Maui Development Limited

Disclosure of pricing methodologies and price changes

May 2013

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This document represents our disclosures for our pricing year starting on 1 July 2013 in relation to our pricing methodologies and price changes, as required by clauses 2.4.1 and 2.4.19 in the Gas Transmission Information Disclosure Determination 2012 issued by the Commerce Commission. The terms "MDL", "we", "us" and "our" in this document refer to the Gas Transmission Business of Maui Development Limited.

1. Pricing methodologies

MPOC requirements

Requirements for the pricing methodology to be used by MDL are set out in the Maui Pipeline Operating Code (MPOC). The principles for setting our tariffs are set out in Schedule 10 of the MPOC, as presented in full below.

SCHEDULE 10 TARIFF PRINCIPLES

MDL will set the Transmission Charges in accordance with the standard practice adopted by utilities businesses in New Zealand.

Accordingly, MDL will recover the cost and return of capital as follows. MDL will

(a) calculate the Maui Pipeline's Optimised Deprival Value or Optimised Depreciated Replacement Cost and multiply this value by a nominal WACC, and then subtract any revaluation gains/losses on the asset ("Required Return");

(b) calculate the return of capital based on the useful life of the asset ("Depreciation");

(c) aggregate the Required Return and Depreciation to derive the "Required Revenue";

(d) derive a GJ.km tariff ("Tariff 1"); and

(e) apply Tariff 1 across the Maui Pipeline Shippers on the basis of quantity of Gigajoules of Gas transported multiplied by the distance of Gigajoules of Gas transported.

In any given year, in the event that MDL's total revenues are more or less than its required revenue then Tariff 1 may be adjusted for the following years in a manner that endeavours to reduce pricing volatility for Shippers.

The approach adopted by MDL to recover operating expenditure is to:

(a) aggregate the Maui Pipeline's operating costs ("Operational Expenditure");

(b) allocate Operational Expenditure across every Gigajoule of Gas delivered from the Maui Pipeline.

In any given year, in the event that MDL's total Operational Expenditure recovery is more or less than its required recovery then Tariff 2 may be adjusted for the following years in a manner that endeavours to reduce pricing volatility for Shippers.

The effect of these tariff principles is that Tariff 1 is the price component intended to provide for a return on our asset base and investments, while Tariff 2 is the price component intended to cover our operational costs.

Commerce Act requirements

Pursuant to Part 4 of the Commerce Act 1986, the Commerce Commission made a determination on 28 February 2013 that sets out a Default Price-quality Path (DPP) for Gas Transmission Businesses. MDL is subject to this DPP determination with effect from 1 July 2013, for assessment periods running until 30 September 2017. The First Assessment Period for MDL is from 1 July 2013 to 30 June 2014.

The DPP determination does not prescribe any pricing methodology. However, it does impose a revenue cap that can limit the prices we may charge.

Compliance with the DPP price path is based on the concept of notional revenues. The general DPP requirement is that Notional Revenue for each assessment period must not exceed an Allowable Notional Revenue determined by the Commerce Commission for that period. In other words, MDL's pricing is subject to a cap on notional revenues.

Notional revenues are not the same as actual revenues or forecast revenues. They must be calculated by using the sum of: tariffs in a pricing period, multiplied by corresponding tariff quantities during the pricing period ending two years prior. In other words, notional revenues must be calculated with a two year lag between the throughput quantities used in the tariff rate calculation and the pricing year over which the new tariffs apply.

The tariff quantities invoiced by MDL for the July 2011 to June 2012 period were:

19,955,329 TJ.km	(based on Tariff 1 revenues for that period of $37.416 million)
140,749 TJ	(based on Tariff 2 revenues for that period of $5.489 million)

The calculation and assumptions for MDL's Allowable Notional Revenue for the First Assessment Period are set out in Annex 1. The result is $41.163 million.

As a result, compliance with the notional revenue cap of the DPP requires MDL to set tariffs for the July 2013 to June 2014 period so that:

$$\text{Tariff 1 (in \$/GJ.km)} \times 19{,}955{,}329 + \text{Tariff 2 (in \$/GJ)} \times 140{,}749 \leq 41{,}163$$

Tariff setting approach

We use a two-step approach to setting tariffs for our pricing year starting on 1 July 2013.

1. We first calculate required revenues and tariffs following the same methodology, in compliance with Schedule 10 of the MPOC, as was used in recent years. However, the notional revenues resulting from this step exceed our Allowable Notional Revenue cap.
2. We then make proportional reductions to required revenues from Tariff 1 and Tariff 2 until the Notional Revenues calculated from the resulting tariffs are in compliance with the Allowable Notional Revenue cap.

The objective of step 2 is to obtain adjusted target revenues from Tariff 1 and Tariff 2 that are reduced by the same percentage. In the absence of other agreed criteria for making reductions to comply with the DPP this is considered the most equitable approach.

In light of the tariff reductions required to comply with the DPP we have not considered additional tariff adjustments in the 2013-2014 pricing year for smoothing or for prior year over- or under-recoveries.

Consistency with pricing principles

The Commerce Commission has determined pricing principles for regulated gas pipeline business. We are not required to comply with those principles. As part of our disclosure, however, we are required to "demonstrate the extent to which the pricing methodology is consistent with the pricing principles and explain the reasons for any inconsistency between the pricing methodology and the pricing principles". Our views on the consistency between MDL's pricing methodology and the pricing principles determined by the Commerce Commission are set out below.

pricing principles	**MDL pricing methodology consistency**
(1) Prices are to signal the economic costs of service provision, by- (a) being subsidy free, that is, equal to or greater than incremental costs and less than or equal to standalone costs, except where subsidies arise from compliance with legislation and/or other regulation; (b) having regard, to the extent practicable, to the level of available service capacity; and (c) signalling, to the extent practicable, the effect of additional usage on future investment costs.	Our pricing methodology is not consistent with this principle. • We have not considered incremental and standalone costs in setting prices. • Our pricing methodology does not consider nor signal the economic costs of service provision. • Our pricing methodology does not consider available capacity. • Our pricing methodology does not consider the effect of additional usage on future investment costs.
(2) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall is made up by prices being set in a manner that has regard to consumers' demand responsiveness, to the extent practicable.	Our pricing methodology is not consistent with this principle. Our pricing is the same for all our consumers and has no regard to demand responsiveness.
(3) Provided that prices satisfy (1) above, prices are responsive to the requirements and circumstances of consumers in order to- (a) discourage uneconomic bypass; and (b) allow negotiation to better reflect the economic value of services and enable consumers to make price/quality trade-offs or non-standard arrangements for services.	Our pricing methodology does not satisfy principle (1). Even if it did, our prices are the same for all our consumers and cannot provide responses to their individual requirements and circumstances.
(4) Development of prices is transparent, promotes price stability and certainty for consumers, and changes to prices have regard to the effect on consumers	We believe development of our prices is transparent and our pricing methodology promotes price stability and certainty for our consumers in the short to medium term.

The reason for any inconsistency between our pricing methodology and the Commerce Commission's pricing principles lies in the fact that our methodology is prescribed by the MPOC and revenue is constrained by both the MPOC and regulation, with regulation now being a tighter revenue constraint.

The MPOC is a multilateral agreement that was extensively negotiated among all gas industry participants before the start of the open access regime on the Maui pipeline. Any changes to the MPOC, including its pricing methodology, would require prior industry consultation and a positive recommendation from the Gas Industry Co.

2. Changes in prices and target revenues

Step 1 calculations

The initial results for prices and target revenues calculated for our pricing year starting on 1 July 2013 following the approach set out in Schedule 10 of the MPOC (without considering tariff adjustments) are set out in Table 1 below, together with previously disclosed numbers for the 2012-2013 pricing year.

$ million per pricing period	**Jul 2013 – Jun 2014**	**Jul 2012 – Jun 2013**
Tariff 1		
Pipeline Asset Value	296.465	299.847
WACC (post-tax)	6.77%	7.14%
Revaluation gains/(losses)	2.847	5.424
Required Return	17.223	15.971
Depreciation	7.285	7.168
Taxation Adjustment	6.698	8.379
Required Revenue	31.207	31.518
Tariff 1 over/(under)-recovery adjustment	-	(5.574)
Tariff 1 smoothing reduction/(increase)	-	0
Tariff 1 Target Revenue	31.207	37.092
Throughput Forecast (TJ.km)	18,034,165	18,996,941
Tariff 1 ($ / GJ.km)	0.001730	0.001953
Tariff 2		
Operational Expenditure Forecast	13.389	14.692
Tariff 2 over/(under)-recovery adjustment	-	1.831
Tariff 2 smoothing reduction/(increase)	-	1.100
Tariff 2 Target Revenue	13.389	11.761
Throughput Forecast (TJ)	154,807	149,683
Tariff 2 ($ / GJ)	0.086	0.079
Combined		
Total Target Revenue	**44.596**	**48.853**

The inputs in the tariff calculations for the pricing year starting on 1 July 2013 are based on the following information, assumptions and statistics.

- The Pipeline Asset Value, as well as the Revaluation and Depreciation for it, are based on the values for the Regulatory Asset Base (RAB) as calculated per 31 December 2012 in accordance with the Commerce Commission's Gas Transmission Services Input Methodologies Determination 2012.
- WACC is a post-tax WACC, after a 75th percentile adjustment, based on parameters obtained from the Commerce Commission's "Gas Transmission Services Input Methodologies Determination 2012" and "Cost of capital determination for default price-quality paths for suppliers of gas distribution and gas transmission services, and customised price-quality path proposals made by Vector Limited and GasNet Limited" dated 20 December 2012. Both determinations were used to set the DPP for MDL.
- Taxation Adjustment is based on assumed corporate taxation of 28% on forecast income.
- Operational Expenditure Forecast is derived from a combination of budgets for 2013 with a 1.9% inflation adjustment for 2014.
- The 1.9% CPI inflation forecast for 2014 is obtained from the Half-Year Economic and Fiscal Update published by the Treasury on 18 December 2012.
- Throughput Forecasts are based on an independent gas demand forecast report prepared for MDL's Commercial Operator by Arête Consulting Limited.

The Notional Revenues that result from the initial tariff calculation above exceed the DPP revenue cap. Applying the throughput quantities from the 2011-2012 pricing year (instead of the throughput forecasts for 2013-2014 presented above) to the tariffs calculated in Step 1 would lead to Notional Revenues of $ 46.627 million.

Step 2 results

The reductions necessary to comply with the DPP Determination for the 2013-2014 pricing year, and the resulting Adjusted Revenue Targets and Tariffs, are set out in Table 2 below.

Reductions and revenues ($ million)	**Jul 2013 – Jun 2014**
Tariff 1 MPOC Target Revenue	31.207
Taxation adjustment effect from tariff reductions	1.459
Tariff 1 regulatory compliance reduction	2.588
Tariff 1 Adjusted Revenue Target	27.159
Tariff 2 MPOC Target Revenue	13.389
Tariff 2 regulatory compliance reduction	1.165
Tariff 2 Adjusted Revenue Target	12.225
Total Adjusted Revenue Target	**39.384**
Tariff 1 ($ / GJ.km)	0.001505
Tariff 2 ($ / GJ)	0.079

The regulatory compliance reductions, for both tariffs, are equal to 9.5% of the Adjusted Revenue Targets. The Tariff 1 Adjusted Revenue Target is reduced further as a result of the effect of those reductions on the calculated taxation adjustment.

The Notional Revenues from these adjusted tariffs, i.e. the results from multiplying these with historical throughputs from the 2011-2012 pricing year instead of the actually forecast throughputs for the 2013-2014 pricing year, are set out below.

Notional Revenues ($ million)	**Jul 2013 – Jun 2014**
Tariff 1 Notional Throughput (TJ.km)	19,955,329
Tariff 2 Notional Throughput (TJ)	140,749
Tariff 1 Notional Revenue	30.033
Tariff 2 Notional Revenue	11.119
Total Notional Revenue	**41.152**

Reasons for changes

The changes in our prices shown in Table 1 result from changes in the input parameters used to calculate our tariffs. The main reasons for these changes are as follows.

- As a result of historically low interest rates, the mid-point for the post-tax WACC using parameters determined by the Commerce Commission for setting the DPP is only 5.96%. Even after adding a 75th percentile adjustment, the adjusted post-tax WACC increases to only 6.77%, as compared to the value of 7.14% used in setting tariffs for the 2012-2013 pricing year. Continuing to use the prior 7.14% value would have led to an increase in our Required Return (for Tariff 1) by $ 1.083 million.
- Because of low inflation during 2012, the revaluation rate was 0.95% instead of 1.85% for the 2012-2013 pricing year. Continuing to use the prior rate would have led to a decrease in our Required Return (for Tariff 1) by $ 2.507 million.
- Operational Expenditure forecasted for 2013-2014 is $ 1.303 million less than for the 2012-2013 pricing year. This is approximately equal to the costs for enhanced intelligent pigging that was completed during 2012. Pipeline pigging is performed infrequently. Tariff 2 Target Revenue reduced accordingly.
- Changes in the Throughput Forecasts. The TJ forecast increased by 3.4%; mainly due to assumed consumption increase by Methanex. However, the TJ.km forecast declined by 5.0%. This is a result of a declining proportion of gas being sourced from Oaonui and additional gas for Methanex being sourced from production stations that are near to it. Results from dividing the TJ.km forecast by the TJ forecast show the average forecast shipping distance on the Maui Pipeline declining from 127km to 116km. These changes affect the calculation for setting unit tariffs, but do not affect total targeted revenues.

The further changes in Table 2 are made to ensure that our tariffs comply with the DPP Determination.

Pricing strategy

Our Directors have not made any recorded decisions on MDL's plans or strategy to amend or develop prices in the future. (Other than the change of prices set out in this disclosure, and maintaining general compliance with the MPOC and any applicable regulations.)

3. Prices for non-standard contracts

The terms of Transmission Services Agreements are identical for all Shippers on the Maui pipeline. Clause 2.1(a) of the MPOC stipulates that "...every TSA with a Shipper shall include only the terms and conditions of this Operating Code and necessary individual information...". As a result, MDL does not have and cannot offer any non-standard contracts to Shippers.

4. Views of consumers

We have not directly sought the views of our consumers in calculating our current prices.

We do expect the views of our consumers are reflected in the MPOC, including its pricing methodology. This was negotiated at the start of the open access regime on the Maui pipeline. Moreover, any party to the MPOC may submit a change request, including a proposal to change the pricing methodology. Any change request would require industry consultation and allow all of our consumers to make submissions and provide their views on proposed changes.

5. Disclosure of prices

The new and the current prices for MDL's gas transmission services are:

Prices	with effect from 1 July 2013	from 1 July 2012 to 30 June 2013
Tariff 1 ($ / GJ.km)	0.001505	0.001953
Tariff 2 ($ / GJ)	0.079	0.079

The procedure for calculating tariffs payable by specific consumers of gas transmission services, i.e. Shippers, is set out in clause 19.1 of the MPOC, as extracted below.

19.1 Each Shipper shall pay to MDL the Throughput Charges being the sum of A + B + C

where

(a) **A** is the **AQ Fee** being:

Tariff M x AQ Volume

where

Tariff M = Tariff 1 multiplied by the distance between the southern and the northern end of each AQ Zone specified in that Shipper's AQ, less any agreed percentage discount for a long term AQ commitment specified in a TSA provided that the AQ Fee shall be reduced to the extent that an AQ is curtailed on a Day in accordance with section 8 and to the extent that the Shipper trades its AQ in accordance with section 7.7; and

(b) **B is** Tariff 1 x $\sum (Q_i - \text{AQ Volume}_i) \times D_i$

where

$\mathbf{Q_i}$ is the net quantity of Gas being transported between two adjacent Welded Points for that Shipper according to its Approved Nominations at each of those Welded Points; and

AQ $Volume_i$ is that Shipper's AQ Volume between the two adjacent Welded Points to which the relevant quantity of Gas (Q) relates; and

D_i is the distance between the two adjacent Welded Points to which the relevant quantity of Gas (Q) relates

provided that if (Q_i – AQ $Volume_i$) is less than zero, then (Q_i – AQ $Volume_i$) for that D_i shall equal zero; and

(c) **C** is Tariff 2 multiplied by the sum of that Shipper's Approved Nominations at Physical Delivery Points regardless of distance.

It can be noted that AQ Fees are not in effect at present. They may be required in the future, however, at which time a revision in pricing derivation under the MPOC will likely be required. AQ stands for an Authorised Quantity specified in a Shipper's Transmission Services Agreement with MDL. A Shipper may have more than one AQ. Each AQ consists of an AQ Zone, an AQ Volume and an AQ Expiry Date. Nominations by a Shipper within its AQ would have priority over non-AQ nominations. (Details of the AQ regime are set out in section 7 of the MPOC.) To date, we have never received a request from any Shipper for a non-zero AQ. In practice this also means that for all our pricing years to date AQ Volumes for all Shippers have been and are zero.

MDL has 12 Shippers to which these prices apply. Tariff 1 and Tariff 2 are the same for all Shippers.

We do not allocate target revenues among Shippers.

6. Certification

The required certification for this disclosure is attached.

Annex 1 Allowable Notional Revenue calculations

The DPP determination by the Commerce Commission requires Allowable Notional Revenue for MDL to be calculated as follows:

$$ANR_{2014} = \frac{MAR + (K_{2014} + V_{2014})}{\Delta D} - (K_{2014} + V_{2014})$$

where:

ANR_{2014} is the Allowable Notional Revenue for MDL's first assessment period ending on 30 June 2014.

MAR is Maximum Allowable Revenue from starting prices. The DPP determination has set this for MDL at $ 39.805 million.

ΔD is a growth and timing adjustment factor. The DPP determination has set this for MDL at 0.967.

K_{2014} is the sum of all Pass-through Costs that can be claimed for MDL's first assessment period.

V_{2014} is the sum of all Recoverable Costs that can be claimed for MDL's first assessment period.

Each Pass-through Cost or Recoverable Cost must be ascertainable at the time when MDL sets its prices for the assessment period[1], i.e. now.

Pass-through Costs that could apply for MDL at present are those for:

- rates on pipeline assets paid or payable to a local authority under the Local Government (Rating) Act 2002; and
- levies payable:
  - under the Commerce Act 1986, for Commerce Commission activities;
  - under regulations made under the Gas Act 1992, for activities of the Gas Industry Company Limited;
  - to the Electricity and Gas Complaints Commissioner Scheme.

On the assumption that none of those rates and levies are ascertainable now for the upcoming pricing year, they have all been set at zero[2].

The only Recoverable Costs that could apply for MDL at present are those for balancing gas. Because those cannot be ascertained in advance, they must now be set at zero.

As a result, the terms for K_{2014} and V_{2014} can be eliminated from the formula above, leading to

ANR_{2014} = MAR / ΔD = $ 39.805 million / 0.967 = $ 41.163 million

[1] They also may not relate to costs that were incurred prior to the regulatory period, i.e. prior to 1 July 2013.

[2] Pass-through Costs and Recoverable Costs that have been incurred during an assessment period can be recovered in a later assessment period, together with a time value of money adjustment set at 5.38% per year.

Certification for Disclosures at the Beginning of a Pricing Year

Clause 2.9.2

We, Murray Eric Jackson and Paul Anthony Eckford, being directors of Maui Development Limited certify that, having made all reasonable enquiry, to the best of our knowledge-

a) the following attached information of Maui Development Limited prepared for the purposes of clause 2.4.1 of the Gas Transmission Information Disclosure Determination 2012 in all material respects complies with that determination;

b) the prospective financial or non-financial information included in the attached information has been forecast on a basis consistent with regulatory requirements or recognised industry standards.

31 May 2013