.6(b),</i></p> <p><i>the Shipper shall, within 30 Days of the end of that Month, increase the Cash Deposit or the maximum amount which may be payable pursuant to the guarantee, letter of credit and/or bond (as the case may be) accordingly.</i></p> <p>Amend section 20.7(a) to require Shippers and Welded Parties to notify MDL if the Shipper or Welded Party receives notice of a change to its credit rating (or reference, as applicable) such that it no longer holds an acceptable credit rating in terms of section 20.3.</p>	<p>This reflects what appears to have been the parties' original intention and brings section 20.7(a) into line with its third party security provider counterpart (section 20.7(c)).</p>