



The Genesis Energy Building
Level 1
93 The Terrace
PO Box 10568
The Terrace
Wellington
New Zealand
Genesis Power Limited
trading as Genesis Energy
Telephone: 04-495-6357
Fax: 04-495-6363

5 February 2008

Dr Bas Walker
Senior Advisor – Strategic Issues and Projects
Gas Industry Company
WELLINGTON

E-mail: submissions@gasindustry.co.nz

Dear Bas

Levy to Fund the Gas Industry Company (2008/2009)

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide comments to the Gas Industry Company on its consultation paper 'Levy for Gas Industry Co for the 2008/2009 Financial Year' dated December 2007. Genesis Energy has reviewed the consultation paper and attended the Gas Industry Company levy workshop on 17 January.

Genesis Energy appreciates the Gas Industry Company's acceptance of this submission one day later than the due date.

Introductory Comments

In its submission on the 2007/2008 levy¹, Genesis Energy expressed the opinion that significant improvements were needed to the quality of information presented for levy consultation purposes. Genesis Energy is pleased to see that the quality of information has indeed improved this year. However, deficiencies remain and this submission points to where further improvements should be made.

The current consultation paper brings into sharper relief some of the implications of Gas Industry Company's 'dedicated fees' policy. Genesis

¹ Genesis Energy letter to Gas Industry Company regarding *2007/2008 Levy Discussion Paper* dated 2 February 2007.

Energy is increasingly concerned by this approach, as it effectively circumvents the discipline that the levy setting process otherwise places on the charging of monies for regulatory activities.

Genesis Energy is comfortable with the Gas Industry Company's proposed method of handling over- and under-recoveries. Genesis Energy also supports the retention of the existing levy structure plus the revised approach to allocating indirect costs.

Genesis Energy is disappointed that the Gas Industry Company continues to view the government policy statement on gas governance ("the gas GPS") as the primary strategic planning document for gas industry regulation. In this submission, Genesis Energy suggests an alternative approach that would allow the regulatory agenda to better reflect a co-regulatory balance between government and industry.

The remainder of this submission deals with dedicated fees, quality of financial information, and strategic direction in turn. Answers to the Gas Industry Company's specific consultation questions are attached as an appendix.

"Dedicated Fees" Equals Fragmented Levies

For major work streams (switching, compliance, allocation and reconciliation, contingency arrangements and transmission access) the Gas Industry Company has adopted an approach of using 'dedicated fees' to recover costs rather than using the general levy. This approach involves using each set of regulations (or rules) to allow the Gas Industry Company to levy participants for costs. In effect, this results in a fragmentation of the levy into a core "general levy" plus a number of "special levies".

Gas Industry Company considers this to be a "more flexible, tailor-made funding regime" than use of the general levy – meaning that changes can be made more quickly and fee structures can be customised for each work stream (for example, in terms of which parties pay the fees and on what basis)². While Genesis Energy can understand why the Gas Industry Company may find these attributes desirable, the current levy consultation highlights a number of concerns. These are discussed below.

1. Loss of information on total costs:

As costs are carved out of the general levy and into a series of special levies, consumers and industry participants lose information about the cost of gas industry regulation.

This risk could be reduced by collating information on all of the levies into the annual consultation paper on the general levy. To be truly useful, this information would have to include historical costs for each levy, estimates of future costs for each levy, the total

² Gas Industry Company "Discussion Paper: Reconciliation of Downstream Gas Quantities", dated 11 January 2007.

combined levy (as a single figure, and on per-ICP plus per-GJ bases), plus information on outputs against each levy.

Loss of information is further exacerbated where Gas Industry Company overheads are transferred to the special levies, as is proposed.

2. Proliferation of levies:

The flip-side of the flexibility that appeals to the Gas Industry Company is the potential cost to retailers (and ultimately consumers) of multiple levy changes throughout the year. Retailers typically have annual pricing determination cycles and cannot accommodate changes to levies or the introduction of new levies throughout the year without incurring significant additional costs.

In light of this and in Genesis Energy's view, the flexibility of special levies cannot be enjoyed by the Gas Industry Company without compromising the Gas Industry Company's objective of sustained downward pressure on prices.

3. Loss of appropriate checks on power to levy:

The Gas Act 1992 ("the Act") includes empowering provisions to authorise the making of levy regulations to fund the industry body and places a set of checks on the exercise of that authority³. In effect, the Act requires annual consultation with industry participants plus annual scrutiny by the Minister and approval by Cabinet. While these requirements may seem onerous to the Gas Industry Company, Genesis Energy believes that they are appropriate given the nature of the authority concerned.

The regulations and rules put forward by the Gas Industry Company to date do not mirror the checks that are found in the Act. In Genesis Energy's view the checks in regulations and rules put forward by the Gas Industry Company are inadequate, and create an unacceptable risk of levy volatility and growth.

4. Vulnerability to legal challenge:

Genesis Energy is aware that there have been conflicting legal opinions on whether the special levy approach is supported by the Act. Genesis Energy does not offer any legal advice here but suggests that in light of legal uncertainty, use of the general levy may provide a firmer footing than the proposed special levies. In particular, Genesis Energy is concerned with the risk that participants may seek to use the Courts to test their obligation to pay special levies. This could have a destabilising effect on the sector.

³ Gas Act 1992 s43ZZB – s43ZZF.

In light of the concerns discussed above, Genesis Energy has serious reservations about the Gas Industry Company's use of special levies and Genesis Energy believes that there are good policy reasons for revisiting this approach.

Genesis Energy also notes that the special levy approach is at odds with the approach adopted by the Electricity Commission. In its most recent consultation on appropriations, the Electricity Commission indicates that day-to-day operations (including service provider costs) constitute around 60% of its 2007/08 'governance and market operations' appropriation⁴. This highlights the potential magnitude of any problem with special levies.

If the Gas Industry Company is determined to proceed with special levies, Genesis Energy suggests that at a minimum the Gas Industry Company should:

1. Include full information on special levies when consulting on the general levy, including:
 - a. historical and projected levels for each special levy;
 - b. historical and projected outputs for each special levy;
 - c. historical and projected aggregate levy (general plus special) as an annual total and on per-ICP and per-GJ bases.
2. Only change the special levies on the date that the general levy changes (that is, the start of the financial year under normal circumstances);
3. Place appropriate checks within each set of rules or regulations on the special levy setting process, including the requirements listed above, plus a requirement for annual consultation.

Improving the Quality of Financial Information

The information in Appendix B of the consultation paper (Work Programme Details) provides a much improved basis for assessing the levy proposal compared with the information provided in previous years. In particular, the tables titled 'Milestones and Budget: Progress to Date and Indicative Work Programme' provide clear information on outputs and costs for each work area.

There are however two areas in particular where the quality of the information presented for consultation should be improved:

1. Estimated outturn should be provided for the current financial year.

⁴ Electricity Commission, *Proposed work priorities and appropriations for the 2008/09 financial year*, 30 November 2007, Table 2 – 'Summary of appropriation, past and proposed' (p10).

Providing an estimated outturn would make the information slightly more up to date and would make it easier to see where costs are likely to be carried forward a year.

Estimated outturn information is particularly important given the limited number of data points available for comparison at this stage of the Gas Industry Company's life.

2. Budget and actual figures should be broken down to output level.

The tables referred to above break the work programme for each work stream down into a number of 'milestones', but do not do the same for expenditure figures.

If budget and actual figures were reported at the level of 'milestones' then this would provide more appropriate information on cost-per-output.

Strategic Direction – How to Achieve a Balanced Regulatory Agenda

The consultation paper sets out strategic priorities and goals as a basis for developing the Gas Industry Company's work programme. Genesis Energy supports this approach.

Genesis Energy also supports the proposal to establish a new work area focussing on "strategic issues for the gas industry". In particular, Genesis Energy anticipates that this work should facilitate the industry taking a more active role in shaping the regulatory agenda.

To date, the regulatory agenda has largely been set by the gas GPS. While Genesis Energy understands the convenience associated with this, it does not believe that this is an ideal approach for realising the promise of the co-regulatory experiment. Unfortunately, the levy consultation paper carries this approach forward. In particular, the consultation paper says:

"Gas Industry Co's strategic priorities are essentially set by... the GPS."⁵

Genesis Energy agrees that this appears to be a reasonable reflection of how the Gas Industry Company has operated to date, with a couple of caveats:

1. The Gas Industry Company's work on critical contingency arrangements was industry-initiated rather than GPS-initiated. This has become a substantial work stream and indicates that the industry can play a role in setting the regulatory agenda; and

⁵ Page 12.

2. Due to uncertainty around the outcome of work being carried out by the Commerce Commission, the Gas Industry Company has not given priority to the gas GPS output of “consistent standards and protocols across distribution pipelines”⁶. This indicates that the Gas Industry Company has prioritised work streams within the gas GPS in the past.

The Gas Industry Company's approach to work planning could be represented diagrammatically as shown in Figure 1. The diagram illustrates the gas GPS as relating to a subset of the governance regulation powers in Part 4A of the Gas Act 1992. The Gas Industry Company has given near-equal weight to all of the items in the gas GPS and negligible weight to matters outside of the GPS (other than the matter of critical contingency arrangements).

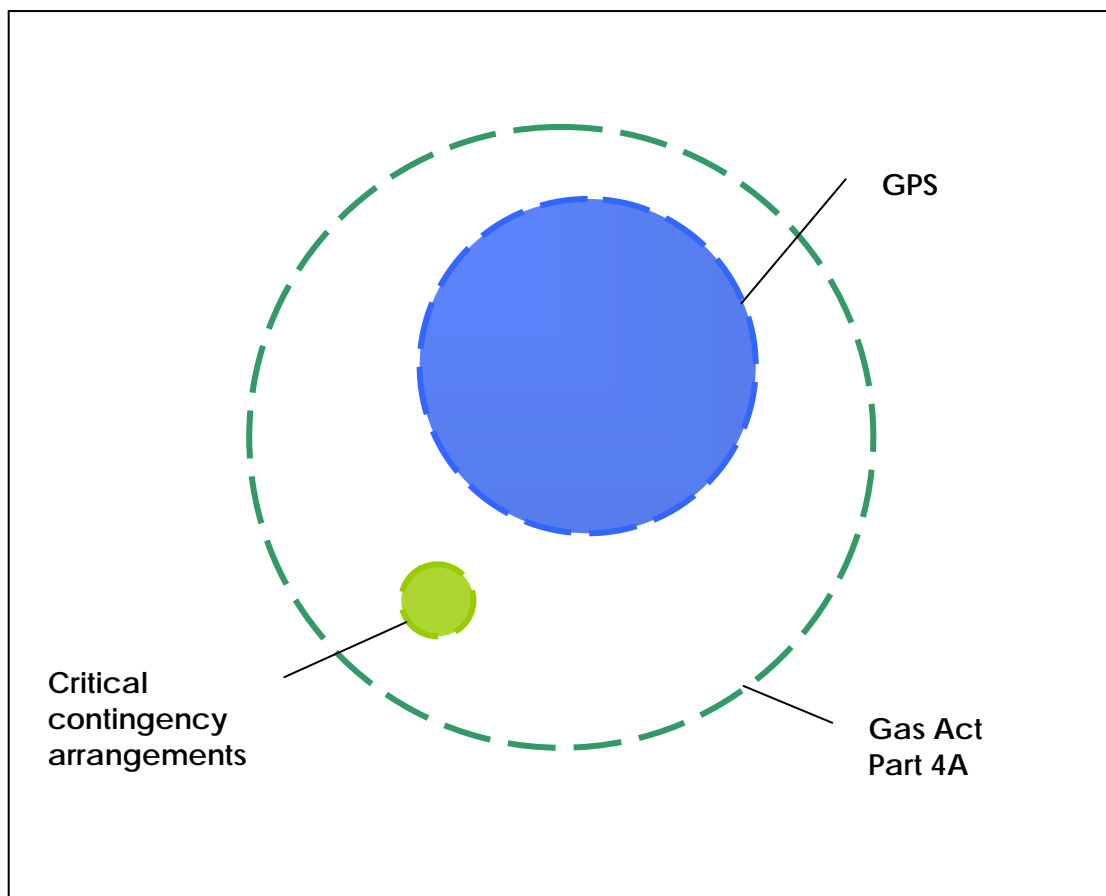


Figure 1 - Diagrammatic representation of Gas Industry Company's approach to priority setting.

Genesis Energy acknowledges that the approach the Gas Industry Company has taken to priority setting may well reflect the dictates of the Board of the Gas Industry Company. However, Genesis Energy believes that there is scope to change the priority setting approach so that the regulatory agenda can reflect a balance between government and industry priorities. Genesis Energy's suggested approach is represented diagrammatically in Figure 2. Major features of the approach are:

⁶ Government Policy Statement on Gas Governance, October 2004.

1. Strategic priorities (Tier I) are set by the Gas Industry Company, but influenced by the gas GPS.
2. Matters that are in the gas GPS, but are not aligned with the Gas Industry Company's strategic priorities, are given a lower priority (Tier II) but are not ignored.
3. Matters that relate to the regulatory powers in Part 4A of the Gas Act, but are not aligned with either the gas GPS or the Gas Industry Company's strategic priorities, are given the lowest priority (Tier III) and are 'scanned' only.

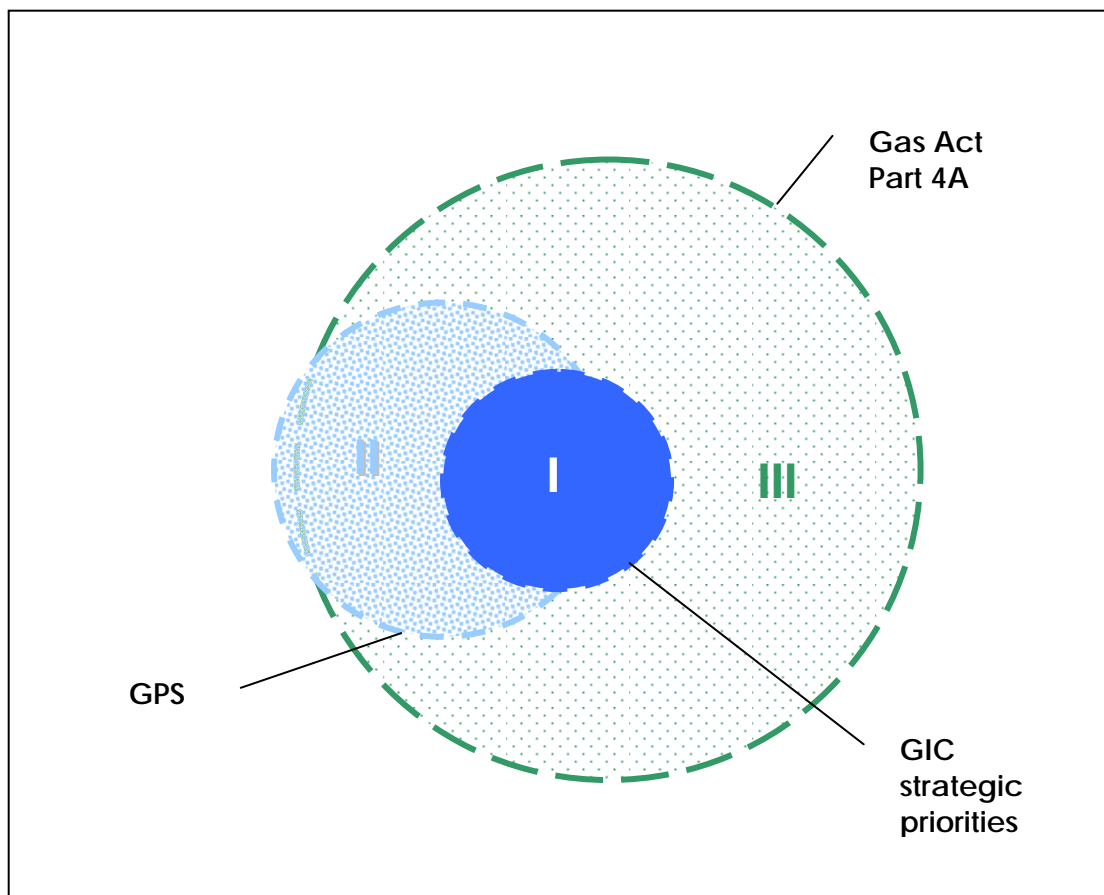


Figure 2 - Diagrammatic representation of Genesis Energy's suggested approach to priority setting.

In this approach, Tier I would usually be a more focussed set of items than the matters covered by the gas GPS. Gas Industry Company would consult stakeholders annually on what matters should be included at Tier I (similar to the Electricity Commission's 'big picture' consultation).

For most of the items in Tier II, the level of attention warranted would be dictated by the obligation under the Gas Act 1992 for the Gas Industry Company to report against GPS outcomes and objectives. Other items may be governed by the obligation in the Gas Industry Company's

constitution to report on matters that the Minister requests⁷. Occasionally, Tier II items may extend outside the bounds of Part 4A of the Gas Act 1992⁸.

Genesis Energy's expectation is that this approach would not lead to an expansion of the Gas Industry Company's funding requirements, rather it would result in a more focussed (and tiered) regulatory agenda that strikes a healthy balance between government and industry priorities.

If you would like to discuss any of these matters further, please contact me on 04 495 6357.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Carnegie'.

John A Carnegie
Regulatory Affairs Manager
Genesis Energy

⁷ Genesis Energy intends to include a more complete discussion of the Gas Industry Company's obligations in its upcoming submission on the draft gas GPS.

⁸ As a consequence of s43ZZC(1)(e) of the Gas Act 1992, which allows the Gas Industry Company to collect levy funding for advising the Minister on matters concerning the gas industry in general.

Appendix One – Responses to specific consultation questions

QUESTION	COMMENT
<p>Q1: Do you agree with the proposal not to alter the structure of the levy for the 2008/2009 financial year?</p>	<p>Yes.</p>
<p>Q2: Do you agree with the proposed policy for funding the implementation of gas governance arrangements?</p>	<p>No.</p>
<p>Q3: Do you agree with the proposed indirect cost allocation methodology?</p>	<p>Yes.</p>
<p>Q4: Do you agree with the proposed approach to balancing levy revenue against relevant expenditure over several years?</p>	<p>Yes.</p>
<p>Q5: Do you agree that the strategic goals proposed are an appropriate basis for providing work programme and cost inputs for levy setting?</p>	<p>No.</p> <p>Genesis Energy agrees that it is appropriate to base the Gas Industry Company's work programme on a set of strategic priorities and goals.</p> <p>Genesis Energy does not agree with the statement that "...strategic priorities are essentially set by...the GPS". While this is a reasonable reflection of the way that the Gas Industry Company has operated, Genesis Energy believes that a better approach to setting priorities could be developed.</p> <p>Please refer to the section of the cover letter headed 'strategic direction' for further discussion on this topic.</p>
<p>Q6: Do you agree that the work programme set out above is appropriate to achieving the objectives, outcomes and tasks set in the GPS?</p>	<p>Genesis Energy does not accept that this is the correct question – especially with respect to 'tasks' set in the gas GPS. Instead, the Gas Industry Company should be asking whether the work programme is appropriate to achieving the Gas Industry Company's strategic priorities.</p> <p>However, as the Gas Industry Company is for the present equating its priorities to the items in the gas GPS, then these two questions are very similar.</p>

QUESTION	COMMENT
	<p>It is not clear that the Gas Industry Company can levy for 'tasks' set by the Minister unless they relate to a regulation making power (under s43ZZC(1)(a)), to providing advice to the Minister (under s43ZZC(1)(e)), or to facilitating operation of markets for industry participants (under s43ZZC(1)(c)).</p> <p>Genesis Energy also has the following specific comments:</p> <ol style="list-style-type: none"> 1. It is difficult to see how the task 'working with other government agencies to improve the quality of information available to consumers about their energy choices' could be funded by the Gas Industry Company levy. It is possible that a more tightly defined subset of this task could be funded, but not the entire task as broadly stated. 2. Genesis Energy suggests that the Gas Industry Company should allow for the possibility that 6 to 9 months might not be a long enough period on which to base a final recommendation to the Minister on whether the wholesale market trading platform should continue. Also, if the Gas Industry Company concludes that a regulated market is not necessary, then a report to the Minister would be appropriate rather than a formal recommendation. 3. In light of the submissions received by the Gas Industry Company on transmission access, it seems unlikely that transmission access regulations with a prescribed transition period will come into effect towards the end of 2008.
<p>Q7: Do you agree that the indicated budgets are appropriate to the proposed work programme?</p>	<p>Budget estimates are based on the assumption that each major work stream will:</p> <p style="padding-left: 40px;">"...involve... development of a statement of proposal, MED approval..., a recommendation to the Minister, Ministerial approval and an implementation phase".</p> <p>Genesis Energy makes the observation that these steps are not required if the Gas Industry Company concludes that the optimal approach does not involve regulations or</p>

QUESTION	COMMENT
	<p>rules.</p> <p>In reviewing the budgets and work programmes, Genesis Energy has found Appendix Two to be a far more useful summary than the information in Section 5.5. Genesis Energy welcomes this improvement in the quality of information.</p> <p>As discussed in the cover letter, Genesis Energy recommends that the summary should be further improved by adding an estimated outturn for the current year and by breaking the budget down to the level of 'milestones'.</p> <p>Genesis Energy also welcomes the Gas Industry Company's intention to use industry working groups and ongoing liaison with industry as a strategy for mitigating risks of industry disagreement delaying work streams. Genesis Energy suggests that this strategy should also help mitigate the capacity restraint risks that the Gas Industry Company has identified.</p> <p>Genesis Energy has the following specific comments:</p> <ol style="list-style-type: none"> 1. Removal of the prescribed transition period for transmission access could reduce the levy requirement for that work stream in 2008/09. 2. The allocation of \$400,000 for new issues arising from the revised gas GPS suggests that each issue will be reasonably heavily resourced. Genesis Energy suggests that some prioritisation of these issues should be possible and that it shouldn't be considered necessary to develop comprehensive advice in every area, or to complete all items in one year.
<p>Q8: Do you agree with the calculation of the funding requirements, including the allocation of costs between wholesale and retail work programmes and the carrying over of some of the accumulated surplus?</p>	<p>Yes.</p>

QUESTION	COMMENT
<p>Q9: Do you agree that it is appropriate to decrease the levy for 2008/09 to the levels set out above given the requirements of the indicated work programme and Gas Industry Co's statutory obligations?</p>	<p>In light of the discussion above, Genesis Energy cannot give an unequivocal answer to this question.</p> <p>Also, because no estimate is provided for the magnitude of 'dedicated fees', there is no guarantee that the Gas Industry Company's funding is actually decreasing.</p> <p>However, in principle Genesis Energy is happy to support a decrease in the general levy.</p>