22 February 2007

Kelly Rastovich
Gas Industry Company Ltd.
PO Box 10-646
1 Willis Street
Wellington

Dear Kelly,

SUBMISSION ON THE DISCUSSION PAPER REGARDING RECONCILIATION OF DOWNSTREAM GAS QUANTITIES DATED 11 JANUARY 2007

1. On Gas welcomes the opportunity to provide a submission on the proposed Downstream Reconciliation Arrangements for the New Zealand Gas Industry. On Gas is the retail arm of Vector Ltd.
2. On Gas supports the GPS objectives in general, and more specifically supports measures that improve the accuracy and efficiency with which the industry handles information (as expressed in the Regulatory Objective). However in this case On Gas is concerned that the proposed 'Possible framework of Regulatory Approach' does not fulfill the GPS objectives, as it fails to provide for a more accurate and fair allocation. This is detailed later in this submission.
3. Further, On Gas considers that the discussion paper and the attached 'Cost-Benefit Analysis Framework' prepared by NZIER do not 'identify all reasonably practicable options for achieving the objective of the regulation' and to 'assess those options', as is asked for by the Gas Act 1992 (s43N).
4. Our reasoning for the above and our main concerns with the GIC's Discussion paper follow within the main body of this submission, below. On Gas believes that the GIC should make changes to the proposed regulations outlined in the paper. Without such changes a reduction of competition in the industrial and large commercial market sectors could occur. The potential economic consequences of this are discussed further below
5. As requested we have also provided answers to the specific questions within the Discussion Paper in Appendix A.

Terms used require more definition

6. On Gas is concerned that analysis by the GIC is at risk from poor definitions and use of terms. Examples include a lack of definition of 'Loss Factor' and 'Unaccounted for Gas' as used in the discussion paper, as well as of the various Allocation Methods under consideration. On Gas believes that terms, conditions and definitions must be clear and transparent for the sake of clarity of argument and informed discussion of these issues.

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The need to meet policy objectives

7. As stated above, many of On Gas's following concerns relate to whether or not the Government policy statement objective has been sufficiently met, in particular the objective to 'provide for more accurate identification and fairer allocation of the amount of unaccounted for gas'.

8. While we commend the initiatives contained in the paper to improve data quality and to more accurately identify the amount of unaccounted for gas, On Gas does not believe that the proposal meets the objective of a 'fairer allocation'. On Gas feels that prior to any global allocation methodology being applied, significant progress needs to be made in ensuring good quality data enters the allocation process and that Loss Factors have been properly assessed.

9. The discussion paper rightly introduces some measures designed to improve data quality going into the allocation process. On Gas believes that even stronger measures are justified, and this is detailed in Appendix A.

Global Allocation Method most suitable

10. For the purpose of our discussion below, we use 'Loss Factor' as the long run difference between the Gate load and the sum of all metered load (as should be published and reviewed by network operators), and 'Unaccounted for Gas' or 'UfG' for all unaccounted for gas every day or month that is still not accounted for after application of the 'Loss Factor' (plus or minus).[1] *Note, this definition does not coincide with the definition given in the 'Reconciliation Code', but it appears to follow the usage of the term 'Unaccounted for Gas' in the discussion document.*

11. On Gas considers the Global Allocation Method as described in the Reconciliation Code as a fairer and more suitable option than the proposed 1 month UfG Global Method. This is because:

    - The proposed 1 month UfG Global Method would result in the estimation uncertainties, re-submissions and seasonal monthly misallocations of Groups 5 and 6 impacting adversely on groups 1-4.
    - Since Groups 1-4 do not contribute to these, it is unfair to subject them to these through the 1 month UfG Global Method.
    - Assuming Loss Factors are regularly reviewed and accounted for, this is the only significant difference between the two methods.

12. The fact that some retailers report errors between actual and estimated consumption for Allocation Groups 5 and 6 of up to 20% for a given consumption month (Section 6.38 of the discussion paper) only heightens On Gas's concern about the GIC's proposed allocation method and supports the point above.

13. The need for the proposed Interim Allocation (after 4 months) and Final Allocation (after 13 months) is largely driven by subsequent corrections to the estimates for Allocation Groups 5 and 6. For monthly read Allocation Groups (Groups 1–4) generally no better information becomes available after the initial Allocation. Allocation Groups 1-4 should therefore not be subject to the ups and downs of

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1. [1] To avoid misunderstanding, the statement in the GIC discussion paper Section 5.2 (5^{th} bullet point) and elsewhere that the Global Method in the Reconciliation Code would not allocate any UfG to Time of Use (TOU) devices is correct when using the definition above, but is incorrect using the definition of UfG in the same Reconciliation Code.

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subsequent re-allocations caused by Groups 5 and 6, as would be the case under the GIC's proposed allocation method.

14. The fact that some mass market (Groups 5 and 6) misallocations would subsequently be corrected through Interim and Final Allocations provides little comfort to Groups 1-4, since complete flow-through of these corrections to gas, transmission and Maui pipeline costs is not assured - even less so for overrun charges or charges through the BPP.

15. Apart from the estimation uncertainties and seasonal misallocations of Groups 5 and 6, these groups are also thought to contribute more to Loss Factors and UfG than other Allocation Groups because:
    - ICPs are often not properly accounted for,
    - Meters are not checked as often, and
    - Meters have higher permissible meter errors.

    This should be acknowledged by applying lower Loss Factors to Allocation Groups 1-4.

16. For the reasons quoted above, On Gas is of the firm opinion that the Global Allocation Method as described in the Reconciliation Code (or possibly a variation of this) is a fairer method of allocating gas between customer groups, than the 1 month UfG global method proposed. The 1-month UfG global method unfairly makes Groups 1-4 take a share of the problems inherent with allocating Groups 5 and 6 – therefore failing to meet the policy objective of fairness.

17. On Gas also wishes to point out that the Global Allocation Method is more likely to meet the requirements of the Gas Act (1992). Discussion Paper only mentions in passing (in Section 7.17) the Global Allocation Method as described in the 'Reconciliation Code'. Apart from this method being seen as the fairer option as discussed above, On Gas also believes that this method is a 'reasonably practicable option for achieving the objective of the regulation', and it therefore needs to be assessed in terms of benefits and costs, as well as to 'the extent to which the objective would be promoted or achieved'. Failure to include this option in any assessment appears to run contrary to section 43N of the Act. On Gas would be interested in hearing the GIC's reasons why the existing global allocation approach was not fully considered.

The risk of cross-subsidy and economic inefficiencies

18. As noted above, On Gas is concerned that without our concerns being implemented (and the objectives of the GPS being followed) there is a high risk of cross-subsidy occurring from the large industrial/commercial sector to the residential mass market. This has the potential to cause both allocative and dynamic inefficiencies.

19. If the result of the GIC's proposals was an increase in costs to large industrial and commercial customers then they would face artificial incentives to reduce their demand; this conversely would reduce incentives on the mass-market to use gas efficiently. In the longer term, dynamic inefficiencies could result from large commercial/industrial customer exit, and inefficient consumption during peak periods as a result of poor management and understanding of gas flows.

Specific Comments on Appendix D: Possible Framework of Regulatory Approach

20. Clause D21: On Gas suggests bi-monthly reads for 100% of all meters, after allowing for meter access or failure issues.

21. Clause D28, 2nd bullet point: Seasonal adjustment profiles should be mandatory. If not, mass market retailers would be incentivised to read meters as rarely as

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possible and to submit flat profiles, thereby allocating an unfair share of the load to actually read meters exactly at times of potentially high peaking costs.

22. Clause D33: Even though the Reconciliation Code specifies that retailers report to the Allocation Agent at 8.00 am on the 3rd business day of each month (and these times are quoted in the discussion paper), current practice by mutual agreement is to report by 8.00 am on the 4th business day. Current practice timelines are acceptable and should be quoted in the proposed regulations.

23. Clause D35: Would these be considered technical breaches only, and what would be the consequences? Some exceptions may need to be permissible (such as meter access issues), but they should be as few as possible.

24. Clause D41: On Gas is not clear as to why this clause is part of a proposed framework on allocation.

25. Clause D62: On Gas considers that if rules are made mandatory, they should equally apply to all market participants at the same time. Adjustment of reporting systems should be possible within normal lead times for the introduction of rules, and should not provide an excuse for non-compliance.

26. Clause D69: The allocation process described is not seen as the fairest option by On Gas, for the reasons discussed above.

Concluding remarks

27. On Gas supports the GIC's continued efforts to introduce effective measures for the handling of information within the industry (as expressed in the Regulatory Objective). On Gas would like to emphasise that the objectives of the GPS regarding accurate and fair allocation need to be satisfied by the proposed Approach Framework.

28. On Gas would like to reiterate its view that the discussion paper appears to give undue regard to the view of large mass market retailers only, to the detriment of the industrial and large commercial customer groups (those with TOU meters) - hence our concern at the potential for reduced competition in this market. These groups contribute significantly less to the problems observed but they would be unfairly penalized by regulations as proposed in the discussion paper. As discussed above, unfavourable economic outcomes could result.

29. On Gas believes that our concerns above need addressing if the potential for a reduction of competition in the industrial and large commercial market sectors is to be alleviated. We are very happy to comment further on this issue in particular, and on any other aspect of this submission. Please contact Ewan Gebbie in the first instance.

Kind Regards

Steve Bullock
Divisional Manager – Gas Sales

Recommended Format for Submissions

To assist Gas Industry Co in the orderly and efficient consideration of stakeholders' responses, a suggested format for submissions has been prepared. This is drawn from the questions posed throughout the body of this consultation document. Respondents are also free to include other material in their responses.

Submission prepared by: On Gas – Steve Bullock (Divisional Manager - Gas Sales)

Question	Comment
Q1: Do you agree with the definitions adopted by Gas Industry Co in this Discussion Paper? If not, what do you suggest?	On Gas agrees with the definitions of "upstream" and "downstream" reconciliation as cited in the paper. However, a clear definition of "Unaccounted for Gas (UfG)" as used in the paper is missing and is critical to an informed discussion. Definitions of the allocation methods suggested should also be included.
Q2: Do you agree with the proposed Regulatory Objective for downstream reconciliation? If not, what do you think would be a more appropriate regulatory objective?	Yes, On Gas agrees with the objectives as stated.
Q3: Do you agree with Gas Industry Co's preferred approach towards standardised file formats? If not, how should it be improved?	Yes, On Gas agrees with GIC's approach, and believes that there is opportunity for a 'quick win' in implementing standardised file formats as quickly as possible.
Q4: Do you agree with the proposed estimation accuracy criteria and proposal to require normalisation of data? If not, why not?	On Gas agrees with the proposed estimation accuracy criteria. On Gas does not agree with GIC's proposal not to introduce prescribed estimation methodologies. Any forward or historical estimates by retailers need to take into account seasonal profiles. If not, mass market retailers are incentivised to read meters as rarely as possible and to submit flat profiles, thereby allocating an unfair share of the load to actually read meters exactly at times of potentially high peaking costs.
Q5: Do you agree with the proposed minimum meter reading requirements? If not, why not?	On Gas supports obligations to read mass market meters more regularly, and considers that the GIC's proposal (95% of meters read quarterly) does not go far enough. On Gas suggests bi-monthly reads for 100% of all meters (with proper consideration of meter access or failure issues), in order to support the point above.
Q6: Do you consider the 10TJ threshold for allocation groups 1 and 2 should be reviewed? If so, do you have	Yes, On Gas believes that requirements on retailers to more closely monitor and to nominate daily loads for upstream nomination purposes will

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any information that would assist Gas Industry Co to perform this review?	provide retailers with added incentives to install TOU meters even below the 10 TJ threshold.
Q7: Do you agree with the proposed process for the calculation and publication of loss factors appropriate? If not, how should it be improved?	Yes, On Gas agrees with the proposed process, but strongly disagrees with the statements leading up to this question in Section 6.81 discussing allocation methods, as detailed elsewhere in our submission. It is also noted that distributors are reliant on good quality data from all retailers, including incumbents, when updating Loss Factors. Making progress on issues of data quality is therefore of paramount importance.
Q8: Do you consider that the current month end timeframes for the provision and calculation of allocation information are appropriate?	Yes. It should be noted that even though the Reconciliation Code specifies that retailers report to the Allocation Agent at 8.00 am on the 3rd business day of each month (and these times are quoted in the discussion paper), current practice by mutual agreement is to report by 8.00 am on the 4th business day.
Q9: Do you consider transitional provisions and/or exemptions will be required prior to the central registry go-live date?	Yes, On Gas agrees.
Q10: Do you agree with the preferred approach of implementing a mandatory requirement on all industry participants to submit accurate data and comply with all data submission requirements?	Yes, On Gas agrees.
Q11: Is Gas Industry Co's proposed regime for rolling 4 month (interim allocation) and 13 month (final allocation) revisions appropriate? Is the terminology ("interim allocation" and "final allocation") appropriate or would alternative terminology (e.g. "first revision" and "second revision") be clearer?	While On Gas agrees that regular revisions could be required, they should not be used as an excuse to put less emphasis on getting the initial allocation correct. The flow through of subsequent revisions on transmission charges, including overruns and BPP charges, on wholesale gas charges and on distribution charges is less than clear.
Q12: Do you agree with Gas Industry Co's proposed restriction of the correction process (i.e. limiting corrections to within one working day of publication and only if a manifest error is discovered)? If not, what alternative correction process do you propose?	On Gas agrees with a one-day window for corrections, as long as time-lines for upstream allocations can still be met.
Q13: Do you agree with the preferred approach of publishing gas gate, UFG and specified allocation information?	On Gas agrees with the publication of UfG by gas gate. Daily gas gate metered quantity should only be

	published where relevant, e.g. gates with a single customer supplied by another retailer are not considered relevant. On Gas does not see the benefit of publishing aggregated monthly gas allocated to each retailer per gas gate, and questions the relevance to other retailers.
Q14: Do you agree with the preferred approach of mandating the 1 month UFG global method?	No, On Gas does not support mandating the 1 month UfG global method, but is of the opinion that the Global Allocation Method as described in the Reconciliation Code is the fairer method to use. GIC should not be under the impression that the majority of retailers (and network operators) favour the proposed 1 month UfG Global Allocation Method. The more important issue the GIC should concentrate on are measures to improve data quality, such as the implementation of a central registry, as well as the measures listed in Table 3 in the discussion paper. These measures are aimed at the root causes of the problem. Simply changing the allocation method before these root causes are fixed only re-distribute the problem (thereby diluting the incentive to fix them), rather than solving any problems.
Q15: Do you agree that the mandatory downstream reconciliation arrangements should not include the day end estimated allocation service and month end monthly allocation service?	Yes
Q16: Do you agree that Gas Industry Co should appoint the Allocation Agent using a service provider model similar to that used in the electricity industry? Do you agree that the initial appointment should be for a 5 year term?	Yes
Q17: Is a pan-industry arrangement as described in this section the most appropriate alternative governance structure to the use of regulations and rules under the Gas Act? Which governance structures would you prefer (regulatory or pan-industry)?	Yes, which includes existing reconciliation code arrangements
Q18: Should funding of the reconciliation arrangements be covered by a process detailed in the reconciliation	Yes, On Gas agrees

arrangements (rather than, for example, by the levy)? Do you agree with Gas Industry Co's preliminary view that the arrangements should be funded by retailers according to the number of ICPs?	
Q19: Do you agree with the proposed audit arrangements? If not, please specify which aspects of the proposed arrangements are inappropriate and how you consider they should be improved?	Yes
Q20: Do you agree that the auditor should be excluded from coverage of the compliance regime (i.e. should compliance be only a contractual matter between Gas Industry Co and the auditor)?	On Gas supports the inclusion of the requirement for an audit process with this compliance regime.
Q21: Are the proposed arrangements for Allocation Agent compliance appropriate? What do you think is a suitable liability cap for non performance?	Yes, agree with the proposed arrangements. On Gas considers a liability cap for the Allocation Agent of $200,000 to be appropriate.
Q22: Do you agree that reporting of breaches should be voluntary for participants (not mandatory)?	Yes
Q23: Do you agree that the Allocation Agent should have a mandatory obligation to report breaches and suspected breaches?	Yes
Q24: Do you agree that all other persons (e.g. consumers, Gas Industry Co and auditors) should have the right to report a breach?	Yes
Q25: Do you agree with the proposed time limit for reporting breaches?	Yes
Q26: The preferred approach for the design of the compliance regime for reconciliation is similar to the compliance regime proposed for switching. Do you agree that the proposed compliance regime is appropriate? If not, how should the compliance regime be changed?	Yes
Q27: Do you agree that there is a need to provide for special allocations? Do you agree with the proposed process for	Yes

special allocations?	
Q28: Do you have any comments on the detail in Appendix D? Are there any additional matters that should be included in this framework?	Please see comments in the main body of the submission.
Q29: Do you agree that obtaining unanimous agreement will likely require seeking authorisation from the Commerce Commission of any pan-industry agreement on downstream reconciliation?	On Gas would recommend obtaining the Commission's view on this.
Q30: Do you have any views on the feasibility of a pan-industry agreement? Would participants be willing to agree to a pan-industry agreement covering the measures proposed in section 11 of this paper (subject to any necessary approvals, including any necessary Commerce Commission or Ministerial approval)?	On Gas believes a Pan-Industry agreement would be possible of the proposed solutions demonstrably improved current arrangements to all.

Submitter responses to the questions that are included in the NZIER cost/benefit framework paper:

CBA Q1: Is the first five years from the earliest date of the proposals taking effect a long enough time period to capture the resulting changes, particularly the benefits? If not, what period do you propose?	On Gas agrees with the 5 year assessment period.
CBA Q2: Is this baseline scenario a realistic representation of what would happen in the absence of the proposals? If not, in what ways do you think it could be made more realistic and why?	On Gas believes some progress would have been made by the industry in the absence of regulation, particularly in the areas of data format standardisation. On Gas would have been very disappointed if the absence of regulation would have resulted in the increased adoption of the 1 month UfG global method, since this would have simply re-allocated problems between industry players and customer groups, rather than solving the fundamental problems of data quality.
CBA Q3: Do you agree with assessing the costs and benefits of all of the proposals' options, under each of a regulatory regime and a pan-industry agreement, to simplify and reduce the costs of undertaking the CBA? If not, what alternative approach do you suggest and why?	On Gas believes that more options need to be considered in the CBA, particularly the benefits and costs of other allocation methods. An alternative would be not to recommend any allocation method at this point, but rather let the CBA assess the impact of achieving better data quality in isolation. This is somewhat independent from assessing the allocation method the data is eventually used for. The choice of allocation method could be seen as wealth transfer between different parties (retailers or customer groups), which is the subject of Question 8.
CBA Q4: Are there any costs identified in Table 1 that you consider it inappropriate to include in the CBA? Are there any significant costs missing from Table 1? Do you have any suggestions as to the likely magnitudes of the costs or how they might, in practice, be estimated?	A move from the current method of allocation 'by difference' to a global method will not only lead to increased administration costs for the incumbent retailer, but also for all other retailers, because all retailers on a gate would be impacted by all subsequent revisions of allocation data under a global method.

CBA Q5: Is there any relevant information on electricity market reconciliation that could be used to inform the cost estimates?	Not in a position to comment.
CBA Q6: Are there any benefits identified in Table 2 that you consider it inappropriate to include in the CBA? Are there any significant benefits missing from Table 2? Do you have any suggestions as to the likely magnitudes of the benefits or how they might, in practice, be estimated?	On Gas questions whether any change in allocation method would really reduce operational costs (on the contrary, see answer to question 4), or lead to a reduction in search, negotiation or agreement cost. It is also unclear why the proposed allocation method should lead to an increase in retailer competition.
CBA Q7: Do you agree that negotiation and agreement would cost less under the regulatory regime and be less likely to involve inefficient compromises? If not, why not?	Yes
CBA Q8: Do you agree that wealth transfers should be disregarded in assessing the net public benefit of the proposals? If not, why not, and what alternative approach do you favour and why?	On Gas feels that wealth transfer between parties can not be ignored completely, because it impacts on fairness of proposals and potentially reduces retailer competition.
CBA Q9: Do you agree with the use of real discount rates of six percent and twelve percent? If not, why not, and what alternative values do you favour and why?	No comment
CBA Q10: Do you agree with the use of sensitivity analysis to test the robustness of the CBA's conclusions? If not, why not, and what alternative approach do you favour and why?	Yes