

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

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Applicant: Maui Development Limited (**MDL**)

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BRIEF DESCRIPTION OF PROPOSED AMENDMENTS

This Application sets out the amendments to the MPOC that MDL considers necessary or desirable to establish and operate notional "Trading Hub" Welded Points on the Maui Pipeline.

1. INTRODUCTION

1.1 In accordance with the standard "Recommendation Request form" issued by the Gas Industry Company Limited (the **GIC**), this Change Request by MDL (the **Applicant**) includes:

- (a) details of the amendments to the Operating Code proposed by the Applicant;
- (b) the reasons for the proposed amendments;
- (c) the Applicant's assessment of the effect of the proposed amendments on:
 - (i) the rights and obligations of parties to ICAs and TSAs; and
 - (ii) the operation of the Maui Pipeline;
- (d) the Applicant's assessment of how and why the proposed amendments are consistent with:
 - (i) dealings between the Applicant and users of the Maui Pipeline being transparent, commercial, at arm's length and non-preferential;
 - (ii) the bi-lateral contractual relationships between parties to ICAs and TSAs;
 - (iii) any relevant Government policy requirements; and
 - (iv) any relevant objective of the kind referred to in paragraph 2.3 of the Memorandum of Understanding between the GIC and the Applicant dated 5 October 2006;

- (e) the Applicant's assessment of what costs and benefits the proposed amendments will bring to the Applicant and other industry participants; and
- (f) the Applicant's opinion on how the proposed amendments comply with the Commerce Act and other relevant law.

1.2 In this Change Request, unless otherwise stated:

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

2. DETAILS OF THE PROPOSED AMENDMENTS

2.1 The amendments to the Operating Code proposed by the Applicant are:

- (a) addition of the following definitions in section 1 (Definitions and Interpretation):
 - (i) ***“Notional Point Welded Party”*** means the Welded Party at a Notional Welded Point;
 - (ii) ***“Notional Welded Point”*** means each of the Trading Hub Receipt Point and the Trading Hub Delivery Point;
 - (iii) ***“Trading Hub Delivery Point”*** means the notional Delivery Point established for the purposes of a Trading System (which, for the purposes of calculating any Throughput Charges, shall be deemed to be located at a point on the Maui Pipeline specified in the relevant ICA);
 - (iv) ***“Trading Hub Receipt Point”*** means the notional Receipt Point established for the purposes of a Trading System (which for the purposes of calculating any Throughput Charges shall be deemed to be located at a point on the Maui Pipeline specified in the relevant ICA);
 - (v) ***“Trading System”*** means a wholesale market system for use for the trading of short-term quantities of Gas;
 - (vi) ***“Physical Point Welded Party”*** means a Welded Party at a Physical Welded Point;
 - (vii) ***“Physical Welded Point”*** means any point at which there is a connection between the Maui Pipeline and the infrastructure of a Welded Party (including the facilities connecting the Maui Gas production station at Oaonui to the Maui Pipeline);
 - (viii) ***“Physical Delivery Point”*** means a Delivery Point that is a Physical Welded Point; and
 - (ix) ***“Deemed Measured Quantity”*** means, in respect of a Day and a Notional Welded Point, a quantity of Gas equal to that Day's Scheduled Quantity for the Trading Hub Delivery Point;

- (b) amendment of the following definitions in section 1 (Definitions and Interpretation):
- (i) **“Excess Daily Imbalance”**;
 - (ii) **“Operational Imbalance”**;
 - (iii) **“Reasonable and Prudent Operator”**;
 - (iv) **“Scheduled Quantity”**;
 - (v) **“Shipper Rolling Forecast”**;
 - (vi) **“Transmission Day”**; and
 - (vii) **“Welded Point”**;
- (c) amendments to section 2.1 relating to the provision for, and disclosure of, special terms and conditions in an ICA between MDL and a Notional Point Welded Party;
- (d) addition of section 8.32, which states:

Notwithstanding any other provision of this Operating Code, MDL shall not deliver, and a Shipper shall not request MDL to deliver, any quantity of Gas to or from a Notional Welded Point unless that Notional Welded Point is at the relevant time registered on the MDL IX as included in that Shipper’s TSA. MDL shall, if requested by the Notional Point Welded Party in writing, in respect of a Shipper:

- (a) *register the Notional Welded Points on the MDL IX as included in that Shipper’s TSA;*
or
 - (b) *de-register the Notional Welded Points from that Shipper’s TSA on the MDL IX.*
- (e) amendments to sections 12.6 and 12.8 to confirm that the Daily Operational Imbalance Limit at each Notional Welded Point shall be zero;
- (f) amendment to section 12.11 to allow MDL to “cash-out” any Operational Imbalance that remains at the end of a Transmission Day at a Notional Welded Point;
- (g) addition of section 12.19, which states:

Notwithstanding any other provision of this Operating Code, for the purposes of calculating Operational Imbalance, Running Operational Imbalance and Excess Daily Imbalance in relation to a Notional Welded Point the quantity of Gas that on a Day has flowed through the Trading Hub Delivery Point and the Trading Hub Receipt Point, respectively, shall be the Deemed Measured Quantity for that Day. The Parties acknowledge that the effect of this section 12.19 is that there shall be no Operational Imbalance, Running Operational Imbalance or Excess Daily Imbalance at the Trading Hub Delivery Point. The Notional Point Welded Party shall use all reasonable endeavours to ensure that at all times there is no Operational Imbalance, Running Operational Imbalance or Excess Daily Imbalance at the Trading Hub Receipt Point;

- (h) amendments to section 13.2 and 13.3 to confirm that Operational Profile Notices and Incentives Pool Debits for exceeding the Peaking Limit only apply to Physical Welded Points;
- (i) amendments to sections 15.1 to enable MDL to curtail Approved Nominations and associated Scheduled Quantities at any relevant Welded Point in order to prevent Operational Imbalance occurring at Notional Welded Points. This amendment is required due to OATIS's inability to 'see through' the Trading Hub Delivery Point and carry through a curtailment to the Trading Hub Receipt Point (or vice versa);
- (j) amendment to section 19.1(c) to reflect the fact that Tariff 2 will not be payable on Gas transported to the Trading Hub Delivery Point;
- (k) addition of section 22.13, which states:

MDL may suspend the ICA of a Notional Point Welded Party by giving the Notional Point Welded Party 30 Days' notice. During any such suspension Shippers shall not be able to submit Nominated Quantities in respect of the Trading Hub Delivery Point or the Trading Hub Receipt Point. MDL may reinstate the ICA of a Notional Point Welded Party that has been suspended by giving the Notional Point Welded Party 7 Days' notice;
- (l) Amendments to Schedule 3 to allow for the establishment of Notional Welded Points in Welded Party Agreement form; and
- (m) amendments to sections 6.4, 8.1, 8.7, 12.1, 12.8, 14.6, 19.5, 19.7, 21.4, 24.2 and Schedule 1 that are purely of a drafting nature and consequential to the amendments described above,

(together, the **Proposed Amendments**).

2.2 The Proposed Amendments are highlighted in yellow in the mark-up of the Operating Code attached to this Change Request.

3. **REASONS FOR THE PROPOSED AMENDMENTS**

3.1 The Gas Industry Company Limited (**GIC**) engaged MDL to assess the feasibility of establishing and operating two Notional Welded Points on the Maui Pipeline that would function as a gas "Trading Hub" for the wholesale gas market in New Zealand. MDL has prepared a set of amendments to the current MPOC that incorporates the Notional Welded Points and makes the changes to existing MPOC provisions that MDL considers would be necessary to accommodate the operation of a Trading Hub Receipt Point and Trading Hub Delivery Point.

3.2 Primarily, the Proposed Amendments are required to:

- (a) address the notional nature of the Trading Hub Receipt Point and Trading Hub Delivery Point;

- (b) incorporate the Notional Welded Points into the MPOC, and consequently OATIS, in a way that makes them function in a similar fashion to standard Physical Welded Points in respect of Operational Imbalance; and
- (c) enable a Trading System to:
 - (i) work interdependently with; and
 - (ii) minimise impact on existing systems, processes and procedures related to the transmission and allocation of gas on the Maui Pipeline.

4. EFFECT OF THE PROPOSED AMENDMENTS

4.1 The parts of the Operating Code amended by the Proposed Amendments are incorporated in each ICA and TSA, so the amendments to Operating Code provisions effected by the Proposed Amendments would result in those provisions being amended in each ICA and TSA.

4.2 After the Proposed Amendments are incorporated into the Operating Code it will be clear that:

- (a) a Shipper on the Maui Pipeline will not be able to nominate any quantity of Gas to or from a Notional Welded Point (and therefore trade gas through the Trading System) unless the Notional Point Welded Party has requested MDL to register the Notional Welded Points on the MDL IX as included in that Shipper's TSA;
- (b) a Shipper will be prevented from utilising the Notional Welded Points if:
 - (i) the Notional Point Welded Party requests MDL to de-register the Notional Welded Points from that Shipper's TSA on the MDL IX; or
 - (ii) MDL suspends the ICA of a Notional Point Welded Party in accordance with proposed section 22.13;
- (c) a Shipper transporting gas to the Trading Hub Delivery Point will not be charged Tariff 2;
- (d) MDL will not track title of gas through the Trading System. This is because:
 - (i) OATIS does not have the ability to track the title of a Shipper's quantity of gas from the moment it is delivered to the Trading Hub Delivery Point through all of the subsequent Trading System trades relating to that Shipper's gas to the point in which it is received back into the Maui Pipeline at the Trading Hub Receipt Point;
 - (ii) if curtailment occurs at a Notional Welded Point, Shippers' Approved Nominations will be reduced based on MPOC provisions and pro-ration rules in OATIS; and
 - (iii) the Notional Point Welded Party will be required to reconcile any differences between title allocated under the MPOC and title tracked on the Trading System;
- (e) Operational Imbalances at Notional Welded Points will be determined on the following basis:

- (i) the Daily Operational Limit (**DOIL**) and Running Operational Limit (**ROIL**) at each Notional Welded Point shall be zero; and
 - (ii) the Deemed Measured Quantity used to calculate Operational Imbalances at the Trading Hub Receipt Point and Trading Hub Delivery Point will be the quantity of Gas equal to that Day's Scheduled Quantity for the Trading Hub Delivery Point;
- (f) if the Trading Hub Receipt Point has an Operational Imbalance at the end of a Transmission Day (i.e. if the Scheduled Quantity at the Trading Hub Receipt Point is different to the Scheduled Quantity at the Trading Hub Delivery Point), then:
- (i) the operational Imbalance will be cashed out; and
 - (ii) Incentives Pool Debits will accrue for the Excess Daily Imbalance;
- (g) the Notional Point Welded Party will not accrue Incentives Pool Debits for exceeding the Peaking Limit (which will also be set at the minimum limit).
- (h) DOIL, ROIL and Peaking Limits at the Notional Welded Points will be set at their minimum limits to remove any impact on the calculated flexibility line pack during OATIS capacity checks;
- (i) there may be an Operational Imbalance at the Trading Hub Receipt Point. The items below describe how this may occur and the tools available under the MPOC to respond to this Operational Imbalance:
- (i) errors may occur in:
 - (aa) Shippers' Nominated Quantities to or from the Notional Welded Points;
 - (bb) the Notional Point Welded Party confirmations (although this should be prevented by auto-confirmation at the Notional Welded Points); and
 - (cc) Welded Party confirmations at the Physical Welded Point which is at the other end of the Nominated Quantity.

Any such errors are expected to be corrected during subsequent Intra-Day Cycles. If errors are not corrected and the imbalance is contributing to declining Line Pack, MDL may curtail the Notional Welded Point to reduce the imbalance. If errors remain at the end of the Transmission Day, MDL will cash out the Operational Imbalance on the following Business Day;

- (ii) curtailments due to Maui Pipeline or Welded Point events affecting Approved Nominations to/from the Notional Welded Points may result in an Operational Imbalance (due to OATIS's inability to 'see through' the Trading Hub Delivery Point to the Trading Hub Receipt Point or vice versa). In order to carry the curtailment through to the opposing end physical Welded Point(s), MDL will balance the Notional Welded Points by curtailing (relying on section 15.1(vi)) the appropriate Notional Welded Point (the one with the higher Scheduled Quantity);
- (iii) complex OATIS validation checks which are part of the MDL/OATIS approvals

process including the check which prevents negative Scheduled Quantities as a result of Displaced Gas Nominations may result in an Operational Imbalance. MDL may be required to perform a number of curtailments at the Notional Welded Points (relying on section 15.1(vi)) to prevent an Operational Imbalance from occurring; and

- (iv) it should be noted that any Operational Imbalance that remains at the end of a Transmission Day, regardless of the cause of the Operational Imbalance, will be cashed out and the Notional Point Welded Party will have an Excess Daily Imbalance and be liable to incur Incentives Pool Debits;
- (j) MDL will have access to imbalance management and cost recovery tools at Notional Welded Points such as the ability to:
 - (i) cash out all Operational Imbalances (no Daily Operational Imbalance Limits or Running Operational Imbalance Limits apply at Notional Welded Points) that remain at the end of each Transmission Day at a Notional Welded Point;
 - (ii) curtail a Notional Welded Point under section 15.1;
 - (iii) have the Balancing Agent make an Incentives Pool Claim for a Day where balancing gas was utilised to replace a Notional Welded Point's Excess Daily Imbalance; and
 - (iv) suspend the ICA of a Notional Point Welded Party on 30 Days' notice.

4.3 MDL does not know all of the implications that the Notional Welded Points may have on pipeline operations and management costs. Accordingly, MDL needs to have a very broad right to suspend the Notional Point Welded Party's ICA if the operation of the Notional Welded Points is impacting on the pipeline at all (or is likely to do so). The proposed section 22.13 gives MDL the right to suspend even if there is a potential problem that has not yet had an effect.

4.4 MDL will not:

- (a) manage "operational profile" notices and Incentives Pool Debits in relation to peaking at Notional Welded Points since peaking gas flows occur only at Physical Welded Points; or
- (b) charge Tariff 2 for any Gas transported to the Trading Hub Delivery Point as MDL will receive Tariff 2 in respect of transport from the Trading Hub Receipt Point to the relevant Physical Welded Point.

5. **CONSISTENCY OF THE PROPOSED AMENDMENTS WITH OPERATING CODE RELATIONSHIPS AND GOVERNMENT POLICY**

Consistency with dealings between MDL and users of the Maui Pipeline being transparent, commercial, at arm's length, and, non-preferential

5.1 All participants in a Trading System (i.e. Shippers that have also agreed to be bound by the terms and conditions governing the operation of a Trading System) will have the Trading Hub Receipt Point and Trading Hub Delivery Point added to their Transmission Services Agreements (**TSAs**). Shippers that are not participants in a Trading System will be unable to make nominations to or

from the Notional Welded Points. MDL understands that all Shippers will have the right to participate in a Trading System on the same terms. In accordance with proposed section 8.32, the Notional Point Welded Party will advise MDL in writing of the Maui Pipeline Shippers' who are authorised to make nominations to or from the Notional Welded Points. This is a similar provision to section 2.14 (that applies to Shippers' use of Welded Points connecting with Transmission Pipelines).

5.2 MDL assumes that a Notional Point Welded Party will ensure that its activities, when managing the Notional Welded Points are transparent, commercial, at arm's length and non-discriminatory. However, consistent with section 2.14, MDL does not seek to impose conditions in the MPOC that would limit the Notional Point Welded Party's contractual freedom.

5.3 The Proposed Amendments are consistent with dealings between MDL and users of the Maui Pipeline being transparent, commercial, at arm's length and non-preferential.

Consistency with the bi-lateral contractual relationships between parties to ICAs and TSAs

5.4 No amendment to any individual ICA or TSA is required in order to give effect to the Proposed Amendments. The Proposed Amendments apply equally to all ICAs and TSAs. MDL will post details of the ICA with the Notional Point Welded Party on the MDL IX.

Consistency with any relevant Government policy requirements

5.5 The Applicant considers that the relevant Government policy requirements in this context (the **GPS Objectives**) are those set out in the *Government Policy Statement on Gas Governance* dated April 2008 (the **GPS**).

5.6 The Proposed Amendments are consistent with the relevant GPS Objectives for the following reasons:

(a) *Gas is delivered to existing and new consumers in a safe, efficient and reliable manner:* The Proposed Amendments are consistent with this objective as a Trading System enables an efficient market to be established where buyers can seek the cheapest source of gas from sellers, and sellers can seek the parties who place the highest value on the gas available. The deeming of title associated with Approved Nominations under the MPOC means that transferring title to gas should be relatively simple at the Notional Welded Points. In addition, if the only users of the Notional Welded Points are participants in the wholesale market then the trading activity is isolated from other trading activities which occur at Physical Welded Points, which is expected to minimise contractual complexity. Even though Notional Welded Points do not physically delivery or receive gas, the nominations to/from the Notional Welded Points will always reflect physical flow to/from Physical Welded Points and the balancing tools available to the Notional Point Welded Party and MDL are there to help ensure the overall pipeline system is balanced.

(b) *The facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure and competitive market arrangements:* The Proposed Amendments encourage access and competition because a Trading System assists in avoiding high transaction costs by providing standard short-term contracting between blind counterparties, which encourages liquidity in the market.

- (c) *Barriers to competition in the gas industry are minimised:* The Applicant considers that the Proposed Amendments will increase competition in the gas industry. A Trading System should be open to any participant that agrees to the terms of the Notional Point Welded Party. And by enabling trading to occur at one location, there is a greater chance for increased competition with multiple buyers and sellers.
- (d) *Incentives for investment in gas processing facilities, transmission, and distribution are maintained or enhanced:* The “incentives for investment” are maintained and not hampered in any way by the introduction of Notional Welded Points on the Maui Pipeline. There may be situations in the future that encourage investment in firm transportation to and from Notional Welded Points to protect these nominations/trades from curtailment.
- (e) *Delivered gas costs and prices are subject to sustained downward pressure:* A Trading System provides for a homogenous product where the only distinguishing features are price and time period. The Notional Point Welded Party, like existing Physical Point Welded Parties, remains liable for Operational Imbalance charges, including Incentives Pool claims for Excess Daily Imbalance. Gas prices will be exposed to sustained downward pressure by virtue of the market having access to the cheapest source of gas on the day. Price transparency will increase as prices will reset more frequently in a Trading System enabling more parties to see the change in value and react or be more responsive to changing conditions.
- (f) *The full costs of producing and transporting gas are signalled to consumers:* Notional Welded Points will be deemed to have a physical location (for tariff purposes) at a point on the Maui Pipeline (i.e. a kilometre distance from the origin of the Maui Pipeline). MDL and the Notional Point Welded Party will agree on the specific location – taking into account transport costs for sellers (to bring gas to the Trading Hub Delivery Point) and buyers (transporting gas away from the Trading Hub Receipt Point). MDL has agreed to waive charging Tariff 2 on any Gas nominated to the Trading Hub Delivery Point on the basis that such Gas is not leaving the pipeline and that such volume of Gas will be the subject of a charge for Tariff 2 by virtue of being nominated to a physical Delivery Welded Point from the Trading Hub Receipt Point.

How and why the Proposed Amendments relate to, and are consistent with, any relevant objectives specified in section 43ZN of the Gas Act

- 5.7 The relevant objectives specified in section 43ZN of the Gas Act (the **Gas Act Objectives**) essentially mirror the relevant GPS Objectives. Accordingly, the Applicant considers that the Proposed Amendments are consistent with the Gas Act Objectives for the same reasons (outlined above) as the Proposed Amendments are consistent with the GPS Objectives.

6. MDL SUPPORT OF PROPOSED AMENDMENTS

MDL is the applicant.

7. **APPLICANT'S ASSESSMENT OF WHAT COSTS AND BENEFITS THE PROPOSED AMENDMENTS WOULD BRING TO MDL, OTHER PARTIES AND OTHER INDUSTRY PARTICIPANTS**

The Applicant's assessment of these matters has been set out above. In summary, the Applicant considers that the Proposed Amendments would benefit the Operating Code parties and other industry participants by clarifying that:

- (a) aggregating trading activity at a Trading System at one location should provide the benefits of:
 - (i) increased market liquidity resulting from increases in the number of trading participants, number of trades, and quantities being traded;
 - (ii) price and information transparency; and
 - (iii) increased competition;
- (b) encouraging trading activity in a Trading System minimises transport costs to the Shipper by virtue of:
 - (i) no Tariff 2 charges being applied to Gas transported to the Trading Hub Delivery Point (this bears no cost to MDL on the basis that gas transported to the Trading Hub Delivery Point is not leaving the pipeline and such volume of Gas will be the subject of a charge for Tariff 2 by virtue of being nominated to a Physical Delivery Point from the Trading Hub Receipt Point); and
 - (ii) potentially associating the Notional Welded Points for a Trading System with a location that minimises the risk of back-haul charges for parties transporting Gas away from the Trading Hub Receipt Point;
- (c) a Trading System provides participants with an imbalance management tool which encourages participants to self balance their pipeline positions and may:
 - (i) prevent costs associated with MDL action against imbalances;
 - (ii) minimise balancing actions by the Balancing Agent;
 - (iii) minimise the need for curtailment; and
 - (iv) avoid critical contingency events.

MDL attempted to draft the Proposed Amendments so that it could manage Notional Welded Points in a similar fashion to Physical Welded Points during situations where the Maui Pipeline System Operator is monitoring Line Pack and making curtailment decisions. However, due to OATIS's inability to "see through" one Notional Welded Point to the other Notional Welded Point, there may be circumstances where additional curtailment action must be taken to balance the Notional Welded Points and ensure that the impact on Line Pack is minimised.

8. **HOW THE PROPOSED AMENDMENTS COMPLY WITH THE COMMERCE ACT AND OTHER RELEVANT LAW**

8.1 In the Applicant's view, the Proposed Amendments:

- (a) comply with, and will not contravene, the Commerce Act
- (b) do not contravene any other relevant law; and
- (c) will enable the gas industry to establish a Trading System that will increase opportunities for competitive activity in the wholesale gas market.