FY2010 Levy for Gas Industry Co

Date issued: 16 January 2009
Submissions close: 5 February 2009

GAS INDUSTRY COMPANY LIMITED

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About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

Authorship

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Submissions close: 5 February 2009

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Executive summary

The Gas Act 1992 (the “Act”) enables Gas Industry Company Limited (Gas Industry Co) to recommend to the Minister of Energy that levy regulations be made requiring industry participants to pay a levy to Gas Industry Co. The purpose of the levy is to recover the estimated costs of Gas Industry Co in exercising its functions as the industry body under the Act. The levy is required to be established each year and there is a new consultation every year to achieve this.

The proposed levy rates for FY2010 are:

- Retail levy of $7.91 per annum payable on each ICP. This is a 6.6% increase on the FY2009 rate of $7.42 per annum payable on each ICP;

- Wholesale levy of 1.77 cents per GJ of gas purchased directly from gas producers. This is a 1% reduction on the FY2009 rate of 1.79 cents per GJ; and

- Special one-off Gas (Downstream Reconciliation) Establishment Costs Levy of $1,052,500, levied in proportion to allocated gas volumes.

This consultation document sets the context for levy setting, reviews last year’s levy development process, and explains the development of the FY2010 levy, including work done on the general framework for levy setting. It then describes the work Gas Industry Co expects to undertake in FY2010, outlines the calculation of the levy funding requirement for that year, and proposes the FY2010 levy.

The total revenue requirement for FY2010 is $8.299M, which is $2.188M higher than estimated for FY2009. Although FY2010 sees a slight decline in the scale of the policy development and implementation activities undertaken in FY2009, the higher revenue requirement reflects the need to recover the significant unexpected costs incurred in FY2009 in establishing the Downstream Reconciliation regulations and includes the new costs of administering the six sets of gas governance regulations introduced in FY2009 (including service provider costs of $2.015M).

Gas Industry Co proposes to meet the FY2010 revenue requirement from four sources: the Annual Levy; Market Fees; a special-purpose one-off establishment levy for Downstream Reconciliation regulations; and the application of reserves, comprising past levy over-recoveries and accumulated interest. The proposed Annual Levy has been set to recover $4.545M, Market Fees are estimated to recover $2.015M, the special-purpose levy will recover $1.053M and $686K will be applied from Gas Industry Co reserves.

It is proposed the structure of the FY2010 levy remains the same as for previous years, including the cost allocation methodology driving the apportioning of costs between the retail and wholesale areas. Applying this cost allocation methodology to the FY2010 budget projections, and then deducting Market Fees, other revenue and past levy over-recoveries, the funding requirement for the retail levy is $1.978M and for the wholesale levy is $2.567M.

Based on discussions with industry participants, Gas Industry Co has assumed ICP numbers and wholesale gas volumes will remain at the same levels as assumed for FY2009, which were 250,000 ICPs and 145 PJs respectively.

Gas Industry Co is currently accepting submissions on the proposals in this discussion paper, to be provided no later than **5.00pm on Thursday, 5 February 2009**. Submissions can be made by registering on Gas Industry Co's website, downloading the submission template, and uploading your submission. All submissions will be published on this website after the closing date. All submissions remain editable up to closure date.

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1 Introduction

1.1 Background

Amendments to the Gas Act, introduced in 2004, provided for the co-regulation of the gas industry by the Government and an industry body. Gas Industry Co was established by the gas industry to fulfil the role of the industry body, as set out in the Act. Gas Industry Co was approved as the industry body by Order in Council on 22 December 2004.

Gas Industry Co is responsible for proposing arrangements, which may include rules and regulations, in a range of areas relating to the gas industry, including wholesale markets and processing, transmission and distribution networks, and retail and consumer protection. Where appropriate, Gas Industry Co is involved in the implementation of market arrangements, and in the surveillance and enforcement of market rules.

The principal source of funding for this work is through a levy on industry participants. Section 43ZZB of the Gas Act 1992 (the "Act") enables Gas Industry Co to recommend to the Minister of Energy that levy regulations be made requiring industry participants to pay a levy to Gas Industry Co. The levy is to recover the estimated costs of Gas Industry Co exercising its functions as the industry body under Section 43ZZC of the Act.

The proposed amount and structure of this levy are based on Gas Industry Co's work programme, including its statutory roles under various pieces of legislation, and budget.

1.2 Levy process

The timing of the levy-setting process is dictated by the requirement in the Act for the levy to be set through annual regulations. This requires the levy to be set earlier than is desirable, and in particular before the work programme for the coming year has been finalised. It is accordingly stressed that the work programmes and budgets in the present paper are indicative, and provided only for the purposes of levy setting. Changes are possible before the start of FY2010.

1.3 Overall timetable

The following table presents the indicative timetable for the 2008/09 levy process.

Activity	Timing
Levy consultation paper released.	Friday, 16 January 2009
Levy workshop held for industry participants.	Wednesday, 21 January 2009 Wednesday, 28 January 2009
Closing date for submissions.	Thursday, 5 February 2009
Report on submissions and proposed levy recommendation to Gas Industry Co Board for approval.	Board meeting Thursday, 19 February 2009
Levy recommendation to the Minister.	Thursday, 12 March 2009
Levy proposal confirmed by Cabinet.	April 2009
Levy regulations promulgated and take effect.	Monday, 29 June 2009

1.4 Contents of consultation paper

This consultation paper:

- reviews last year's levy development process;
- explains the development of the FY2010 levy, including work done on updating the framework for levy setting, and the review of the levy structure;
- describes the work which Gas Industry Co will undertake in FY2010 and the associated estimated costs;
- outlines the calculation of the levy funding requirement for FY2010;
- proposes the levy for FY2010; and
- invites submissions on all of the above, as a precursor to formulating a recommendation to the Minister of Energy for the required levy regulations.

2 Call for Submissions

Gas Industry Co invites submissions on the proposed annual levy and the associated issues set out in this paper. Specific matters on which submissions are sought are set out in each section of the paper, and a suggested format for submissions is set out in the template in Appendix A.

Submissions can be made by registering on Gas Industry Co's website, downloading the submission template, and uploading your submission. All submissions will be published on this website after the closing date. All submissions remain editable up to closure date. One hard copy of the submission should be posted to:

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Gas Industry Co will acknowledge receipt of all submissions electronically. Please contact Jay Jefferies (Ph: +64 4 472 1800 or email: jay.jefferies@gasindustry.co.nz) if you do not receive electronic acknowledgment of your submission within two business days.

The closing time for submissions is 4pm on Thursday 5 February 2009. Please note that submissions received after this date may not be able to be considered.

Gas Industry Co values openness and transparency and therefore submissions will be made available to the public on Gas Industry Co's website. Submitters should discuss any intended provision of confidential information with Gas Industry Co prior to submitting the information.

To assist industry participants with submissions and to provide a prior indication of matters which will require consideration by Gas Industry Co, an industry workshop will be held at Gas Industry Co's office in Wellington, from 10am to 12 noon on Wednesday, 21 January 2009. A second workshop will also be offered for those unable to attend the first workshop, to be held at Gas Industry Co's office in Wellington, from 10am to 12 noon on Wednesday, 28 January 2009.

It would be appreciated if a prior indication of those planning to attend either workshop could be provided by 5pm on Tuesday 20 January 2009.

3 Review of FY2009 Levy Development

Nine matters were raised in the consultation document for the FY2009 levy. These matters are recapped briefly below.

3.1 Structure of the FY2009 levy

As part of the development of the levy proposal for FY2009, Gas Industry Co completed a review of a number of structural options for the levy, including a separate charge to pipeline owners, against the levy-setting principles it applies to the levy-setting process. The Company concluded that although there could be some benefits in moving to a more complex levy structure, which included a separate levy for pipeline owners, arguments for simplicity and stability strongly favoured retention of the existing structure. Gas Industry Co therefore made the decision to retain the existing levy structure. All but one of the submitters either agreed or provided no comment on the proposal not to alter the structure of the levy.

3.2 Funding policy implementation

Gas Industry Co reviewed the options for funding implementation costs, both development and establishment, as part of developing the FY2009 levy proposal. Based on its review, the Company's proposed general approach was that market fees should be used to fund the implementation of gas governance arrangements, including a portion of the company's internal costs. All but one of the submitters either had no comment or expressed conditional support for the proposed policy.

However, some submitters expressed a view that including Gas Industry Co costs in the calculation of market fees circumvented the requirement for the Company to undertake annual consultation with the industry over its funding requirements.

3.3 Cost allocation methodology

Gas Industry Co reviewed its cost allocation methodology, and proposed its indirect costs be allocated on a proportional cost basis, based on the total direct costs (salaries and consultants, but not service provider costs) of each aggregated work area.

All respondents either agreed or had no comment on the proposed change to the cost allocation methodology.

3.4 Balancing of revenue against expenditure

Section 43ZZC of the Act indicates over- and under-recoveries of the levy from previous years should be specifically reflected in the level of the levy over time. Gas Industry Co proposed to use any over- or under-recoveries of levy funds to stabilise the level of the levy over the medium term. Respondents were generally comfortable with that proposal. Vector, however, wanted to see excess funds returned at the earliest opportunity.

3.5 Strategic priorities & goals

All but one of the submitters either supported the strategic goals proposed by Gas Industry Co or had no comment. Genesis supported the concept of having strategic goals, but disagreed they should be so strongly linked to the GPS.

Given the general industry support, Gas Industry Co considered its proposed strategic goals were appropriate. The Company noted, however, that the issue raised by Genesis about the development of strategic goals was an important one. It undertook to address this matter as part of the development of its Strategic Plan for 2009 – 2011.

3.6 Indicative work programme for FY2009

Most respondents either had no comment or generally agreed the proposed work programme for FY2009 was appropriate. Given the general industry support for the Company's strategic goals and work programme, Gas Industry Co considered its proposed work programme for FY2009 was appropriate.

3.7 Indicative budget for FY2009

A range of submissions were received regarding whether the indicative budget was appropriate to the proposed work programme. There were some concerns expressed at the increased costs of compliance being imposed on the industry, as well as queries about the whether extent of consultation being undertaken was necessary in all cases. Gas Industry Co had taken a prudent view in estimating its costs, planning on the basis of the Company's analysis of the steps required to develop a gas governance arrangement to the stage of implementation. The Company considered that until the problem definition work was concluded, it was prudent to assume all those steps would be required and therefore included a provision for the cost of doing this work in its budget forecasts. Gas Industry Co therefore considered its indicative budget for FY2009 was appropriate.

3.8 Levy funding requirement

A number of submissions were received requesting information on the Company's costs to include both policy development costs (i.e. levy funding requirement) and implementation costs (i.e. market fee requirement), so the total cost of each work stream was transparent. Gas Industry Co agreed with these submissions.

However, because implementation was still in its early stages and cost estimates were still being developed, it was difficult to provide an estimate of the level of market fees. The Company, however, reviewed the market fees expected to be implemented in FY2009 and prepared a summary of their estimated amount. It was noted, however, that the amount of market fees was an initial estimate based on current data and should be treated with caution.

The Company also noted that over time, it expected the size of the market fees component to increase as more of its work streams moved into implementation, while the proportion of funding provided by the annual levy would decrease. The Company also undertook to provide better-quality information about implementation costs and market fees to industry participants in the FY2010 levy consultation document.

3.9 Outcome of levy setting

By Order in Council dated 26 May 2008, the Gas (Levy of Industry Participants) Regulations 2008 were passed into law and came into effect on 1 July 2008. These regulations provided for the rate and structure of the FY2009 levy as follows:

- Retail Gas Levy: $7.42/ICP payable by the retailer supplying each ICP.

- Wholesale Gas Levy: 1.79c/GJ payable by purchasers on all gas purchased from producers.

4 Development of FY2010 Levy

This section presents the principles and methodology that have been applied to determine the proposed FY2010 levy.

4.1 Principles

A robust set of general principles covering levy setting have been developed by Gas Industry Co and were discussed in the FY2009 levy consultation document. No significant change has been made to these principles and Gas Industry Co has consequently applied them for the FY2010 levy.

Principle 1: Economic efficiency

- The levy structure should promote efficient market behaviour (or at least not detract from it significantly).

Principle 2: Beneficiary/causer pays

- The costs of regulation development and implementation should be allocated in a way that reflects the cause of regulation (causer pays) and/or the incidence of the benefits from regulation.

Principle 3: Rationality

- Where levies are to recover costs that are allocated to participant classes, there should be a relatively strong and logical link between the participants on whom a levy is imposed and the costs being recovered through that levy.

Principle 4: Simplicity

- The levy structure should not create undue transaction costs for the organisation which implements and administers it, or for the participants who must pay it;

- The levy structure should only consist of as many individual levies as are necessary to recover the costs in an efficient manner, taking account of all the other principles applying; and

- The levy structures should be transparent to industry participants.

Principle 5: Equity

- Users in similar situations should pay similar amounts; and

- Competitive neutrality should be preserved, so that within a class of participants the allocation of costs should not competitively advantage one participant over another.

Principle 6: Revenue sufficiency

- The levies need to be sufficient to recover the costs borne by the organisation collecting the levy.
- Levy setting must nevertheless be in accordance with section 43ZZC(3) of the Act which says the levy may be adjusted in any year to take account of under-recoveries and over-recoveries in previous years.

4.2 Levy History

To date, four annual levies for a full year have been set by Gas Industry Co. The process followed in each year has been similar, i.e. generation of consultation proposals, consideration of industry submissions, and then the formulation of a recommendation to the Minister.

Over the period from FY2006 to FY2009, the only significant changes in the structure of the levy have been the simplification of the retail levy, to be wholly on a per ICP basis, and the introduction of market fees in FY2009.

It is noted the levies overall have been set high in relation to expenditure, creating surpluses to balance the deficit in the first year, and these surpluses have been used to repay the initial shareholder loans. The table below summarises between FY2005 to FY2009 the levy rate, total levy income received, total annual expenditure and the resulting annual surplus or deficit.

Table 1 - Levy History

Financial Year	Wholesale Levy	Retail Levy	Total Levy Income ($000)	Market Fees ($000)	Expenditure ($000)	Financial Result ($000)
2005	No levy – expenditure funded by shareholder loans		$0	$0	$1,206	($1,095)
2006	1.50c/GJ $2,176K	$6c/GJ plus $4.00/year per ICP $1,772K	$3,948	$0	$3,500	$763
2007	1.78c/GJ $2,634K	$6.30/year per ICP $1,570K	$4,205	$0	$3,640	$711
2008	1.93c/GJ $2,799	$8.18/year per ICP $2,045	$4,844	$0	$4,559	$791
2009*	1.79c/GJ $2,590K	$7.42/year per ICP $1,855K	$4,445	Establishment $1,075 Ongoing $1,221	$7,941	($1,030)

* Forecast

The forecast deficit in FY2009 is primarily the result of unbudgeted development costs of $1,052,500 arising from implementing the Gas (Downstream Reconciliation) Rules 2008. This matter is discussed further as follows.

4.3 Levy structure

Gas Industry Co has completed a review of a number of structural options for the FY2010 levy against the levy-setting principles outlined above. It was concluded that arguments for simplicity and stability strongly favour retention of the existing structure and Gas Industry Co has, therefore, made the decision to retain the existing levy structure, i.e. a separate per ICP retail and per GJ wholesale levies.

The levy is structured so that particular levy components fund relevant parts of Gas Industry Co's work programme. There is a retail levy and a wholesale levy to fund a programme divided into three work streams.

Table 2 Levy Components

Work Stream	Description
Wholesale	Work on those parts of the gas supply chain upstream of distribution comprises the wholesale gas aggregated work stream including pipeline access;
Retail	Work on consumer issues, retail markets and distribution comprises the retail gas aggregated work stream; and
Corporate	Work which is broadly related to gas governance, rather than to one of the two aggregated work streams, as well as the indirect costs of Gas Industry Co's governance, general support services and infrastructure.

Indirect cost allocation

Costs which are directly related to a work stream, including staff salaries and consultancy costs, have been allocated to that work stream. The issue of how indirect corporate costs should be allocated to retail and wholesale work streams was discussed in the FY2009 levy consultation process. The approach agreed then (allocating indirect costs based on the proportion of direct costs, excluding service provider costs consumed by each work stream) remains the preferred allocation methodology.

Market fees

In addition to the levy, Gas Industry Co will continue to fund gas governance arrangements, implementation and operations through specified market fees. For FY2010, four classifications of market fees will be charged to industry participants, in accordance with previously published guidelines:

- **Switching and Registry:** the ongoing fees of the registry operator;

- **Downstream Reconciliation:** the ongoing fees of the allocation agent appointed under the Downstream Reconciliation rules;

- **Compliance and Enforcement:** the costs of the Rulings Panel and investigators; and

- **Critical Contingency Management:** the costs associated with the ongoing fees of the Critical Contingency Operator and any industry experts.

Levy under- and over-recoveries

Section 43ZZC of the Act allows for the annual levy to either deduct past over-recoveries or add past under-recoveries. In the FY2009 consultation, Gas Industry Co suggested it wanted to implement a multi-year approach in order to achieve stability in the average level of the levy. It proposed to do this by, where possible, using any over- or under- recoveries. The Company had proposed to do this by preparing indicative forward estimates of expenditure and applying over- or under-recoveries so as to minimise year-on-year fluctuations in the levy. After the experience of the last financial year, the Company now views this approach as being overly complex and, to some extent, risky.

In FY2008, as part of the Company's implementation of New Zealand International Financial Reporting Standards, the Board agreed to the creation of a separate reserve account, the "Industry Advances Reserve". The purpose of the account was to clearly identify what portion of the Company's surplus was attributable to levy over- or under-recoveries. Because of the added transparency this account has brought, it is proposed to apply the balance of the Industry Advances Reserve, as reported in the Annual Report, to the subsequent levy-setting process. For example, an over-recovery in FY2009 would be reported on by September 2010 and the adjustment included in the levy-setting process for FY2011. This would be the earliest possible date any over- or under-recovery could be applied. For FY2010, Gas Industry Co has applied the balance of its Industry Advances Reserve, as at FY2008, to the levy-funding requirement calculation, reducing it by $686K.

Q1:	*Do you agree with the proposal not to alter the structure of the levy for the FY2010 financial year?*

4.4 Gas (Downstream Reconciliation) Establishment Costs Levy

During FY2009, Gas Industry Co had unbudgeted development costs of $1,052,500 as a result of implementing the Gas (Downstream Reconciliation) Rules 2008. At its meeting on 31 August 2008, the Board agreed these costs should be recovered in the annual levy for FY2010 and, in the interim, the shortfall should be funded by curtailment of other Company expenditure. A letter was sent to stakeholders on 5 September 2008 advising that these unexpected increased costs would need to be recovered in the FY2010 levy.

There are two options for recovery of these establishment costs in the annual levy:

(a) an increase in the FY2010 retail levy which is payable by retailers on a per ICP basis; or

(b) a separate one-off levy which is payable by retailers on the basis of their proportionate share of allocated gas quantities.

These options are described further below.

Increase in FY2010 retail levy

If the unbudgeted downstream reconciliation establishment costs were included in the retail levy, they could be charged to retailers on a per ICP basis under the existing levy structure. This would result in an increase over and above any other proposal of $4.21 per ICP in FY2010. Levy regulations prevent us from disclosing the impact on all gas retailers, although individual retailers should be able to calculate their proportionate share.

Gas Industry Co does not favour this method of collection as an ICP-based levy is not consistent with the methodology used for recovering the ongoing operational costs in the Gas (Downstream Reconciliation) Rules 2008, and so is significantly different from the methodology that would have been used had the recovery of establishment costs been originally included in those rules.

One-off Special-Purpose Levy

Alternatively, a special-purpose one-off “Gas (Downstream Reconciliation) Establishment Costs Levy” could be recommended to the Minister. This would spread the costs between the retailers on the same basis used to allocate the ongoing operational costs in the Gas (Downstream Reconciliation) Rules 2008, with the allocated volumes based on the first six months of the gas year (1 October 2008 – 1 April 2009) and be invoiced on 1 July 2009.

Gas Industry Co’s preference is to use this option as it provides more transparency as to the actual costs of developing and implementing these particular governance arrangements and spreads the cost more appropriately and proportionately across the users.

Q2: Do you agree with the proposal to recover the establishment costs of the Gas (Downstream Reconciliation) Rules 2008 by way of a one-off Special Purpose Levy calculated on the same basis used to allocate the ongoing operational costs?

4.5 Funding policy implementation

Gas Industry Co policy has been to recover the implementation costs of gas governance arrangements by market fees, unless those costs were expected to be immaterial, in which case they would be recovered from the annual levy. However, experience with the Downstream Reconciliation establishment costs have shown this approach can provide cash-flow difficulties for Gas Industry Co, In that case, those establishment costs were far greater than industry expectations had initially indicated.

In order to mitigate this risk we will in future apply a standardised approach, funding all development costs via a market fee. This was how the switching arrangements were structured.

There is a question, however, as to whether these market fees should be used to recover the internal costs of Gas Industry Co as well its direct external costs. Currently, the existing regulations make provision for the recovery of our direct costs in relation to the implementation of regulations. This has generally been interpreted to mean direct labour costs. However, the administrative burden of tracking individual timesheets in order to confidently determine the correct proportion of staff time to be classified as a direct cost is somewhat problematic. Current systems are sufficient for planning purposes but fall short of what would be required if industry participants were to be billed via a market fee arrangement.

Consequently, for the FY2010 levy, Gas Industry Co would prefer to use market fees to recover only the external costs of its service providers, with the internal costs of administering these regulatory arrangements being met from the general levy. This proposal reflects industry submissions made during the FY2009 levy consultation process. The proposed policy for funding development and establishment, and ongoing implementation costs, is therefore as follows:

- Gas Industry Co will fund the direct external costs for the development, establishment and ongoing operating for gas governance arrangements through specified market fees.

- the internal costs of the Company in developing, establishing and administering gas governance arrangements will be funded from the general levy.

The levy for FY2010 has been calculated on the assumption that market fees will recover only those direct external costs likely to be incurred.

Q3:	*Do you agree with the proposed policy for funding the establishment, implementation and ongoing administration costs of gas governance arrangements?*

5 Strategic Priorities for FY2010

In April 2008, Government issued a new GPS setting out a list of outcomes it wants Gas Industry Co to pursue and report against. These amount to a statement of work priorities for Gas Industry Co and form a key input to its work programming for FY2010.

The Gas Industry Co Board has decided its strategic priorities for FY2010 are to:

- complete our recommendations to the Minister on balancing, interconnection, retail contracts, and consumer complaints resolution by the end of FY2010;
- develop a framework for monitoring industry performance, measuring the impact of the GPS interventions and assessing data requirements; and
- develop the capability and systems to efficiently administer all approved gas governance arrangements on behalf of the industry.

Section 2 of Appendix B discusses in greater depth the role of Gas Industry Co and the Company's strategic priorities for FY2010.

Q4:	*Do you consider there to be any other items in the external work programme which should be included in the Company's strategic priorities for FY2010?*

6 Levy Funding Requirement

6.1 Sources of funding

In FY2010 the Company will receive three sources of funds: annual levy, shareholder fees and market fees. In FY2010 the Company proposes to continue its policy of setting aside the annual shareholder fees as an equity reserve, providing a level of risk mitigation against unforeseen events. This means the primary source of revenue for the proposed expenditure for FY2010 continues to be the annual levy. However, in addition to the annual levy, market fees now make a significant contribution towards the ongoing costs of the new gas governance arrangements.

The table below sets out the expected source of funding (annual levy or market fees) for each of the four work areas for FY2010.

Work Area		**Recovery Mechanism**	**Costs**
Policy work	Retail & Wholesale Markets	• Costs recovered from retail or wholesale levies depending on project.	$785,580
	Pipeline access	• Annual Wholesale levy.	$864,604
Business as usual	Market Administration	• One-off levy is proposed for establishment costs of Gas (Downstream Reconciliation) Rules 2008. • Existing rules and regulations provide for recovery of costs of service providers and external consultants from market fees. • Annual retail levy for Gas Industry Co retail costs. • Annual wholesale levy for Gas Industry Co wholesale costs.	$3,990,024
	Corporate	• Costs recovered from annual levy in proportion to direct costs of the aggregated expenditure on wholesale and retail projects.	$2,658,894
			$8,299,102

The aggregate funding sources proposed for FY2010 are estimated below:

Source of funds	Amount ($000)
Annual Levies:	
• Wholesale levy	$2,957,256
• Retail levy	$2,273,946
Subtotal	**$5,231,202**
Market fees	$2,015,400
Subtotal	**$7,246,602**
Gas (Downstream Reconciliation) Establishment Costs Levy	$1,052,500
Total Funding	**$8,299,102**

6.2 Market fees

Gas Industry Co has estimated the proportion of costs that will be recovered through market fees. This is presented in the table below.

Regulations	Cost Type	Amount
Switching	Service Provider Contract	260,000
	Other External Direct Costs	40,000
Reconciliation	Service Provider Contract	830,000
	Other External Direct Costs	74,000
Compliance	Rulings Panel and Investigator	166,400
	Other External Direct Costs	45,000
Critical Contingency Management	Service Provider Contract	600,000
	Total	**2,015,400**

Copies of the service provider contracts which comprise the major component of these costs are available on our website. The other costs proposed to be recovered under market fees in FY2010 are the costs of persons appointed under provisions in the rules and regulations, for example independent experts and external consultants who assist with market administration.

6.3 Other revenue and over- and under-recoveries of the levy

To determine the final levy funding requirement, work programme costs need to be adjusted for other revenue and over-and under-recoveries of prior years' levies. As at 30 June 2008, Gas Industry Co had a retained earnings balance of $1,165,857. This figure represented $599,309 from over-recoveries the Company has collected from the retail and wholesale levy between FY2006 and FY2009, $400,000 in accumulated annual shareholder fees and $166,548 in net interest. The table below analyses these amounts in more detail.

Year	Wholesale levy (Under)/Over-recovery	Retail levy (Under)/Over-recovery	Total levy (Under)/Over-recovery	Annual fee	Net interest income	Retained earnings	Cumulative retained earnings
FY2005	(712,580)	(493,314)	(1,205,894)	100,000	10,581	(1,095,313)	(1,095,313)
FY2006	219,583	402,417	622,000	100,000	40,828	762,828	(332,485)
FY2007	529,086	35,856	564,942	100,000	42,361	707,303	374,817*
FY2008	356,050	262,209	618,259	100,000	72,781	791,040	1,165,857
Sub Total	***392,138***	***207,168***	***599,306***	***400,000***	***166,551***	***1,165,857***	***1,165,857***
FY2009†	(77,315)	(1,111,487)	(1,188,802)	90,000	55,551	(1,043,251)	122,606
TOTAL	**314,824**	**(904,320)**	**(589,496)**	**490,000**	**222,102**	**122,606**	**122,606**

* Previously $379,754 prior to IFRS restatement in FY2008

† Estimated

Allowing for the retention of $100K in annual fees from FY2008 and factoring in the $379,754 to be returned to levy payers over FY2009, the total amount available to apply against the FY2010 levy is $686,103. This equates to a reduction in the retail funding requirement of $296,131, and $389,972 in the wholesale funding requirement.

6.4 FY2010 Levy funding requirement

Calculation of the FY2010 levy funding requirement is based on the following methodology:

- allocation of direct costs to each work stream;
- allocation of indirect costs based on the proportion of total direct costs of each work stream;
- deduction of revenue from dedicated fees from the relevant work streams;
- allocation of a proportion of the Industry Advances Reserve balance to the retail and wholesale areas of activity.

Table 3 - Levy Funding Requirement

	Retail	Wholesale	Total
Work Programme Direct Costs	2,382,816	2,204,892	4,587,708
Work Programme Indirect Costs	1,236,219	1,422,674	2,658,894
Sub-total	**3,619,035**	**3,627,567**	**7,246,602**
Less Over Recovery from Prior Levies	(296,131)	(389,972)	(686,103)
Sub-total	3,322,904	3,237,595	6,560,499
Less Market Fee Recovery	(1,345,090)	(670,310)	(2,015,400)
Total Levy Funding Requirement	**1,977,815**	**2,567,284**	**4,545,099**

In addition, a one-off levy of $1,052,500 is proposed to recover the costs of the unbudgeted reconciliation development costs in FY2009. The industry has already been advised of the intention to have a one-off levy in FY2010 for these costs.

Q5: Do you have any comment on the levy funding requirement for FY2010?

7 Proposed Levy

7.1 Levy assumptions

The following volume assumptions have been made to calculate the levy rates for FY2010:

- ICP numbers for FY2010 will be approximately 250,000. This estimate was used to calculate the FY2009 levy rate and has been reconfirmed through an independent analysis of ICP numbers disclosed as a result of the Switching and Registry implementation.

- Wholesale gas volumes will be 145 PJ in FY2010. This estimate was used to calculate the FY2009 levy rate. Gas Industry Co evaluated an increase in assumed wholesale gas volumes in anticipation of an expected increase of methanol production during FY2010. However, there have been made significant reductions in the wholesale volumes of some levy payers in the current financial year and the Company is consequently reluctant to assume total wholesale gas volumes will increase in the current economic climate.

7.2 Retail and wholesale levies

Based on these assumptions, the table following presents the calculation of the retail and wholesale levies for FY2010:

	2009/10 Retail	Wholesale	Total
Direct Costs	2,382,816	2,204,892	4,587,708
Proportion of Direct Costs to Total Costs	*51.9%*	*48.1%*	
Indirect Costs	1,236,219	1,422,674	2,658,894
Total Work Programme Costs	**3,619,035**	**3,627,567**	**7,246,602**
Deduction of Market Fees	(1,345,090)	(670,310)	(2,015,400)
Allocation of Other Revenue	-	-	-
Under (Over) Recovery of Levy	(296,131)	(389,972)	(686,103)
	(1,641,221)	**(1,060,282)**	**(2,701,503)**
Total Retail Levy Funding Requirement	**1,977,815**	**2,567,284**	**4,545,099**
Volume Units	*ICPs*	*GJ*	
Volume	250,000	145,000,000	
Levy Unit	*$/ICP*	*cent/GJ*	
Levy Rate	**7.91**	**1.77**	
Projected Levy Revenue	**1,977,815**	**2,567,284**	**4,545,099**

The proposed levy rates for FY2010 are therefore:

- Retail levy of $7.91 per annum payable on each ICP. This is an increase of 6.6% on the FY2009 rate, which was $7.42 per annum payable on each ICP;
- Wholesale levy of 1.77 cents per GJ of gas purchased directly from gas producers. This is a 1% reduction on the FY2009 rate, which was 1.79 cents per GJ; and
- Special one-off Gas (Downstream Reconciliation) Establishment Costs Levy of $1,052,500 levied in proportion to allocated gas volumes.

7.3 Comparison with prior years

The table below compares the proposed levy for FY2010 with the preceding two years.

Year	Retail Levy	Wholesale Levy
FY2008	$8.18 per ICP	1.93 cents per GJ
FY2009	$7.42 per ICP	1.79 cents per GJ
FY2010	$7.91 per ICP	1.77 cents per GJ

Q6: Do you have any comment on the proposed levy for FY2010?

Appendix A 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. Respondents are also free to include other material in their responses.

Submission prepared by: (company name and contact)

QUESTION	COMMENT
Q 1: Do you agree with the proposal not to alter the structure of the levy for the 2010 financial year?	
Q 2: Do you agree with the proposal to recover the establishment costs of the Gas (Downstream Reconciliation) Rules 2008 by way of a one-off Special Purpose Levy, calculated on the same basis used to allocate the ongoing operational costs?	
Q 3: Do you agree with the proposed policy for funding the establishment, implementation and ongoing administration costs of gas governance arrangements?	
Q4: Do you consider there to be any other items in the external work programme which should be included in the Company's strategic priorities for FY2010?	
Q5: Do you have any comment on the levy funding requirement for FY2010?	

QUESTION	COMMENT
Q6: Do you have any comment on the proposed levy for FY2010?	

Appendix B Work Programme Details

This Appendix presents Gas Industry Co's detailed work programme and budget for FY2010.

FY2010 - Indicative Work Programme and Budget

Appendix B of the 2010 Levy Consultation Paper

GAS INDUSTRY COMPANY LIMITED

About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

Authorship

This paper was prepared by Christine Southey, Peter Davies and Wayne Mitchell

149286.1

Contents

1 Introduction

The Gas Act 1992 (the Act) provides for the co-regulation of the gas industry by the Government and an industry body. Gas Industry Co is a company established by the gas industry to fulfil the role of the industry body as set out in the Act, and its constitution.

Gas Industry Co is responsible for proposing arrangements, including rules and regulations, which improve the operation of gas markets, access to infrastructure and consumer outcomes. It also has statutory responsibilities to administer, oversee compliance with and review such arrangements, and to report regularly to the Minister of Energy on the performance and present state of the New Zealand gas industry and the achievement of the Government's policy objectives for the gas sector.

The majority of Gas Industry Co's funding to undertake this work comes from levies which are set annually in regulations recommended by Gas Industry Co. Prior to making a recommendation, Gas Industry Co consults with affected stakeholders on its proposed work programme, budget and levy.

In addition to the annual levy, Gas Industry Co has three other sources of funding to meet the costs incurred in delivering effective co-regulation and fulfilling its Gas and Companies Act obligations. They are:

- market fees specified under various rules or regulations made under the Act to meet the costs of the new gas market arrangements;
- fees under contracts entered into with industry participants; and
- annual shareholder fees set in accordance with its constitution.

This proposed work programme and budget has been prepared for the purpose of consultation on the FY2010 levy. However, it goes beyond the levy requirements and addresses the totality of the Company's budget and work programme requirements. Input is sought from stakeholders on the proposed work priorities for FY2010 and on the proposed levy (as required by section 43ZZD(2)(b) of the Act).

2 Overview of proposed work programme

Governance of New Zealand's gas industry is effected through a co-regulatory partnership between the Government and an industry body, Gas Industry Co. The approval of the Company as the industry body was the first step in bringing to fruition the concept of a co-regulated gas industry, where both the Government and the gas industry seek the development of industry-led solutions affecting the governance of the New Zealand gas sector.

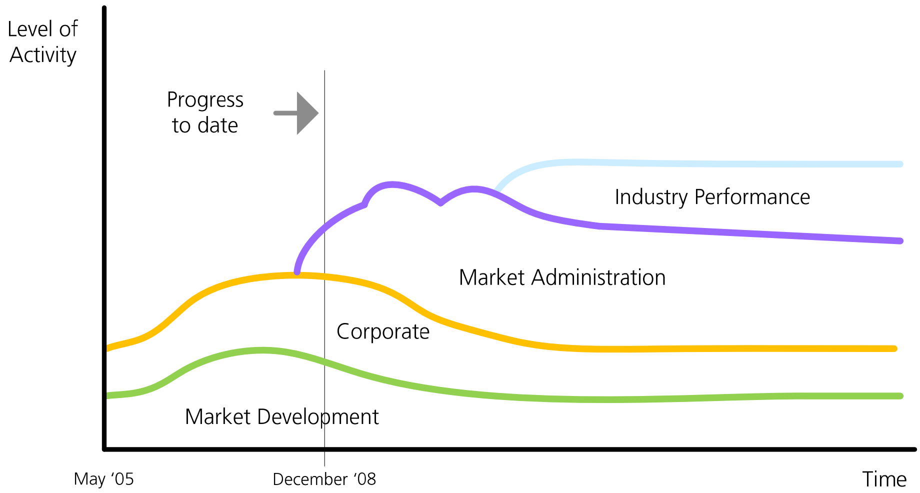
Since its establishment in 2004, Gas Industry Co has advanced a diverse set of policy development work streams, covering almost all sectors of the gas industry. Its work programme and priorities are drawn from Government expectations set out in the Government Policy Statement on Gas Governance (GPS), direct requests from the Minister and invitations from industry participants.

As a result of the significant number of gas governance arrangements approved in the last year, the role of Gas Industry Co is evolving quickly. The Company has now added market administration activities to its core policy work as it starts to deliver market services. Longer-term, it also needs to review the effectiveness of those arrangements as part of its ongoing responsibility to give the Minister advice on the present state and performance of the sector.

As a result of these changes, the Company has reorganised its work programme into three major work areas: market development (which incorporates policy development), market administration and industry performance. Underpinning this, and to meet its statutory report obligations, is the corporate function.

The changing levels of these activities are depicted in Figure 1, showing the Company is still building its capability to undertake the full range of roles required of it by the Act, the GPS and its constitution.

Figure 1 – Evolution of the co-regulatory model



2.1 Market Development

A key challenge for the gas sector is developing a more competitive environment and responding to the transition to a more diverse mix of smaller, less flexible gas fields. Successive GPS have set out the government's assessment of the minimum institutional requirements for this to occur. It is clear a significant portion of the work required in these GPSs is either at or nearing completion. For example, in FY2009 the Company implemented six separate gas governance arrangements, with significant progress being achieved on a further five recommendations. However, it is inevitable that as market circumstances change and practical experience of the arrangements is obtained, stakeholders will seek to amend existing arrangements to ensure they remain fit for purpose. The role of Gas Industry Co in the immediate future will be therefore twofold. Firstly, the Company needs to complete its remaining policy development work, in particular the work associated with ensuring access to pipeline networks on reasonable terms and conditions. Secondly, it needs utilise its extensive policy development experience to ensure all existing and future gas governance arrangements retain their relevance and effectiveness in the face of changing market conditions.

2.2 Market Administration

The significant number of gas governance arrangements approved in the last financial year as well as those likely to be implemented during FY2010 mean Gas Industry Co must now add market administration activities to its core work. This work area encompasses managing the performance of service providers, estimating and collecting fees, collecting and publishing information, determining technical detail, appointing experts and auditors and approving contingency plans.

2.3 Industry Performance

Gas Industry Co's constitution requires it to report regularly to the Minister on the performance and present state of the gas industry. Until now, the Company has lacked the necessary industry data to enable it to completely fulfil this obligation. However, the gas governance arrangements now implemented, as well as those likely to be recommended during FY2010, will begin to address the issue of industry data sufficiency. Therefore, the Company will begin to develop a framework for monitoring industry performance, measuring the impact of the GPS interventions and assessing whether further action is required.

2.4 Corporate

Although Gas Industry Co is a small organisation in terms of budget and staff numbers, its role means it has the organisational, financial reporting, governance and communication requirements of a much larger entity. Corporate support activities in FY2010 will include stakeholder communications, internal governance, finance, human resources, project management, IT infrastructure, administrative support and premises management.

2.5 Strategic Objectives

In April 2008, Government issued a new GPS setting out a list of outcomes it wants Gas Industry Co to pursue and report against. These amount to a statement of work priorities for Gas Industry Co and form a key input to its work programming for FY2010.

The Gas Industry Co Board has decided its strategic objectives for FY2010 are to:

- complete our recommendations to the Minister on balancing, interconnection, retail contracts, and consumer complaints resolution by the end of FY2010;
- develop a framework for monitoring industry performance, measuring the impact of the GPS interventions and assessing data requirements; and
- develop the capability and systems to efficiently administer all approved gas governance arrangements on behalf of the industry.

An overview of the activities expected to be undertaken in FY2010 and their expected cost is set out in the following pages.

Market Development			
Description	**Activities**	**Outputs**	**Desired Outcome**
Incorporates policy development and industry performance review for retail and wholesale markets and improvements to consumer outcomes.	• Best practice analysis. • Market analysis. • Problem definition. • Stakeholder consultation. • Solution development. • Rule review and revision.	• Policy guidelines. • Framework for assessing industry performance. • Report on Direct Use of Gas. • Strategic advice on performance of gas markets.	• Best practice policy development. • Gas sector contributes to achieving Government's goals in NZES. • Barriers to retail and wholesale competition are minimised.

Market Development			
Description	**Activities**	**Outputs**	**Desired Outcome**
		• Recommendations on o Consumer complaints resolution; o Retail contracts; o Retail market rule changes; o Wholesale market rule changes; and o Compliance regulation changes.	• Downward pressure on prices. • Improved consumer outcomes.
Total Budget			**$785,580**

Pipeline Access			
Description	**Activities**	**Outputs**	**Desired Outcome**
Policy development, market performance and industry roles relating to transmission and distribution pipelines.	• Best practice analysis. • Market analysis. • Problem definition. • Stakeholder consultation. • Solution development. • Rule review and revision. • Facilitation of industry discussions.	• Recommendations on: o Balancing; o Interconnection; o Upstream reconciliation; and o Distribution. • MPOC and VTC rule changes and appeals recommendation.	• Improved transmission and distribution access.
Total Budget			**$864,604**

Market Administration		
Description	**Activities**	**Desired Outcomes**
Encompasses the implementation and management of approved gas governance arrangements.	• Engagement of service providers and other persons required by regulations. • Monitoring and management of appointed personnel.	• Cost-effective market administration. • Achievement of the purpose of gas governance arrangements, eg o Faster and more reliable customer switching; o More accurate and efficient reconciliation;

Market Administration		
Description	**Activities**	**Desired Outcomes**
	• Industry Body roles in regulations. • Compliance and enforcement.	o Timely and efficient resolution of rule breaches; o More information about availability of gas processing facilities; o Greater certainty on the physical and commercial outcomes of outage and contingency events; o More efficient and transparent short-term gas trading in wholesale market.
Total Budget		**$2,937,524**

Corporate			
Description	**Activities**	**Outputs**	**Desired Outcome**
Finance, human resources, information technology, communications, administrative support, property management and internal governance.	• Board and management reporting, internal governance. • Advice on non-work stream legal issues. • Annual meeting of shareholders. • Industry forum, Consumer forum. • Website and external communications.	• Monthly Board reports. • Management reporting. • Project reporting. • Business planning. • Annual Report. • Strategic Plan. • Levy consultation. • Quarterly reports to Minister.	• Gas Industry Co operates efficiently and effectively. • Compliance with the accountability framework set out in the Gas Act, Companies Act, Financial Reporting Act, GPS and constitution. • Stakeholders informed of the activities of the Company.
Total Budget			**$2,658,894**

Further information about the “business as usual” outputs, policy priorities and other work included in these work areas is set out in further sections of this report.

3 Overview of proposed expenditure

3.1 FY2010 budget

Table 1: FY2010 Budget Analysis

	Direct External	Direct Salaries	Direct Total	Overhead	Market Fees	Total
Retail Work Programme Costs						
Downstream Reconciliaiton	904,000	232,143	1,136,143	324,733	(904,000)	556,876
Switching	300,000	107,766	407,766	142,221	(300,000)	249,988
Industry Performance 50/50	125,000	29,699	154,699	148,893		303,592
Distribution	60,000	100,479	160,479	154,457		314,936
Retail & Consumer Issues	200,000	141,183	341,183	328,380		669,563
Compliance	141,090	41,456	182,546	137,535	(141,090)	178,991
Total Retail Work Programme Costs	**1,730,090**	**652,726**	**2,382,816**	**1,236,219**	**(1,345,090)**	**2,273,945**
Wholesale Work Programme Costs						
Critical Contingency Management	600,000	232,182	832,182	223,469	(600,000)	455,651
Wholesale Market	.	199,586	199,586	192,097		391,683
Industry Performance 50/50	125,000	29,699	154,699	148,893		303,592
Wholesale Issues	135,000	-	135,000	129,934		264,934
Gas Processiing	-	16,826	16,826	16,194		33,020
Balancing	120,000	184,235	304,235	292,819		597,054
Interconnection	30,000	53,061	83,061	79,944		163,005
MPOC / VTC	80,000	104,164	184,164	177,253		361,417
Other	55,000	77,665	132,665	127,687		260,352
Compliance	70,310	92,165	162,475	34,384	(70,310)	126,549
Total Wholesale Work Programme Costs	**1,215,310**	**989,582**	**2,204,892**	**1,422,674**	**(670,310)**	**2,957,256**
Total Work Programme Costs	**2,945,400**	**1,642,308**	**4,587,708**	**2,658,894**	**(2,015,400)**	**5,231,202**

3.2 Comparison of FY2010 costs with previous years

Table 2 presents a comparison of the retail revenue requirements for FY2009 and FY2010 on an annualised basis. It shows an overall decrease in the retail revenue requirement of $159,623 (3.5%).

Two significant items of expenditure are one-offs – the establishment costs of $1,075K for the switching and $1,053K for the reconciliation rules. The reconciliation establishment costs were incurred in FY2009 but will be recovered in FY2010 under the proposals previously described. Other items of increase are of a permanent nature and relate to the step change in the Company's activities as it takes on new market administration work and improves its corporate accountability and support systems.

Table 2: Gas Industry Co - Retail Funding Comparison

Source of Income	FY2009	FY2010	Comment
Retail Funding Requirement	$1,951,389	$2,273,946	FY2010 now includes all GIC internal costs of market administration.
Market fee for Switching & Registry establishment costs	$1,075,360	0	
One-off annual levy for Downstream Reconciliation establishment costs	0	$1,052,500	
Ongoing Market Fees	$1,603,891†	$1,345,090	FY2009 included a portion of GIC direct costs which are now part of the levy.
Gross Retail Revenue Requirement	**$4,630,640**	**4,671,536**	
less over-recoveries and interest	($95,612)	($296,131)	Proportionate share of Industry Advances Reserve as at FY2008.
Net Retail Funding Comparison	**4,535,028**	**$4,375,405**	

† Estimated per annum basis. Estimated costs for FY2009 are $1,097,188

Table 3 presents a comparison of the wholesale revenues for FY2009 and FY2010 on an annualised basis. It shows an overall decrease in the wholesale revenue requirement of $6,462.

Table 3: Gas Industry Co - Wholesale Revenue Comparison

Source of Income	FY2009	FY2010	Comment
Wholesale Revenue Requirement	$3,028,388	$2,957,256	FY2010 now includes all GIC internal costs of market administration.
Ongoing Market Fees (per annum basis)	$653,547‡	$670,310	FY2009 included a portion of GIC direct costs which are now part of the levy.
Gross Wholesale Revenue	**3,681,935**	**3,627,566**	
less over-recoveries and interest	**($437,897)**	**($389,972)**	Proportionate share of Industry Advances Reserve as at FY2008.
Net Wholesale Funding Comparison	**$3,244,056**	**$3,237,594**	

‡Estimated per annum basis. Estimated costs for FY2009 are $123,547

3.3 Allocation of expenditure by levy income stream

The following table groups the proposed work area expenditure into the items covered by retail and wholesale levies with corporate costs allocated to each work area on the basis of its proportion to the total costs.

Retail Expenditure	**Total**
Industry Performance	303,592
Downstream Reconciliation	1,460,876
Switching	549,988
Retail & Consumer Issues	669,563
Distribution	314,935
Compliance (80% of total)	320,080
Total	**3,619,034**
Wholesale Expenditure	
Industry Performance	303,592
Critical Contingency Management	1,055,651
Wholesale Market Trial	391,683
Wholesale Issues	264,934
Gas Processing	33,020
Balancing	597,054
Interconnection	163,005
MPOC / VTC	361,417
Other Pipelines	260,352
Compliance (20% total)	196,859
Total	**3,627,567**
Total Retail and Wholesale	**7,246,602**

3.4 Risks

There are a number of risks that could adversely impact on Gas Industry Co's ability to achieve its work programme and to remain within its budget, which have implications for the levy.

A summary of these risks and the mitigation strategies that have been put in place is provided below.

Risk	Description	Mitigation Strategy
New unbudgeted work stream	The Minister or industry participants request an additional, large piece of new work be undertaken.	The Work Programme and Budget includes a limited contingency provision for unforeseen events.
Unbudgeted extension of an existing work stream	Unforeseen circumstances require a significant extension of an existing work stream to be undertaken.	The Work Programme and Budget includes a limited contingency provision for unforeseen events.
Regulatory setting risk	Delays in the establishment of rules or regulations (or in passing amendments to the Gas Act) required to give effect to an industry arrangement. Delays could be caused by concerns from the Minister or officials, particularly if these concerns are raised late in the development of a recommendation, or because of other competing demands on parliamentary processes.	A structured approval process for proposed arrangements will be agreed with officials and recorded in a MOU between Gas Industry Co and MED. Quarterly Reports provided to the Minister and a 'no surprises' policy in relation to recommendations. Ongoing liaison with officials following a recommendation to the Minister to implement rules, regulations or amend the Gas Act.
Stakeholder disagreement	Industry or MED disagreement over a particular issue that has a bearing on a proposed arrangement could delay the progress of a work stream.	Ongoing liaison with stakeholders to identify and, where possible, address issues as they arise.
Internal capacity constraints	Internal capacity constraints could cause slippage in milestones and could impact on the budget due to a greater reliance on external consultants.	The process of developing the Work Programme has facilitated discussions about the sequencing of activities and the allocation of internal resources.
External capacity constraints	The ability of external parties to provide timely input into the development of industry arrangements could cause slippage in milestones.	The Company intends to give the industry as much notice as possible of its consultation timeframes.
Errors in cost forecasts	Gas Industry Co relies on external information in estimating implementation costs and for its cost-benefit analysis. There is an exposure if final costs differ from estimates provided by potential service providers (as occurred in the current year).	Additional reviews of cost forecasts will be undertaken as part of implementation planning.

4 Further information about "Market Development" revenue requirement

4.1 Background

A key challenge for the gas sector is developing a more competitive environment and responding to the transition to a more diverse mix of smaller, less flexible gas fields. Successive GPS have set out the government's assessment of the minimum institutional requirements for competition. Many of these have already been implemented (as described in Section 7). However the GPS requires that these arrangements are monitored by the Company for their ongoing relevance and effectiveness. It is inevitable that as market circumstances change and practical experience of the arrangements is obtained stakeholders will seek to amend existing arrangements to ensure they remain fit for purpose.

The market development work area includes:

- completion of existing GPS projects;
- progression of rule changes necessary to improve existing retail and wholesale gas governance arrangements;
- any new policy development required by the industry or Government;
- advice to the Minister on specific strategic areas; and
- advice to the Minister on the performance and present state of the sector.

4.2 Overview of proposed market development work for FY2010

Subject	Activities and Milestones	Estimated costs
Policy Development	• Complete recommendations to Minister on policy priorities areas in accordance with published policy process. The policy priorities are:	
	o Retail contracts.	$67,892
	o Complaints resolution scheme.	$69,773
Strategic Advice	• Complete report to Minister on direct use of gas.	$185,638
	• Develop a framework for assessment of performance of wholesale and retail market sectors and collect necessary data.	$123,759
Market Development	• Progress any identified priority improvements to existing gas governance arrangements to ensure ongoing relevance and effectiveness:	
	o Retail market rule changes.	$203,517
	o Wholesale/contingency rule changes.	$135,000
	Total	**$785,580**

4.3 Policy priorities

A key expectation of Government is that it delivers improved outcomes for gas consumers. The Minister has power to directly regulate on a range of consumer issues under the Gas Act and has requested advice from Gas Industry Co on a number of these matters.

One of these matters is arrangements for a complaints resolution scheme. In early 2005 Gas Industry Co recommended that the Minister approve the Electricity and Gas Complaints Commission scheme which would have made the scheme mandatory for all gas retailers. However, for a variety of reasons, this recommendation has not been accepted and instead, Gas Industry Co has been requested to work with the Electricity Commission on a joint approach to approval of a complaints resolution scheme. This work is under way and will continue in FY2010.

A second matter relates to the terms and conditions of retail gas supply. Gas Industry Co has been asked to advise whether it is necessary to have a model contract or regulated minimum terms to ensure all domestic and small business consumers have access to gas supply on fair and reasonable terms. The Company is currently developing an options paper on this matter and expects to complete its advice to the Minister by the close of FY2010.

5 Further information about "Pipeline Access" revenue requirement

5.1 Background

Gas pipelines in New Zealand have natural monopoly characteristics which may have the effect of reducing competition or yielding inefficient outcomes. The purpose of the pipeline access work stream is to ensure that industry participants are able to access pipeline networks on reasonable terms and conditions. This in turn will facilitate competition in upstream and downstream markets.

Gas Industry Co has recommended that access framework regulations be considered by the Minister of Energy to ensure access rights for new entrants, provide uniform processes for developing and enforcing access arrangements, and to address conflicts of interest that might otherwise induce a transmission system owner to favour its own affiliates over other customers. This approach was designed to dovetail with the existing transmission codes: the Maui Pipeline Operating Code and Vector Transmission Code.

Following the development of the access framework regulations it became clear there was a risk of legal challenge to their validity. This resulted in a recommendation to the Minister in July 2008 that the Gas Act be amended. Gas Industry Co intends to continue to work with officials to progress any changes necessary for implementing an effective transmission access regime.

In the interim Gas Industry Co has established a number of projects to progress those areas of transmission access which are considered to be of most pressing concern. It envisages using a combination of guidelines, existing code change processes and regulation to improve access outcomes for pipeline owners and shippers. Currently the Company has the equivalent of 3 FTEs involved in pipeline access work. However due to the volume of work it has assumed an increase in resources will be required in FY2010.

The next sections describe the outputs for this expenditure under the following headings: policy priorities, business as usual outputs, and other work. Section 6.5 then provides further information on prior years' expenditure.

5.2 Policy priorities

The Company has identified two priority projects for FY2010:

Pipeline balancing	**Expected direct costs in FY2009 $326,374**	**Estimated direct costs in FY2010 $304,235**
Project Rationale	**Current Activities**	**Forecast activities**
There is general agreement that current pipeline balancing arrangements are inefficient and not achieving Gas Act objectives.	The Company has issued a research paper and an issues paper and expects to develop an options paper before year end.	The next steps will depend on consultation feedback. For planning purposes it has been assumed that a regulated solution will be required and that FY2010 activity will involve the preparation of a statement of proposal and recommendation to the Minister.

Interconnection	**Expected direct costs in FY2009 $124,143**	**Estimated direct costs in FY2010 $83,061**
Project Rationale	**Current Activities**	**Forecast activities**
It is a core requirement for competition that shippers can connect to transmission networks on reasonable terms. Recent experiences have indicated difficulties with interconnection.	Guidelines have been developed and it is planned to have discussions with the pipeline owners and access seekers to see if these can be adopted on a voluntary basis.	In FY2010 the Company proposes to consult on the guidelines with all shippers following a review of compliance, facilitate any changes required and monitor their effectiveness.

5.3 Industry roles

In the transmission work stream Gas Industry Co undertakes significant facilitation roles by convening or attending industry meetings (for example over-pressurisation forums and MDL balancing forums), commissioning independent research (for example research on UFG or capacity) and participating in dialogue with industry participants on specific issues (for example interconnection matters). The Company's aim in these activities is to improve the quality of the debate and thereby facilitate industry solutions to achieving Gas Act objectives wherever practicable.

In addition to these activities the Company has obligations under:

- a Memorandum of Understanding entered into with Maui Development Limited on 5 October 2006 to make recommendations on rule change requests to the Maui Pipeline Operating Code; and
- a Memorandum of Understanding entered into with Vector Limited on 17 October 2008 to consider appeals from rule change requests to the Vector Transmission Code.

The Company believes that it is appropriate to recover its costs under the annual levy for this work because it is more efficient to amend the existing access codes to achieve Gas Act objectives than to develop new rules or regulations[1]. Therefore the budget has included provision for this work.

Industry facilitation roles	**Expected direct costs in FY2009 $60,000**	**Estimated direct costs in FY2010 $184,164**
Project Rationale	**Current Activities**	**Forecast activities**
Multilateral terms of access need a process to evolve to ensure ongoing relevance and efficiency.	Two rule changes and one rule change appeal request will be progressed in the current year.	A similar number of rule change requests are expected next year but they could be more complex. However there may be some cross-over with the analysis done on other pipeline work streams.

5.4 Other project work

In addition to the policy priorities and industry roles Gas Industry Co intends to complete the following projects in FY2010:

Distribution	**Expected direct costs in FY2009 $28,750**	**Estimated direct costs in FY2010 $160,479**
Project Rationale	**Current Activities**	**Forecast activities**
GPS seeks consistency and reasonableness in access terms across distribution networks.	The Company has deferred work on this work stream because of competing priorities.	Significant work remains to be done before the Company is in a position to make a recommendation to the Minister. This includes the development of issues and options papers for consultation with the industry.

[1] The MOU only allows Gas Industry Co to charge the applicant for rule changes, not the other persons who benefit from the proposed change. The Company is keen to ensure there are no barriers to the progression of rule changes. The GPS contemplates gas governance occurring under industry agreements as well as regulated arrangements.

Other policy work	Expected direct costs in FY2009 $106,485	Estimated direct costs in FY2010 $132,665
Project Rationale	**Current Activities**	**Forecast activities**
Upstream reconciliation	Upstream reconciliation is a key element of many settlement processes in the industry. In order to manage transmission pipeline positions, shippers need to know their delivery quantities on a daily basis.	The Company is planning to release a consultation paper on the major issues shortly and the next steps will depend on consultation feedback. One possible outcome is a central reconciliation agent similar to downstream reconciliation rules. However there may be other possible solutions.
Capacity	The Company expects to publish a review paper on the availability of short-term capacity under the VTC in March 2009.	Further work may be required depending on the policy issues which arise from discussions on short-term capacity between Vector and its shippers
Compliance	Not applicable.	It is expected that policy advice will be needed to ensure compliance with any new gas governance arrangements, for example by extending the application of the existing compliance regime
Contingency	Much of the transmission work is reliant on industry dialogue and agreement (eg interconnection and upstream reconciliation).	In the event that work becomes more complex or industry agreement proves elusive, the Company will need to develop regulatory alternatives and so a small contingency sum has been included for this eventuality.

6 Further information about "Market Administration" revenue requirement

6.1 Background

With the approval of six gas governance arrangements, the Company has now embarked on a new set of business activities – the delivery of market administration services on behalf of the industry.

Gas Industry Co has already worked with industry groups to develop detailed implementation plans, functional specifications for new software, select service providers and negotiate their contracts. It has consulted, and made determinations, on matters of technical detail required for implementation of new rules. The Company has also selected a Rulings Panel and investigator for the new compliance regime, and considered and made decisions on the materiality of breaches and a range of exemption applications.

Going forward it will need to act as the agent of the industry in managing the performance of service providers as well as undertake a number of other roles in the new rules such as estimating and collecting fees, collecting and publishing information, determining technical detail, appointing experts and auditors and approving contingency plans.

These activities will now become a core part of our business.

6.2 Business as usual outputs

The main outputs of the market administration work area are delivery of the various matters required of it in the approved gas governance arrangements. The table over describes these business as usual outputs and the Company's estimated direct costs for each market administration role:

Approved Gas Governance Arrangement	Description of Market Administration Role	Estimated direct cost
Gas (Downstream Reconciliation) Rules 2008	Monitoring the allocation agent in accordance with the service provider agreement. Carry out functions assigned to the Company by the rules, such as determining fees and accuracy standards for mass market consumption information, producing profile guidelines, and determining customer designations. The Company will also need to make decisions on exemptions and assist with enforcement, market education and administration.	$1,136,143
Gas (Switching Arrangements) Rules 2008	Monitoring services provided by the Registry Operator in accordance with the service provider contracts, processing system change requests, co-ordinating system upgrades and testing, database and administrative assistance in enforcement matters, market education and other administrative activities.	$407,766
Gas Governance (Compliance) Regulations 2008	Receive and process allegations of breaches of approved arrangements in accordance with Compliance Regulations including making decisions on materiality. Oversee operation of investigator and Rulings Panel.	$345,021
Gas (Processing Facilities Information Disclosure) Rules 2008	Ensure all disclosures are kept up to date, report to the Minister on access seekers and, in the event of non-disclosure, assist in any enforcement actions.	$16,826
Gas Governance (Critical Contingency Management) Regulations 2008	Manage the critical contingency operator in accordance with the service provider contract, approve any amendments to critical contingency management plans, market education and other operational matters, assist in any enforcement actions, administer the process of payments and receipts for contingency imbalances following a critical contingency, undertake review of arrangements in event of any contingency.	$832,182
Wholesale Market (Trial)	The activity is expected to include overseeing the operation of a market trial and then evaluating the results.	$199,586
Total		**$2,937,524**

7 Further information about "Corporate" revenue requirement

7.1 Background

Although Gas Industry Co is a small organisation in terms of budget and staff numbers, its role means it has the organisational, financial reporting, governance and communication requirements of a much larger entity. It has statutory requirements to meet and stakeholders who expect a high level of transparency and corporate accountability. This is appropriate for an organisation with statutory powers to recommend regulations for gas governance and levies.

These requirements, combined with an increasingly complex range of activities, have meant the Company needs to upgrade its project management and planning processes, website and financial management systems. The "Corporate" component of the FY2010 budget includes the costs of stakeholder communications and internal governance, and the corporate support functions of finance, human resources, project management, IT infrastructure, administrative support and other overheads such as premises and depreciation. It also includes non-work stream-related legal advice and corporate governance services. The Budget assumes a staff of 10 FTEs will be required to undertake corporate activity in FY2010.

7.2 Business as usual outputs

The main outputs for the corporate services work stream relate to its statutory reporting obligations (to consult on and recommend an annual levy, report quarterly to the Minister, develop and agree on the Strategic Plan with the Minister, produce an Annual Report and hold an AGM). In addition the Company proposes to continue its engagement with industry and consumers via annual forums for each of these stakeholder groups.

Activity	Milestones
Meeting statutory reporting obligations	Prepare Strategic Plan, Quarterly Reports and Annual Report by due dates.
Obtain levy funding	Levy Recommendation to Minister in March 2009.
Meet stakeholder obligations	Hold: • AGM by 31 December 2009 • Industry Conference by September 2009 • Consumer forum by June 2009.

7.3 Comparison of forecast FY2010 corporate costs with FY2009

The table below compares the estimated current costs with the budgeted and forecast amounts for the current year. The table shows the significant under-estimation of the overhead and corporate costs in the FY2009 Levy Budget reflecting additional employee costs, particularly in the Corporate Services and Market Administration areas and a substantial increase (237%) in rent. These increases are expected to carry over into FY2010.

	Levy Budget FY2009	Current forecast FY2009	Estimated FY2010
Board	261,980	355,209	325,576
Overheads	496,448	1,032,889	1,237,642
Corporate	822,214	1,277,807	834,725
Legal	198,490	367,694	260,951
Total	**1,779,132**	**3,033,599**	**2,658,894**

The Legal budget includes corporate governance, legal services not relating to work areas and a litigation contingency of $100,000. Legal services relating to the compliance regime are included in the Market Administration budget and legal services on policy matters are included in the relevant policy project.

Overhead budget includes rent, depreciation, KiwiSaver contributions, finance staff, training and staff development and external HR advice. Corporate costs include project management, business planning, levy process, and communications. The reduction in corporate costs from FY2009 to FY2010 is because of a decision to remove a consultancy contingency from the corporate budget.