## COMMERCE ACT 1986: RESTRICTIVE TRADE PRACTICE
## SECTION 58: APPLICATION FOR AUTHORISATION

The Registrar
Business Acquisitions & Authorisations
Commerce Commission
P O Box 2351
WELLINGTON

**1. AN APPLICATION FOR AUTHORISATION OF A RESTRICTIVE TRADE PRACTICE IS HEREBY MADE IN TERMS OF S58 OF THE COMMERCE ACT 1986 BY:**

Todd Petroleum Mining Company Limited/Todd Taranaki Limited
Level 15
95 Customhouse Quay
PO Box 3141
Wellington
Phone: 04 471 6555

Contact Person: Rodney Deppe: Acquisition and Development Manager, Todd Petroleum Mining Company Limited/Director, Todd Taranaki Limited

Todd Petroleum Mining Company Limited is one of the principals on whose behalf Maui Development Limited will implement and operate the Code as agent.

Todd Taranaki Limited is a producer of natural gas who will be required to enter into a Welded Party agreement under the Code in order to inject gas into the Maui Pipeline, and a TSA under the Code in order to ship gas in the Maui Pipeline, on the implementation of open access.

Both companies will thereby become parties to the Code.

**2. THIS APPLICATION RELATES TO A PRACTICE OF A KIND DETAILED IN S58 OF THE ACT. FULL PARTICULARS ARE:**

The relevant parts of section 58 are: 58(1); 58(3) and 58(5).

This application is made in respect of the draft Maui Pipeline Operating Code (the "**Code**") dated 8 August (copy enclosed) on the basis that certain provisions of the Code may breach sections 27, 28 and/or 29 of the Commerce Act 1986 (the "**Act**"). Broadly there are two aspects of the Code which potentially result in a breach of the Commerce Act:

(a) The differential (and preferential) treatment afforded to gas delivered under the Maui Gas Contract (between the Maui Mining Companies and the Crown) and gas delivered under the Methanex 20/20 agreement (between the Maui Mining Companies and Methanex) ("**Legacy gas**") as compared to all other gas injected into the Maui pipeline under the Code. This aspect of the Code potentially breaches sections 27 and 28 (by substantially lessening competition in the wholesale gas market),

(b) The prohibition on shipping of gas to a Welded Point with a transmission pipeline unless the shipper, or the person to whom the shipper sells the gas, has a transmission services agreement ("**TSA**") with the relevant transmission pipeline owner (the "**TP Welded Party**"). This aspect of the Code potentially breaches sections 27 and 28 (by substantially lessening competition in the gas transport market) as well as section 29 (as an agreement between competitors having the purpose of restricting the supply of services in particular circumstances).

**Differential treatment of Legacy and other gas**

Articles 3.5 and 3.6 of the Code provide significant exemptions to Legacy gas from the provisions of the Code including the obligation to settle a Running Operational Imbalance by selling or buying gas, Peaking restrictions and the incentives regime. As a result, Legacy gas sold by the Maui Mining Companies will be treated differently to any other gas transported in the Maui line.

As a result of these exemptions non-Legacy gas on the Maui Pipeline will face hasher penalties, fees and restrictions than will Legacy gas. Non-Legacy gas will be subject to penalties which will not apply to Legacy gas.

Legacy gas and non-Legacy gas will be sold in competition. Buyers of Legacy gas are not required to take solely Legacy gas and might, if the price and/or terms were attractive enough, take non-Legacy gas in preference to Legacy gas (preserving their Legacy gas entitlements until a later time). Imposing a materially onerous penalty/liability regime on non-Legacy gas which does not apply to Legacy gas will inhibit sellers of non-Legacy gas competing with sellers of Legacy gas. Terms of sale/prices for non-Legacy gas would have to incorporate the risk of such liabilities/penalties (or the purchasers of non-Legacy gas would have to take on the risk of such penalties direct). This would make non-Legacy gas significantly less attractive to potential buyers. As a result there is a risk that this aspect of the Code could breach sections 27 and/or 28 by the imposition of such penalties on non-Legacy gas in circumstances where competing gas does not face such penalties.

In addition to the detriment to non-Legacy gas sellers, Legacy gas buyers (i.e Contact, NGC and Methanex) obtain an advantage over buyers who purchase only non-Legacy gas. The preferential treatment afforded to Legacy gas enables its buyers to use their rights to Legacy gas to shelter themselves from the penalty regime in relation to much of any non-Legacy gas which they purchase. Because neither MDL nor NGC can measure hourly or daily usage of Legacy gas at a Delivery Point there is no clarity or certainty as to who will and who will not have relief from, for example, Incentive Pool Debits incurred as a result of a breach of the Peaking Limit. Under section 3.8 it is up to the TP Welded Party to determine to what extent any Operational Imbalances or Peaking Limit overruns were caused by Legacy gas, but no guidance is provided for how this is to be calculated. The Legacy gas buyers would then have the opportunity to attribute such breaches to their Legacy gas allocations, and consequently, avoid payment of the Incentive Debit Price.

Maui has a deliverability of 5-600 TJ/day for at least for the next few years. McKee and Mangahewa have a deliverability of 40-50TJ/day. For 2005 and 2006 Maui therefore comprises 94% of capacity. Pohokura will come on stream gradually from the end of 2006. From 2007 onwards, the Pohokura deliverability is 200 TJ/day. This means Maui deliverability will still comprise 70%. However, because Legacy gas buyers will be able to combine Legacy gas with non-legacy Gas, and at least two thirds to three quarters of Pohokura will be purchased by Legacy gas buyers, the effective amount of gas that will be uncontrolled will be closer to 90%.

**Retrospective allocation of only Legacy gas under the Code.**

Retrospective allocation of gas is exclusively allowed only for Maui Legacy Gas under the Code. Retrospective allocation allows a party to correct mismatches (being situations where that party has taken more (or less) gas than it had nominated on any day (outside tolerances) and thereby avoid paying mismatch costs (where more has been used than nominated) or receiving less than a market price for gas (where less has been used than nominated).

In addition, having the ability to retrospectively allocate allows purchases Legacy gas to pass on flexibility to its customers to accommodate variable demand by the customers. That is, retrospective allocation enables differences in demand from nominations to be accommodated without incurring mismatch costs.

An additional benefit of allowing retrospective allocation in relation to non-Legacy gas is that it would enable parties to minimise their exposure to the penalties and therefore would significantly address the problems associated with the differential treatment of Legacy and non-Legacy gas.

The OBA open access system creates a problem for shippers. They are allocated their nominated quantities but only at the end of the month does the NGC allocation methodology allocate actual use of gas for each day of the month. Shippers therefore do not have ready access to the information to even adjust their nominations during the month. Nevertheless, NGC calculates daily mismatch at month end, being the difference between actual use and the OBA allocations for the day. If the accumulated mismatch exceeds a certain limit shippers are cashed out.[1] The allocation methodology for Legacy Gas in the Code allows Legacy gas to change the OBA open access allocation at month end, to the extent that additional balancing gas is provided by Maui plus the amount of Contingency Volume (from the pipeline pack) on the day.

The Contingency Volume is normally around 50TJ and therefore provides a large amount of flexibility to Maui and Maui Legacy Buyers. Maui Legacy Buyers can use the Contingency Volume flexibility that is available on the day even if Maui does not have any additional deliverability. In this circumstance, the pipeline pressure will drop and the integrity of the whole network and third party gas shipments will be more at risk.

Under the Code MDL can charge third parties shippers for replacing the Contingency Volume. Thus MDL and Maui have the ability to charge third parties for the flexibility provided to its Legacy gas customers.

The Code should not allow MDL to charge third parties for the balancing gas flexibility that it then provides to its own customers and/or MDL should wait until after the Contingency Volume was exhausted before buying balancing gas. The additional amount beyond the Contingecy Volume could legitimately be charged to third parties as Legacy Buyers cannot be allocated an additional amount that is in excess of the Contingency Volume. However this also means that the system has to wait until the network is close to being in a perilous state before activating balancing gas. The allocation methodology agreed with the Crown gas thus makes the system far more fragile than is necessary by international standards.

If other fields are allowed to provide balancing gas to the network free of charge to be called at MDL's discretion the whole system would be far more robust. Other parties

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[1] NGC says that it will allow trading of mismatch but trading is limited to other shippers with mismatch and this has to be a mismatch on the exact same day. Parties (or even the same party) with extra gas supplies is prevented from removing a mismatch by providing the gas at month end when the mismatch is known.

are likely to be prepared to make balancing gas available to the network on demand on a day, if they are also allowed the same competitive advantage that MDL has granted to itself, namely the ability to add the balancing gas (that they make available to MDL) to the OBA allocations at month end, in the same way as is done for Legacy.

The result will be that the network system of New Zealand will instead of being more fragile, will benefit from a greater quantity and diversity of balancing gas supplies. The system will not have to pay for this benefit. Downstream retailers and customers that currently feel that they are deprived of daily information until month end but nevertheless are still responsible for the daily mismatch will have a means of covering this risk. What is more there will be competition between suppliers to provide this service. Potential suppliers could include purchases and sellers of gas with access to surplus or variable capacity, including storage and parties that can switch fuels.

Why would a purchaser, producer or party with storage offer this service to the system for free? Before a shipper or producer offered this service to MDL it would have had to negotiate a flexibility supply arrangement with a downstream party that wished to have the flexibility to balance its fixed open access allocations (under OBA) with its less predictable actual use at month end. Any party with flexibility supply arrangements buyers or sellers can negotiate such arrangements with downstream customers/retailers.

If non-Legacy gas were treated in a similar way to Legacy gas it would provide an even playing field on which non-Legacy gas could effectively compete with Legacy gas. As drafted the Code provides a significant advantage to Legacy gas meaning that competition in the wholesale gas market may be substantially reduced.

**Requirement for TP Welded Party TSA**

As drafted, section 2.14 of the Code provides that:

> Except for Maui Legacy Gas, MDL shall not deliver, and a Shipper shall not request MDL to deliver, any quantity of Gas to a Welded Point with a Transmission Pipeline unless:
>
> (a) where that Shipper sells or trades, or will sell or trade, that Gas (or any part of it) at that Welded Point, that Shipper, and each other party who receives or will receive any quantity of Gas attributable to that Shipper (that Shipper and each other such party to be known as a "TP Shipper"), has a valid and binding gas transfer agreement whose terms comply with the Gas Transfer Code; and
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> (b) where that Shipper takes delivery of that Gas (or any part of it) at a Welded Point with a Transmission Pipeline for transport through any part of the Transmission Pipeline, that Shipper has a valid and binding transmission services agreement with the TP Welded Party of that Welded Point, the terms of which are consistent with the principles set out in Schedule 9, so as to achieve the outcomes described in section 2.13; and
>
> (c) where that Shipper sells or trades, or will sell or trade, that Gas (or any part of it) to a TP Shipper, that TP Shipper has a valid and binding transmission services agreement with the TP Welded Party for that Welded Point, the terms of which are consistent with the principles set out in Schedule 9, so as to achieve the outcomes described in section 2.13. Prior to any request for such delivery of Gas being made, that Shipper shall notify MDL and the TP Welded Party of each TP Shipper that it has sold or traded with, or will sell or trade with.

Schedule 9 (with which the terms of the TSAs referred to in sections 2.14(b) and (c) must be consistent) provides that:

> The principles referred to in section 2.14 are:
>
> - daily balancing of Gas;
> - recovery by the TP Welded Party of costs, expenses and liabilities incurred on account of shippers' Gas, and associated indemnification of the TP Welded Party;
> - consequential amendments to title warranty, invoicing, payments and other provisions;
> - agreement by shippers not to trade Gas other than with a shipper or other person who is a party to the requisite transmission services agreement with the TP Welded Party;
> - ability to give shippers operational notices and information via the internet and to post on the internet information as to who has the requisite transmission services agreement with the TP Welded Party;
> - agreement to abide by the Gas Transfer Code and as to ability to trade mismatches
> - any direct financial benefits or any costs associated with the Daily Operational Imbalance Limits or Peaking Limits for a Welded Point with the Transmission Pipeline will be allocated by the relevant TP Welded Party in a transparent manner amongst its customers who have, and in accordance with, the requisite transmission services agreement.

As a result, if the Code were implemented in its current form shippers would be prohibited from transporting gas on the Maui line to or from an NGC Welded Point unless those shippers have signed agreements with NGC. This gives rise to potential breaches of sections 27 and 29 of the Commerce Act

The Maui and NGC pipelines originate in the Taranaki region and run parallel for significant distances from the Taranaki region to Rotowaro/Huntly and are able to provide alternative transport options to those wishing to transport gas. Under the Code the right to transport gas on the Maui Pipeline to Rotowaro is subject to the shipper entering into an agreement with the competing network owner.

In terms of section 29,:

(a) The Code when implemented will be an agreement between, inter alia, the owners of the Maui Pipeline and NGC. As outlined above, compete in the provision of gas transport;

(b) The purpose of the clause is to prevent shippers who wish to transport gas to or from an NGC Wielded Point from using the Maui Pipeline unless they have an agreement with NGC. This is the prevention of the supply of a service by MDL to a particular class of persons in particular circumstances; and

(c) Both NGC and the owners of the Maui Pipeline (or interconnected bodies corporate) will be in competition with shippers of gas on the Maui pipeline in the selling of that gas to third parties.

As a result, on its face, the Code would, if implemented, breach section 29.

In the absence of this agreement, a shipper would be able to transport gas on the Maui Pipeline irrespective of whether it had an agreement with NGC in respect of the relevant gas. The shipper would then be in a position to use the fact that the two pipelines provide alternative transport options in negotiations with NGC. It could seek to agree with NGC that in return for using NGC's line in priority to the Maui Pipeline the terms presented by NGC should be negotiated. NGC may not be prepared to negotiate in this way but by the Code sanctioning NGC's position the shippers have lost all bargaining power they have as a result of the potential competition between the Maui and NGC pipeline.

The requirement to have a TSA with NGC as a pre-requisite to access to the Maui line removes the competitive tension between the Maui and NGC competing pipelines. The mere threat of competition has already seen the incremental NGC tariffs from Taranaki to Rotowaro decline from $2.50/GJ in the late 1990's to a booking fee of 45cents/GJ at present. Where Nova Gas Limited has built competing distribution lines the tariffs have fallen to well below ODV levels.

Shippers, producers and explorers need to at least retain the competitive tension that exists between pipelines in order to ensure that competitive terms and tariffs can be negotiated. Otherwise, tariffs and terms are likely to deteriorate to their former levels. As drafted, whatever level of competition that might have existed between the Maui and NGC pipelines will effectively be eliminated.

The Commerce Commission recognised in its Section 56 Gas Control Inquiry Final Report the Maui Pipeline provided a degree of competitive restraint on the NGC Pipeline even though at the time open access was some distance away Once open access is implemented that degree of competition would increase substantially but for the requirement shippers to Rotowaro (or those to whom they sell the relevant gas) have a TSA with NGC. It should be noted that, while the Commerce Commission considered that the competitive restraint provided by the NGC Pipeline on the Maui Pipeline was limited due to the size difference between the two pipelines, despite Nova Gas Limited's by-pass distribution pipelines frequently being of lower capacity than existing distribution pipelines, distribution charges in by-pass areas have decreased significantly due to Nova Gas Limited's entry into the market.

The requirement for a TP Welded Party TSA will also inhibit or prevent the current gas trading undertaken on the Maui Pipeline and the development of a broader gas trading market.

Many of the parties that Todd and other sellers trade with currently do not have a TSA with NGC and do not intend or need to enter into such an agreement even though the gas in question is to be transported to Rotowaro. These parties trade or swap the gas before it is injected into the NGC system. The effect of the TSA pre-condition in the Code will be to cut down the number of parties trading and/or act as a barrier to trading.

The TSA pre-condition to shipping gas would require the seller, then MDL, and then NGC to individually vet each and every trade before it is allowed to take place. No efficient market, especially a modern computer/web based market exchange, whereby buys and sells are executed at the "press of a button", and sellers and buyers are anonymous to each other, can ever develop with such a pre-condition to each trade.

In international spot markets, buyers and sellers are not only anonymous to each other but the majority of trades do not result in transmission and trading is not conditional on entering into a TSA in relation to the gas.

## 3. THE INDIVIDUALS/COMPANIES/ORGANISATIONS DIRECTLY AFFECTED BY THE TRADE PRACTICE ARE:

All sellers of non-Legacy gas:

**Todd Pohokura Limited**
Level 15

The Todd Building
95 Customhouse Quay
P O Box 3141
WELLINGTON
Phone 471 6555

**SWIFT**
P O Box 10844
WELLINGTON
Phone 472 7400

**Austral Pacific**
284 Karori Road
Karori
WELLINGTON
Phone 476 2717

**OMV New Zealand Limited**
Level 27
Majestic Centre
100 Willis Street
P O Box 2621
WELLINGTON
Phone 471 1411

**Shell**
3 Queens Wharf
P O Box 1873
WELLINGTON
Phone 472 0080

**Origin Energy Resources (Kupe) Limited**
57 Victoria St
Hawera
Phone 06 278 7080

**New Zealand Oil and Gas**
Level 9
The Shortland Street Centre
51-53 Shortland Street
P O Box 3198
AUCKLAND
Phone 09 377 0941

**Bridge Petroleum Ltd**
PO Box 112341
Penrose
Auckland
Phone 09 579 5055

All shippers or purchasers of non-Legacy gas who want to transport gas to Rotowaro or onto the NGC Pipeline:

**Nova Gas Limited**
Level 15
The Todd Building
95 Customhouse Quay

P O Box 10-141
WELLINGTON
Phone 472 6263

**Genesis Energy Limited**
Ground Floor
The Genesis Energy Building
602 Great South Road
P O Box 17-188
Greenlane
AUCKLAND
Phone 09 580 2094

**Contact Energy Limited**
Harbour City Tower
29 Brandon Street
P O Box 624
WELLINGTON
Phone 0800 80 9000

**Methanex Limited**
Level 38
ANZ Centre
23-29 Albert Street
AUCKLAND
Phone: 09 356 9300

**Mighty River Power Limited**
Level 19
1 Queen Street
P O Box 90399
AUCKLAND
Phone 09 308 8200

**Wanganui Gas**
179 Hill Street
P O Box 32
WANGANUI
Phone: 0-6-349 0909

**NGC Ltd**
The NGC Building
44 The Terrace
Private Bag 39980
WELLINGTON
Phone: 462 8700

**E Gas Ltd**
P O Box 2577
WELLINGTON
Phone: 499 4964

Potential participants in a gas trading market arrangement:

All producers of non-Legacy gas

All purchasers of wholesale gas who may have excess gas to dispose of on a day

All retailers of gas

All large customers: for example Methanex, Fonterra, Carter Holt Harvey, Ballance, ACI

4. OTHER PARTIES LIKELY TO BE AFFECTED BY THE PRACTICE WOULD INCLUDE:

Downstream users of gas who lose the benefit of the competition that would otherwise occur in the gas wholesale and gas transmission markets.

5. DOES THE AUTHORISATION NOW SOUGHT RELATE TO A CONTRACT OR OTHER ARRANGEMENT WHICH HAS ALREADY BEEN ENTERED INTO?

The Code has not yet been implemented but it is proposed by Shell and OMV (in their roles as Maui Mining Companies) that the Code be approved on Friday 26 August 2005 and be implemented on 1 September 2005.

**MARKET AND COMPETITION CONSIDERATIONS**

6. PLEASE DESCRIBE THE MARKET TO WHICH THE PRACTICE FOR WHICH AUTHORISATION IS SOUGHT RELATES, BY REFERENCE TO PRODUCT, GEOGRAPHIC BOUNDARIES, OR FUNCTION, AS APPROPRIATE. IF MORE THAN ONE MARKET IS AFFECTED, PLEASE DESCRIBE EACH MARKET TO THE BEST OF YOUR KNOWLEDGE, AND INDICATE YOUR MARKET SHARE(S), AND THE SHARES OF OTHER MARKET PARTICIPANTS, AT PRESENT OPERATING IN EACH MARKET AFFECTED.

In relation to the differential treatment of Legacy and non-Legacy gas, the primary relevant markets are the market for the production (and first point of sale) of natural gas and the wholesale natural gas market identified by the Commerce Commission in Decision 505 (Authorisation to enter into arrangements to jointly market and sell gas produced from the Pohokura Field).

In relation to the requirement for TP Welded Party TSA, the relevant market is the market for the provision of gas transmission services between North Taranaki and Huntly as identified by the Commerce Commission in its Section 56 Gas Control Inquiry Final Report.

We **enclose** a copy of a presentation on the competition issues associated with the Code dated 23 August which we have prepared and which contains further information which may assist the Commission's consideration of this authorisation application.

**Transmission market: Demand and Supply in the regional Taranaki Market**

Given current demand, the Maui line is expected to transmit around 110 PJ pa. from Taranaki to Huntly. The Maui line with compression can increase its capacity significantly above these levels. The NGC eight inch line north line can carry around 14-15 PJ pa.

Until very recently NGC was not technically able to convey gas produced at Kapuni to satisfy the Taranaki Combine Cycle (TCC) station's demand of 20 PJ pa at Stratford, even though they are geographically in reasonable close proximity. In the past therefore NGC has supplied TCC from the Maui line. Now that the technical bottleneck preventing this has been removed, the 20 PJ pa demand from TCC can be supplied from Kapuni. Thus instead of sending the around 10PJ pa surplus Kapuni gas up the NGC north line it can be supplied to the TTC plant. Therefore from now on the Kapuni north line should logically be relatively empty for most of the year.

The demand for gas south of the Maui line currently exceeds the supply of gas south of the Maui line, and hence without major supply or demand changes the Kapuni north eight inch line is expected to have to compete for transmission services with the Maui line. By the time Kupe production is on stream, local supply from other fields is expected to have decreased, while demand is likely to continue growing. Therefore, long term it is likely to continue to be difficult to fill the NGC north eight inch pipeline.

**Connections**

Todd Taranaki Ltd is connected to both the Maui pipeline and the NGC line in Taranaki.

The planned Pohokura gas pipelines are within a few kilometers of both the pipelines are hence potentially capable of being connected to both pipelines.

There are a number of new wells being drilled in the region. There are also a number of licences in close proximity to the same region. For example Todd, Greymouth, Tap etc. are all either planning to drill wells, have well commitments or potentially could drill wells in the immediate region to connect to either or both pipelines.

**Gas Trading Market**

Gas demand in New Zealand is currently in the region of 160 PJ pa and currently comes from Taranaki producers.

The Maui field has supplied around 80% of the New Zealand market for the last two decades. The Maui field is nearing the end of its life and the market is transitioning to a phase when significantly less production will come from Maui. In the near future, the market will be supplied by around 7-8 medium sized fields and a number of smaller fields.

Whereas the surplus deliverability from Maui has allowed the entire market to source its swing demand and balancing gas from Maui, in the future this will not be possible. Smaller quantities of surplus deliverability will be distributed throughout the market. A much higher level of trading however can pool these smaller quantities and this higher level of trading has already begun to emerge in the market. Todd has for example been actively selling, swapping and buying gas on the Maui pipeline, with most market participants since gaining access to the Maui pipeline this year.

It is now more common practice for gas contract entitlements to change hands a few times before delivery onto the NGC pipeline. None of these parties have NGC TSA's because they sell the gas before it enters the NGC system. The increased level of trading and swaps on the Maui line todate has only been possible because the trades have been unencumbered by a NGC TSA requirement and hence did not require prior approval of MDL or NGC.

New Zealand is overdue for a web based market exchange. An essential feature of all market exchanges is that sellers or buyers contract with the market. Sellers and buyers therefore do not know know the identity of their counter-party buyer or seller Because MDL is requiring that all shippers disclose who they are selling gas to prior to shipment this effectively prevents a market from ever operating. Todd and M-co already have an IT platfrom for a web based gas market exchange. The barrier preventing this becoming operational is MDL's requirement to pre-approve each and every trade at NGC welded points.

**COUNTERVAILING PUBLIC BENEFIT**

## 7. THE SPECIFIC PUBLIC BENEFITS WHICH WILL IN ALL THE CIRCUMSTANCES RESULT OR BE LIKELY TO RESULT FROM THE TRADE PRACTICE ARE AS FOLLOWS:

While there is significant and undoubted public benefit in the establishment of open access on the Maui Pipeline, because the two aspects of the Code identified in this application are not necessary for the implementation and operation of open access on the Maui Pipeline there is a serious question as to whether those particular aspects have any public benefit associated with them.

**Differential treatment of Legacy and other gas**

As up to 90% of gas transported on the Maui Pipeline will either be Legacy gas and therefore exempt from the penalties regime or can be sheltered by Legacy gas (and therefore effectively exempt from penalties), there is little benefit in imposing the penalties at all (at least until the Legacy gas contacts have ended). Allowing non-Legacy gas shippers to engage in retrospective allocation would also provide them with the opportunity to avoid penalties in a manner which would cause no detriment to the Maui Pipeline.

**TP Welded Party TSA requirement**

NGC contends that the requirement that gas is not delivered to an NGC Welded Point unless the person receiving that gas has a TSA (in the form mandated by the Code) with NGC is essential for the operation of its pipeline. However, the NGC Allocation System ensures that NGC already has the information and control under its existing TSAs. The allocation system on the NGC system ensures that every GJ on any day is metered at NGC gas gates (namely at the exit of the NGC transmission system). The allocation for a day is done on the basis that the distribution TOU meters (plus UFG) are deducted from the NGC gate meter quantities and the balance is fully allocated to retailers As far as NGC is concerned there is no leakage in the system as all gas gate metered volume is allocated.

The TSA requirement is therefore not required because NGC knows exactly who and how much to bill for transmission. It gets this information from its own NGC meters and this is completely independent of the Maui system.

NGC has expressed a concern that it will not be protected from liabilities it owes to MDL under the Code where those liabilities arise as a result of the actions of shippers on its pipeline. NGC considers that its existing TSAs do not provide it with the necessary rights (as they were entered into prior to the arrangements giving rise to such an issue being contemplated) and that the parties to those TSAs are unlikely to agree to changes to address this issue. Even if this is the case, the problem can be addressed in a manner which does not risk breaching the Commerce Act:

(d) The Code can provide that Shippers who ship gas across a Welded Point with a Transmission Pipeline indemnify the TP Welded Party from all charges and costs imposed on the TP Welded Party under the Code in relation to that gas. The privity provisions of the Code would be amended to provide TP Welded Parties with the right to enforce the indemnities. Shippers would then deal with that risk as they see fit (including pricing it into any trade or passing it on to its buyers)

(e) The indemnity referred to in (a) above would not apply to any new TSAs entered into after 1 January of this year or to existing TSAs following any renewal or extension. If a TP Welded Party is unable to negotiate such protections in new or renewed arrangements then that will reflect the market dynamics and the Code should not in those circumstances provide such protection to the TP Welded Party.

(f) NGC like any other Welded Party can and should control the flow at its WP. NGC can easily avoid imbalance and incentive Fees by simply controlling flow to within the liberal tolerances provided. Given the allocation arrangements negotiated, NGC may have some excuse not to control flow during the term of Legacy gas. However beyond the term of Legacy, given the wide tolerance provided to NGC, it is arguable negligent not to control the flow to within the tolerance and NGC should incur imbalance costs and Incentive Fee costs just like any other Welded Party that declines to control the flow at its Welded Point. Beyond the term of Legacy gas NGC should therefore not be allowed to pass on its own welded point costs through its own TSA arrangements with shippers.

NGC's view however, expressed in an open industry forum, is that the TSA requirement is a more convenient approach to this issue for it and therefore will not agree to any other approach.

At the very least, as the penalties regime does not apply during Early Open Access, the risk perceived by NGC simply cannot arise until full open access is implemented (estimated to be the middle of 2006).

NGC has also expressed a concern that parties whose TSAs have expired may take gas from the NGC pipeline. This is a normal commercial matter that any party faces in any market and is a problem that NGC faces now. It is not a problem created by the Code or open access. In fact open access will alleviate the problem in that, to the extent that gas is being injected into the NGC pipeline from the Maui pipeline on behalf of a person who does not have a TSA with NGC, the only risk to NGC is a payment risk. Prior to open access, a person without a TSA who takes gas from the NGC pipeline could also affect the integrity of the NGC pipeline as there would be no compensating gas passing from the Maui Pipeline to the NGC pipeline to balance that person's offtake.

Parties that are not paid for services supplied either stop supply of the service (i.e. shut off the relevant offtake point) or recover its fee through a claim of quantum merit. It is not up to MDL to protect NGCT from normal commercial principles that apply to any market and to which NGC is exposed today. MDL is exposed to this same risk when NGC injects gas into the Maui system. MDL is not requiring that NGC insert in its TSA, that access to the NGC system is conditional upon the party having a TSA on the MDL system. MDL recognises that shippers will risk losing control and recognition of ownership of valuable gas by so doing and therefore have no incentive to do this. Shippers would also incur contractual liabilities in relation to non-supply of gas under their GSAs. No shipper will risk losing rights to gas.

## 8. COUNTERFACTUAL

It is important to note that the relevant counter-factual is **not** no open access. As detailed above, the two aspects which are the subject of this authorisation are **not** necessary for the implementation and operation of open access on the Maui Pipeline.

For example, the preferential treatment of Legacy gas over non-legacy gas could substantially be dealt with by allowing retrospective allocation in relation to non-Legacy gas. Appendix 1 to this application demonstrates the minor amendments necessary to achieve this. Allowing retrospective allocation for non-Legacy gas would have no detrimental effect on the implementation or operation of open access on the Maui Pipeline.

In relation to the requirement for TP Welded Party TSA, as indicated above there are a number of alternatives to address NGC's concerns which, while perhaps not so convenient for NGC, do not carry with them competition law risks and do not detrimentally affect the implementation or operation of open access.

**CONFIDENTIALITY**

## 9. CONFIDENTIALITY IS NOT CLAIMED IN RESPECT OF THE INFORMATION PROVIDED IN, OR IN CONJUNCTION WITH THIS NOTICE

This application is made by - Todd Petroleum Mining Company Limited and Todd Taranaki Limited

I,Rodney Keith Deppe. Company director, am authorised to make this application on their behalf

I hereby confirm that:

- All information specified by the Commission has been supplied;
- All information known to the applicant(s) which is relevant to the consideration and determination of this application has been supplied; and
- All information supplied is correct as at the date of this application.

I undertake to immediately advise the Commission of any material change in circumstances relating to this application.

Dated this 25th day of August 2005

Rodney Deppe

## Appendix 1

## Amendments to allow retrospective allocation in relation to non-Legacy gas

Additional definitions for the Code would provide that:

**Incremental Balancing Allocation** means an incremental amount by which a Shipper's OBA allocations for a day shall be changed

**Incremental Balancing Allocation Limit** on a day means the quantity of balancing gas on a day (positive and/or negative) that a Shipper or Welded Party makes available prior to the day, free of charge to MDL, to be called as balancing gas by MDL prior to the relevant Day, and that MDL determines, acting reasonably, will be available on the day. If when called an Incremental Balancing Allocation is not made available on a day the Incremental Balancing Allocation Limit reduces to the amount of balancing gas actually supplied.

As amended, section 3 of the Code would provides that:

Section 3

### 3. MAUI LEGACY CONTRACTS

3.1 The Maui Mining Companies' obligations under:

(a) the Maui Gas Contract;

(b) the Settlement and Umbrella Agreement; and

(c) the Methanex 20/20 Agreement,

(d) (collectively the "**Maui Legacy Contracts**") shall take priority over MDL's obligations to Shippers and Welded Parties under TSAs and ICAs until not later than 27 June 2009 but only to the extent of any conflict between the Maui Legacy Contracts on the one hand and TSAs and ICAs on the other. Nothing in this Operating Code will affect the rights or obligations of the parties under the Maui Legacy Contracts, any User Contract or any related documents entered into as part of the 2004 "Maui Strawman Settlement".

3.2 The Maui Mining Companies have consented to MDL having the exclusive right to:

(a) use the Maui Pipeline to provide Transmission Services to Shippers; and

(b) allow Welded Parties to connect Pipelines to the Maui Pipeline.

3.3 The Maui Mining Companies have allowed MDL to permit Shippers to obtain Transmission Services on, and Welded Parties to connect Pipelines to, the Maui

Pipeline, provided that Shippers and Welded Parties acknowledge that the Maui Mining Companies may:

(a) make a claim against the Incentives Pool in accordance with section 14.9 in respect of non-delivery of Maui Legacy Gas to Buyer and/or Methanex; and

(b) make a claim against MDL under the indemnity set out in section 17.22(c) in respect of any delivery of Non-Specification Gas to Buyer and/or Methanex.

3.4 In the event of any conflict, or purported conflict, between the Maui Legacy Contracts on one hand, and this Operating Code on the other, MDL shall:

(a) notify the other Party as soon as reasonably practicable upon becoming aware of such event; and

(b) use all reasonable endeavours to perform its obligations notwithstanding the occurrence of such event; and

(c) use all reasonable endeavours to mitigate the extent to which it and the other Party are detrimentally affected by the occurrence of such event.

3.5 The Maui Mining Companies shall be the Welded Party at the Oaonui Welded Point on the terms of an ICA and a Shipper on the terms of a TSA but, in relation to Maui Legacy Gas, shall be exempt from:

(a) the obligations contained in section 12.11 to sell Gas to, or buy Gas from, MDL to settle a Running Operational Imbalance. For the avoidance of doubt, this exemption does not exempt the Maui Mining Companies from the obligation to settle a Running Operational Imbalance in any other manner within the period set out in an Imbalance Limit Overrun Notice;

(b) the obligations contained in 11.8 to sell Gas to, or buy gas from, MDL to settle a Mismatch. For the avoidance of doubt, this exemption does not exempt the Maui Mining Companies from their obligation to settle a Mismatch in any other manner within the Mismatch Period; and

(c) the provisions of this Operating Code that apply to breaches of the Peaking Limit at the Oaonui Welded Point.

3.6 Each Welded Party shall not incur an Incentives Pool Debit to the extent that such payment is attributable under the Primary Allocation Agreement to Maui Legacy Gas or Gas delivered under a User Contract. For the avoidance of doubt, nothing in this section 3.6 affects a Welded Party's obligations under this Operating Code in respect of settling Running Operational Imbalances.

3.7 MDL shall:

(a) notify each Welded Party at whose Welded Point that Welded Party receives Maui Legacy Gas of the division of quantities of Gas between Maui Gas (as determined by sections 3.10 to 3.14 below), other Maui Legacy Gas and other Gas in respect of each Day of the Month in which Maui Legacy Gas was delivered by 1.00pm on the 7th Business Day after the end of that Month; and

(b) notify each Welded Party at whose Welded Point that Welded Party receives an Incremental Balancing Gas Allocation of the division of quantities of Gas between in respect of each Day of the Month in which Incremental Balancing Gas Allocation was delivered, by 4.00 1.00pm on the 7th Business Day after the end of that Month; and

(c) adjust, to the extent required by the division notified under section 3.7(a) and (b) with effect on the Transmission Day, the relevant Approved Nominations, Scheduled Quantities, Operational Imbalances, Running Operational Imbalances, Incentives Pool Debits, payment under section 12.13(c) and any settlement of Accumulated Excess Operational Imbalance under section 12.11 and

(d) for avoidance of doubt the Incremental Balancing Allocation notified after the end of the month shall revise the allocations of Incremental Balancing Allocation called by MDL at injection points during the month.

3.8 Where a Welded Point is connected to a Transmission Pipeline, the relevant TP Welded Party shall determine, in its reasonable opinion and to MDL's reasonable satisfaction, the extent to which any Maui Legacy Gas delivered to that Welded Point caused a breach of a Peaking Limit, and, on the basis of that determination, calculate the resulting Incentives Pool Debits. That TP Welded Party shall notify MDL of its calculation which, upon such notice, shall be deemed to be the number of Incentives Pool Debits for that TP Welded Party.

3.9 To the extent that any of the Maui Mining Companies is acting in a capacity other than as seller or shipper of Maui Legacy Gas, the terms and conditions of this Operating Code shall apply to it in full.

**Maui Legacy Contract Primary Allocation Agreement**

3.10 The total quantity of Gas allocated as Maui Gas on any Day shall not exceed the greater of:

(a) the aggregate Approved Nominations of Maui Legacy Gas for that Day at the end of that Day less the quantity of Gas provided in the Approved Nominations for Gas taken under the Methanex 20/20 Agreement for that Day at the end of that Day; and

(b) the quantity of Gas delivered into the Maui Pipeline as measured at or near the Oaonui Welded Point, less the quantity of Gas used by Seller in the Mokau compressor station and other Gas used by Seller downstream of the Oaonui Welded Point for the operation of all facilities connected with the Maui Field including the onshore pipelines, each in accordance with the Maui Gas Contract, less the quantity of Gas provided in the aggregate of Approved Nominations made in accordance with valid Third Party Sales Arrangements (as defined in the Settlement and Umbrella Agreement) for the Day at the end of the Day less the quantity of Gas provided in the Approved Nominations for Gas taken under the Methanex 20/20 Agreement for the Day at the end of that Day plus the quantity of gas equal to the lesser of :

(i) the actual reduction in Line Pack on that Day; and

(ii) the available Contingency Volume as determined by MDL on the Day acting as a Reasonable and Prudent Operator, as posted by MDL on or after 6pm on the Day prior to Gas flow, reduced by the amount of any available Contingency Volume released by MDL to address any Non-Maui Contingency Event in respect of the Day (occurring after 6.00pm of the Day prior).

3.11 MDL shall determine and use its best endeavours to provide this limit quantity to the Buyer by 4.00 pm on the 3rd Business Day after the end of the Month.

3.12 Subject to the Buyer providing the information as to quantities in accordance with section 3.13, and subject always to section 3.10 for any Day, the quantities of Maui Gas delivered and purchased under the Maui Gas Contract at any Welded Point shall be determined as:

(a) where only Maui Gas is delivered at the Welded Point, the metered quantity at that Welded Point;

(b) where Maui Gas and other Gas are delivered at the Welded Point and there is no downstream metering or downstream reconciliation agreements, the quantity determined by the rules meeting the requirements of section 3.12 that are in place in respect of that Welded Point and which must fully allocate all Gas which is delivered through that Welded Point; and

(c) in all other cases, the quantity determined by the downstream metering and reconciliation agreements required to determine each User's allocation of Gas at the Welded Point and the allocation rules meeting the requirements of section 3.12 that are in place in respect of that Welded Point required to determine each User's allocation of Maui Gas at such Welded Point and the quantity of Maui Gas determined shall be consistent with allocation arrangements which fully allocate all Gas which is delivered through that Welded Point.

3.13 For the avoidance of doubt, the Primary Allocation Agreement must be applied to determining the quantities of delivered Gas that is not Maui Legacy Gas.

3.14 For the purpose of section 3.11(b) and section 3.11(c), the rules must be pre-determined and specified prior to Gas flow for the subject Month, and enable the calculation of quantities on the basis of applying such rules objectively to Metering information complying with the requirements of the Operating Code.

3.15 In respect of all quantities determined under section 3.11(b) and section 3.11(c), by 1.00pm on the 6th Business Day of each Month, the Buyer will notify MDL of the quantities of Maui Gas delivered for each Welded Point for each Day of the previous Month, and with certification that:

(a) there were pre-determined and specified rules in place prior to gas flow for the relevant month which enabled the calculation of quantities on the basis of applying such rules objectively to properly validated Metering information complying with the requirements of the Operating Code; and

(b) the quantities notified by Buyer pursuant to this 3.13 were determined in accordance with such rules.

3.16 In respect of all Incremental Balancing Allocations determined under section xxx, by 1.00pm on the 6th Business Day of each Month, the Shipper will notify MDL of the revised quantities of such Incremental Balancing Allocations for each Welded Point for each Day of the previous Month, and with certification that:

(e) there were pre-determined and specified rules in place prior to gas flow for the relevant month which enabled the calculation of quantities on the basis of applying such rules objectively to properly validated Metering information complying with the requirements of the Operating Code; and

(f) the quantities notified by the Shipper pursuant to this section were determined in accordance with such rules.

3.12 The revised Incremental Balancing Allocation determined by section 3.16 shall be less than or equal to the Incremental Balancing Allocation Limit.

3.17 Each Party acknowledges and agrees that no Incentives Pool Debits shall be incurred and no Imbalance Limit Overrun Notices shall be issued for a Welded Point where Maui Legacy Gas or an Incremental Balancing Allocation is delivered until the processes used in section 3.7 for that Month have been completed.

3.18 Section 10.1 of the Operating Code is subject to this section 3 in relation to the Maui Legacy Contracts and Incremental Balancing Allocation and the application of OBA Principles. 10.2 of the Operating Code does not apply to an Incremental Balancing Allocation and the Maui Mining Companies as Shipper in relation to Maui Legacy Gas.

# Maui Open Access Code

## Competition Issues

23 August 2005

Todd Energy

## Maui Open Access issues ... Contents

Todd Energy

- Gas Market Vision
- Maui Gas allocation for open access
- Maui open access Code
  - Maui Legacy Gas Exemption
    - unequal treatment of Legacy and non-legacy gas substantially lessens competition
  - TSA clause
    - Before being allowed to ship on the Maui pipeline to a NGC WP parties must first sign a new NGC TSA/amendment to their existing NGC contracts
    - NGC gain greater control of a competitive pipeline
    - NGC given new control on gas trading

## Issues for the future gas market ...

- Maui increasingly cannot be relied on for backup
- Flexibility from each field will be reduced
- Supply of Peak Capacity - in shorter supply
- Flexibility - becoming more valuable
- Storage - becoming more valuable
- Fuel switching - become more important as an alternative to storage

## Issues for the future gas market ...

- Post Maui - Numerous smaller fields
- Spare capacity - Maui replaced by 7-8 smaller fields
  - in diverse contracts/fields, and
  - in smaller quantities and
  - at different times
- Balancing - fields and customers
  - no one field will be large enough
  - parties will need to make their own balancing arrangements

## Maui Gas allocation for open access

## Maui Gas allocation for open access

- Imbalance costs and incentive fee penalties on the Maui system:
  - Third parties pay these if actual use varies from nomination
  - Maui legacy is exempt
- Also in relation to downstream balancing on the NGC system:
  - Code allows Maui Gas to retrospectively change allocation to equal actual use
  - Code does not allow third parties the same right
- therefore Maui Gas has no imbalance costs and incentive fee penalties on either system



## Maui Gas allocation for open access

- MDL has a right to charge non-Maui shippers for balancing gas
- Legacy gas exemptions allow Legacy gas buyers to shelter other gas from penalties and imbalance costs
- result NGC and Contact will be able to avoid imbalance costs and incentive fee penalties for the term of the Maui Contract

## Maui open access Code
## Maui gas Exemption

## Maui Open Access Code

NGC has required a prohibition on MDL carrying shippers gas to the interconnection point between the Maui and NGC pipelines unless:

- If the Shipper trades that gas at the interconnection point, the shipper and the person with whom the trade is made have a gas transfer agreement; and
- The person taking delivery of that gas for transport through NGC's pipeline has a transmission services agreement with NGC

## Before being allowed to ship to a NGC WP, traders/shippers must first sign a new NGC TSA/amendment to their existing NGC contracts



## Acess to Maui pipeline conditional on new NGC TSA/amendment

- Timeframe: impossible for shippers or welded parties to complete their arrangements
  - Code not approved vet
  - Deadline for application 22 August for 1 September start
  - First nomination date next week
- Genesis:
  - We note that as recently as 16th August NGCT has published a collation of industry submissions on the draft deed of amendment to their TSA. How you expect this process to be completed by 22 August is beyond belief.
  - We also note that the Gas Transfer Code currently has no standing and NGC has proposed that this document be developed bv the GIC (by letter to GIC of 18 July).
  - It is also our understanding that the legacy gas allocation process has not yet gone through all the necessarv approval steps and until this is done parties are unable to develop and finalise gas transfer agreements.

## Acess to Maui pipeline conditional on new NGC TSA/amendment

- Todd Interim: Terminated on 1 September 2005
- If Todd customers are not ready to sign the Code because thev have not sorted out their downstream TSA issues with NGC and are unlikelv to be able to in the limited time remaining,
- Todd immediate dilemma
  - If Todd signs Code, but its customers do not have a revised NGC TSA, then Todd cannot continue to ship to its customers
  - This would affect the electricity supply and electricity market - an essential service
  - Maui could suspend NGC TSA clause until Full Open Access (no incentive fees during EOA), but refuses
  - If Todd does not sign, can Todd continue to inject for essential customers? Maui says no

## Long Term
## NGC gained greater control of a competitive pipeline

- Nova Bypass has dropped much larger competing pipeline tariffs 50% because
- Marginal costs of filling a pipeline is very low, but return is high
- Therefore the fact that the Maui line is a lot bigger will not stop the two pipelines competing for marginal volume
- Price is set by marginal competitive volume not average volume
- Oligopoly - created by MDL ceding control of competition
- MDL benefits from NGC controlling competition
- NGC and Maui tariffs are enhanced
- Shippers Lose competitive price tension

## Code gives NGC new enhanced control on gas trading



## Code gives NGC new enhanced control on gas trading

- **Not a Requirement today:**
  - **For example Todd (TTL) recently transported gas to Rotowaro where it sold this gas to Methanex at Rotowaro. Methanex then sold this gas to NGC. Methanex or TTL do not have a transmission agreement with NGC.**
  - **Methanex or TTL do not have a NGC TSA**
  - **Not a requirement today, and not an issue today, because shippers will lose rights to valuable gas if they ship without a NGC TSA**

## Code gives NGC new enhanced control on gas trading

- **New Barrier to trading for:**
  - **existing producers and consumers on the Maui line**
    - **need to trade imbalance**
    - **undertake swaps**
    - **need to continue to trade gas at NGC Welded Points**
  - **a first world market exchange whereby buying and selling is "blind" to the counterparty**

## Maui Open Access issues ...Barrier to a a market exchange

- Alternatives considered - Will a Non NGC Point of Delivery avoid NGC TSA pre-qualification ?
  - Seller's still have to sell blind to Buyer's
  - Seller's still have the liability to MDL for what the Buyer does with the gas and whether the Buyer has a NGC TSA
  - Therefore sellers could not take this "blind" risk and are unlikely to trade

## Maui Open Access issues ... Barrier to a a market exchange

- Internationally; entry into a market is not conditional upon entering into a transmission agreement on a competing pipeline or downstream pipeline.



## Maui Open Access issues ...

– Traders provide the liquidity to International Markets:
  - traders have no intention of shipping gas, or
  - seeking delivery of, the gas.

– Traders close out (reverse) their net positions before or on the day of delivery and do not need a TSA.

– Conclusion: Entry barriers mean that a gas market is not viable

## Why does NGC say they need the TSA clause?

- Stop gas going onto its system without signing a NGC TSA
- To recover Maui open access costs

## Why does NGC say they need the TSA clause?

To recover new Maui open access costs

- Incentive Fees
  - Peaking
  - DOIL
- Imbalance costs

## Why does NGC say they need the TSA clause?

To recover new Maui open access costs

- Incentive Fees
  - purpose - control hourly and daily flow
  - Cannot measure hourly offtake by shipper at Maui/NGC WP
  - No hourly allocation even on the NGC system and NGC say that they do not allocate hourly
  - Legacy exempt; plus sheltering = 90% of gas
  - suspended for early open access -until May/June 2006
  - therefore, for the duration of Legacy contract incentive fees will be ineffective



## Why does NGC say they need the TSA clause?

To recover new Maui open access costs

- Imbalance costs
  - Legacy exemption plus sheltering =90% of gas
  - all NGC's existing TSA's charge for imbalance costs at month end
- Crown allocation requires no fees or imbalance cost can be levied until month end
- As Incentive fees are ineffective they can be suspended until Maui Legacy has ended, then existing NGC TSA's cover all NGC's costs

## Why does NGC say they need the TSA clause?

To recover new Maui open access costs

- the NGC TSA clause is therefore
  - definitely not required for early open access, and
  - if the ineffective Incentive Fees are suspended until Maui Legacy has ended, then NGC has no need for the TSA's clause until later of Sept 2009
  - on NGC's own argument it does not need the TSA clause after its term TSA contracts have expired as its new contracts will include new terms
- NGC should not be allowed to indefinitely entrench its control of the Maui line on the pretext that its term TSA's do not allow recovery of open access costs