



Consultation on Compliance Thresholds

Date issued: 12 November 2014
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About Gas Industry Co.

Gas Industry Co is the gas industry body and co-regulator under the Gas Act. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to infrastructure; and
 - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

Submissions close: 12 December 2014

Submit to: www.gasindustry.co.nz

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Introduction

The purpose of this consultation paper is to outline Gas Industry Co's proposed thresholds that would form Market Administrator guidelines pursuant to the recently introduced regulation 19A of the Gas Governance (Compliance) Regulations 2008 (the Regulations).

1.1 Background

In May 2012 Gas Industry Co issued a Statement of Proposal setting out proposed amendments to the Regulations¹. The proposed amendments were designed to:

- tidy up the Compliance Regulations to clarify and enhance their operation, and rectify drafting errors and anomalies; and
- change the mandatory breach reporting requirements on the Allocation Agent and Registry Operator under regulation 11(1) to ensure that the compliance costs of alleging breaches of the type that are unlikely to raise a material issue do not outweigh the benefits (referred to as the threshold regime).

Regulation 11 places mandatory reporting requirements on service providers. It refers to the Registry Operator, Allocation Agent, Critical Contingency Operator and auditors appointed to carry out audits under the Gas (Downstream Reconciliation) Rules 2008 or Gas Governance (Critical Contingency Management) Regulations 2008. For the purposes of the proposed amendments, only the Registry Operator and Allocation Agent will be subject to the threshold regime. Mandatory reporting requirements will still apply to all breaches identified by the Critical Contingency Operator and auditors.

In a document setting out further details of the threshold regime², Gas Industry Co requested industry participant's submissions in regards to the proposed rules to be covered by the above mentioned threshold regime. Submissions on this paper were uniformly supportive of the proposals.

¹ Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/compliance/policy-development/#amendments-to-compliance-regulations-2012-2014/statement-of-proposal-amendments-to-the-gas-governance-compliance-regulations-2008/>

² Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/compliance/policy-development/#amendments-to-compliance-regulations-2012-2014/proposed-amendments-to-the-gas-governance-compliance-regulations-2008-further-details-of-the-threshold-regime/>

Gas Industry Co provided a recommendation to the Minister of Energy and Resources that the Regulations be amended. That recommendation was accepted and the amended Regulations came into force on 1 March 2014.

1.2 Regulation 11A

The Regulations now contain, in regulation 11A, an exception to the mandatory breach reporting requirement for certain rules and in certain circumstances. Following feedback on the May 2012 Statement of Proposal, Gas Industry Co decided to explicitly identify the rules to which the exception may be applied. The applicable rules are set out in regulation 11A along with the circumstances under which the reporting entity may make an exception:

11A Exception to regulation 11 for certain rule breaches

- (1) Regulation 11(1) does not apply to the extent that—
 - (a) the rules that a reporting participant believes to have been breached are one or more of the following:
 - (i) rule 37 of the Gas (Downstream Reconciliation) Rules 2008;
 - (ii) rules 67.3, 69.1, 69.2, 70.2, and 72.2 of the Gas (Switching Arrangements) Rules 2008; and
 - (b) the reporting participant is satisfied that, if it were to notify the market administrator of the alleged breach of any rule specified in paragraph (a), there is no likelihood that the market administrator would determine under regulation 18 that the alleged breach raises a material issue on the basis of information known to the reporting participant.
- (2) In making a decision for the purpose of subclause (1)(b), a reporting participant must have regard to—
 - (a) any determinations published by the market administrator under regulation 22; and
 - (b) any guidelines issued by the market administrator under regulation 19(2) or 19A.
- (3) Each reporting participant must ensure that the market administrator receives a monthly report detailing any alleged breaches that the reporting participant, in reliance on this regulation, does not notify under regulation 11(1).
- (4) This regulation does not limit regulations 9 and 10 (voluntary reporting of alleged breaches).

The thresholds would be applied by way of Market Administrator guidelines issued pursuant to regulation 19A, that detail the circumstances when it would not consider an alleged breach to raise a material issue. This will give the Registry Operator and Allocation Agent the ability to apply a uniform process to determining what should be alleged as a breach.

It was initially proposed that rules 31, 32, 33 and 41 of the Reconciliation Rules would also be included in the threshold regime due to the frequency of breaches being alleged by the Allocation Agent. However these breaches were largely attributable to participants estimating daily consumption or injection volumes and the Reconciliation Rules have since been amended to allow for estimation where actual volumes are not available. This greatly reduced the incidence of alleged breaches of these four rules so they were not included in the amendment to the Regulations.

1.3 Submissions

Submissions on this consultation paper must be provided no later than **5pm on 12 December 2014**.

Submissions can be made by registering on Gas Industry Co's website and uploading your submission, preferably in the form of the submissions template attached to the consultation document. All submissions will be published on this website after the closing date. Submissions may be amended up to closure date.

All submissions will be published on the website after the closing date. Submitters intending to provide confidential information as part of their submission should discuss this with Gas Industry Co prior to submitting the information.

1.4 Next steps

The consultation period will run until 12 December 2014. Gas Industry Co will then analyse submissions during November and will publish Market Administrator guidelines pursuant to regulation 19A where appropriate. Any guidelines will be published on the Gas Industry Co website and notified to affected parties including the Registry Operator and/or Allocation Agent.

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Operation of threshold regime

This section provides further detail on how the threshold regime would operate, if a Market Administrator guideline is published pursuant to regulation 19A. Section 3 of this paper addresses the proposed thresholds for the specific rules covered by Regulation 11A.

2.1 Monthly breach notices

Breaches of the rules covered by the threshold regime are routinely flagged by either the Allocation Agent or the Registry Operator as part of monthly business-as-usual operations:

- On the first business day of each month the Registry generates a switch breach report covering activity in the previous month, which is sent to the Market Administrator and Registry participants; and
- After each final allocation, the Allocation Agent prepares breach notices for each retailer that had excursions outside the acceptable rule 37 threshold for one or more gas gates, and sends these to the Market Administrator.

The Market Administrator receives the alleged breaches and notifies the participant involved and other (potentially) affected participants. After inviting parties to join the alleged breach and seeking any further information about the circumstances of the alleged breach, the Market Administrator makes a materiality determination or, if unable to do so, refers the breach for investigation.

If a threshold regime is introduced for any rule, this monthly process will be affected. The Registry Operator and Allocation Agent will still send the same monthly information to the Market Administrator but will distinguish between:

- Alleged breaches that fall under, or within, any threshold set out in a Market Administrator guideline; and
- Alleged breaches that fall outside of, or over, any threshold set out in a Market Administrator guideline.

A breach that is over/outside of a threshold will follow the current compliance process, that is, information will be sought by the Market Administrator, affected parties will be invited to join, and the Market Administrator will make a determination on the materiality of the breach.

A breach that is under/within a threshold will not progress any further through the compliance process i.e. the participant will not be required to respond and other participants will not be notified or asked to join the breach. No determination of whether the breach is material or not material will be made by the Market Administrator as the service provider is not formally alleging a breach.

Notwithstanding any threshold set out in a Market Administrator guideline, participants, consumers, other persons and Gas Industry Co will still be able to allege a breach at any time.

2.2 Monitoring

As mentioned above, all breach activity will continue to be reported to Gas Industry Co by service providers. We will carry out regular monitoring of the breaches within the threshold to assess whether any behavioural change has eventuated that indicates a de facto rule change, and whether action is required to address the change. This may include varying or revoking any Market Administrator guideline.

For the benefit of transparency, Gas Industry Co may choose to provide high-level reporting of the breaches that fall under or within a threshold (along with formally alleged breaches) by way of a monthly or quarterly compliance report published on the Gas Industry Co website. This will serve as further monitoring tool of the threshold regime. The Registry Operator and Allocation Agent will also continue to provide monthly review reports to Gas Industry Co which are published on our website.³

³ Registry Operator reports are available here: <http://gasindustry.co.nz/work-programmes/switching-and-registry/operations/#registry-operator/>

Allocation Agent reports are published here: <http://gasindustry.co.nz/work-programmes/downstream-reconciliation/operations/#allocation-agent/monthly-reports/>

3 Proposed thresholds

3.1 Rule 37 of the Reconciliation Rules

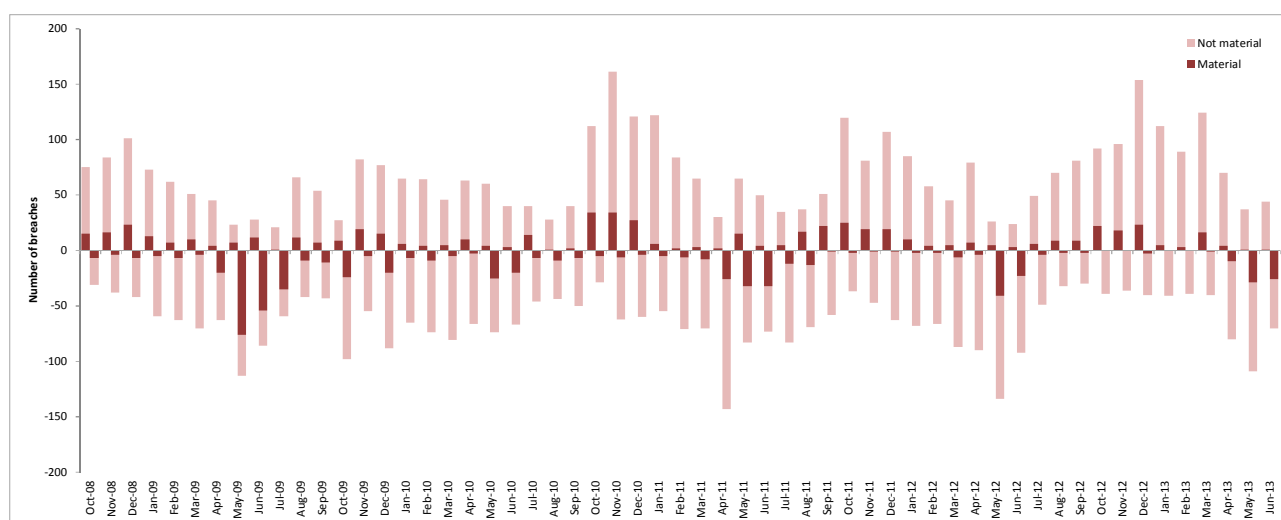
Rule summary

Rule 37 provides for an accuracy threshold, in the form of a percentage determined by Gas Industry Co, within which each retailer's aggregate submissions for allocation groups 3 to 6 for the initial allocation must fall when compared against the equivalent submissions for the final allocation. If a retailer's aggregate initial submission at a gas gate falls outside of the accuracy threshold then the Allocation Agent alleges a breach of rule 37 for that gas gate.

Experience to date

Rule 37 is the most frequently breached rule of the Reconciliation Rules. Mass market retailers regularly breach the accuracy threshold at one or more gas gates each month. Retailers who read their customer's meters bi-monthly breach more often than retailers with monthly reads, but non-compliance is common across both, particularly in shoulder seasons when forward estimation of consumption is more difficult. Chart 1 shows the incidence of rule 37 breaches, clearly illustrating the seasonality of under- and over-submissions.

Chart 1 Number of material and not material breaches of rule 37, October 2008 to June 2013

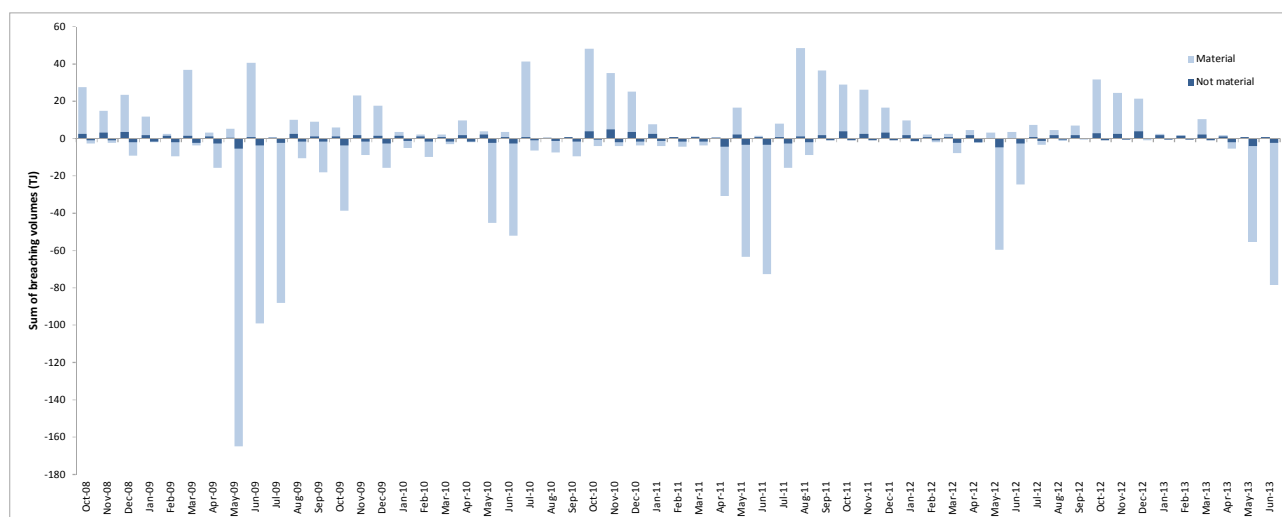


Existing guideline

To assist with determining the materiality of rule 37 breaches, the Market Administrator has issued a guideline⁴ applying a volume threshold, such that any breach under 200 gigajoules (that is, any difference between the aggregated initial and final submission of less than 200 gigajoules) will generally be considered not material, absent any other factors. The guideline sets out the weighting of factors applied to the materiality decision.

The choice of 200 gigajoules for the volume threshold is considered to be a reasonable trade-off between reducing the large number of breaches alleged against retailers by the Allocation Agent each month and still capturing the majority of the harm that is caused by excursions outside of the accuracy threshold. This is illustrated in Charts 1 and 2: the *number* of material breaches is comparatively low compared to all breaches (less than 15%), but the *volume* captured by material breaches is 90% of the total volume associated with all such breaches. The materiality threshold value was chosen following analysis and consultation with allocation participants in 2010⁵ and again in 2011⁶.

Chart 2 Sum of material and not material breaching volumes (terajoules), October 2008 to June 2013



Proposal

Gas Industry Co proposes using the same volume threshold for rule 37 as the threshold for reporting breaches to the Market Administrator. Minor wording changes may be required to the current Market Administrator guideline in order to clarify that it may be used by the Allocation Agent to consider exceptions pursuant to regulation 11A.

⁴ Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/compliance/compliance-process/#market-administrator/market-administrator-guideline-notes/>

⁵ Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/downstream-reconciliation/operations/#determination/previous-determinations/consultation-on-rule-37-percentage-of-error-determination-under-the-gas-downstream-reconciliation-rules-2/>

⁶ Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/downstream-reconciliation/operations/#determination/previous-determinations/consultation-on-rule-37-percentage-of-error-determination-under-the-gas-downstream-reconciliation-rules-2008/>

In effect this means that all breaches formally alleged by the Allocation Agent will be over the 200 gigajoule threshold and hence considered material breaches under the current guideline. We invite feedback on whether participants are comfortable with this approach.

Q1: Do you agree that the current guideline in relation to rule 37 of the Reconciliation Rules should be used as the threshold for reporting of breaches under the amended Regulations?

3.2 Rules 67.3, 70.2 and 72.2 of the Switching Rules

Rule summary

Rules 67.3, 70.2 and 72.2 of the Switching Rules all place obligations on retailers to use switch dates that fall within certain parameters in their switch notices, as set out below:

67.3 If the new retailer includes a requested switch date for a standard switch, that date must not pre-date the date the gas switching notice is given to the registry and must not be more than 23 business days after the date the gas switching notice is given to the registry.

A gas acceptance notice must state –

70.2 An expected switch date which –

70.2.1 Except as required under rule 72.2, is not limited to any requested switch date in the gas switching notice; but

70.2.2 Must be no later than 23 business days after the date the responsible retailer received the gas switching notice from the registry

72.2 Subject to rules 72.3 and 72.4, if the gas switching notice included a requested switch date that complied with rule 67.3 or 67.3A, the responsible retailer must use the requested switch date as the switch date and provide switch readings applicable to that date.

The frequency of breaches of these rules, and the fact that all but one of these breaches in recent years have been found not material was identified in the previous consultation paper introducing the threshold regime⁷.

⁷ Available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/compliance/policy-development/#amendments-to-compliance-regulations-2012-2014/proposed-amendments-to-the-gas-governance-compliance-regulations-2008-further-details-of-the-threshold-regime>

Experience to date: rule 67.3

Rule 67.3 relates to the requested switch date in the Gas Switching Notice (GNT) and is most often breached when a retailer attempts to backdate a standard switch or requests a switch date more than 23 business days in the future. Backdating of standard switches seems to occur most frequently with large time-of-use (TOU) consumers that have a fixed contract start date. As these switches often do not follow the same automated process in retailer systems as a mass market switch—and may involve extra coordination or negotiation if multiple sites are involved—the switch request can occasionally be sent after the contract start date.

While it is less than optimal that the switch request is delayed, Gas Industry Co understands that it is also unlikely that the switch request is unexpected when entered, since contracts for large sites typically only change following a tender process and/or contract negotiation which itself will generally occur some time before the end of the losing retailer's current contract term.

Backdating of standard switches can also occur where a switch has to be withdrawn due to an error and re-entered at a point where the requested switch date in the original GNT has passed. In both of these situations, back dating the requested switch date is giving effect to the customer's wishes and will occur with the knowledge of the losing retailer. Further, the losing retailer has the protection of rule 72.4 which allows it to use a switch date seven business days after the GNT sent date if it does not wish to accept the requested switch date in the GNT.

Rule 67.3 has been breached on average 27 times per year since 2012 but no breaches have been found material since 2009, the year the Gas Registry went live.

Experience to date: rule 72.2

Rule 72.2 relates to the actual switch date in the Gas Transfer Notice (GTN) and is most often breached when a losing retailer completes a switch using a switch date which precedes the date requested by the new retailer.

Feedback supplied to the Market Administrator on previous breaches of rule 72.2 indicates that these scenarios have generally occurred in order to give effect to the customer's wishes and, further, that the other retailer involved in the switch has not raised any concern or identified any harm caused by the breach. There has been only a single instance of a material breach of rule 72.2 since 2009. This was a case in late 2013 where a breach was found material due to repeated breaches of the same rule by the same retailer over an extended period. The breaches, when considered independently, were not judged to raise a material issue, but their frequent recurrence pointed to a systemic failure and non-compliance, which, after investigation, has since been addressed and resolved. More recently there has been a spate of not material breaches of rule 72.2 caused by a retailer's IT system upgrade; these are viewed as an isolated event but will be monitored closely to ensure that they do not persist.

The problem with a losing retailer using an actual switch date in the GTN which precedes the requested switch date is that the new retailer may not be prepared to take on a customer earlier than the date requested in the GNT. For a mass market customer the marginal cost-to-serve for this extra period is perhaps less likely to cause a problem, but for a large TOU customer there may be implications around contracting wholesale gas volumes, booking transmission capacity, providing timely consumption submissions to the Allocation Agent and contractual ability to bill the customer. In practice, large TOU contracts generally commence on the first day of a month so if a switch was backdated into the previous month there is potential for the losing retailer to cause a significant negative impact on the gaining retailer.

Backdating standard switches

The issue of backdating standard switches (via the requested switch date and/or actual switch date) was raised in a working group of gas registry participants⁸ and it was suggested that backdating a *requested* switch date should be allowed if it occurs within the same consumption period (i.e. the same calendar month) as the switch notice being given but not before. For example a standard switch request entered on 7th April with a requested switch date of 1st April would be permitted but if it had a requested switch date of 31st March it would not be permitted. This would address the TOU problem identified above and it was suggested that this aligns with the approach taken in electricity switching. Gas Industry Co would be comfortable that a threshold on this basis would make an adequate distinction between switches that have no likelihood of causing a material issue and those that require further investigation by the Market Administrator.

Backdating within the same consumption period would extend to the actual switch date in the GTN if it was to give effect to a backdated requested switch date. However Registry participants in the working group were not in favour of allowing actual switch dates to pre-date the requested switch date. It was noted in the meeting that the requested switch date is integral to the switch process and, where it is used in a switch request, it should be respected.

In any case following the settlement of the material rule 72.2 breach, it is not expected that rule 72.2 will be breached on a regular basis going forward. Aside from the retailer with the material breach and the retailer impacted by a system upgrade, there have been only nine breaches of rule 72.2 since 2009 so it appears that other retailers' systems are geared towards providing rule-compliant GTNs.

Gas Industry Co therefore proposes that the application of a compliance threshold for rule 72.2 should be limited to cases where the actual switch date is before the GNT delivery date but on or after the requested switch date in the GNT.

Examples are given in the table below to illustrate scenarios where the compliance thresholds for rules 67.3 and 72.2 would result in the Registry Operator alleging a breach or not. It is not an exhaustive list

⁸ RAPT Meeting #1 on 26/02/14, further details available here: <http://gasindustry.co.nz/work-programmes/switching-and-registry/policy-development/#registry-amendments-project-2014/>

of possible scenarios. As noted in Section 2, breaches that are ‘flagged’ will still appear on switch breach reports generated by the Registry but will not be formally alleged. All switches in the table are standard switches.

Table 1 Switch messages causing breaches to be flagged or alleged under the new proposals

	Switch message	Date entered	Switch date	Breach flagged	Breach alleged
Example 1	GNT	7 May 2014	8 May 2014	No	No
	GTN	9 May 2014	8 May 2014	No	No
Example 2	GNT	7 May 2014	1 May 2014	Yes	No
	GTN	9 May 2014	1 May 2014	Yes	No
Example 3	GNT	7 May 2014	1 May 2014	Yes	No
	GTN	9 May 2014	28 April 2014	Yes	Yes
Example 4	GNT	7 May 2014	28 April 2014	Yes	Yes
	GTN	9 May 2014	28 April 2014	Yes	Yes
Example 5	GNT	7 May 2014	28 April 2014	Yes	Yes
	GTN	9 May 2014	1 May 2014	Yes	No

Experience to date: rule 70.2

Rule 70.2 is breached when the expected switch date in the Gas Acceptance Notice (GAN) supplied by the losing retailer does not fall within the required timeframes (the restrictions on the value used for the expected switch date are the same as those on the actual switch date in the GTN, i.e. it must be on or after the requested switch date but not more than 23 business days after the GNT). Again the threshold regime is suitable for this rule as there has not been a material breach of this rule since 2009—and then only because it was associated with other rule breaches—but it has still been breached around 10 times per year since 2012.

Gas Industry Co considers that the likelihood of a rule 70.2 date breach being found material is significantly less than a breach of rule 67.3 or 72.2. The GAN is an interim step in the switch process that is independent of the GTN, that is, a mistake in the expected switch date need not impact on the timeliness of the switch completion or the accuracy of the actual switch date in the GTN, nor is there any requirement for the actual switch date to match the expected switch date. It is therefore hard to see how a non-compliant date would cause an impact on any affected party. However, there may be benefits to the gaining retailer receiving an accurate expected switch date from the losing retailer, for

its billing process in particular, so we invite feedback from stakeholders on the value of the Registry Operator continuing to allege breaches of this rule.

If stakeholders consider that there is no likelihood of a rule 70.2 breach being found material then this, along with the evidence of previous rule 70.2 breaches, would support a Market Administrator guideline that exempted all 'AND' breaches from being formally alleged by the Registry Operator.

Proposal

Based on the above, Gas Industry Co invites comments on the following proposed thresholds to be issued as a Market Administrator guideline:

- If a GNT for a standard switch contains a requested switch date that is before the date that the GNT was delivered to the Registry, but in the same month as the GNT delivery, then in the absence of any other information there is no likelihood that this will raise a material issue and it need not be alleged as a breach by the Registry Operator;
- If a GTN for a standard switch contains an actual switch date that is before the date that the GNT was delivered to the Registry, but is on or after the requested switch date in that GNT, then in the absence of any other information there is no likelihood that this will raise a material issue and it need not be alleged as a breach by the Registry Operator;
- If the expected switch date in a GAN falls outside of the required timeframes then in the absence of any other information there is no likelihood that this will raise a material issue and it need not be alleged as a breach by the Registry Operator.

Q2: Do you agree that the proposed threshold for rules 67.3, 70.2 and 72.2 of the Switching Rules should be applied for reporting breaches under the amended Regulations?

3.3 Rules 69.1 and 69.2 of the Switching Rules

Rule summary & experience to date

Rules 69.1 and 69.2 set out the timeframes for responding to a switch request and completing a switch (within two business days of the GNT and 23 business days of the GNT respectively). In the last five years no breaches of rule 69 have been found material. It is also noteworthy that 80% of breaches of rule 69.1 were only one day overdue and 70% of rule 69.2 breaches were three or less days overdue. This points to the suitability of the threshold regime being applied to these rules to eliminate the frequent, non-material breaches.

Chart 3 illustrates the frequency of breaches of rule 69.1 in the years since go live, and for each year shows the distribution of number of days overdue. The prominence of breaches by a single day is apparent each year, as is a declining total number of breaches. The outlying number of breaches in

2014 is due to a retailer’s IT upgrade mentioned above in section 3.2. Ignoring the breaches associated with this event, 2014 continues the previous trend with only 2 other 69.1 breaches alleged.

Chart 3 Breaches of rule 69.1 by number of days overdue, 2009 to 2014

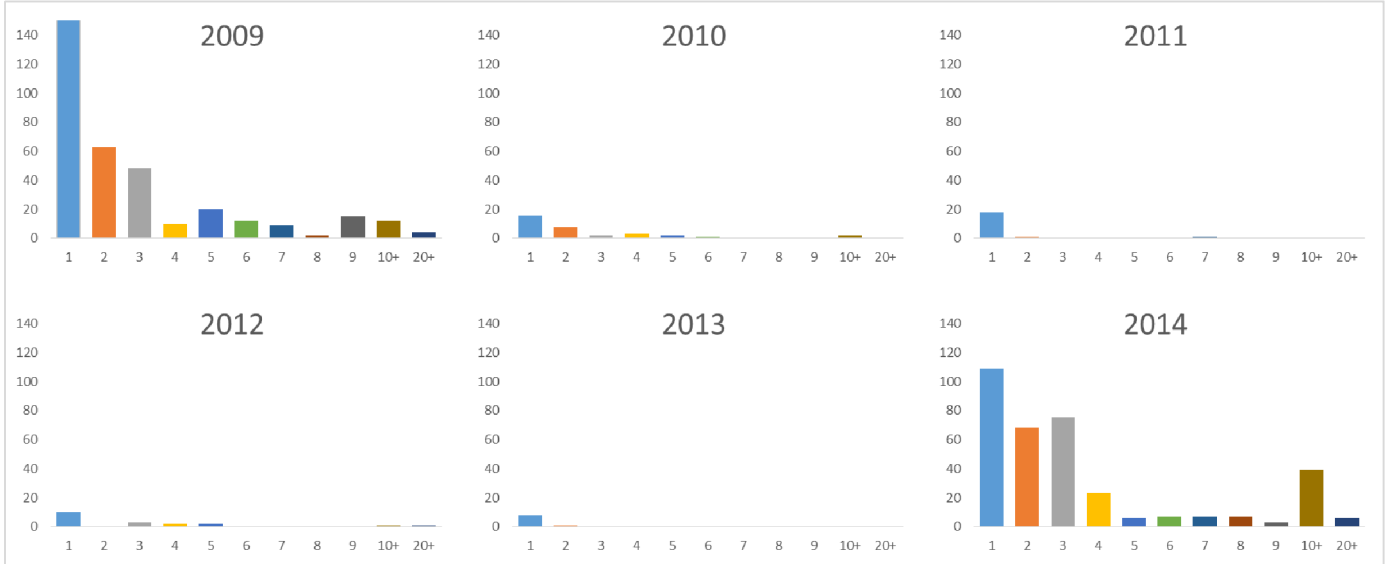
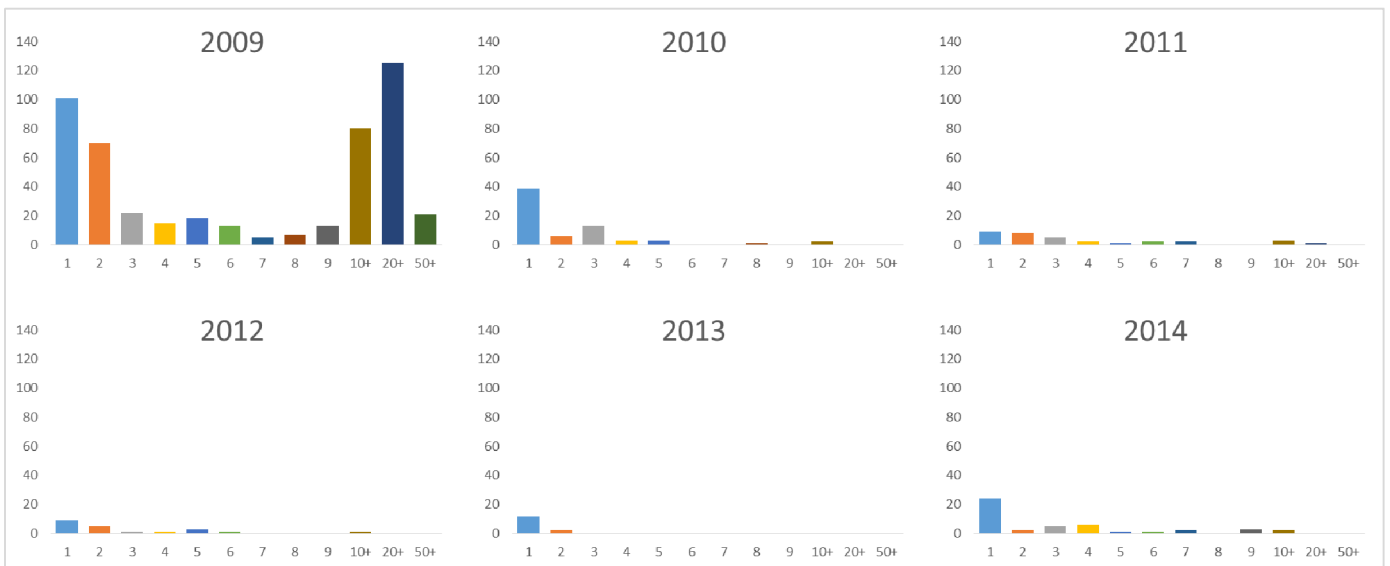


Chart 4 gives the same presentation of breaches and distribution of days overdue for rule 69.2. A similar pattern is evident to the breaches of rule 69.1: a large amount of breach activity in the first year and declining volumes since then. 2014 has a spike in breaches due to the same retailer issue as previously mentioned (albeit at a much smaller level). As with rule 69.1 breaches, the majority of breaches in each year are only one day overdue.

Chart 4 Breaches of rule 69.2 by number of days overdue, 2009 to 2014



From the customer's perspective the late receipt, by a day, of a losing retailer's GTN or response to a GNT is unlikely to be visible. The general expectation of a customer (according to stakeholder discussions) is for a switch to be completed within one billing cycle. Therefore having a one day threshold on the initial response to the GNT and on the deadline for providing a GTN is unlikely to have a negative (or noticeable) impact on the customer.

It is worth noting that the average switch length for standard switches is around seven business days – well under the 23 business day maximum – so it is only a small proportion of switches that are completed at the latter end of the spectrum. Also Gas Industry Co has recently consulted on proposals to amend the Switching Rules⁹ which include reducing the maximum length of a switch to 10 business days to better align with electricity switches.

Proposal

Based on the above experience, the proposals for a Market Administrator guideline are:

- If a response to a GNT is given one day after the two business day deadline then in the absence of any other information there is no likelihood that this will raise a material issue and it need not be alleged as a breach by the Registry Operator;
- If a GTN is given one day after the 23 business day deadline then in the absence of any other information there is no likelihood that this will raise a material issue and it need not be alleged as a breach by the Registry Operator.

Q3: Do you agree that the proposed threshold for rules 69.1 and 69.2 of the Switching Rules should be applied for reporting breaches under the amended Regulations?

⁹ See the Statement of Proposal: Gas Registry Amendments available from the Gas Industry Co website: <http://gasindustry.co.nz/work-programmes/switching-and-registry/policy-development/#registry-amendments-project-2014/statement-of-proposal-2014/>

Appendix A Submission template

Consultation on Compliance Threshold

Submission prepared by: (company name and contact)

QUESTION	COMMENT
Q1: Do you agree that the current guideline in relation to rule 37 of the Reconciliation Rules should be used as the threshold for reporting of breaches under the amended Regulations?	
Q2: Do you agree that the proposed threshold for rules 67.3, 70.2 and 72.2 of the Switching Rules should be applied for reporting breaches under the amended Regulations?	
Q3: Do you agree that the proposed threshold for rules 69.1 and 69.2 of the Switching Rules should be applied for reporting breaches under the amended Regulations?	