



29 January 2007

Nicole McFarlane
Gas Industry Company
PO Box 10-646
Wellington

Mighty River Power Limited
Level 19, 1 Queen Street
Auckland 1010
PO Box 90399
Auckland Mail Centre
Auckland 1142

Phone: +64 9 308 8200
Fax: +64 9 308 8209
www.mightyriverpower.co.nz

Dear Nicole

SUBMISSION ON GAS LEVY PROPOSAL

Introduction

1. Thank you for the opportunity to comment on the Gas Industry Company's (GIC's) "*Levy Discussion Paper*", January 2007 (**Levy Paper**). No part of our submission is confidential and we are happy for it to be publicly released.
2. Mighty River Power is concerned about the statements the GIC has made in the Levy Paper around provision of financial information. We are disappointed that the GIC has not provided an updated budget (including actual costs) for the 2006/07 financial year. In particular we are disappointed about the lack of detailed budget information provided in the Levy Paper. Without detailed budget information we are not able to fully assess the merits of the large increase in levy payments sought by the GIC.
3. Given the above, the tone of this submission is critical of the GIC. Despite this, we continue to support the GIC and consider that the GIC is doing a good job overall.
4. We do not wish our criticism to be received by the GIC as an indication that Mighty River Power considers the levy payments sought are not justified. Our position is that the GIC has failed to provide adequately detailed financial information resulting in Mighty River Power not being able to properly review the GIC's levy proposal.

Mighty River Power's views

Do you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year?

5. Yes. Mighty River Power agrees that the fixed c/GJ (retail) and variable \$/ICP (wholesale) approach strikes an appropriate balance between administrative simplicity and economic efficiency.

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?

6. Mighty River Power acknowledges the GIC's desire to alter the manner in which the wholesale levy is calculated to address concerns about mismatch between the period in which income is earned and the period in which the levy is paid.
7. Mighty River Power is largely indifferent to this proposal. However, we believe that there may be one potential disadvantage of this approach. This pertains to prospective changes to the manner in which downstream gas is reconciled¹ - if changes to the manner in which gas is reconciled go ahead (i.e. retailers go to wash ups) then the requirement to pay a levy on the previous month's gas purchased will create administrative difficulties depending on the length of wash up period - i.e. the amount of levy paid may change subsequent to reconciliation requiring some kind of settlement. This problem may be greater under a consecutive monthly levy arrangement than under a quarter before the last quarter approach.

Over- and under-recovery of costs

8. Mighty River Power agrees that over- and under-recovery of costs in one financial year should be provided for in the following financial year and that this is consistent with section 43ZZC(3) of the Gas Act.

Two year levy review period

9. Mighty River Power agrees with the Ministry of Economic Development that the Gas Act as presently worded restricts the levy process to an annual one.
10. Mighty River Power is supportive of an amendment to the Gas Act to allow for a two yearly review period.

¹ Signaled in the GIC's discussion paper entitled "*Reconciliation of downstream gas quantities*" dated 11 January 2007.

Provision of increased financial information

Do participants consider that it is useful to provide a comparison of previous years' costs with the budget figures?

11. Yes it is useful to provide a comparison of previous years actual costs with budgeted costs. However, the extent to which that comparison is useful depends on the level of financial information provided. In this respect, Mighty River Power is unable to critically assess whether the amounts sought for each work stream, work programme and total levy are justified because of the lack of granularity in the information provided.
12. Section 43ZZD Gas Act sets out various conditions for the recommendation by the GIC of levy regulations. Subsection 2 provides that if these conditions are met the Minister must accept the GIC's recommendation. One of these conditions is that the GIC "*has consulted with industry participants on the levy rate or amount*". Accordingly, the GIC is required to satisfy a statutory obligation to consult with industry participants should it wish to meet the conditions prescribed in section 43ZZD(2).²
13. In respect of a statutory obligation to consult the Court of Appeal decision in *Wellington Airport Limited v Air New Zealand*³ provides guidance. In that case the Court of Appeal stated that:⁴

for consultation to be meaningful, there must be made available to the other party sufficient information to enable it to be adequately informed so as to be able to make intelligent and useful responses.
14. Applied to the present case - section 43ZZD(2)(b) requires that the GIC give industry participants sufficient information about the proposed levy to make "*intelligent and useful responses*" to the proposal – in other words, there must be enough information so that industry participants can form a view about whether the proposed expenditures are prudent and justifiable.
15. The question becomes: has the GIC provided sufficient information to give industry participants the ability to properly review the levy proposal?

² We note that the section does not mandatory require the GIC to consult. Rather the section requires that the GIC must consult to fulfill the conditions provided in subsection (2). We trust that given the GIC has consulted with industry participants that it wishes to do so in a manner that satisfies section 43ZZD(2)(b).

³ [1993] 1 NZLR 671 (CA).

⁴ Ibid at 676.

16. The GIC noted in the Levy Paper that some submitters had suggested that the GIC should provide additional financial information. In response to submitters concerns the GIC stated:

The Board has a statutory obligation to report on progress against the GPS. Gas Industry Co therefore considers that its detailed work programme and budget are properly matters of consideration for its Board and that the focus of the levy discussions should be the merits of the levy proposed rather than on the content of the work programme or budget.

17. In our view, the GIC misses the point when it suggests that, the fact the levy discussions are on the merits of the levy proposed negates the need to provide a budget.

18. The levy proposal is an aggregation of the detailed budget items. Accordingly, the merits of the levy proposal can only be assessed with reference to the content of the detailed budget and work programme. In this respect, Mighty River Power sees no reason why industry participants should not be provided with the same budgetary information as the Board. The requirements of good consultation, as noted above, mean that the GIC should provide the information underlying the levy proposal such that submitters can fully consider its propriety – much in the same way as the Board would make the same assessment.

19. This approach also accords with the principle of being an open consistent and transparent regulator.

20. Further, the consultation process facilitates the oversight by industry participants of the GIC, thereby giving the GIC the opportunity to receive critical analysis of the detail underpinning its levy proposal. Industry participants have not been able to fulfill this function because of the inadequacy of information provided by the GIC.

21. In essence, Mighty River Power is unable to critically evaluate the relationship between the monies sought by the GIC and the various costs provided by the GIC to a sufficient level of granularity. In particular:

- a. Although 2005/06 actual figures are provided, the Levy Paper does not provide an analysis of how 2005/06 actual expenditures compared with budgeted amounts, i.e. what is the explanation for differences;
- b. The GIC does not provide updated budget (including actual costs) for the 2006/07 financial year;
- c. A significant cause of our inability to contrast actual figures with budget figures is the generality of the information provided - the GIC only provides figures to work stream

level. A break down of costs is required to gain visibility of what money is actually being spent on;

- d. The lack of information provided makes it impossible to draw inferences from this year's performance to date through to the forecast expenditure for the new financial year.

22. To address the above concerns, Mighty River Power **recommends** that the GIC provide the following information as part of its future levy consultations:

- a. A detailed budget that includes specific costs broken down beyond the work stream level, i.e. to income expense group categories.
- b. Actual prior year figures verse prior year budgeted figures together with analysis. This analysis should explain if any variance between actual and budgeted figures is due to timing of planned activities (work deferred or brought forward) or permanent cost savings or over-runs.
- c. Actual prior year figures verse current year budgeted figures together with analysis. This comparison should identify differences in work being undertaken between years.
- d. Sensitivity analysis. This analysis should provide information on how budgeted costs would fluctuate given changes in key factors. One of the objects of this analysis is to identify the key drivers behind the GIC's levy proposal and provide a frame of reference for industry participants to make an assessment.

Concluding remarks

23. Mighty River Power respectfully reminds the GIC that the consultation provisions in the Gas Act are designed to provide an extra level of oversight of the GIC's levy process, over and above that of the Board. This is to provide an extra safeguard against escalating regulatory costs.

24. Mighty River Power has not been able to provide this oversight because the GIC has not provided adequately detailed financial information.

25. Accordingly, we **recommend** that the GIC implement the recommendations at paragraph 22 above.
26. If you would like to discuss this matter directly with Mighty River Power, please do not hesitate to contact me (on 09 308 8202 or john.gilkison@mightyriver.co.nz).

Yours faithfully

John Gilkison
Regulatory Counsel