Consultation on Exemptions and Rule 37 Determination under the Gas (Downstream Reconciliation) Rules 2008

Introduction

Purpose

The purpose of this paper is to consult on two issues relating to the Gas (Downstream Reconciliation) Rules 2008 (the Rules). The first is to propose the extension of a set of exemptions under the Rules which are due to expire on 30 September 2012. The second is to carry out the required consultation on the accuracy threshold in rule 37 before the annual determination of the threshold is made by Gas Industry Co. The rule 37 determination must also take place by 30 September 2012.

Exemptions

The second section deals with the set of exemptions which are currently in force. The exemptions cover atypical gas gates (direct connects, unmetered and oversized metered gas gates and gas gates at which the global 1-month UFG allocation (G1M) methodology is applied) and the provision and publication of injection information by transmission system owners (TSOs).

The background and purpose of the exemptions are briefly set out along with a reference to how the exemptions will be affected by the current Statement of Proposal which proposes amendments to the Rules.

The proposal is for Gas Industry Co to vary all current exemptions by extending the expiry date by two years (from 30 September 2012 to 30 September 2014). This extension should give sufficient time for the Rules review process to be completed which addresses the policy issues behind the exemptions and will remove the need for the exemptions.

Rule 37 determination

The rule 37 determination is considered in the third section. Previous decisions and experience are summarised and statistics on performance against the threshold since go-live are analysed. This will be the fifth year of operations under the Rules and therefore the fifth determination of the threshold.

The proposal for the gas year beginning 1 October 2012 is to maintain the current threshold of ±10% for a third consecutive year.

Submissions

Feedback is sought from participants on this consultation paper. The deadline for submissions is 5pm on **Wednesday 26 September 2012**. This is a short-form consultation on the basis that the matters covered in the paper have been consulted on several times before and the proposals will maintain the status quo operation of the rules.

Submissions can be made by logging on to the Gas Industry Co website, navigating to the Downstream Reconciliation work programme and uploading your submission in the Consultation section. All submissions will be published on the website after the closing date. Submitters should discuss any intended provision of confidential information with Gas Industry Co prior to uploading their submissions.

Exemptions

Background

Almost all of the exemptions currently in force have been in existence since the Rules went live in October 2008. They cover situations which were either unforeseen when the Rules were drafted or where alternative arrangements were found to better meet the purpose of the Rules than the status quo.

The first tranche of exemptions all had an expiry date of 30 September 2010 which was the end of the two-year transitional period under the Rules. It was intended that the Rules would be reviewed by the time the exemptions had expired to determine whether the exemptions should be allowed to lapse or whether the Rules should be amended to reflect the policy settings implied by the exemptions. Some minor and technical amendments were made to the Rules in October 2009 which addressed the content of five exemptions. For the remaining exemptions it was decided that a more substantial policy review was required and thus more time would be needed to conduct that review.

To that end a consultation paper was released in September 2010 which proposed extending the deadlines of the remaining exemptions (nine in total) for a further two years to allow time for the policy review to take place. That consultation paper is available here.

The extension was granted and the Rules review is now well underway, with the first of two Statements of Proposal (the 2012 Statement of Proposal) recently out for consultation. As discussed below, the 2012 Statement of Proposal analyses the policy intent behind the current exemptions and, in the majority of cases, proposes rule changes which adopt the arrangements contained in those exemptions. The purpose of this current paper is to consult on extending the deadline of the exemptions once more so that the current Rules review process can reach its conclusion and allocation participants are not disadvantaged in the interim by a change to the status quo.

Summary of exemptions

Substantial background information for all of the exemptions is provided in the September 2010 consultation paper referenced above. The policy issues surrounding the exemptions have been analysed and addressed in the 2012 Statement of Proposal. Both of these documents are available on the Gas Industry Co website . A brief summary of each exemption and the reason for each exemption is given below.

Direct connect gas gates

Notices: Exemption (DR10-03-S: Direct Connect Gas Gates) Notice 2010

Exemption (DR10-02-S: Te Rapa Cogen) Notice 2010

This exemption covers 39 consumer installations directly connected to the transmission system. At these gas gates the application of the allocation arrangements is largely redundant as the gate volume is accounted for by a single user.

Unmetered gas gates

Notice: Exemption (DR10-07-S: Unmetered Gas Gates) Notice 2010

This exemption covers seven gas gates where there is no gas gate meter installed. The TSO's obligation to measure and report injection quantities is relieved at these gas gates on the basis that the small volumes associated with these gates and the high cost of GMS installation in each case make it uneconomic to require compliance.

Oversized metered gas gates

Notice: Exemption (DR10-06-S: Oversized Metered Gas Gates) Notice 2010

In the same vein as the above exemption, there are two gas gates where the TSO is unable to accurately measure injection quantities because the meters are too large for the current level of gas flow. The same argument applies that it is not economically viable to replace the meters (particularly as the demand for gas at the gates could change).

Global 1-month UFG methodology (G1M) gas gates

Notice: Exemption (DR10-04-S: Global 1-Month UFG Methodology) Notice 2010

Three gas gates have the G1M allocation methodology applied via an exemption. This is due to the dominance of TOU load at the gates which makes the standard allocation methodology (which applies a fixed UFG factor to TOU load) unsuitable. The G1M methodology applies the same monthly UFG factor to all consumers at a gas gate.

Injection information

Notice: Exemption (DR10-05-S: Injection Information) Notice 2010

TSOs are required to publish estimated day-end injection quantities for each gas gate on a daily basis. This exemption lifts that obligation for all calendar days for gas gates without telemetry and for non-business days for gas gates without SCADA.

Correction of injection quantities

Notice: Exemption (DR11-01-S: Revision of Injection Quantities) Notice 2011

This exemption allows TSOs to apply corrections to injection quantities in situations where metering data have failed validation checks and the TSO is able to create a correction before the submission deadline which is likely to be closer to the actual flow than an estimate created by the allocation agent.

Power to grant exemptions

Gas Industry Co's power to grant exemptions is given in rule 19 of the Rules. Before granting an exemption, Gas Industry Co is required to consult with persons it considers are representative of those likely to be affected by the exemption. An exemption can only be granted if Gas Industry Co is satisfied that it is desirable to better achieve:

- the objectives set out in section 43ZN of the Gas Act; and
- the purpose of the Rules.

Rule 21 allows that any exemption may be varied or revoked, either on application by an allocation participant or the allocation agent or on the initiative of the Gas Industry Co. The same requirements apply to a variation or revocation as to an application for an exemption.

The proposal in this paper is for Gas Industry Co, under its own initiative pursuant to rule 21.1, to vary all current exemptions by extending the deadline of each exemption from 30 September 2012 to 30 September 2014.

Assessment against criteria

An overview of the assessment against the criteria set out in the Rules is set out in the table below:

Criterion	Assessment
1. Allocations are fairer (rule 2)	Allocation arrangements are unchanged from the status quo position and the extension allows Gas Industry Co sufficient time to evaluate what is the most fair and efficient approach to take
2. Allocations are more efficient (rule 2 and s43ZN(a) of the Act)	Allocation arrangements are unchanged from the status quo position and the extension allows Gas Industry Co sufficient time to evaluate what is the most fair and efficient approach to take
3. Reliability of allocation and supply is enhanced (s43ZN(a) of the Act)	Extending the exemptions provides security and reliability to exemption-holders and other participants since there will be no change to operations until the policy review has been completed
4. Other s43ZN objectives	Objectives (i), (iii) and (iv) are furthered since the exemptions variously provide for fairer allocations and/or remove a compliance burden in situations where the costs of compliance are high and the benefits are limited. The other s43ZN objectives are not relevant.
5. Departure from uniform processes	Although exemptions necessarily create a departure from the Rules, the process that has been in place since go-live of the Rules (through subsisting exemptions) will not change

Criterion	Assessment
6. Any other relevant considerations	There are no other relevant considerations
Overall assessment	The assessment against criteria supports granting the variations to extend the exemptions

Assessment conclusions

Both the general assessment and the assessment against criteria support granting the variations to the exemptions. The conditions to be applied to the exemptions will remain the same.

2012 Statement of Proposal

A significant portion of the 2012 Statement of Proposal is devoted to addressing the issues which gave rise to the current exemptions. Based on feedback from the Downstream Reconciliation Advisory Group, and an assessment of practicable options, the paper proposes making the following rule changes which will address the issues discussed in the previous section.

Exemption Type	Proposal in SoP
Direct connect gas gates	New rule allowing Gas Industry Co to determine, following consultation with allocation participants, a list of direct connect gas gates which are not covered by the allocation provisions in the Rules
Unmetered gas gates Oversized metered gas gates	New rule allowing Gas Industry Co to determine, following consultation with allocation participants, a list of unmetered and oversized metered gas gates, for which the TSO is not required to submit injection information and the allocation agent is responsible for estimating injection quantities
Global 1-month UFG methodology gas gates	New rules allowing for: • Gas Industry Co to set the criteria for gas gates to be classed as G1M gas gates; • The allocation agent to determine and publish the G1M gas gates each year; and • The application of the G1M allocation methodology at the G1M gas gates
Revision of injection quantities	Removal of references to *actual daily energy quantities* and replacement with the defined term *daily metered energy quantities*, which incorporates the notion that where no reliable information is available such quantities may be estimated by the allocation participant
Estimated day end injection quantities	Removal of rule 42 in its entirety on the basis that this information is required to be provided to shippers under contractual arrangements

Q1: Do you agree with the proposal to vary all current exemptions by extending the deadline in each case to 30 September 2014?

Rule 37 determination

Background

Each year, Gas Industry Co is required to determine and publish an accuracy threshold, in the form of a permissible percentage of error, for the non-TOU consumption information submitted to the allocation agent for the initial allocation. For each gas gate, the aggregated consumption information in allocation groups three to six must, when compared with submissions for the final allocation, fall within the required percentage of error.

In making its determination, Gas Industry Co must have regard to the following matters:

- The primary aim of ensuring consumption information provided for initial allocation is as accurate as possible when compared with consumption information provided for final allocation;
- The extent to which retailers are able to comply with the percentage of error for the accuracy of consumption information provided for initial allocation;
- Any expected costs that would be reasonably incurred by retailers to achieve compliance with the percentage of error for the accuracy of consumption information provided for initial allocation; and
- Any other matter it considers relevant to its determination.

Previous determinations

The gas year beginning 1 October 2012 will be the fifth year of operation of the reconciliation arrangements under the Rules. The rule 37 determination for each of the previous years is shown in the table below.

Gas year	Threshold
Oct-08 to Sep-09	±15.0%
Oct-09 to Sep-10	±12.5%
Oct-10 to Sep-11	±10.0%
Oct-11 to Sep-12	±10.0%

With the go-live of the new reconciliation arrangements there was scope for improvements to be made. The threshold was therefore gradually tightened for the first three years, to provide a strong incentive to retailers to do all they can reasonably do to improve estimation accuracy. Last year's determination maintained the threshold at ±10% on the basis that a further tightening was not expected to bring a greater level of compliance and the extra harm captured by breaches of rule 37 would not outweigh the burden created by a larger number of breaches.

Themes in the submissions on the 2011 consultation paper (which proposed maintaining the ±10% threshold) included:

Support for maintaining threshold at current level

- All submitters supported (or were not opposed to) maintaining the ±10% threshold
- One submitter commented that there is no evidence to support either increasing or reducing the threshold

Limits to level of accuracy that can be achieved under present arrangements

- Submitters noted that any further tightening of the percentage threshold would not incentivise improved accuracy as all reasonable steps to improve have already been taken
- Submitters suggested that the only remaining step to improve accuracy would be to increase the frequency of mass market meter reading but this would be costly and would not solve the problem (as evidenced by those retailers who read more frequently still breaching the threshold)

Solution to retailer inaccuracy may be found in alternative arrangements

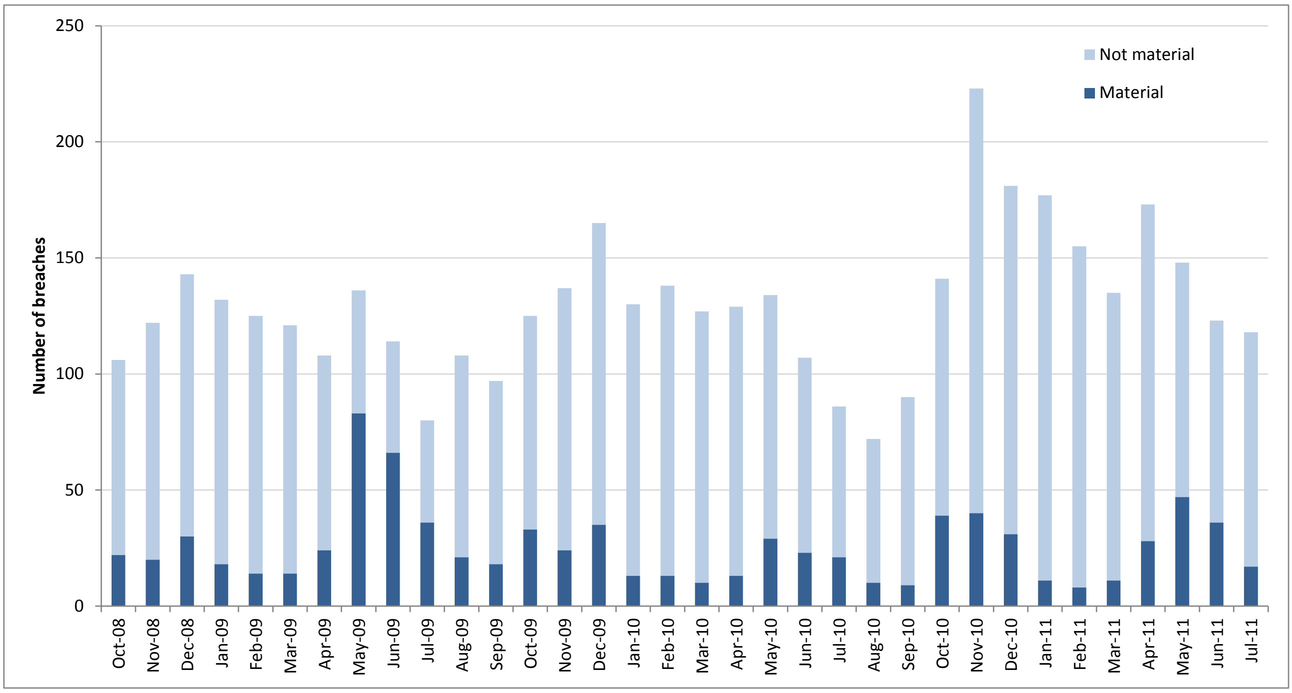
- Submitters suggested that the focus should turn to seeking more cost-effective methods of improving accuracy than a target threshold
- One submitter noted that the policy intention of the rule was not to address the harm caused by retailer inaccuracy at the initial allocation
- Various avenues were suggested for improving the accuracy of submissions to the initial allocation or removing the need for initial submissions which rely on forward estimates. Suggestions included:
    - Early publication of residual profiles
    - A D+1 allocation algorithm
    - A top-down algorithm
    - An algorithm which allocates UFG proportionately to causers

On the latter point, work is still progressing on alternative approaches to the initial allocation which could address retailer accuracy. As noted in the 2012 Statement of Proposal, the UFG-to-causers algorithm has been trialled but did not provide results that improved on the status quo. The other remaining options will be addressed in the 2013 Statement of Proposal.

Past performance

In previous years, it has been instructive to provide a high-level analysis of the incidence of breaches to date. With the availability of another 12 months of data, a clearer picture is evolving of breach activity. Chart 1 shows the total number of breaches, with those found to be material represented by darker shading. The materiality of the breaches has so far been determined by the application of a gigajoule threshold, that is, where the difference between initial and final submissions is greater than 200GJ then the breach is considered to be material.

Chart 1 Total breaches of rule 37, October 2008 to July 2011



Over the first two years there was some seasonal swing in the total number of breaches (lighter shading) but no overall upward or downward trend despite the incremental tightening of the threshold. The material breaches were reasonably flat with the exception of the peak in May to June 2009, associated with unseasonal temperatures. The gas year beginning October 2010 had a higher overall level of breach activity, which is consistent with the further tightening of the threshold to 10%, but may also indicate that temperatures diverged more regularly from their seasonal averages, particularly in late 2010 and mid 2011 where the material breaches increased considerably.

The seasonal trend in total breaches is more obvious in Chart 2 which separates the breaches due to under-estimation from the breaches due to over-estimation. The pattern of under-estimation going into winter and over-estimation in early-summer appears to continue and even when non-material breaches are ignored, the noticeable spikes are centred around the shoulder periods of May 2009, November 2010 and May 2011. The level of material breaches, and the size of those breaches in gigajoules (shown in Chart 3) appears to have reduced in the more recent spikes, but the changes are not significant enough to draw conclusions on change in behaviour, particularly with a moving threshold.

Chart 2 Breaches of positive and negative thresholds, October 2008 to July 2011

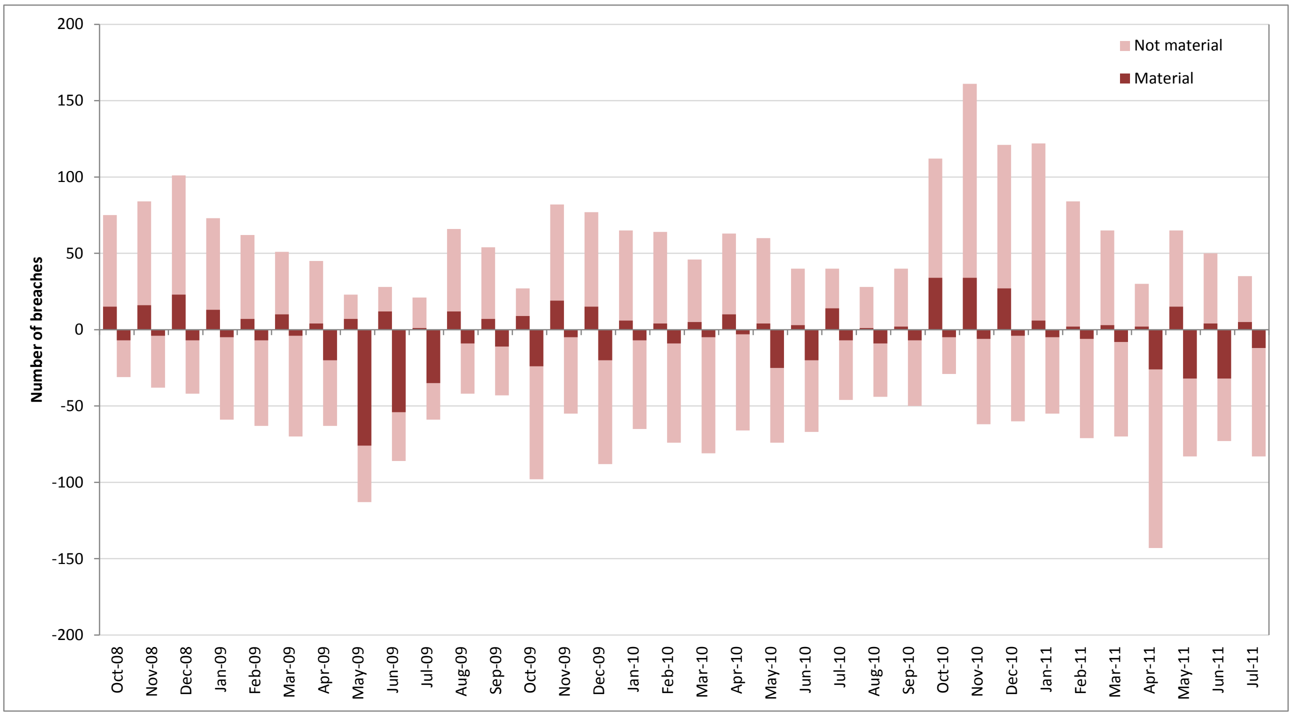


Chart 3 Volumes associated with material and not material breaches, October 2008 to July 2011

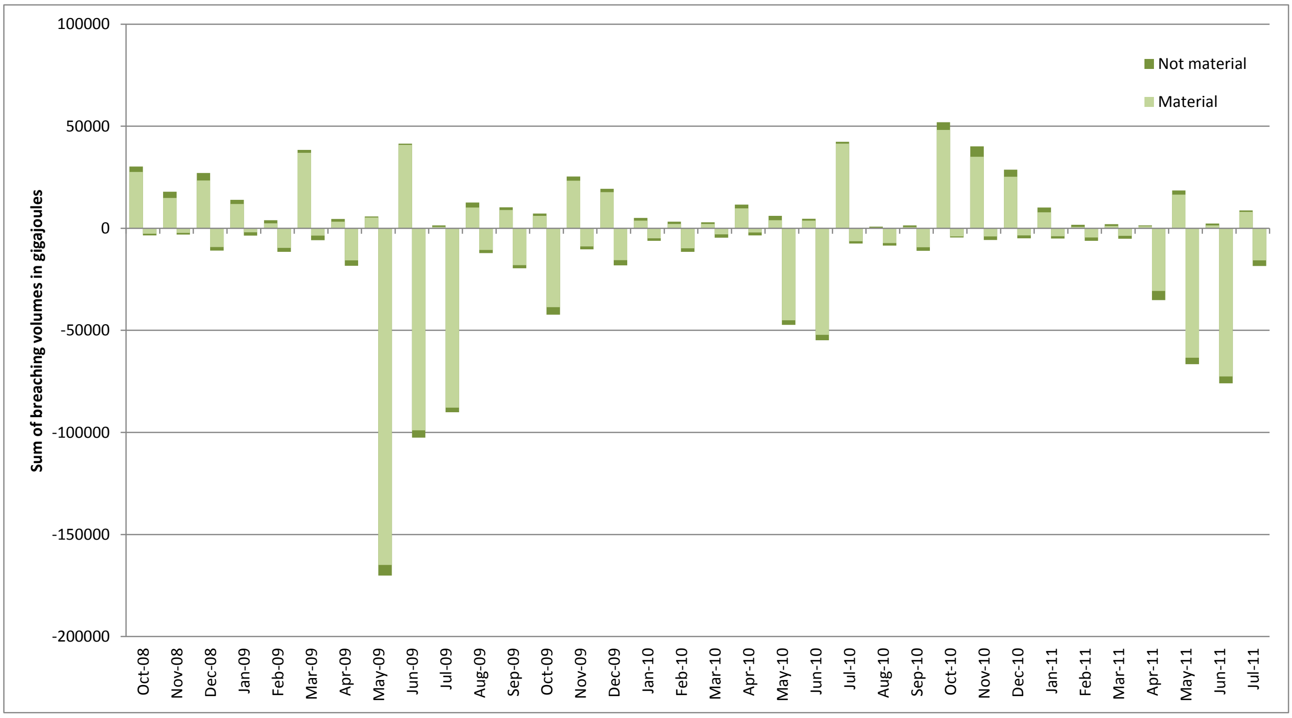
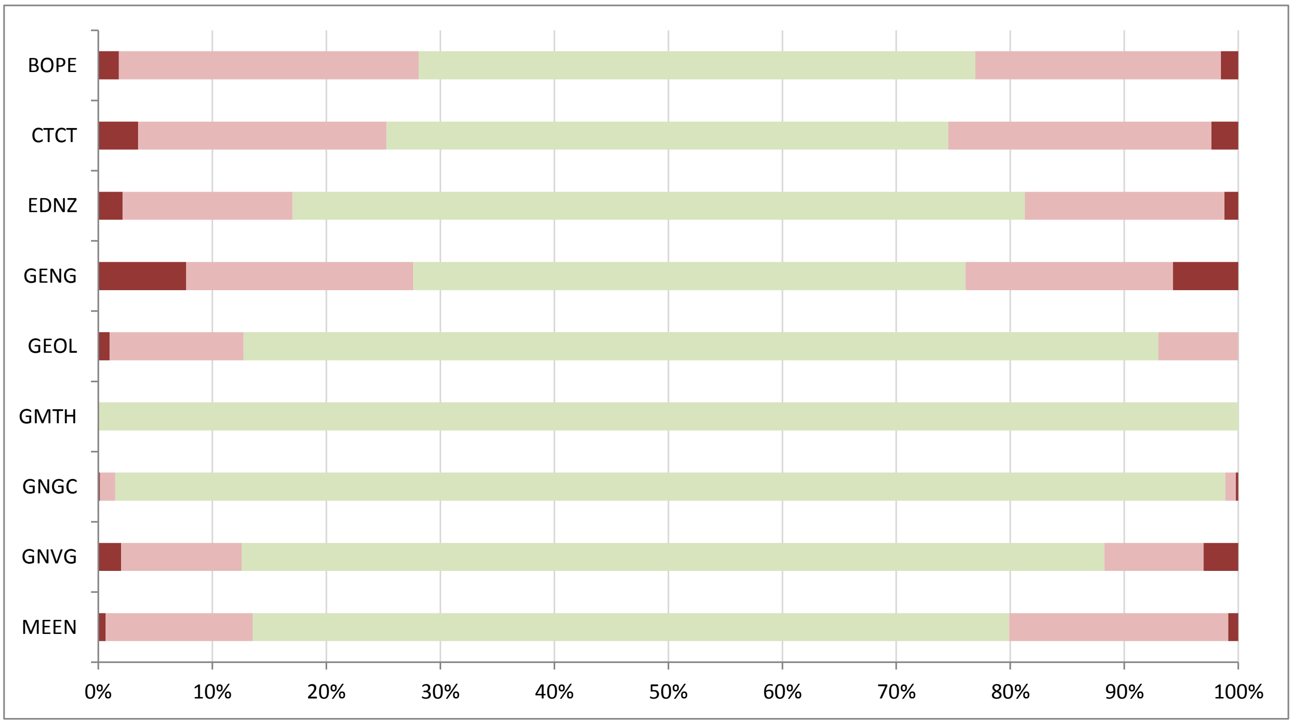


Chart 4 gives the retailer-level performance, showing the proportion of gas gate submissions which fall inside and outside the accuracy threshold. The red bars to the left are submissions which fell outside of the negative threshold (deeper shade indicating material breaches) indicating under-estimation at the initial; the red bars to the right are submissions which fell outside of the positive threshold, indicating over-estimation. Chart 4 includes all data since go-live so does not give an indication of recent improvements, but it does highlight that market share, frequency of meter reading and target market all play a role in the ability to provide accurate submissions.

Chart 4 Proportion of retailer submissions which fall under, over or within the accuracy and materiality thresholds, October 2008 to July 2011



Proposal

Based on the same analysis as presented in last year's consultation paper (listed below and available here), and recognising the general tenor of submissions on that paper, Gas Industry Co is proposing to maintain the accuracy threshold at ±10% for a further year. This will give more time to identify and analyse the flow-through effects of improvements made to date, whilst providing a steady-state backdrop to the work which continues on making improvements to the current initial allocation arrangements.

Gas Industry Co takes the following view against each of the matters it has to consider in determining the accuracy threshold:

Primary aim that consumption information is as accurate as possible

The intent of rule 37 is to ensure that initial submission accuracy is as accurate as possible, so as to mitigate the harm caused by under- and over-submissions. Analysis of available data suggests that, while retailers in general have improved in their forward estimations somewhat, they are still liable to mis-estimations during shoulder seasons and in times of unseasonal weather.

At the same time, Gas Industry Co understands that balancing and peaking pool charges have decreased over the past two years, so that the harm experienced due to inaccurate estimations is not as great as it was when the Rules were implemented.

Both of these factors suggest that 10% is an appropriate threshold for the coming gas year.

Extent to which retailers are able to comply

Analysis of available data shows that, despite the tightening of the accuracy threshold on two occasions, there has not been a noticeable impact on general compliance with rule 37. This suggests that minor improvements have been made against the baseline, although given the small amount of actual data available (plus the lack of a baseline before rule 37 existed), the result is not statistically significant in terms of conclusions about changes in retailer accuracy.

It is clear from the pattern of material breaches and also from participant feedback that the factors which drive compliance are either unpredictable (in the case of domestic consumer response to temperature change) or involve significant cost (in the case of meter reading frequency).

Consideration of the extent to which retailers are able to comply also suggests that the accuracy threshold should remain at 10% for the coming gas year.

Any expected costs to achieve compliance

Given the reported difficulty in forecasting gas demand, and the use of retrospective methodologies that involve calculating past average usage to determine forward estimates, it is not expected that further tightening will drive a step change in retailers' attempts to comply with the accuracy threshold. The data presented suggests that the most successful method of creating accurate submissions is to read meters more frequently. Given that balancing costs have trended downwards over the past couple of years, the benefit of increasing the frequency of meter reads for mass market retailers (in terms of mitigating BPP costs) is not likely to offset the cost of doubling the number of meter reads. Gas Industry Co continues to investigate other approaches to addressing retailer inaccuracy in the hope of finding an alternative effective solution.

Any other relevant matters

A settlement has recently been reached regarding the second set of rule 37 breaches found material by the market administrator. The settlement involves financial transactions that approximate compensation for the extra charges incurred as a result of over- or under-allocations at the initial stage due to breaching parties' behaviour. The second settlement (covering December 2009 to March 2011) involved payments which were an order of magnitude smaller than the first settlement ($63,000 compared to $380,000). Whilst it is tempting to observe that behaviour must have therefore improved, there are a number of qualifications around this conclusion: first and foremost, that the party paying the lion's share in the first settlement was under supervision for much of the second period and displayed much greater compliance; second that the first settlement only covered a single divergent weather event whereas the second period covered several more moderate events; third that the recent settlement spans a much longer period, with lower balancing costs and an increased likelihood that payments between parties cancel each other out.

Based on this analysis, Gas Industry Co considers that the accuracy threshold should remain at 10% for the coming gas year.

Q2: Do you agree with the proposal to maintain the rule 37 threshold at ±10% for the gas year beginning 1 October 2012?

Appendix A Submissions template

Consultation on Exemptions and Rule 37 Determination under the Gas (Downstream Reconciliation) Rules 2008

Submission prepared by: (company name and contact)

QUESTION		COMMENT
Q1:	Do you agree with the proposal to vary all current exemptions by extending the deadline in each case to 30 September 2014?	
Q2:	Do you agree with the proposal to maintain the rule 37 threshold at ±10% for the gas year beginning 1 October 2012?	