Submission to the Gas Industry Company on its Proposed Gas (Levy of Participants) Regulations 2010, February 2010

From

Contact Energy Limited

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Introduction

Contact Energy Limited ("Contact") welcomes the opportunity to provide feedback to the Gas Industry Company ("GIC") on its Proposed Gas (Levy of Participants) Regulations 2010 ("2010 Levy Regulations").

Provision of Value

In commenting on the 2010 Levy Regulations Contact's overriding concern is that expenditure incurred by the GIC and its service providers should provide value. From the information provided in the 2010 Levy Regulations Consultation Paper ("Consultation Paper") it is difficult to make an assessment of that. The only benchmarks provided in the Consultation Paper are the Retail Levy and the Wholesale Levy payable in previous years.

Increase in Levies and Market Fees

The GIC proposes that both the Retail Levy and the Wholesale Levy should increase by 28% from FY 2010 to FY 2011. However, comparison of the levy does not tell the full story. The following table shows the total work programme costs for FY2010 and FY2011 before deduction of market fees and allowance for the over and under recovery of the previous year.

Levy	FY2010, $	FY2011, $	% Increase/(% Decrease)
Wholesale Levy	3,478,077	3,483,342	2
Retail Levy	3,241,894	4,394,944	36

The GIC also proposes an increase in funding collected from Market Fees. The following table shows the change in proposed market fees from FY2010 to FY2011.

	FY2010, $	FY2011, $	% Increase/(% Decrease)
Market Fees	2,015,400	2,155,400	7

Prima facie the increase in the retail levy appears excessive.

Retail Work Programme Costs

The following table compares the breakdown of the retail work programme provided in the FY2010 and the FY2011 Consultation Papers.

Work Stream	FY2010, $	FY2011, $	Difference, $ (FY2011 less FY2010)
Compliance	290,258	337,782	47,524
Consumer Issues	443,187	420,802	-22,385
Distribution Contracts	0	185,374	185,374
Downstream Reconciliation	1,327,645	1,494,494	166,849
Performance Measures	77,294	203,004	125,710
Rule Changes - Retail	293,842	562,257	268,415
Strategic Issues	116,141	260,910	144,769
Switching	693,527	930,322	236,795
Total	3,241,894	4,394,945	1,153,051

Some \$0.3 million to \$0.4 million of the increase in retail work programme cost probably results from deferral of work under the Government Policy Statement from FY2010. Examples include work on distribution contracts, performance measures and strategic issues.

That leaves around \$0.7 million of the increase in the retail work programme to be explained. To explain that Contact would have liked the GIC to provide more justification for its expenditure in areas such as downstream reconciliation, rule changes (largely reconciliation rule changes) and switching. These are areas where implementation of rules has identified issues some of which relate to particular industry participants. We would expect that the costs of resolving those issues are being recovered from the industry participants involved rather than through the industry levies.

Explanation of Cost Increases

To better explain changes in the GIC costs the GIC could provide additional information of the following kinds:

- a comparison of the proposed expenditure with the budgeted and actual expenditure of the previous year broken down by the main items of the GIC's work programme;
- a comparison of the proposed average number of staff employed by the GIC with the number employed in the previous year;
- a comparison of the proposed expenditure on service providers and consultants with the budgeted and actual expenditure of the previous year broken down by the main items of the GIC's work programme; and
- a comparison of market fees by activity with the amount forecast in the cost/benefit analysis of that activity used to justify that activity.

Management of Costs

In addition, it would be helpful for the GIC to describe the procedures and processes it follows in employing service providers to ensure the costs are appropriate and remain appropriate as needs change. That would provide reassurance that the GIC is efficiently managing its costs. For example, unless there were good reasons not to, we would expect the GIC to employ service providers through a competitive tender process.

The GIC is now incurring significant costs to employ the service providers required under its regulatory recommendations. The GIC should consider, for example, whether integration of some of this activity such as development of IT systems, collection of data and employment of staff would lead to more efficient outcomes.

Justification of Major Costs

Some of the larger expenditure items of the GIC's work programme justify further explanation.

The GIC proposes to spend some $850,000 on balancing. At this time it is unclear how balancing will progress. If the GIC continues to pursue the rules it has drafted to address balancing and it is necessary for it to construct the balancing plan and appoint the balancing agent these costs could become substantial. The alternative approach of addressing balancing issues through pipeline code change requests should require less GIC involvement and result in lower costs.

On going critical contingency management costs of $850,000 seem high given the limited operational and gas allocation roles of the GIC, and the critical contingency operator and industry expert service providers, under the Critical Contingency Regulations. Most of these roles are performed by the transmission system owners. Is the forecast level of cost consistent with the cost/benefit analysis that was the basis of the GIC's recommendation to implement the Critical Contingency Regulations? More regard to potential cost in drafting the Critical Contingency Regulations could have resulted in lower costs. For example was it necessary to employ an expert service provider to determine critical contingency prices? Could more of the role of the critical contingency operator have been undertaken by the transmission system owners?

There seems to be scope to reduce industry facilitation costs, particularly the contribution to those costs from the role the GIC plays under the MPOC and the VTC in assessing change requests. Independent overview of contentious change requests potentially can contribute value but a mechanism that stops pursuit of change requests that have little support is required. In addition, it is unnecessary for the GIC to overview change requests that have a large measure of support.

There is concern that the wholesale market trial continues to drift and generate more costs. Our recollection is that the net benefit of establishing a platform for a wholesale market was not large. Given the current expectation of costs is there still a net benefit? A review of the cost/benefit analysis seems justified before committing to additional costs.

Establishment of downstream reconciliation procedures was necessary. The voluntary arrangements employed prior to the GIC's intervention were completely unacceptable. There is clearly a need to address further issues in this area such as the inaccuracy of initial data submissions. Nevertheless there is concern that these arrangements are generating costs of $1.5 million. Some of this expenditure seems associated with deficiencies in the rules that could have been identified before the rules were implemented. That did not seem to occur because of the limited facilitation of industry input when the rules were drafted. What can be done to prevent that in the future?

In respect of balancing rules there is concern that the GIC seems reluctant to provide sufficient time to facilitate industry review of the proposed rules. That risks the same problems that have arisen in respect of the reconciliation rules. Detailed face to face and clause by clause review of proposed rules and regulations would help avoid these pitfalls.

It is unclear why the allocation of overhead to switching is so large. The switching arrangements have been in place for some time and should have stabilised. That should have reduced the need for GIC oversight.

The level of the GIC's corporate costs is of concern. Some 34% of those costs are external costs. External costs are significantly influenced by the use of consultants. Is the balance between external and internal costs appropriate? There seems to be areas where corporate costs could be reduced. The detail and size of papers prepared for the GIC board seems excessive. It is expected that the time required to prepare those papers would be a considerable burden for an organisation of the size of the GIC and would incur significant cost. The GIC should investigate whether that burden and cost could be reduced by delegation of more decision making authority to GIC management with reporting to the board on exercise of that authority. That should greatly reduce the burden of board reporting, allow the board to request more detail if required and allow the board to focus more on significant issues. The need to justify and consult on the levy that funds the GIC must also be a significant burden. Reducing that at least to biannual consultation could reduce that load without impacting significantly on control over the GIC's costs. Requiring the GIC to manage its funding over a period longer than a year could encourage the GIC to control its costs more carefully.

Resolution of Upstream Allocation Issues (D+1)

The GIC's proposed expenditure on upstream reconciliation seems very limited. This is an activity, particularly the lag in allocation of gas to consumers that do not have time of use metering, which considerably troubles the industry. It is closely linked to balancing issues. Resolution of this issue is required. The need to resolve this issue may justify increased expenditure on this issue.

Expenditure Priorities

To better understand how the GIC's costs could be reduced it would be useful for the

GIC to distinguish between activities of high priority or expenditure commitments and low priority activities or uncommitted expenditure.

Conclusion

In summary Contact seeks reassurance that costs generated by the GIC create value and that the GIC efficiently manages its costs.

Contact's responses to the questions that the GIC has set out in the Consultation Paper follow.

If required Contact is happy to clarify these responses.

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Discussion Paper Questions

QUESTION	
Q1: Do you consider there to be any other items that should be included in the Company's intended work programme for FY2011?	Upstream reconciliation issues, particularly the D+1 issues require urgent attention. UFG issues also remain unresolved.
Q2: Do you consider there to be any items that should be excluded from the Company's intended work programme for FY2011?	No, but some larger expenditure items require further justification.
Q3: Do you have any questions on the calculation of the levy funding requirement for FY2011?	Putting aside the justification issues the method of calculation of the levies seems clear.
Q4: Do you have any comment on the proposed levy for FY2011?	See above.
Q5: Do you have any comment on regulatory amendments describe in section 8?	The problem with the definition of a "gas producer" is that the definition, if taken literally, doesn't encompass the ordinary meaning. Given the GIC's intention to tidy up the provisions related to gas storage we don't understand the GIC's reluctance to make the requirements completely clear. We note that the obligation to pay the wholesale levy seems to depend on a purchase of gas from a gas producer. Does that mean industry participants that are gas producers and transport gas through the transmission system to their own point of consumption escape the obligation to pay the levy? Moreover, in some circumstances it may be unclear whether the seller of gas is acting in the role of a gas producer or some other role. The obligation to pay the levy should be as clear as possible so that all industry participants can see that they are treated fairly.
Q6: Do you consider that GIC should alter its current method of defining direct costs and allocate more of its indirect costs to work streams?	The method of allocation of indirect costs seems unclear. The GIC states that it allocates indirect costs to each work stream in proportion to the direct costs of that work stream. Table 1 and 2 of the Consultation Paper suggests that is not correct. We don't think the difference in the levies resulting from the changed allocation method would be material. Contact prefers a simple approach that yields an allocation that is reasonably fair.

QUESTION	
Q7: Do you support the inclusion of a portion of Gas Industry Co's indirect costs in market fees for FY2012, as opposed to their inclusion in the FY2011 levy?	In principle costs associated with a work programme activity should be recovered from the beneficiaries of that activity. That justifies recoveries of the GIC's indirect costs in market fees assuming market fees are allocated to the beneficiaries of the relevant gas governance arrangement. However in practice we think that will not make any significant difference to the industry participants who are required to pay those costs.
Q8: Do you agree that Gas Industry Co should recover its costs associated with MPOC/VTC outside the levy regulations?	If those costs are not recovered through the levy then they will have to be recovered elsewhere. There are several possibilities: • recovery from the party making the change request; • recovery from the shippers using the relevant transmission system; and • recovery from the relevant transmission system owner. Recovery from the party making the change request would inappropriately discourage parties from making change requests. Recovery from shippers and transmission system owners is likely to lead to the same outcome as transmission system owners paying the costs. Transmission systems owners are likely to recover the costs from shippers through their tariffs. Industry participants generally benefit from MPOC and VTC change requests. Therefore there is logic in the GIC recovering its costs in assessing these requests through the wholesale levy. Instead of focussing on means of recovering these costs the GIC should consider ways in which its assessments could be made more efficient: • elimination of the need to assess change requests that are widely support; • elimination of the need to assess change requests that have little support; • eliminating unnecessary consultation; and • making determinations and the reporting of consultation and determinations simpler and more concise.