

## Contact Energy's response to questions listed in the Gas Industry Company's consultation paper "Options for Amending Allocation and Reconciliation Arrangements"

QUESTION	COMMENT
<p><b>Q1</b> Do you agree that it is sensible to divide the issues (with the downstream and upstream allocation arrangements) into short-term and long-term issues and to advance the short-term issues ahead of the long-term ones?</p>	<p>This may be sensible but submitters are unable to make that judgement as the discussion paper does not clearly identify which issues would be addressed in the short-term or long term, or a proposed timetable.</p>
<p><b>Q2</b> Do you agree that compliance with existing arrangements for downstream allocation is poor?</p>	<p>It is impossible to tell with the existing arrangements whether compliance is poor, however what is clear is that the existing arrangements are not delivering outcomes that ensure good alignment of allocations with deliveries in each month, or equitable allocation of losses.</p> <p>When the gas Reconciliation Code ("Code") was established in July 2000, it was anticipated that after a reasonable period of experience the industry would review the effectiveness of the retail market arrangements contained in the Code and if appropriate amend it. In April 2002 an industry workshop was held to review the Code arrangements and a clear consensus was reached that it was not adequately meeting the industry's requirements. Among issues of concern were:</p> <ul style="list-style-type: none"> <li>• lack of appropriate governance to oversee the retail market arrangements and compliance;</li> <li>• processes lacked rigour, were inefficient and were not achieving equitable outcomes.</li> </ul>

QUESTION	COMMENT
<p><b>Q3</b> Do you agree that governance arrangements (e.g. code modification processes, dispute resolution processes) are not working effectively? Please provide any specific examples that demonstrate your view.</p>	<p>Contact agrees that the code modification processes and audit processes are ineffective.</p> <p>Specific examples include:</p> <ul style="list-style-type: none"> <li>• Difficulty in effecting a change to the allocation month from second to last business day month to calendar month, even when the Reconciliation Code Working Group ("RCWG") was in place;</li> <li>• Since the RCWG was disestablished in mid 2003 there has been no body to refer Code issues to, or to address the issues identified in the industry workshop held in April 2002;</li> <li>• Refusal by a participant to provide complete data to the auditor during a recent allocation audit initiated by Contact Energy. Furthermore the Code does not entitle the auditor to conduct investigative on-site work to identify or dismiss potential data quality issues.</li> </ul>
<p><b>Q4</b> Do substantial difficulties arise as a result of the need for all shippers at a gate station to agree who to appoint as the allocation agent?</p>	<p>Yes.</p> <p>Substantial difficulties arise when a majority (but not 100%) of shippers at a gas gate (or set of gas gates) want to change the allocation agent, or when an allocation agreement expires and one or more shippers (but not all) wish to amend the agreement or term.</p> <p>It is acknowledged that the backstop position is for the distributor to provide the service, or appoint an allocation agent to provide the service, and this to some extent mitigates the issue. However it is not an ideal outcome when it is not the preferred position for the majority of shippers or the shippers most affected by the allocation process.</p>
<p><b>Q5</b> Do you agree that the Gas Industry Co should implement a regime where the Gas Industry Co becomes the single industry body responsible for appointing an allocation agent (or allocation agents)?</p>	<p>The preferred option is for a single party to contract with the allocation agent (or allocation agents) and monitor performance in accordance with the arrangements for allocation determined under the umbrella of the GIC.</p> <p>This could be achieved by the Vector in its Transmission Service Agreements setting out how gas title will be determined at receipt points and delivery points, and identifying responsibility for allocation and reconciliation and an appointment process that will avoid the issues that arise currently.</p>

QUESTION	COMMENT
<p><b>Q6</b> Does the use of the "difference" allocation method and the resulting implications for the allocation of UFG variations create a substantial problem in the industry?</p>	<p>With difference allocation the key issue is that the incumbent retailer is dependent on the quality (accuracy and completeness) of non-incumbent retailer data, not only for the month but intra month.</p> <p>For gas gates where the incumbent remains dominant in terms of volume, the issues associated with difference allocation are relatively insignificant. However where the incumbent has lost a significant amount of load difference allocation results in the incumbent retailer wearing a disproportionate share of the UFG, and the only practical solution is global allocation with UFG allocated based on each retailer's total load (including DM and NDM volumes).</p> <p>If distributors were obligated to annually review and declare loss factors that reflected actual losses trends then "difference" allocation would deliver more equitable allocation of losses.</p> <p>An alternative to distributors determining loss factors would be for the allocation agent to do so, however to enable this to happen with "difference" allocation the incumbent retailer would also have to provide monthly sales data to the allocation agent. Contact Energy currently does this to enable the allocation agent to identify and investigate unaccounted for gas (UFG) anomalies.</p>
<p><b>Q7</b> If there are problems with the allocation of UFG variations, is working towards mandatory global allocation an appropriate response for the Gas Industry Co?</p>	<p>Global allocation is the most sensible mechanism to deliver equitable allocation of losses, provided the allocation of UFG is based on total retailer volumes submitted, i.e. including DM and NDM volumes and not just groups 5&amp;6.</p> <p>Irrespective of whether or not global allocation is adopted, Contact still considers it is important to require an annual review and reset of loss factors to reflect actual losses trends as relevant loss factors are also required by retailers for other purposes.</p>

QUESTION	COMMENT
<p><b>Q8</b> If global allocation is not made mandatory, how important would it be for 12 month rolling loss factors to be used in the allocation process?</p>	<p>If difference allocation is retained it is essential that loss factors are reviewed and reset annually to reflect actual losses trends. It is also recommended that an annual review and reset should also occur even if global allocation is adopted as loss factors are used for other than allocation of losses in the allocation process.</p> <p>Contact considers an appropriate process would be for the loss factors to be calculated as at the end of July each year and be reset with an effective date of 1 October, reflecting the actual losses for the previous 12 months to 31 March (or possibly 31 December).</p> <p>Contact has written to Vector and Powerco and requested they reset loss factors from 1 October 2006 for Contact's incumbencies. Contact has provided the last 3 years of losses, UFG and loss ratio trend data in support of the request.</p>
<p><b>Q9</b> Should all gas gate daily metered quantities be published daily? What difficulties (e.g. confidentiality) might arise from daily publication?</p>	<p>Gas gate metered quantities should be published daily. That is necessary to manage pipeline balancing and shipper balancing risks. As far as we are aware only NGC Energy (Vector's gas retail business) has indicated any concern that publication of metered quantities would result in the release of confidential information. Industry participants will have a reasonable understanding of gas quantities delivered at gate stations. Confidentiality concerns are insignificant and far outweighed by the benefits that would result from release of the information.</p> <p>Consideration should also be given to which gate station data should be available near real time as opposed to the day after. Such a decision would need to take into account materiality.</p>

QUESTION	COMMENT
<p><b>Q10</b> To what extent do industry problems arise as a result of poor quality data supplied into the allocation process?</p>	<p>There are two issues here:</p> <ol style="list-style-type: none"> <li>the impact on "upstream" allocations and settlement processes of downstream allocations and revisions to downstream allocations;</li> <li>the downstream allocation arrangements fail to deliver quality allocation data and equitable allocation of UFG.</li> </ol> <p><u>Issue 1</u></p> <p>The current linkage will have to continue while Maui legacy contracts remain which require determination of the actual quantity of Maui legacy gas delivered at Maui delivery points. That determination can only be made when allocations at Vector gate stations have been calculated. Once the Maui legacy arrangements terminate it would be possible to establish arrangements at Vector gate stations so that imbalances and overruns on Vector pipelines are determined at each gate station. That would require ex-ante nominations to be made at each gate station. Vector's current arrangements mean that mismatches (balancing charges) are not identified at gate stations. Mismatches relate to a pipeline rather than to specific gate stations.</p> <p><u>Issue 2</u></p> <p>A measure of a quality allocation process is that</p> <ul style="list-style-type: none"> <li>each retailer's allocations reflect actual deliveries to its customers plus an equitable allocation of UFG.</li> <li>residual UFG is close to zero on a rolling 12 months basis (i.e. after removal of the effect of estimating daily quantities for non daily metered sites);</li> <li>monthly absolute UFG is close to zero.</li> </ul> <p>Contact's monitoring of its energy balance (residual UFG) where it is the incumbent retailer indicates that the current arrangements fail to deliver on the second and third points, while lack of transparency and on site investigative audits of participant systems and data production processes means that it is impossible to confirm the first point.</p> <p>The bottom line is that the playing field is not level and Contact in its incumbencies is wearing an unacceptable level of UFG related costs – including transmission overruns, gas purchase costs, and variable network charges due to the affect of scaling by Vector and Powerco).</p>

QUESTION	COMMENT
<p><b>Q11</b> Should the Gas Industry Co introduce formalised, regular wash-ups of month end allocations after 4 or 6 months and after 12 months following the month in question?</p>	<p>Yes.</p> <p>Allocation submissions include daily metered (DM) energy quantities for allocation groups 1-2, and non daily metered (NDM) energy quantities for allocation groups 3-6.</p> <p>For group 3-4 sites which are required to be read at or close to month end, the read-read consumption is currently deemed to align with the allocation period (calendar month, was initially last business day month). This natural misalignment of the read-read period with the calendar month can result in errors of up to + or – 6.7%.</p> <p>For group 5-6 sites there is no mandatory formula for production of monthly estimates, and even if there was it would be unlikely to produce estimates materially aligned with actual deliveries due to the need to estimate forward for substantial periods for many of the contributing ICPs.</p> <p>To achieve material alignment between allocations and deliveries for NDM sites, Contact considers that there should be a revision process and mandatory formula for allocating actual read-read energy quantities to the days in between by applying a seasonal shape. Furthermore Contact considers the allocation agent should have no discretion as to the processing of revisions as is the current position for “corrections”. In effect this would result in:</p> <ul style="list-style-type: none"> <li>• Initial allocation quantities based on estimated deliveries for the calendar month produced shortly after month end, these would be 100% forward estimates;</li> <li>• Revisions based on a mix of materially accurate historic estimates (using a mandatory formula which allocates actual read-read energy quantities to the days in between by applying an all-time seasonal shape provided by the allocation agent from the last allocation), and forward estimates for any period post the last actual read;</li> <li>• Materially accurate allocations would be achieved when the % of historic estimate volume is close to 100%.</li> </ul> <p>Contact’s analysis indicates that with a standard read frequency of monthly for group 3-4 sites, and bi-monthly for group 5-6 sites, a 4 month revision would achieve close to 100% historic estimates while a 12 month revision would clean up any residual including correction of prior period errors older than 4 months.</p> <p>The key objective, however, should still be to get high quality data in the initial submission. It is noted that this is difficult given the tight submissions timeline - effectively close of business 3<sup>rd</sup> business day.</p>

QUESTION	COMMENT
<p><b>Q12</b> Is it appropriate, as part of the initial changes to allocation arrangements, to require all retailers to read every non-TOU ICP at least once in every twelve month cycle?</p>	<p>A better option would be an output related measure, e.g. to require the last revision to include 100% historic estimates.</p>
<p><b>Q13</b> Should the Gas Industry Co establish accuracy criteria for estimates (in conjunction with an appropriate compliance regime)?</p>	<p>Because of the upstream effect of corrections or revisions, it is appropriate to set accuracy criteria for estimates.</p> <p>It is noted the electricity industry currently has an accuracy requirement for the initial submission (containing 100% forward estimates) of + or – 15% of the final submission, by NSP.</p>
<p><b>Q14</b> Is it appropriate in the longer term (after the initial changes are made to the allocation arrangements) to introduce a requirement that submitted data contains a minimum percentage of historic read data?</p>	<p>Because of the upstream effect of corrections or revisions, and the effect on other shippers, it is appropriate to set criteria for historic estimate percentages.</p> <p>It is noted the electricity industry is proposing requirements for subsequent revision submissions of:</p> <ul style="list-style-type: none"> <li>• 80% historic estimates at month 3 revision</li> <li>• 90% historic estimates at month 7 revision</li> <li>• 100% historic estimates at month 14 (final) revision</li> </ul> <p>The closest equivalent for gas would be 85% for month 4 and 100% for month 12.</p>

QUESTION	COMMENT
<p><b>Q15</b> Is it appropriate in the longer term to introduce a standardised data transfer format?</p>	<p>It is noted that the upstream industry has already established a standard for the exchange of data. This standard has been adopted for OATIS. The standard is set out on the website <a href="http://www.gas.org.nz">www.gas.org.nz</a>.</p> <p>However one of the key needs is for a common library of terms to be used by the industry for use in codes, rules and regulation. It would also be sensible to achieve reasonable consistency between gas and electricity where appropriate – e.g. losses, loss factors, UFG, loss ratio.</p>
<p><b>Q16</b> Do you agree that the two main options that should be considered for making allocation and reconciliation arrangements mandatory and enforceable are a modification of the existing contractual arrangements, and Ministerial rules under the Gas Act?</p>	<p>A combination of the two main options should be used. That approach would use the industry to develop the arrangements, while the development process should be under the umbrella of and facilitated by GIC. If this approach fails to yield an industry-agreed result within a reasonable time then GIC should use its regulatory powers to resolve the matter.</p> <p>Given the track record of the downstream industry in progressing development of the Reconciliation Code, and improvements to retail market arrangements and/or amendments to the Reconciliation Code, it would suggest the above approach is likely to fail without setting rules under the Gas Act. However having the GIC to oversee improvements, and with the ability to threaten Ministerial rules if adequate progress is not achieved, provides a more positive environment in which to move forward. Furthermore it will incentivise participants to achieve sensible and timely solutions, and compliant behaviour.</p> <p>Contact also considers that greater transparency is an effective mechanism for achieving compliant performance by highlighting poor performance or issues at an early date so they can be dealt with on a timely basis.</p>



QUESTION	COMMENT
<p><b>Q17</b> Do you agree that potential problems with pipeline owner leverage and Commerce Act risks associated with the contractual arrangements favour the Ministerial rules solution?</p>	<p>We are not, at present, convinced that the Ministerial rules approach is necessary. Increased bureaucracy, higher costs, less flexibility and the stifling of innovation associated with that approach make it unattractive. The industry should have the opportunity to employ the alternative approach. That effort would not be wasted even if the Ministerial rules approach was adopted as inevitably the industry will need to develop the rules.</p> <p>The Commerce Act risks appear overstated. Most of the organisations involved in developing the MPOC obtained advice on whether the MPOC raised Commerce Act concerns. The companies were sufficiently reassured to allow development of the MPOC to continue. It should be noted that the Minister of Energy invited MDL to implement the MPOC after his officials had reviewed it.</p>