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

Date of Application:	13 October 2011
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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 details of and reasons for the amendments to the Maui Pipeline Operating Code (**MPOC**) proposed by the Applicant.

1.2 Please find **enclosed** a marked up copy of MPOC showing the Applicant's proposed amendments in full. The document which formed the basis of the recent Applicant-led informal consultation process has been included as Appendix I. And a synopsis of stakeholder feedback given during that process has been included as Appendix II.

1.3 In this Change Request application (**Application**), unless the context otherwise requires:

(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 Applicant's 17 December 2009 Change Request (**Dec 2009 CR**);

(b) submissions lodged by stakeholders on the Dec 2009 CR, including the GIC Status Update dated 12 March 2010 (**Status Update**) and submissions lodged on the Status Update;

(c) the Industry Code Development (**ICD**) Process and the MoU that came out of it;

(d) informal views expressed by stakeholders during and subsequent to:

(i) the balancing workshops hosted by the Applicant in March 2011; and

(ii) the consultation round the Applicant conducted throughout August and September 2011.

1.5 The Applicant also notes that should this application ultimately be successful, the proposed changes would have implications downstream on Vector's system (in particular, for the mechanics of the Vector Transmission Code). In the interests of a smooth transition we record our willingness to work together with Vector in coordinating implementation of any changes, on the following terms:

(a) Vector provides the Applicant – within one month of the GIC's Final Recommendation – with a reasonable plan setting out the process Vector proposes to undertake in order to make all necessary changes.

(b) The changes would become effective:

(i) six months after the date of the GIC's Final Recommendation; or

(ii) on an earlier date agreed with Vector.

2. The application at a glance

2.1 In addressing an issue that has for several years proved disproportionately fractious given the annual costs associated with it, the Applicant hopes that this Application will gain safe passage and mark another step in the improvement of New Zealand's gas transmission balancing framework.

2.2 The purpose of the Application is to put forward a "back to back" (**B2B**) balancing framework, the mechanics of which the industry is now – after the failed Dec 2009 CR and subsequent consultation initiatives – very familiar. In short, if the Application is successful, the industry will benefit from greater certainty in terms of their exposure to balancing charges and significantly better targeting of those charges to "causers". The Applicant also expects that the new regime, with its tighter compliance incentives, would put downward pressure on overall Balancing Gas volumes, ultimately at a saving to end users.

2.3 Importantly the Application proposes only the bare minimum changes to MPOC that are required to bring in a B2B framework in a workable fashion. This follows the Applicant's experience with the Dec 2009 CR and reflects strong messages from industry and the GIC in response to the recently approved 18 April 2011 Change Request (**Apr 2011 CR**).

2.4 Given this approach the Applicant hopes not to be faced with objections that the Application does not go far enough. Before submitting this Application the Applicant has engaged with stakeholders in recent months to seek their views on the proper parameters of the changes required (if any). While inevitably there will be disparate views on some matters based on the different interests at play, the Applicant considers that the Application contains only and all those changes required to introduce a B2B system in a workable fashion – no more, no less.

2.5 Most notable among the proposed amendments are:

(a) ***Introduction of a new section 3A ("Balancing Principles")***. These provisions would enhance transparency surrounding the role of the Balancing Agent.

(b) ***New information to be published on OATIS and the BGX under section 4***. This information primarily relates to entry by the Balancing Agent into balancing transactions – prices, circumstances, terms and conditions – but will also include among other things real time metering information at all Welded Points (**WTs**) located at Large Stations.

(c) ***Removal of TP Welded Parties' ability to nominate Balancing Gas during the post Intra-Day Cycle***. This removes a facility the Applicant believes to have been originally included in MPOC as a transitional measure, the justification for retaining it having now passed.[1] Vector has never used the facility. To retain the facility would in the Applicant's view frustrate the integrity of the B2B framework and the introduction of a real-time spot market.

(d) ***Removal of the current Imbalance Limit Overrun Notice (ILON) process and corresponding introduction of B2B provisions***. WTs would instead be cashed out at the end of every Day on which the Balancing Agent undertakes a balancing transaction (if the WT in question has an Accumulated Excess Operational Imbalance (**AEOI**) in "the same direction" as that transaction).

(e) ***Removal of the Balancing Agent's ability to claim against the Incentives Pool (IP)***. This is consequential upon introduction of B2B cash outs as the primary cost recovery mechanism. The Welded Party (**WP**) to WP claim facility has however remained intact.

(f) ***Introduction of a peaking charge that is triggered on Days when either Balancing Gas has been called or when Line Pack has fallen below a certain threshold***. This represents a "softer" charge than was proposed during the informal consultation process, the softening having been driven largely by the resistance that the original proposal – a flat peaking charge that would have applied every day – met from stakeholders. Once either of the preconditions is triggered the System Operator (**SO**) would notify users, in accordance with the Maui Balancing Gas Instruction (**Balancing SOPs**), that the Peaking Charge is live. The charge would apply in respect of the Day as a whole, not just during the subsequent period prior to the end of the Day. However the incentive created is an important one: when the transmission system is in distress, sending a price signal that gas is a scarce resource will promote the optimal use of the system

[1] At the time the MPOC was negotiated, Vector had no contractual mechanism to ensure its shippers' gas usage matched their nominations. It was intended however that Vector would amend its TSAs over time to address this issue – and that the protection afforded by section 8.17 would no longer be required. Vector has had over six years to amend its TSAs; and there are now four Intra-Day Cycles available to a TPWP to deal with fluctuating Line Pack on its pipelines.

and provide a line of defence against activating the emergency measures under the Gas Governance (Critical Contingency Management) Regulations 2008.[2]

(g) ***Revised Peaking Limits and Running Operational Imbalance Limits (ROILs)***. These have been reduced for the most part,[3] largely in pursuit of the aim of better targeting balancing costs to "causers". Tolerances plainly being a socialisation mechanism. If left unchanged the Applicant's analysis shows the industry would likely face greater (not lesser) levels of socialised costs, by virtue of how the B2B mechanism operates.

2.6 These proposed amendments and those incidental to them are discussed in further detail below.

3. **ILONs out; B2B cash-outs in**

3.1 Fundamental to this Application is replacement of the current ILON process with a B2B cash-out mechanism. In tandem with this, Balancing Agent claims on the IP would be removed – a prospect discussed in section 5 below – leaving "end of Day" cash-outs as the primary cost recovery mechanism on Days when the Balancing Agent has put or called Balancing Gas.

3.2 Below are the most notable features of B2B balancing:

(a) On Days when the Balancing Agent enters into a Balancing Gas transaction (put or call) all WTs with an AEOI at the end of the Day "in the same direction" as that transaction (i.e. negative AEOI in the case of call, positive AEOI in the case of put) are cashed-out up to the cost of that transaction.

(b) If on a balancing Day there is more than enough AEOI available to meet the Balancing Agent's costs, the relevant WTs will be cashed-out on a pro rata basis according to their AEOI. If on the other hand there is insufficient AEOI to meet

[2] By analogy, r67(b) of the Gas Governance (Critical Contingency Management) Regulations 2008 notes that one of the purposes of applying a "critical contingency price" to "contingency imbalances" is to "signal to suppliers and consumers of gas that it is a scarce and valuable product during a critical contingency".

[3] This is particularly so in the case of ROIL tolerances which – rather than being codified in MPOC itself have historically been benchmarked with their DOIL counterparts – would play an integral role in the B2B cash out regime.

the Balancing Agent's costs, the relevant WTs will be cashed-out to the full amount of their AEOI.

3.3 Under the current system, costs not recovered from "causers" are socialised (and redistributed) the following year through tariff adjustment. This means that "causers" are being subsidised, that other Parties get the bill for balancing actions they did not cause. While under the status quo levels of socialised costs are not perceived by the industry as overly problematic in the scheme of things, socialisation (and therefore subsidisation) can be reduced, thereby promoting competition in line with Government policy.

4. Introduction of a Peaking Charge

4.1 As noted above, the Peaking Charge would be triggered on Days when either Balancing Gas is called or Line Pack falls below a certain threshold. That threshold would be set after each nomination cycle by the SO, at 10TJ above the top of the Contingency Volume (**Low Line Pack Threshold**). The SO already carries out capacity check calculations – as noted in section 2.1 of the Balancing SOPs – which:

(a) demonstrate that requested nominations can be flowed by the pipeline without breaching Target Taranaki Pressure; and

(b) compute the components of target Line Pack, including the Contingency Volume.

4.2 The Contingency Volume threshold is currently visible to Shippers on the MDL IX (on the "Linepack Graph and Details Page"). Rather than simply including the Low Line Pack Threshold as another line on the same graph, the Low Line Pack Threshold would instead be included as a new line on the Maui Pipeline Line Pack graph displayed on the "Pipeline Data" page of the BGX (which, to the Applicant's knowledge, is more often used for monitoring purposes). When Line Pack falls below the Low Line Pack Threshold the SO would notify Shippers and WPs in accordance with the Balancing SOPs.

4.3 The Commercial Operator's modelling projects that, based on 2010 data, there would have been 15 Days when the Low Line Pack Threshold was breached but Balancing Gas not called (there were 62 Days when Balancing Gas was called). That is, Peaking Charges would have applied on 15 additional Days than they did under the (current) IP mechanism.

4.4 Analysis suggests that there will likely be Days when the Applicant calls Balancing Gas when Line Pack remains above the Low Line Pack Threshold (i.e. in "the green zone"), for daily Line Pack management purposes. As a matter of policy, given the Applicant would be incurring a cost, Peaking Charges should apply on such Days. Hence the use of call Balancing Gas Days as a secondary trigger.

4.5 The charge would be calculated based on the current section 13.3 peaking methodology (but remain quite separate from the IP itself). That is, for every GJ by which a WT exceeds its Peaking Limit the WP would be invoiced at a price, being the Mismatch Price spread on the Day.

4.6 Peaking relief per the current section 13.4 (proposed section 13.5) would continue to apply. That is, in respect of Force Majeure Events, Contingency Events, Pipeline Contingency Events and unscheduled Maintenance.

5. No Balancing Agent claims against the Incentives Pool

5.1 This follows the proposed introduction of the B2B cash out facility as the Applicant's primary cost recovery mechanism in tandem with the proposed Peaking Charge. To maintain the Balancing Agent's ability to claim on the IP would yield a "double jeopardy" outcome whereby WPs are penalised twice in respect of the same imbalance.

5.2 WPs' ability to claim on the IP would remain intact. While the Applicant admits it would be "cleaner" to remove the Incentives Pool altogether under the proposal:

(a) there has historically been opposition from certain stakeholders to removal of the WP to WP claim mechanism; and

(b) it's not a change that's absolutely necessary to the introduction of a B2B system, and so it falls beyond the scope of this "minimalist" Application.

6. Revised tolerances

ROILs

6.1 Because balancing has always been a zero sum game for the Applicant – any surplus recovery or shortfall results in tariff adjustment the following year – the Applicant's overriding objective is to allocate to the best of our ability costs to "causers", preventing otherwise avoidable subsidisation.

6.2 ROILs have the effect of "blunting" the B2B mechanism as a tool that recovers costs from "causers". The wider they are set, the more other Parties subsidise "causers". The Applicant proposes that they be set at 1% of SQ or 1TJ (whichever is higher) – a level which we believe strikes an appropriate balance between the targeting of costs to "causers" and nonetheless allowing users some level of operational flexibility before facing the prospect of balancing charges.

DOILs

6.3 DOILs have not been revised in this proposal. The WP to WP IP Claim mechanism has been retained at the request of certain stakeholders; and this is the only context in which DOILs would play a part (in calculating Excess Daily Imbalance). Because such claims do not involve the Applicant – and because the mechanism has traditionally proved to be a source of some sensitivity – the Applicant does not propose to interfere by revising the DOILs currently listed in Schedule 7.

Peaking Limits

6.4 The proposed Peaking Limits have been set by reference to historic flows – at one standard deviation above 2011 YTD[4] average hourly flows.

7. Transparency – Balancing Principles and information published

7.1 The proposed new section 3A increases transparency surrounding the role of the Balancing Agent, in particular by:

(a) distinguishing between the processes for buying and selling Gas for normal (relatively predictable) pipeline operations (i.e. Fuel Gas) and for balancing;

[4] 1 January to 30 September 2011.

(b) laying out the principles governing how the Balancing Agent will go about buying and selling Gas (e.g. buy at the lowest available price, sell at the highest available price);

(c) prescribing the criteria that the Balancing Agent's standard terms and conditions for Balancing Gas Calls and Balancing Gas Puts must address; and

(d) setting out what transaction details the Balancing Agent will publish and the platform they will be published on.

8. General

8.1 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	Matter / issue	Proposed Change(s)	Rationale for Proposed Change(s)
1.1	New and amended definitions	New definitions: • "Balancing Gas Call" / "Balancing Gas Put" • "BGX" • "Cash-Out Quantity" / "Cash-Out Transaction" • "Low Line Pack Threshold" / "Flow Line Pack" • "Mean Call Price" / "Mean Put Price" • "Peaking Charge" The "Balancing Agent", "Incentives Pool Claim" and "ROIL" definitions have necessarily been amended.	These proposed amendments are consequential upon substantive changes proposed to bring in a B2B balancing framework.
1.2	Interpretation	New subclause (o): *a reference to a "price" for Gas includes a negative price (being, for the avoidance of doubt, a transaction where the seller of a quantity of Gas pays the buyer to take title that quantity of Gas) and the payment obligations in respect of a negative dollar value shall be interpreted so that the payer of a negative value shall be the payee of the same positive value*	To complement the calculation methodologies for Mean Call and Put Prices.
3A	Balancing Principles	New section 3A (broadly similar to that proposed in the Dec 2009 CR) setting out principles governing the	To provide a greater level of transparency in relation to the role of the Balancing Agent, the processes that are

Section	Matter / issue	Proposed Change(s)	Rationale for Proposed Change(s)
		Balancing Agent's role, for example: • how details of balancing transactions will be published, and • the basis on which the Balancing Agent will buy and sell Balancing Gas.	carried out by the Balancing Agent and publication of information relating to Balancing Gas transactions.
4	MDL IX & BGX	• Balancing Gas Calls / Puts and Mean Call / Put Prices to be "generally available" on MDL IX • Various details to be made generally available on the BGX including Balancing Gas standard terms and conditions, Balancing Gas Calls / Puts, Cash-Out Transactions, real time metering information at Large Station WPs and monthly ledger of Balancing Agent income/expenditure.	To enhance transparency surrounding the entry into and details of balancing transactions.
8.17, 9.10	Post Intra-Day Cycle nominations	Delete the current section 8.17.	The original justification for this provision has now subsided.
12.10 – 12.13	Current ILON framework replaced with B2B	Delete sections 12.10 to 12.13. Introduce new sections 12.10 and 12.11 to deal with cash out of positive AEOI and negative AEOI respectively, and a new section 12.12 to deal with cash out of Notional Point Welded Parties.	Replace the current cash-out (ILON) framework with a (daily) B2B one.
12.15	Outstanding ROI on	Amend section 12.15 (section 12.13 under proposed	This is consistent with the proposed move to a daily B2B

Section	Matter / issue	Proposed Change(s)	Rationale for Proposed Change(s)
	termination of ICA	amendments) to provide that ROI is cashed out at the end of the Day, rather than the WP effectively having a two Day window to eliminate it.	regime. Note in these circumstances it is the WP's ROI, not AEOI (i.e. BAU) which is cashed out.
13.4	Peaking Charge	New section 13.4 requiring WPs to pay a Peaking Charge to MDL for every GJ by which they exceed their Peaking Limit on Days when either: • Balancing Gas has been called, or • Line Pack drops below the "Low Line Pack Threshold".	This creates an important incentive when the Pipeline is vulnerable by putting a premium on a scarce resource. In doing so it most efficiently allocates the available Gas to those that have a need for it.
14	Balancing Agent claims on the Incentives Pool	Remove the Balancing Agent's ability to claim against (and the IP Trustee's ability to receive claims from) the Incentives Pool.	This reflects two things. First, that B2B cash-outs would provide the primary cost recovery mechanism under the proposed framework. And second, that peaking would be managed through the proposed Peaking Charge, rather than through the Incentives Pool.
19.5	Fees payable to WP	WPs to pay the Mean Call Price (rather than the Negative Mismatch Price) for any quantity of Gas MDL sells to that WP under the B2B cash-out provision.	Consequential upon introduction of B2B framework.
19.7	Fees payable by MDL	MDL to pay the Mean Put Price (rather than the Positive Mismatch Price) for any quantity of Gas MDL buys from a WP under the B2B cash-out provision.	Consequential upon introduction of B2B framework.

Section	Matter / issue	Proposed Change(s)	Rationale for Proposed Change(s)
Schedule 7	Minimum tolerances	Revised Peaking Limits and ROILs.	To optimally calibrate the B2B framework in terms of targeting cost to "causers" while at the same time providing participants with sufficient flexibility to manage their positions without incurring penalties.

APPENDIX: CONSULTATION DOCUMENT

APPENDIX II: CONSULTATION FEEDBACK AND THE APPLICANT'S RESPONSES