



# Final Recommendation on the 18 April 2011 MPOC Change Request

11 July 2011







## **About Gas Industry Co.**

Gas Industry Co was formed to be the co-regulator under the Gas Act.

As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy and Resources on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

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# 1

## Introduction

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### 1.1 Purpose

This paper presents a final recommendation in respect of the Maui Pipeline Operating Code (MPOC) change request submitted by Maui Development Limited (MDL) on 18 April 2011 (the April Change Request).

### 1.2 Background

#### **Gas Industry Co's role under the MPOC**

Section 29 of the MPOC assigns Gas Industry Company Limited (Gas Industry Co) a role in respect of any proposed amendment to the MPOC (a change request). Gas Industry Co's role is to consult on a change request with the gas industry and determine whether or not to support it. A change request proceeds only where required by law or where Gas Industry Co makes a written recommendation to MDL supporting the change request. MDL has sole discretion to reject a recommendation if it considers the change would materially adversely affect its business, or require MDL to incur a capital expenditure (that may not be recoverable).

Gas Industry Co has agreed a memorandum of understanding (MoU) with MDL describing how its role will be performed. The MoU sets out a process under which Gas Industry Co receives a change request, calls for submissions, issues a draft recommendation, considers further submissions, and finally makes a recommendation to MDL. For further information (including a copy of the MoU) please refer to Gas Industry Co's website at [www.gasindustry.co.nz](http://www.gasindustry.co.nz).

Capitalised terms used in this recommendation have the same meaning given to those terms in the MPOC, unless stated otherwise.

### 1.3 Current change request and process to date

#### **Change request**

On 18 April 2011, Gas Industry Co received the April Change Request from MDL. The April Change Request proposes amendments to:

- Section 1.1 (Definitions) to reflect the end of the National Gas Outage Contingency Plan (and its replacement with the Gas Governance (Critical Contingency Management) Regulations 2008) and to include new terms to reflect the proposed changes to section 20;

- Section 4 (MDL IX) to make more information on real time pipeline conditions and Operational Imbalances at all Welded Points available to all parties; and
- Section 20 (Prudential Requirements) to reduce MDL's exposure to credit risk, improve clarity and in some cases to correct manifest errors.

On 29 April 2011, Gas Industry Co notified industry participants of the change request and invited submissions to be made. Five submissions on the April Change Request were received.

### **Draft recommendation**

On 8 June 2011, Gas Industry Co issued a Draft Recommendation on the April Change Request. The paper included an analysis of the April Change Request and the submissions received on it. Gas Industry Co's Draft Recommendation supported the April Change Request.

Five submissions were received on the Draft Recommendation. The submissions are summarised in Section 4 of this Final Recommendation.



# 2

## Approach to analysis

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### 2.1 General approach to analysis

As set out in Section 2.4 of the MoU, Gas Industry Co is required to prepare an analysis of the issues under consideration, including a cost-benefit analysis (unless Gas Industry Co is satisfied that the issues are minor and will not adversely affect the interests of an industry participant in a substantial way). This analysis will have regard to the objectives of section 43ZN of the Gas Act (as noted in Section 2.3 of the MoU).

Gas Industry Co's analysis of any change request is subject to some constraints. In particular, Gas Industry Co is not free to reject a change request because it considers there may be a better alternative, or to approve some parts of the change request but not others, or to make its approval conditional. These constraints are outlined in further detail below.

#### **Changes are assessed relative to the existing MPOC**

Gas Industry Co's contractual role under the MPOC requires it to evaluate whether proposed changes will provide a net benefit, with reference to the existing MPOC.<sup>1</sup> Gas Industry Co cannot reject a change request because it believes there may be a better alternative that has not yet been presented.

#### **A change request cannot be partially approved**

Change requests, including the April Change Request, often comprise a number of proposed changes to the MPOC. Gas Industry Co has previously considered whether it can approve some such changes and reject others. Our conclusion is that this is not possible. A change request is submitted as a package and must be approved or not approved in its entirety. For this reason, Gas Industry Co encourages submitters to limit the scope of change requests. This allows for easier analysis and lowers the chance that one unacceptable aspect of the request can cause the whole request to be rejected.

#### **Approval of a change request must be substantially unconditional**

Although a change request cannot be partially approved, it can be approved subject to some small changes being made. This avoids the situation where a minor or technical error in a change request requires the change request to be resubmitted.

### 2.2 Approach to analysing this change request

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<sup>1</sup> This contrasts with Gas Industry Co's role when assessing options under the Gas Act. In that situation we are required to identify and consider all practicable options for achieving a Gas Act objective before making a recommendation to the Minister.

Gas Industry Co carried out its analysis of the April Change Request in accordance with Section 2.1 above. The outcomes of this analysis were described in detail in Section 6 of the Draft Recommendation.

Given the relatively limited nature of the changes proposed by the April Change Request, Gas Industry Co elected not to carry out a fully quantified cost-benefit analysis. Gas Industry Co considered a qualitative cost-benefit analysis was sufficient and appropriate.

# 3

## Proposed changes

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### 3.1 Overview of changes

The April Change Request proposes changes that can be organised into three groups:

- Information on MDL IX (section 4);
- Prudential requirements (section 20); and
- Consequential changes and minor amendments.

Each of these categories is outlined in further detail below.

### 3.2 Information on MDL IX

The April Change Request proposes amendments to section 4 (MDL IX) of the MPOC. The changes are directed at making more real time information on pipeline conditions and Operational Imbalances publically available.

MDL considers the additional information will help parties make more informed decisions in relation to their primary balancing obligations under the MPOC, and to reduce their exposure to balancing costs.

The additional information MDL proposes to make publically available on the MDL IX is outlined in the table below.

**Table 1 Proposed information to publish on the MDL IX**

<b>Proposed information</b>	<b>Frequency of posting</b>
Operational Imbalance for each Welded Point	<i>Unvalidated:</i> For each Transmission Day by 8:00am the following Day. <i>Validated:</i> For each Transmission Day by 12:00pm on the next Business Day and in accordance with sections 12.2 to 12.4.
Running Operational Imbalance for each Welded Point	<i>Unvalidated:</i> For each Transmission Day by 8:00am the following Day. <i>Validated:</i> For each Transmission Day by 12:00pm on the next Business Day and in accordance with sections 12.2 to 12.4.
Provisional Cycle Scheduled Quantity at each Welded Point pursuant to section 9.4	Each Nomination Day by 6:00pm.

Changed Provisional Cycle Scheduled Quantity at each Welded Point pursuant to section 9.7	For each Transmission Day by 6:00pm of the Previous Day.
Intra-Day Cycle changes to Scheduled Quantities at each Welded Point	Within 2 hours after the Intra-Day Nomination Deadline.
Hourly Scheduled Quantity at each Welded Point	For each Transmission Day, by 12:00pm on the following Day.
Quantities of Gas purchased or sold at each Welded Point in accordance with section 12.11	Within 2 hours after the Intra-Day Nomination Deadline.
Quantities of Gas traded at each Welded Point in accordance with section 12.17	For each Transmission Day, by 12:00pm on the following Day.

### 3.3 Prudential Requirements

The April Change Request proposes several changes to section 20 of the MPOC (Prudential Requirements).

#### **Increase in maximum amount of Cash Deposits**

Under the proposed changes, the maximum amount of Cash Deposits and/or third party securities provided to MDL is increased. Currently the maximum amount equates to one month's worth of Throughput Charges for the Shipper (based on the highest monthly throughput forecast for that Shipper). The change would see the maximum amount increase to equate to three times the level of the highest Throughput Charge for the relevant Shipper in the previous 12 months (with provision for estimation by MDL in the first 12 months).

In the April Change Request, MDL acknowledges the additional compliance burden this may result in for some Shippers, although does not quantify the nature of this perceived burden. It notes, however, that any payment default by a Shipper currently leaves MDL exposed to credit risk in respect of:

- the month in which the Throughput Charge was incurred;
- the current month (in which services have been provided but not invoiced); and
- the month following the current month.

This 'three month' credit risk arises due to the timeframe involved before MDL can terminate its TSA with the Shipper. MDL asserts that any losses suffered by MDL would be passed onto all Shippers through higher Throughput Charges in subsequent periods.

MDL therefore considers the change to embody a 'causer pays' approach to avoid losses (as a result of a Shipper defaulting on payment) having to be socialised across participants.

MDL also points out in its application that Vector imposes similar prudential requirements on the shippers using its pipeline as those proposed by the April Change Request. Under the Vector Transmission Code (VTC), shippers are required to provide security equal to Vector's reasonable estimate of three months of their transmission charges.

### **Credit ratings**

MDL proposes to amend the threshold for an acceptable credit rating so that a credit rating which otherwise sits at the minimum level (Baa2 (Moody's Investors Service), BBB (Standard & Poor's) or B (AM Best)) ceases to be acceptable if the rating is subject to negative credit watch. Previously, in addition to the imposition of negative credit watch, MDL had to have reasonable grounds to believe the minimum credit rating would not be maintained. MDL is also seeking greater control as to what level of alternative credit reference is or is not acceptable. Under the proposed changes, an alternative reference must be reasonably acceptable to MDL.

MDL characterises the changes as removing ambiguity. Gas Industry Co however considers that they do represent a substantive change, in that they do tighten the credit rating requirements.

### **Other changes**

The other proposed changes to section 20 seek to clarify any ambiguity that might result from the operation and application of these provisions. The changes seek to clarify that:

- section 20.4 is intended to establish what an acceptable credit rating is in the context of a third party service provider, and not in respect of a Shipper or Welded Party; and
- the independent auditor providing confirmation (under section 20.3(a)) does not need to be the same independent auditor that audits the Incentive Pool (under section 14.8).

## **3.4 Consequential and minor amendments**

MDL has also proposed several consequential and minor amendments. The consequential amendments include two new definitions in section 1 to reflect the changes proposed to the Prudential Requirements.

The April Change Request also proposes the deletion of all references to the National Gas Outage Contingency Plan. The Plan has been replaced by the Gas Governance (Critical Contingency Management) Regulations 2008.

# 4

## Submissions on Draft Recommendation

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### 4.1 Overview

As noted, the Draft Recommendation, published by Gas Industry Company on 8 June 2011, supported the April Change Request.

Submissions on the Draft Recommendation were received from the following five parties:

- Contact Energy Limited (Contact);
- Genesis Energy Limited (Genesis);
- Maui Development Limited (MDL);
- Mighty River Power Limited (MRP); and
- Vector Limited (Vector).

Below is a summary of the key points from each submission.

### 4.2 Contact

Contact reiterated the position outlined in its initial submission (dated 12 May 2011) on the April Change Request. In Contact's view, the proposed changes to sections 20.3(b) and 20.4(b) do not (and are not necessary to) achieve the purpose of the changes identified by MDL in the April Change Request (namely, the removal of uncertainty in the application of ambiguous provisions, and the alignment of the MPOC with the VTC). Contact also reiterates that the proposed changes to sections 20.3(b) and 20.4(b) do not materially add to the risk protection available to MDL as a transmission system owner.

Contact also considers it unacceptable for change requests that contain numerous changes to be submitted for consideration, leaving Gas Industry Co to determine the acceptability of a change request on balance rather than on the merits of the individual components. On the basis that the MPOC and the MoU do not appear to specifically deal with these types of change requests, Contact believes that Gas Industry Co and MDL should amend the MoU so that an approval or rejection of a change request can be made in part or in its entirety.

### **4.3 Genesis**

Genesis supports the April Change Request. Genesis suggests Gas Industry Co should not be cautious in declining an entire change request if there is one element or a small component of a change request that it finds unreasonable. In Genesis' view it would have been preferable for MDL to submit separate change requests for the proposed changes to the Prudential Requirements and the balancing information changes. This would remove any uncertainty created by bundling the proposals.

### **4.4 MDL**

MDL responds to points made in the initial submissions made by Contact and Greymouth, rather than responding to Gas Industry Co's Draft Recommendation.

MDL makes the following key points:

- MDL has adopted a policy of correcting evident mistakes in the MPOC when it has the opportunity to do so. When preparing a change request, MDL also has to bear in mind the desire for small changes against the cost and confusion likely to be caused by addressing many separate small changes simultaneously in separate requests.
- The proposed changes to section 4 constitute a barrier (by codifying current practice), while the proposed changes to the Prudential Requirements address a 'well-known' problem in the industry.
- The process for amending the MPOC was negotiated and agreed upon by the industry and it is reasonable for MDL to seek to utilise it.
- An amendment process that allows some elements of a change request to be contested and removed will not work. 100% agreement on the changes proposed by a change request is extremely unlikely, and as a result, an overall balancing of arguments is necessary.
- It does not believe it should not bear the credit risk associated with parties who want gas transmission services, nor does it think this risk should be passed on to the industry as a whole. Given the relative size of the sums involved, it does not believe that the proposed amendments to the Prudential Requirements will result in a significant barrier to gas exploration and gas field development.
- In relation to the proposed changes to section 20.3(b), MDL notes that company credit ratings can deteriorate quickly with little warning and that there is a clear drafting error in section 20.3(b) that warrants correction.

### **4.5 MRP**

MRP supports Gas Industry Co's Draft Recommendation. However, MRP agrees with Contact Energy with regards to the proposed changes to sections 20.3(b) and 20.4(b) of the MPOC. In particular, MRP does not believe that a shipper with a credit rating subject to a negative credit watch is necessarily a higher risk to MDL than a shipper whose credit rating is not subject to a credit watch. MRP asks that MDL reconsider the changes.

## **4.6 Vector**

Vector supports Gas Industry Co's Draft Recommendation.



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## Gas Industry Co analysis of submissions on the Draft Recommendation

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### 5.1 Prudential requirements

Contact argues that the proposed changes to section 20.3(b) and 20.4(b) do not (and are not necessary to) achieve the purpose of the changes identified by MDL (namely, the removal of uncertainty in the application of ambiguous provisions, and the alignment of the MPOC with the VTC). Contact also notes that the proposed changes to sections 20.3(b) and 20.4(b) do not materially add to the risk protection available to MDL.

Contact's position is supported by MRP. MRP notes that it does not believe a shipper with a credit rating subject to a negative credit watch is necessarily a higher risk to MDL than a shipper whose credit rating is not subject to a negative credit watch.

As noted in the Draft Recommendation, Gas Industry Co accepts that the change to the credit rating provisions proposed by the April Change Request goes beyond the removal of ambiguity, and in fact represents a substantive (albeit relatively minor) change to the credit rating provisions. Gas Industry Co also recognises the discrepancies between the proposed changes to the Prudential Requirements in the MPOC and the corresponding provisions in the VTC.

However, Gas Industry Co acknowledges and accepts, as noted by Vector, a transmission system owner's right to have reasonable prudential arrangements in place to reduce its exposure to credit risk.

It remains Gas Industry Co's view that the proposed amendments to the Prudential Requirements in the MPOC are reasonable, particularly when compared against the standards imposed in analogous codes and industry documents. Further, when considered against the statutory objectives, Gas Industry Co considers the proposed change to the credit rating provisions to be neutral and there is no detriment that impacts Gas Industry Co's view that, in total, the changes to the Prudential Requirements are positive.

In summary, the submissions received in relation to the proposed changes to the Prudential Requirements do not change the conclusions reached by Gas Industry Co and recorded in the Draft Recommendation.

## 5.2 'Packaged' change requests

Contact argues that it is unacceptable for change requests that contain numerous changes to be submitted for consideration. Doing so leaves Gas Industry Co to determine the acceptability of the change request on balance rather than on the merits of the individual components. Contact believes that Gas Industry Co and MDL should amend the MoU so that an approval or rejection of a change request can be made in part or in its entirety.

Genesis also raises issue with the scope and nature of the changes proposed. Genesis reminds Gas Industry Co not to be cautious in declining an entire change request if there is one element or a small component of a change request that it finds unreasonable. In Genesis' view it would have been preferable for MDL to submit separate change requests for the proposed changes to the Prudential Requirements and the balancing information changes.

In defence of the approach taken in formulating and presenting the April Change Request, MDL submits that it has adopted a policy of correcting evident mistakes in the MPOC when it has the opportunity to do so and in preparing a change request. MDL also bears in mind the desire for small changes against the cost and confusion likely to be caused by addressing many separate small changes simultaneously in separate requests. On this basis, some degree of consolidation appears logical.

It is worthwhile reiterating the points noted in Section 2.1 of this Final Recommendation. Change requests, including the April Change Request, often comprise a number of different changes to the MPOC. Gas Industry Co has previously considered whether it can approve some such changes and reject others. Our conclusion is that this is not possible. A change request is submitted as a package and must be approved or not approved in its entirety. For this reason, Gas Industry Co actively encourages submitters to limit the scope of change requests. This allows for easier analysis and lowers the chance that one unacceptable aspect of a change request can cause the whole request to be rejected.

In contrast to its statutory role, Gas Industry Co's role under the MPOC is not a proactive regulatory role of considering issues and formulating and driving potential solutions in order to advance the statutory objectives. Instead, it is a reactive role (within the context of a specific contractual framework) of considering the specific "solutions" that others have formulated, and assessing those "solutions" against the Gas Act objectives. As such, it is not open for Gas Industry Co to alter a proposed amendment in a material manner or to unilaterally "split up" (and separately assess) individual elements of a change request.

The decision as to the form and content of a change request, and any revisions or alternatives (in response to submissions), is one for the MPOC parties themselves, rather than for Gas Industry Co. Accordingly, while Gas Industry Co acknowledges the desirability (for the reasons set out above) of discrete change requests (balanced against considerations of cost and complexity), the terms of the MPOC and the MoU oblige Gas Industry Co to assess the costs and benefits of a change request as a whole and to make its recommendation based on the outcome of that assessment.

In summary, Gas Industry Co will continue to work within the current framework of the MoU and the MPOC, and the submissions received do not change the conclusions reached by Gas Industry Co as recorded in the Draft Recommendation.

### **5.3 Overall final evaluation**

Overall, the submissions received do not change the conclusions reached by Gas Industry Co and recorded in the Draft Recommendation. For the reasons set out in the Draft Recommendation, Gas Industry Co considers the changes proposed by the April Change Request will provide a net benefit.

# 6

## Final recommendation

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Gas Industry Co supports the April Change Request.