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

Date of application: 20 June 2008

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

Contact person: Ron Kelly

DDI: (04) 463 4059

Mobile: (021) 390 188

Email: ron.m.Kelly@shell.com

BRIEF DESCRIPTION OF PROPOSED AMENDMENTS

Amendments agreed by the Maui Mining Companies, comprising:

- the deletion of those parts of the Operating Code that relate to Maui Legacy Gas including those provisions which relate to retrospective allocations of Maui Legacy Gas; and
- changes to certain parts of the Operating Code relating to the Target Taranaki Pressure.

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) the deletion of those parts of the Operating Code that relate to Maui Legacy Gas (the **Maui Legacy Gas Amendments**), including:

(i) the section 3 provisions which relate to retrospective allocations of Maui Legacy Gas and the part of section 12.9 that qualifies a Welded Party's obligation to manage its gas flows at its Welded Points so its Running Operational Imbalance (**ROI**) tend towards zero over a reasonable period of time to the extent that in the Welded Party's reasonable opinion such ROI is attributable to Maui Legacy Gas (the **Maui Legacy Gas Allocation Provisions**);

(ii) the parts of sections 7.1, 7.3, 8.18, 8.19, 8.20, 8.24, 8.26, 8.28, 14, 15.3(e), 15.11 and 18.1(a) that give priority of delivery, or some other preference or benefit, to parties to Maui Legacy Gas Contracts over and above the rights of other users of the Maui Pipeline (the **Maui Legacy Gas Preference Provisions**);

(b) amendments to section 2.19 and the deletion of section 2.21, each relating to the Target Taranaki Pressure (the **Target Taranaki Pressure Amendments**); and

(c) amendments 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 Applicant proposes the Maui Legacy Gas Amendments are made so that, for the purposes of the Operating Code, Maui Legacy Gas is treated similarly to other gas transported in the Maui Pipeline. The Applicant believes this is now appropriate because:

(a) the Maui Legacy Gas Allocation Provisions and the Maui Legacy Gas Preference Provisions were included in the Operating Code to grandfather the Maui Legacy Contracts;

(b) the Applicant believes that these grandfathering provisions are now no longer required; and

(c) to the extent that the Maui Legacy Gas Amendments delete provisions that relate to the Methanex 20/20 Agreement or were otherwise included in the Operating Code for the benefit of Methanex, those deletions are appropriate and have no adverse impact on Methanex or any other industry party because the Methanex 20/20 Agreement has now expired.

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 deletions of, or amendments to, Operating Code provisions effected by the Proposed Amendments would result in those provisions being deleted from, or amended in, each ICA and TSA.

4.2 After the deletion of the Maui Legacy Gas Allocation Provisions it will be clear that the following apply:

(a) each Welded Party at a Welded Point to which Maui Legacy Gas is delivered (a **Legacy Welded Point**) is not subject to retrospective allocation adjustments which could otherwise prevent it from:

(i) ascertaining its Scheduled Quantities at the time that gas flows on a Transmission Day; and

(ii) having the same certainty in relation to the quantum of the Operational Imbalance at the Legacy Welded Point as a Welded Party at any other Welded Point;

(b) MDL is not subject to retrospective allocation adjustments which could otherwise prevent MDL from:

(i) ascertaining Running Operational Imbalances (**ROIs**) at Legacy Welded Points at the end of each Transmission Day; and

(ii) sending Imbalance Limit Overrun Notices (**ILONs**) to Welded Parties that have Accumulated Excess Operational Imbalances (**AEOIs**), and subsequently cashing out those AEOIs, where the ILON's are not complied with; and

(c) the costs of balancing the Maui Pipeline are to be borne by the Welded Parties that have the AEOIs, rather than those costs potentially being treated as part of MDL's operational costs of running the Maui Pipeline business and being passed on to Shippers under Tariff 2;

(d) when MDL enters into contracts with suppliers of balancing gas services MDL can:

(i) ascertain in real time and for certain each Welded Point's Operational Imbalance at any point in a month; and

(ii) therefore, know that the same quantity of gas sold/bought under a balancing gas contract can be required to be sold/bought by a defaulting Welded Party in a cash-out transaction for its AEOI.

4.3 The deletion of the Maui Legacy Gas Preference Provisions would have the effect that, in the circumstances contemplated by those provisions, Maui Legacy Gas and other gas would be treated the same for the purposes of the MPOC.

4.4 The Target Taranaki Pressure Amendments:

(a) to section 2.19, would have the effect that MDL has to give 12 months' prior notice to each Shipper and Welded Party before *changing* the Target Taranaki Pressure limits set out under section 2.19 through the Change Request process. The current wording requires that such notice period be given only if MDL is *reducing* the TTP below 42 bar gauge and is tied to a period when Legacy Gas is flowing. Removal of the reference to Legacy Gas is recommended because the upper limit of the TTP protects many systems against excessive backpressure, and not just the Maui delivery system. ; and

(b) to section 2.21, would have the effect of removing limitations on the circumstances in which adjustments of Nominated Quantities or Approved Nominations can take place under sections 8.25(a), 8.27(a), 8.29(a) or 8.30. Section 2.19 and 2.21 provide an automatic increase to TTP under certain circumstances. The specification of circumstances and the stipulation of the new TTP in such circumstances is not required if an MPOC change is necessary before the TTP limits can be raised.

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 Currently there is a perception amongst some industry participants of a lack of transparency in the Operating Code in relation to the Maui Legacy Gas Allocation Provisions and the Maui Legacy Gas Preference Provisions because of the confidential nature of the Maui Gas Contract, User Contracts and allocation methodologies.

5.2 Accordingly, making the Maui Legacy Gas Amendments would assist with ensuring that all dealings between MDL and users of the Maui Pipeline are seen to be transparent, commercial, at arm's length and non-preferential.

5.3 The Target Taranaki Pressure Amendments would be 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 to MPOC apply equally to all ICAs and TSAs and are therefore consistent between them.

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 appear to be consistent with this objective, in particular the efficiency and reliability aspects provided by more transparent daily Scheduled Quantities at Welded Points and the balancing position described in paragraphs 4.2 (c) and (d) above.

(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 would seem to encourage access and competition because it would remove any perception that there exists an un-even playing field and would result in sending clear pricing signals to parties who do not play by the rules of daily balancing within tolerances.

(c) *Barriers to competition in the gas industry are minimised:* The Applicant believes that by removing the distinction between Maui Legacy Gas and all other gas, the Proposed Amendments would further enhance competition between all Shippers and Welded Parties as all gas would be treated consistently.

(d) *Incentives for investment in gas processing facilities, transmission, and distribution are maintained or enhanced:* A more transparent and straightforward transmission regime would incentivise investment in proper balancing and allocation arrangements.

(e) *Delivered gas costs and prices are subject to sustained downward pressure*: With the clarification of the Operating Code position described in paragraph 4.2 above, the Proposed Amendments would make the position in relation to ILONs clearer and so better ensure parties would comply with them. With the deletion of section 3, the obligations and incentives on parties to maintain imbalances within tolerance will also be clearer. Improved management of imbalances at Welded Points will result in incentives for better balancing arrangements, and therefore a more active and competitive market. This in time should lead to costs better allocated to causers and therefore a downward pressure on delivered costs and prices in the medium to long term.

(f) *The full costs of producing and transporting gas are signalled to consumers*: A daily confirmed operational imbalance position provides transparency to all market participants including the risk that costs associated with any potential cash-out are signalled to the market.

(g) *Risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties:* The Proposed Amendments appear to be consistent with this objective, or at least the reliability aspect, because by clarifying the Operating Code position, as described in paragraph 4.2 above, the Proposed Amendments would also clarify that:

(i) gas from the Maui field would not need to be used to balance the Maui Pipeline; and

(ii) therefore, there should be no risk of adverse impact on pipeline operations if production from the Maui field is unavailable.

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) each Welded Party at a Legacy Welded Point can ascertain its Scheduled Quantities on the day that gas is flowing;

(b) the costs of balancing the Maui Pipeline should be borne by the Welded Parties that have AEOIs, rather than such costs being passed on to Shippers (e.g. in the form of higher Throughput Charges);

(c) MDL has a commercial rationale for balancing the Maui Pipeline because MDL can pass on to defaulting Welded Parties under a cash-out transaction MDL's costs of buying/selling gas under a balancing gas contract in a transparent manner; and

(d) MDL does not need to rely on the Maui gas field to balance the Maui Pipeline, which reduces the risk of curtailment if the pipeline requires urgent balancing at a time when Maui field production capacity is unavailable.

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 and any other relevant law; and

(b) are more pro-competitive than the current arrangements, which might be seen to favour some market participants above and at the expense of other pipeline users.