

<b>Subject</b>	<b>Analysis of Submissions and Responses – Notice of Determinations by the Industry Body (Gas Industry Co) under the Gas (Downstream Reconciliation) Rules 2008</b>
<b>Date</b>	<b>12 November 2010 (paper held until after publication of Market Administrator guideline note on rule 37)</b>

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## **Introduction and summary**

Rule 37.3 of the Gas (Downstream Reconciliation) Rules 2008 (Reconciliation Rules) requires that, prior to the beginning of each gas year, Gas Industry Co determine and publish a percentage of error for the accuracy of the consumption information provided for initial allocation (when compared against consumption information provided for final allocation). This accuracy requirement only applies to consumption data for allocation groups 3 to 6.

As required, the *Notice of Determinations by the Industry Body (Gas Industry Co) under the Gas (Downstream Reconciliation) Rules 2008*, version 1.4 was published on 30 September 2010 and is available on Gas Industry Co's website at <http://www.gasindustry.co.nz/work-programme/market-administration/determinations>. The purpose of this document is to outline the decision process in making this determination.

Gas Industry Co published a consultation paper<sup>1</sup> on this issue on 9 September 2010, and the paper, as well as submissions received, is available on Gas Industry Co's website at [www.gasindustry.co.nz/work-programme/downstream-reconciliation/consultation](http://www.gasindustry.co.nz/work-programme/downstream-reconciliation/consultation). Submissions were received from Contact Energy, Energy Direct, Genesis Energy, Mighty River Power, Nova Energy, and Vector.

The consultation paper proposed two items:

- A percentage of error threshold of 10% for the 2010/2011 gas year, in conjunction with
- A series of exemptions to implement a 200 GJ materiality threshold on breaches of rule 37.

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<sup>1</sup> *Consultation of rule 37 percentage of error determination under the Gas (Downstream Reconciliation) Rules 2008*

These proposals were generally well supported in the submissions received. Gas Industry Co therefore considers that 10% is an appropriate percentage of error threshold for the upcoming year. In terms of a materiality threshold, the market administrator has now published a guideline note on the materiality of rule 37 breaches,<sup>2</sup> which will allow market participants and the market administrator to focus on the larger-volume breaches that potentially have adversely affected others.

The remainder of this document outlines and responds to issues raised in submissions.

## **10% error threshold proposal**

### ***Proposal***

Gas Industry Co proposed that the percentage of error threshold be lowered from the 12.5% that applied in the 2009-10 gas year to 10% for the 2010-11 gas year.

In making the determination under rule 37.3, Gas Industry Co must have regard to the following matters set out in rule 37.4:

- 37.4.1** 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;
- 37.4.2** The extent to which retailers are able to comply with the percentage of error for the accuracy of consumption information provided for initial allocation;
- 37.4.3** 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
- 37.4.4** Any other matter it considers relevant to its determination.

The consultation paper set out Gas Industry Co's initial assessment of a 10% error threshold with regard to these matters:

- Tightening the accuracy threshold to 10% is consistent with ensuring that the consumption information provided for initial allocation is as accurate as possible. A ratcheting down of the threshold is something that was foreshadowed in previous reconciliation years and provides an incentive for retailers to improve their estimation processes.
- Projected breaches of rule 37 for the period October 2009 to April 2010 (using interim data in place of final data) show a decline of around 20% compared to breaches in the same period of the

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<sup>2</sup> *Market Administrator Guideline note rule 37 – materiality of rule 37.2 breaches (Downstream Reconciliation)*, dated 10 November 2010. Available at <http://www.gasindustry.co.nz/work-programme/market-administration/guideline-notes>

previous gas year, even though the threshold for the 2009/10 gas year is lower than for the 2008/09 gas year (12.5% compared to 15%).

- The financial harm caused by inaccurate initial submission is reflected in the balancing charges, which are levied based on allocated volumes and are not revisited after the initial allocation. Tightening the accuracy threshold for breaches will allow a greater number of inaccurate submissions to be captured by the compliance regime, so the scope for compensation will be wider and the operation of the rules fairer.

### ***Submissions***

Of the six submissions received, four agreed with the proposed 10% error threshold: Energy Direct, Genesis Energy, Mighty River Power, and Vector. Vector's was the only submission to offer unqualified support for the change. The other three agreed that the switch to a 10% threshold was appropriate in conjunction with other changes, such as a materiality threshold and availability of SADSV files before initial consumption data files are submitted.

Contact dissented, saying that it did not consider that such a change would have a significant impact on initial submission accuracy, as retailers are already incentivised to improve the accuracy of their initial submissions. Contact stated that it continues to look for ways to improve accuracy, but that any changes to the current bottom-up approach are likely to result in relatively small gains. A step change in accuracy would only be possible through system changes or more frequent meter reading, both of which could impose significant costs on its customers.

Nova Energy agreed that tighter thresholds could be applied, though it did not explicitly agree with the proposed 10% threshold level. Nova also offered an alternative suggestion to applying accuracy requirements at the gas gate level. As the main affect of inaccurate initial submission is the misallocation of Balancing and Peaking Pool charges, Nova suggested that it would make sense to assess submission accuracy on a pipeline basis; that is, aggregate submissions for all gas gates on a pipeline, and apply an accuracy threshold to the aggregated amount.

### ***Gas Industry Co response***

Gas Industry Co considers that there is sufficient support to proceed with changing the accuracy threshold to 10% for the 2010/11 gas year.

Gas Industry Co accepts Contact's point that retailers are already working to make marginal improvements to submission accuracy. However, inaccurate initial submissions pose costs on other retailers. Lowering the percentage threshold will allow affected retailers to claim redress for a wider range of accuracy breaches. At the same time, the implementation of a materiality volume threshold by the market administrator, discussed below, will allow allocation participants and the market administrator to focus on the breaches that potentially have had a material effect on other market participants.

Nova's suggestion of considering accuracy at a pipeline level, rather than a gas gate level, is an interesting one. At the moment, Gas Industry Co does not have the ability to implement such a change, as rule 37.1 of the Reconciliation Rules stipulates that "[t]his rule applies to consumption information at a gas gate provided to the allocation agent for consumer installations in allocation groups 3 to 6 in respect of a consumption period" (emphasis added). Considering accuracy at the pipeline level would therefore require a rule change. Gas Industry Co will include this issue in its forthcoming review of the Reconciliation Rules.

Consideration of changes to the allocation process, such as the provision of SADSV files in advance of initial consumption submission mentioned by Genesis Energy, will form part of the review of the Reconciliation Rules, which is currently in progress.

## **200 GJ materiality threshold**

### ***Proposal***

As outlined in the consultation paper, Gas Industry Co proposed a materiality threshold of 200 GJ for rule 37 breaches for the following reasons:

- Such a threshold would decrease a significant number of breaches by number, yet would retain the larger breaches, which are more likely to have impacted other participants. Based on historical data, such a threshold would remove about 80% of breaches by number.
- A materiality threshold would lower compliance costs for allocation participants and administration costs for Gas Industry Co, allowing resources to focus on breaches involving significant volumes and potentially material harm to other allocation participants.

### ***Submissions***

Support for a 200 GJ materiality threshold was unanimous.

Contact Energy suggested that such a threshold could be implemented as part of the determination of the error threshold. Such a determination would reflect the purpose of the rule and practical considerations. Further, there is precedent for such a determination: there is a parallel provision for error percentage in the Electricity Governance Rules (Part J, Schedule J3, rule 2.2.3), and the Electricity Authority, in determining this percentage, has specified both a percentage and a materiality threshold.

Genesis Energy queried whether the measure of 200 GJ is overly simplistic, as such an amount might constitute a significant percentage of volume at a small gas gate. It suggested the materiality measure should take into account gate size and the impact the gate has on the total market.

Nova suggested that the materiality threshold should be applied so that errors of less than 200 GJ are allowed as long as the aggregate of breaches of less than 200 GJ is no greater than a total threshold level. Presumably, this suggestion is meant to be applied to each allocation participant and each consumption month, so that participants are still incentivised to eliminate small volume errors as well as larger ones.

Vector suggested that Gas Industry Co revisit the volume threshold in the next review of rule 37 to assess its impact on retailers' accuracy performance and the need for the measure to remain in place.

### ***Gas Industry Co response***

As stated in the consultation paper, Gas Industry Co originally intended to implement a materiality threshold via a series of exemptions for industry participants. The process for granting an exemption to an allocation participant, as specified in the Reconciliation Rules, is for the allocation participant to apply for an exemption and for Gas Industry Co to publish and consult on that application before making its determination. For the implementation of a threshold that is meant to apply to all allocation participants, it would be a cumbersome and labour-intensive process.

Contact Energy's alternative suggestion, to determine materiality as part of the error threshold, has merit in that it would be a straightforward and transparent way to implement a materiality threshold. However, Gas Industry Co is not persuaded that the wording of the Reconciliation Rules allows the specification of a volume threshold as well as a percentage threshold, notwithstanding the actions of the Electricity Authority. This issue will be included in the upcoming review of the Reconciliation Rules, as a change to the wording of rule 37 to allow a volume threshold may prove to be the optimal approach to this issue.

In the meantime, the Market Administrator has issued a guideline note that incorporates a 200 GJ volume threshold into the process for considering the materiality of rule 37 breaches. Under the process outlined in the guidance note, breaches of rule 37 for volumes less than 200 GJ will still be notified to participants, but the market administrator will not request further information about them. In the absence of information to the contrary, the market administrator will consider those breaches not material. Participants who consider that they have been affected by a breach under the volume threshold can provide details to the market administrator, in which case the breach will be considered in the normal manner. In this way, processing and consideration of rule 37 breaches will be streamlined, and market participants and the market administrator can focus on those breaches that potentially have had a material effect on other participants.

Gas Industry Co has considered the concern raised by Genesis Energy, that different volume thresholds might be appropriate for differently-sized gas gates. However, the harm to other participants caused by inaccurate submissions is primarily due to the Balancing and Peaking Pool charges, which are calculated on a pipeline basis. Therefore, it is irrelevant whether a potential breach constitutes a large percentage of a small gate or a small percentage of a large gate, as all gas gates are amalgamated by pipeline. Further, the implementation of a volume threshold does not prevent a participant or Gas Industry Co alleging a breach of rule 26 if a participant has submitted inaccurate or misleading data.

Nova's and Vector's concerns seem related: that the existence of a volume threshold may adversely affect the accuracy of participants' submissions for small volumes. Gas Industry Co does not consider it practical to implement a cap on aggregate breaches by an allocation participant in a consumption month, as Nova seems to be suggesting. However, Gas Industry Co intends to monitor participants'

performance under the percentage error and volume thresholds, as the annual redetermination of the error threshold provides an opportunity to reconsider this issue next year.

## **Determination**

The percentage of error for the accuracy of the consumption information provided for initial allocation to be applied in the gas year commencing 1 October 2010 in accordance with rule 37.3 and 37.4 is set at **±10%**. Gas Industry Co notes that the consideration of breaches of this rule will be in accordance with the process set out in the market administrator's guideline note, which incorporates a 200 GJ volume threshold.

## Appendix A Summary of submissions

	Contact	Energy Direct	Genesis	MRP	Nova	Vector
<p><i>Q1: Do submitters support the determination of a <math>\pm 10\%</math> percentage of error for consumption periods in the 2010/2011 gas year under rule 37.3? Please provide reasons for your preference and indicate your views in respect of each option.</i></p>	<p>No.</p> <p>Would be unlikely to have significant impact on initial submission accuracy. Existing threshold already incentivises retailers to improve.</p> <p>Supports 200GJ threshold; considers it can be implemented as part of threshold.</p>	<p>Yes, provided materiality threshold is also set.</p>	<p>Yes, provided SADSV changes and split allocation process will be in place</p>	<p>Yes, in conjunction with 200GJ materiality threshold.</p>	<p>Would prefer a percentage error threshold to be applied on a pipeline basis, rather than individual gas gate level. Would be easier to monitor and administer; retailers could take advantage of customer diversity across gates to improve performance.</p>	<p>Yes; will provide greater incentives for retailers to improve accuracy. Should be transitioned to 5% threshold the following year.</p>

	<b>Contact</b>	<b>Energy Direct</b>	<b>Genesis</b>	<b>MRP</b>	<b>Nova</b>	<b>Vector</b>
<p><i>Q2: Do submitters consider the information available since go-live indicates that a change to the existing percentage of error is appropriate or not? Please provide reasons.</i></p>	<p>Retailers struggling to comply with 15% and 12.5% requirements, but most instances are at gates where volumes are not material.</p> <p>Support 200GJ threshold and allowance of further 12 months before a percentage decrease.</p>	<p>Percentage of error is most efficient way to determine accuracy, as it can be quickly and simply applied across all gas gates.</p>	<p>Agrees percentage error could be reduced.</p> <p>Accuracy has improved, probably due to transparency of global reconciliation process and retailers' commercial drivers.</p>	<p>Yes; change is a step forward to ensure gas allocation is accurate and robust. Greater accuracy of consumption data would help to reduce financial impact of daily penalties/charges.</p>	<p>Yes.</p> <p>Retailers have been attempting to improve performance, as evidenced by fewer balancing transactions in 2010.</p>	<p>Yes; number of breaches is falling year-on-year. As number of breaches is expected to decline, there is no compelling reason to retain current threshold. Also, retailers are now more experienced with the rules and are improving their systems.</p>
<p><i>Q3: In respect of the proposal for the percentage of error, do submitters have any comments or information in relation to the following matters?</i></p> <ul style="list-style-type: none"> <li><i>•The primary aim of ensuring consumption</i></li> </ul>	<p>Agrees that accuracy of initial submissions is important but there is a limit to amount of accuracy that can be achieved without significant extra costs for</p>	<p>Energy Direct is constantly working to improve accuracy of submissions, regardless of threshold level.</p> <p>Concerned about large number of</p>	<p>A number of factors affect accuracy, including estimation algorithm. Genesis Energy would not put a specific program in place to achieve a lower threshold, but always seeks to</p>	<p>Allocation agent should move to daily allocation and reconciliation.</p>	<p>Assessment of initial versus final allocation submissions should be done by pipeline.</p> <p>GIC should also take into account ways of reducing costs of</p>	<p>10% error margin is a reasonable and achievable threshold; some retailers are already complying with this requirement.</p> <p>Vector does not anticipate</p>



	Contact	Energy Direct	Genesis	MRP	Nova	Vector
<p><i>information provided for initial allocation is as accurate as possible when compared with consumption information provided for final allocation.</i></p> <ul style="list-style-type: none"> <li>•The extent to which retailers are able to comply with the percentage of error for the accuracy of consumption information provided for initial allocation.</li> <li>•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.</li> <li>•Any other matters relevant to Gas Industry Co's</li> </ul>	<p>customers:</p> <ul style="list-style-type: none"> <li>• Difficult for mass market to comply with existing thresholds, as initial submissions based heavily on estimates</li> <li>• System changes would be required to achieve step change in improvement; alternatively, monthly meter reading. Both would entail costs</li> </ul> <p>Contact supports other methods to improve accuracy, such as provision of SADSVs and top-down methods</p>	<p>low GJ breaches.</p> <p>For some gas gates, total monthly consumption may be less than 200 GJ, which would be under the volume threshold regardless of accuracy. Lower volume thresholds may be appropriate for these gates.</p>	<p>improve.</p> <p>Monthly meter reading would improve accuracy, but, at \$1 million/year cost, is not justified by submission accuracy benefits alone. Better to focus on improvements to allocation process.</p>		<p>compliance measurement.</p> <p>Having ongoing large numbers of breaches is not sustainable.</p>	<p>substantial costs arising from the move to 10%. On the contrary, more accurate estimates will improve efficiency levels and reduce overall costs for market participants.</p>

	<b>Contact</b>	<b>Energy Direct</b>	<b>Genesis</b>	<b>MRP</b>	<b>Nova</b>	<b>Vector</b>
<i>determination.</i>						
<i>Q4: Do submitters support an exemption for all percentage of error breaches that are less than 200GJ outside compliance with rule 37.2? Please provide reasons</i>	<p>Yes, though consider it can be done without exemption.</p> <p>Retailers are overwhelmed with breaches, which makes it difficult to identify and remedy the causes. With immaterial breaches filtered out, it will be much clearer what is important to focus on.</p>	Yes.	<p>Yes, though queries whether 200GJ is too simplistic a measure. 200GJ could be insignificant at a large gate in winter or it could be a significant error on a small gate in summer. A better measure would take into account gate size or volume and the impact the gate has on the total market.</p>	Yes.	<p>Yes, but exemption should have a limit so that errors less than 200GJ are allowable as long as aggregate breaches of less than 200 GJ are no greater than a total threshold level of, for example, 1,000 GJ.</p>	<p>Yes, support the threshold exemption. Also support 200GJ volume threshold for consideration of existing breaches. Impact of exemption on retailers' accuracy performance should be monitored and reviewed in next review of rule 37.</p>