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Dear Nicole

## 2007/2008 Levy Discussion Paper

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide comments to the Gas Industry Company on the "Levy Discussion Paper" dated January 2006. Genesis Energy has reviewed the discussion paper and is pleased to have the opportunity to respond to the issues it raises.

In general, Genesis Energy welcomes the Gas Industry Company's approach to the consideration of the issues associated with the setting of its annual levy. It is clear that the Gas Industry Company is, to a certain extent, 'learning by doing' with respect to its own finances, the costs of providing its deliverables, and fulfilling its legislative obligation to consult. While Genesis Energy does not agree with all of the Gas Industry Company's conclusions,<sup>1</sup> it nonetheless considers that the Gas Industry Company should continue to transparently 'front-footing' these issues with industry participants.

Before getting into the detail responses to what the Gas Industry Company is proposing to do in 2007/08 and how much this is proposed to cost, Genesis Energy wishes to raise an over-arching issue. This issue is the degree of the Gas Industry Company's accountability to those participants who pay the levy (accountability which is implied in the Gas Industry Company's legislative obligation to consult), and how that is being, or should be fulfilled in practical terms. Genesis Energy acknowledges that the level of explicit accountability to industry participants is low. However, putting aside those issues associated with what duties a legislative obligation to consult entails in law<sup>2</sup> Genesis Energy considers that there is essentially a two-pronged 'test' against which the reasonableness of the Gas Industry Company's fulfillment of its

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<sup>1</sup> Genesis Energy's responses to the specific questions posed by the Gas Industry Company consultation paper are attached to this letter as Appendix One.

<sup>2</sup> Genesis Energy doubts that the Gas Industry Company would be unfamiliar with the duties set out the 1993 Court of Appeal case Wellington International Airport Limited et al v Air New Zealand et al, 1 NZLR 671 regarding consultation.

accountability to industry participants can be assessed. These are whether the information provided by the Gas Industry Company in its levy paper is:

1. sufficient to reasonably allow industry participants to comment meaningfully on the Gas Industry Company's levy proposal and its value for money; and
2. appropriate to the absolute level of the request being made.

Genesis Energy has applied this framework in considering the issues raised in the consultation paper. Genesis Energy's overall assessment is that from the information provided by the Gas Industry Company it is unable to conclude whether the levels of expenditure proposed (and result in a \$1.063m increase in the proposed levy) are either justified or prudent. This view is largely derived from the inadequate workstream information and the 'disconnect' between the workstream information and the financial information. For example, it is impossible to derive a proposed budget of \$101,295 (excluding a portion of unallocated costs) for the compliance and enforcement workstream in the table on page 22 from either the description in paragraph 6.9 or the two comments in B2 on page 18. Conversely, from the nature of the expected deliverables for the switching and registry, and reconciliation workstreams, Genesis Energy considers these budgets to be relatively light. Further information on the views outlined here is provided in the Appendices attached.

As a result, Genesis Energy is extremely reluctant to agree to the proposed increase. Specifically, Genesis Energy's increase in costs from the 06/07 to the 07/08 financial years, for both retail and wholesale, will be in excess of \$300,000.00. This is a significant increase that will be borne ultimately by Genesis Energy's customers. Despite this reluctance, Genesis Energy recognises that there is a significant amount of work to be pursued by the Gas Industry Company over the coming year and accordingly Genesis Energy will reluctantly agree to the proposed budget. However, having said that, Genesis Energy wishes to put the Gas Industry Company on notice that unless significant improvements are made in the quality of the information the Gas Industry Company provides when seeking future levy increases – Genesis Energy's support of future budget proposals is unlikely to be forthcoming. Clear evidence of the Gas Industry Company's delivering on its expected outputs will be key to this.

If you would like to discuss any of these matters further please contact either myself on 021 375 061, or Tracey Kaio 021 778 375.

Yours sincerely



John A Carnegie  
Regulatory Affairs Manager  
Genesis Energy

## Appendix One: Responses to Specific Consultation Questions

QUESTION	COMMENT
<p><b>Q1:</b> Do you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year?</p>	<p>Yes. Genesis Energy places a high value on certainty over time and considers that the current methodology should be retained until such time as a clear quantitative net benefit can be demonstrated for making changes. Changing the levy methodology year-on-year imposes a hidden, but material cost on industry participants.</p>
<p><b>Q2:</b> Do participants consider that it is appropriate to change the reference quantities for calculating the wholesale levy from the quarter before the last quarter to the quantity used during the previous month?</p>	<p>No. Genesis Energy does not believe that the Gas Industry Company has provided sufficient justification to change the reference quantities to the prior month. The justification for the change of methodology is the "significant time lag between when the gas was taken and when the levy on that gas becomes payable"...which would then "result in a mismatch between income earned in respect of that gas, and the income from which the levy is paid".</p> <p>In Genesis Energy's view, changing to the proposed methodology would increase the complexity of the levy payments and therefore increase administration costs to participants. In comparison, the current methodology allows all parties to budget sufficiently as consumption numbers are known well in advance.</p> <p>Genesis Energy would also expect that the current methodology would be beneficial to the Gas Industry Company to enable it to better forecast income. As identified in 5.6 of the discussion paper, historic data is relatively stable whereas the most recent data is more likely to change.</p> <p>Finally, as outlined in response to Q1 above, it is Genesis Energy's strong preference that the issue of the levy methodology remains settled until such time as a clear quantitative net benefit can be demonstrated for changing it. If the methodology remains a 'live' issue after this consultation process, Genesis Energy would suggest that the Gas Industry Company decouple it from consideration of the 2008/09 levy by addressing it earlier as a separate issue.</p> <p>Should the move to the proposed methodology be made, Genesis Energy would strongly encourage each payment be inclusive of any wash-ups for previous months.</p>

QUESTION	COMMENT
<p><b>Q3:</b> Do participants consider that it is useful to provide a comparison of previous years' costs with the budget figures?</p>	<p>As a matter of principle, as much financial detail as possible should be included in order for participants to satisfy themselves that the 'price' that participants are being charged for the Gas Industry Company's deliverables are being managed appropriately. Indeed, consistent with the second leg of the 'test' outlined in the covering letter, Genesis Energy considers that there is a relationship between the quantity and quality of information provided by the Gas Industry Company and the overall level of the proposed levy. In other words, that the obligation on the Gas Industry Company regarding the information it provides becomes <i>more</i> stringent as its levy proposals increase over time.</p> <p>In terms of the specific question, Genesis Energy would consider it useful for the Gas Industry Company to provide a comparison of previous years' actual costs with the current years budget figures. However, more importantly, Genesis Energy considers that the most relevant piece of financial information is the forecast out-turn for the current year. It is this number that will enable participants to meaningfully assess on the appropriateness of the following years (in this case 2007/08) budget forecast on which the proposed levy is based. Other aspects of relevance to the quality of the financial information that should be provided are:</p> <ol style="list-style-type: none"> <li>1. is it unclear from the information provided which of the proposed deliverables give rise to the major cost increases and which are minor in terms of cost impact. In other words, it is unclear what the specific drivers are to the increased request – is the Gas Industry Company: <ol style="list-style-type: none"> <li>a. increasing the volume of its output delivery? or</li> <li>b. delivering the same volume of outputs but they are just more expensive?</li> </ol> </li> <li>2. participants need to be able to assess any changes in the price of the Gas Industry Company's deliverables over time. To this extent, it is important that the outputs are fully priced and do not exclude 'unallocated' costs. Excluding such costs means that the final price for the outputs delivered can be subject to wild swings from year to year if the Gas Industry Company alters its allocation methodology at its discretion and it therefore becomes impossible for participants to understand the full price of the outputs that the Gas Industry Company is delivering; and</li> <li>3. it is disappointing to note in paragraph 5.17 of the discussion paper that participants are directed to the Annual Report published in 2006. Although participants were able to gain more detail for previous years there was no useful comparison with the proposed budgets for the 07/08 financial year in which to make a more informed decision.</li> </ol>

QUESTION	COMMENT
<p>Q3: cont</p>	<p>However, to focus on the provision of financial information in isolation of robust information on the underpinning deliverables will only provide an inadequate picture and prevent participants from providing the Gas Industry Company with well-informed feedback.</p> <p>Indeed, in Genesis Energy's view, the levy proposal is simply the combined outcome of the Gas Industry Company's proposed budget and work programme. The key issue for the Gas Industry Company is the level of detail of its work programme which it considers (and indeed with industry participants consider) is sufficient to enable informed analysis of the Gas Industry Company's proposed levy rate or amount. In general, Genesis Energy considers the work programme information to be inadequate and this, in turn, is reflected in the inadequate financial information provided. More specifically:</p> <ol style="list-style-type: none"> <li>1. there is no information: <ol style="list-style-type: none"> <li>a. on the outputs that have been and are expected to be delivered by the end of the current financial year. To this extent, it is difficult to tell if the Gas Industry Company has delivered or simply carried over the delivery of outputs into the new financial year;</li> <li>b. regarding what participants are 'buying' for the levy payment. It is unclear from the lists provided on pages 17 – 19 what is actually being purchased. Invariably, the proposed activities are just that – activities when what is required is a description of the actual output being delivered (and therefore purchased). In general, what has been described is the process of delivery (for example – “consult”, “implement”, “form”, “appoint”, “develop” whereas the outcome would be described as complete, conclude etc); and</li> <li>c. on the Gas Industry Company's priorities to the extent that it appears that all of its proposed work is of equal and high priority which must be delivered in the 2007/08 financial year. This is implausible given the extent to which the Gas Industry Company can control its work programme;</li> </ol> </li> <li>2. Genesis Energy considers that within the work programme, the key outputs (or projects) once described should be priced; and</li> <li>3. it would be also appropriate, in order to form a meaningful view on the Gas Industry Company's proposals, for the Gas Industry Company's 'business-as-usual' outputs within each work programme to also be described and priced. This is considered to be particularly pertinent given the expectation over time of the Gas Industry Company's outputs to shift from being project dominated to more routine in nature (for example, market monitoring, on-going rule development to keep them flexible and adaptive to new technologies etc etc).</li> </ol>

QUESTION	COMMENT
<p>Q3: cont</p>	<p>In essence, Genesis Energy considers that to attempt to separate “the merits of the levy” from “the content of the work programme or budget.”<sup>3</sup> misunderstands the objective of consultation on the “levy rate or amount” as set out in section 43ZZD(2) and what it implies in terms of the quality and quantity of information to be provided to participants.</p> <p>Genesis Energy recognises that there is, of course, a balance to the level of detail to be provided by the Gas Industry Company. Genesis Energy’s two ‘tests’ are intended to help in this regard. Genesis Energy has also provided a tentative outline that may assist the Gas Industry Company in regard to the appropriate level of output and financial disclosure that would, in its view, meet the two tests. This is attached as Appendix Two.</p>
<p>Q4: Do you agree with the allocation of costs between the wholesale and retail work programmes?</p>	<p>No. There would appear to be no apparent justification for describing the area of corporate accountability as a separable work programme but not allocating it a portion of the unallocated costs. This should either be subsumed within the area of unallocated costs and then allocated across the retail and wholesale workstreams, or separately described as a set of identifiable outputs to be delivered, allocated a portion of the ‘true’ unallocated costs and recovered as a separate revenue requirement.</p> <p>Ultimately how the Gas Industry Company allocates and recovers its revenue is up to it, but it needs to be based on logical financial analysis of the underlying drivers of the business and what it delivers.</p>

<sup>3</sup> As stated in paragraph 5.17, page 9 of the levy consultation paper.

QUESTION	COMMENT
<p><b>Q5:</b> Do you agree that unallocated costs should be split evenly between retail and wholesale?</p>	<p>Subject to the response to Q4 above, the allocation of 'unallocated costs' is merely an accounting exercise over which the Gas Industry Company should (and rightfully so) have operational discretion. However, as also noted above, Genesis Energy's interest is in understanding the full 'price' of the outputs being delivered by the Gas Industry Company over time and not in how its overheads or input costs are allocated. To this extent, the allocation methodology is only relevant to the degree to which it fails to reflect the underlying drivers of the business and what it delivers and in doing so inappropriately influences the price of the outputs being delivered.</p> <p>Genesis Energy considers that the Gas Industry Company is more than capable of coming up with an efficient accounting allocation mechanism that is consistent with the FRS requirements, and appropriate to the fundamental economic drivers of its business and the outputs it delivers. However, having said that, the Gas Industry Company provides no justification for the even split which suggests that it is driven more by ease of implementation rather than logical financial analysis of the contributing factors.</p> <p>Genesis Energy would like to see more detail with regards to these unallocated costs in order to determine which outputs they should ultimately be allocated across, and why.</p>
<p><b>Q6:</b> Do you agree that it is appropriate to increase the levy for 2007/08 to the levels set out above given the requirements of the proposed work programme and Gas Industry Co's statutory obligations?</p>	<p>See Genesis Energy's covering letter.</p> <p>Since the implementation of the levy, retail fees have increased by 104.5% and wholesale by 28.7%. On the face of it, although the Gas Industry Company has taken up the challenge to engage the industry and pushed forward with specific work streams the increases do not appear to have yet been matched with completed workstreams with regard to wholesale markets, switching &amp; registry and reconciliation work programmes.</p> <p>Genesis Energy's agreement to the proposed levy increase is, therefore, a conditional one. Along with the need to see improved information, Genesis Energy will also closely monitor (as a part of its on-going assessment of value-for-money) the degree to which the Gas Industry Company completes its forecast deliverables in a timely manner.</p> <p>Genesis Energy also suggests that greater industry input into the Gas Industry Company's priority setting would be appropriate – perhaps something akin to the 'big picture' priority setting exercise undertaken by the Electricity Commission. This would greatly assist participants in their ability to comment on the value-for-money of future levy proposals.</p>

## Appendix Two: Proposed Format for Provision of Levy Information

	2005/06 actual <sup>4</sup>	2006/07 budget	2006/07 estimated out-turn	2007/08 proposed
<b>Retail work programme</b>				
<i>Output 1: Switching and Registry</i>				
Project A				
Project B				
Project C				
<i>Output 2: Compliance and Enforcement</i>				
Project A				
Project B				
<i>Output 3: Reconciliation</i>				
Project A				
Project B				
Etc etc				
Retail business-as-usual outputs				
<b>Total workstream</b>				
<b>Wholesale work programme</b>				
As above				
<b>Total workstreams</b>				
<b>Accountability and governance work programme</b>				
As above				
<b>Total workstreams</b>				
Reserves				
Non levy income				
<b>Total Levy Requirement</b>				

<sup>4</sup> Genesis Energy's expectation is that with every additional year, an additional column headed 20xx/20yy would be added to this table in order to assist participants with an easy reference guide to how the Gas Industry Company's outputs and their prices have changed over time.