Recommendation to the Minister of Energy on Gas (Levy of Participants) Regulations 2009

March 2009

GAS INDUSTRY COMPANY LIMITED

149670.1

About Gas Industry Co

The 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 Peter Davies.

Executive summary

Section 43ZZB of the Gas Act 1992 (the 'Act') enables Gas Industry Company Limited ('Gas Industry Co'), to recommend to the Minister of Energy and Resources (Minister) that levy regulations be made requiring industry participants[1] 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 (see s43ZZC of the Act).

This paper presents recommendations on the amount, design and implementation of the levy for the financial year ending 30 June 2010. The recommendations were developed after issuing a Consultation Paper on the levy proposal, and considering submissions on that paper, issuing an amended Consultation Paper and considering subsequent submissions (see Section 3). Key issues raised included the cumulative effect of implementing five sets of rules in a short period, the economic downturn and work programme priorities.

Following consideration of all the issues raised, Gas Industry Co's recommends to the Minister of Energy that:

- the current annual retail levy of $7.42 per ICP (network interconnection point) be decreased to $6.40 per ICP, to be paid by industry participants in respect of every ICP supplied by each retailer at the end of the previous month;
- the current annual wholesale levy of 1.79 cents per gigajoule (GJ), paid by the buyers of all gas purchased from producers (or from the Crown in the case of Maui gas), be decreased to 1.67 cents per GJ, and be calculated monthly on the buyer's total gas purchases up to and including the last day of the previous month;
- a special one-off Gas (Downstream Reconciliation) Rules 2008 Establishment Costs levy of $1,052,500, levied in proportion to average allocated gas volumes between October 2008 and March 2009; and
- these new levies come into effect on 1 July 2009.

The levies are estimated to meet Gas Industry Co's levy funding requirement of $4.018m for FY2010. Gas Industry Co's total funding requirement for FY2010 is estimated at $7.77 million, a 2% decline on forecast expenditure for FY2009, but a 60% increase on its FY2008 funding requirement. The majority of this increase (70%) reflects the costs associated with the five new sets of gas governance arrangements implemented during FY2009 ($2.015 million). After adjusting for these costs and the one-off recovery of establishment costs incurred in FY2009 relating to the Downstream Reconciliation rules, Gas Industry Co's baseline funding requirement has declined by 2.8%, relative to FY2008.

[1] Industry participants are defined in the Act as including retailers, distributors, producers, pipeline or meter owners, wholesalers and major upstream buyers.

While the total amount of levies is significant, the effect on individual consumers is not large. The following tables provide an estimate of the proposal on an average gas bill if the levies are entirely passed through to customers.

Table 1 Estimate of FY2010 gas levy on annual gas bills

User Type	Residential	Commercial	Industrial
Typical Annual Usage (GJ)	25	1,000	1,000,000
Estimated Annual Gas Bill	$780	$10,500	$7,000,000
Annual Retail Levy	$6.40	$6.40	$6.40
Annual Wholesale Levy	$0.42	$16.70	$16,700.00
Total Annual Levies	**$6.82**	**$23.10**	**$16,706.40**
% of Gas Bill	0.87%	0.22%	0.24%

Table 2 Estimate of Downstream Reconciliation Establishment Levy on annual gas bills

User Type	Residential	Commercial	Industrial
Typical Annual Usage (GJ)	25	1000	1,000,000
Estimated Annual Gas Bill	$780	$10,500	$7,000,000
Downstream Reconciliation Establishment Levy	$0.88	$35.20	$35,200.00
% of Gas Bill	0.11%	0.34%	0.50%

Notes: Assumes total allocation for the year March 08 to Feb 09 is 29.91 PJ

The Downstream Reconciliation Establishment Levy relates to the implementation of arrangements anticipated to deliver ongoing cost savings to the industry. The table above calculates only the cost impact on consumers without the attendant benefits[2]. Gas Industry Co relies on competition to ensure those benefits flow on to consumers.

Comparison of FY2010 funding requirement with FY2009

In the FY2009 levy consultation process, Gas Industry Co had estimated its expenditure at $5.03 million. The Company now forecasts its total expenditure for FY2009 at $7.94 million, a 58% increase. Included in the original estimate was $401,000 for establishing and implementing two significant gas governance arrangements, Downstream Reconciliation and Switching. Subsequent to the levy consultation, a tender process was concluded for both projects. The result was a substantial increase in total project costs of $2.47 million, reflecting a substantial increase in the functionality of the software. Industry working groups helped design the enhanced functional specification to meet

[2] See Appendix C - Estimated Benefits of Gas Governance Arrangements

the requirements of the rules and existing systems. Although the costs were more than anticipated, the implementation of the system has been successfully achieved and comments from the industry so far have been very positive.

The remaining variance is primarily the result of an increase in employee numbers during FY2009. At the time the levy consultation took place, the anticipated headcount of the Company was twelve. With the benefit of hindsight this severely underestimated the staffing requirements associated with undertaking the roles required under new gas governance arrangements. Consequently, the actual headcount had increased to nineteen by early FY2009. FY2010 will see this number reduced by 15% to sixteen.

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1 Introduction

1.1 Background

Amendments to the Act introduced in 2004 provide for Government and an industry body to co-regulate the gas industry. 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 24 December 2004.

Gas Industry Co is responsible for developing and recommending gas governance arrangements, which may include rules and regulations, These arrangements cover a range of areas relating to the gas industry including wholesale markets and processing, transmission and distribution networks, retail market development and consumer protection. The principal source of funding for this work is a levy on industry participants. The amount and structure of this levy are based on Gas Industry Co's indicative work programme and budget, stakeholder consultation and analysis.

Gas Industry Co is also involved in implementing market arrangements, and in monitoring and enforcing market rules. The Company employs service providers for specific roles under approved gas governance arrangements. The principal source of funding for external service provider costs is market fees, set under the relevant rules and regulations.

1.2 Overview of Paper

This paper is structured as follows:

- Section 2 explains the basis on which the levies have been determined.
- Section 3 reviews the consultation process, the issues which emerged and Gas Industry Co's position on these.
- Section 4 explains Gas Industry Co's expected costs for FY2010 and how the levy revenue requirement has been derived from those costs.
- Section 5 sets out Gas Industry Co's recommendation with respect to the FY2010 levy.

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2 Basis for Levy Setting

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

2.1 Government's Policy Objectives and Strategic Goals

In April 2008, the Government issued a Government Policy Statement (GPS) on Gas Governance, which replaced the previous GPS issued in October 2004. The GPC covers the following areas:

Industry Sector	GPS Detail
Efficient wholesale market	• Efficient arrangements for the short-term trading of gas. • Accurate, efficient and timely arrangements for allocating and reconciling upstream gas quantities.
Access to key infrastructure	• Gas industry participants and new entrants are able to access the following physical assets and related services on reasonable terms and conditions: o third party gas processing facilities; o transmission pipelines; o distribution pipelines; and o consistent standards and protocols apply to the operations relating to access to all distribution pipelines.
Efficient retail market	• The development of efficient and effective arrangements for the proper handling of consumer complaints. • Effective and efficient customer switching arrangements that minimise barriers to customer switching. • Accurate, efficient and timely arrangements for allocating and reconciling downstream gas quantities.
Consumer benefit	• All small gas consumers have effective access to a complaints resolution system. • Contractual arrangements between gas retailers and small consumers adequately protect the long-term interests of small consumers.

Industry Sector	GPS Detail
Other outcomes	• Gas governance arrangements are supported by appropriate compliance and dispute resolution processes. • Gas governance arrangements approved by the Minister of Energy are monitored by Gas Industry Co for ongoing relevance and effectiveness. • Good information is publicly available on the performance and present state of the gas sector.

The priorities proposed for Gas Industry Co in the context of levy setting for FY2010 are to:

- develop the capability and systems to efficiently administer all approved gas governance arrangements;
- develop a framework to review the effectiveness of the new gas governance arrangements and progress any resulting rule changes; and
- complete our recommendations to the Minister on balancing and interconnection.

The GPS also requires other work, such as the joint project with the Electricity Commission on the approval of a dual fuel consumer complaints scheme. This other work will continue to be progressed, but will be given a lesser priority.

2.2 Levy Setting Principles

Having regard to the objectives of the Act and the objectives and outcomes of the GPS, a robust set of general principles covering levy setting have been developed by Gas Industry Co. The principles are as follows:

Principle	Description
1. Economic efficiency	• The levy structure should promote efficient market behaviour (or at least not detract from it significantly).
2. Beneficiary/causer pays	• The costs of developing and implementing regulations should be allocated in a way that reflects the cause of regulation (causer pays) and/or the incidence of the benefits from regulation.
3. Rationality	• Where levies are to recover costs that are allocated to participant classes, there should be a relatively strong logical nexus between the participants on whom a levy is imposed and the costs being recovered through that levy.

Principle	Description
4. Simplicity	• The levy structure should attempt to avoid undue transaction costs for the organisation which implements and administers it, or for the participants who must pay it; • The levy structure should consist only 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.
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.
6. Revenue sufficiency	• The levies together with other sources of revenue, such as penalty payments, need to be sufficient to recover the costs of collecting the levy; and • Levy setting must nevertheless accord with section 43ZZC(3) of the Act which says that the levy may be adjusted in any year to take account of under-recoveries and over-recoveries in previous years.

These principles have been used to assess and determine the proposed structure and level of the FY2010 levy.

2.3 Work Programme

The following table presents a summary of Gas Industry Co's work programme:

Table 2 Gas Industry Co work programme

<table>
<tr><th>Major Work Areas</th><th>Work Streams</th><th>Desired Outcomes</th></tr>
<tr><td rowspan="4">Policy Development</td><td rowspan="2">Pipelines</td><td>Completed recommendations on Pipeline Balancing</td></tr>
<tr><td>Completed recommendations on Interconnection</td></tr>
<tr><td>Consumer Issues</td><td>Approved consumer complaints scheme</td></tr>
<tr><td>Strategic Alignment</td><td>Industry engagement on strategic priorities</td></tr>
<tr><td rowspan="2">Market Services</td><td rowspan="2">Market Administration</td><td>Management of gas governance arrangements (including statutory and contractual roles)</td></tr>
<tr><td>Framework for reviewing effectiveness of gas governance arrangements</td></tr>
</table>

Major Work Areas	Work Streams	Desired Outcomes
		Rule changes arising from effectiveness reviews
Corporate Support	Regulatory Compliance	Strategic Plan; Annual Report
	Solvency Management	FY2011 Levy
	Corporate Governance	Board Administration
	Overhead Management	HR; IT; Premises; Legal Services

Gas Industry Co's indicative work programme and budget for FY2010 is attached as Appendix A. These have been updated from the Consultation Paper to reflect the current work status.

3 Consultation Process and Outcomes

First Consultation

Gas Industry Co issued a Consultation Paper on 16 January 2009 for the purpose of consultation on the proposed levy and certain specific issues in relation to the levy process. Submissions on the consultation paper closed on 5 February 2009.

A list of the parties to whom Gas Industry Co sent the Consultation Paper for submissions is attached as Appendix B.

Submissions on the Consultation Paper were received from:

- Carter Holt Harvey Pulp and Paper;
- Contact Energy;
- Energy Direct NZ;
- Genesis Energy;
- Methanex New Zealand Ltd;
- Mighty River Power;
- Nova Gas Ltd;
- Origin Energy;
- Powerco; and
- Vector Ltd.

A summary of the issues raised in submissions is set out below.

3.1 Effect of General Economic Situation

What the submissions said

The most prevalent general comment made in the submissions was the FY2010 annual levy should reflect the general economic downturn and international financial crisis. Gas Industry Co needs to be cognisant of the changing economic environment and the increasing expectation that expenditure of all types needs to be restrained.

Gas Industry Co response

Before releasing the Consultation Paper, Gas Industry Co had already implemented significant expenditure controls. This initiative was originally associated with funding the unbudgeted expenditure arising from the implementation of the Gas (Downstream Reconciliation) Rules 2008. However, it became an ongoing process of examining all expenditure against the objective of delivering value-for-money for stakeholders as the general economic situation worsened.

Nevertheless, Gas Industry Co is aware that in response to current economic circumstances, most organisations are conducting extensive reviews of their expenditure to identify where savings can be made. In response to submissions, the Company conducted a further review to identify cost savings that could be made without permanently affecting either its market administration activities or policy development capability. Gas Industry Co found this exercise difficult, given the Company's unique governance arrangements, including its Gas and Companies Act 1993 reporting requirements. However, its budgeted corporate costs have been trimmed through a combination of reducing staff costs, scaling back discretionary activities such as communications, and postponing planned development work such as enhancements to the company website and financial system. These initiatives reduce the annual levy burden on the industry by approximately $527K from what was originally proposed.

3.2 GPS Reprioritising

What the submissions said

A common comment made in submissions was that Gas Industry Co should investigate cutting back its indicative work program in FY2010. Gas Industry Co could achieve cut-back by either reprioritising its planned work programme or renegotiating the GPS deliverables with the Minister. In most cases, submitters had differing views on which items to defer.

Gas Industry Co response

Gas Industry Co's legal obligation is to make recommendations to the Minister of Energy to meet the Government's objectives for the gas sector, as detailed in the Gas Act 1992, the GPS and its constitution. Gas Industry Co intends to engage with the new Government on its objectives and desired outcomes for the gas industry and re-prioritise the Company's work programme in response to that. In the meantime, Gas Industry Co requires funding to continue its market services activities and its priority policy work. The revised budget takes submitters' views into account by seeking to defer work from the FY2010 programme that has not begun or is in its formative stages; and to afford a lower priority to some current work programmes.

In particular, the revised budget gives a lower priority to projects such as the direct use of gas and distribution access and a medium priority to further work on retail contracts. In addition, we have scaled back the strategic priority of developing a framework for monitoring industry performance. Instead we will concentrate on developing indicators to measure the effect of approved gas governance arrangements. The Minister must approve these proposals as part of our annual strategic planning process. If this approval is not given, provision has been made in the budget to increase the resourcing for these areas.

3.3 Levy Structure and Market Fees

What the submissions said

The majority of submissions had no comment on the proposal to retain the existing levy structure which allocates the policy work and market services work into two separate levies: a retail levy which is allocated on a per ICP basis and a wholesale levy which is allocated on a per GJ basis. However one respondent suggested altering the levy structure to include a charge to gas pipeline businesses.

A number of respondents answered this question by suggesting a change in the levy structure so that market fees form part of the annual levy. Some industry participants consider it is misleading and meaningless to isolate the annual levy from market fees, primarily because both costs ultimately affect the consumer. One respondent considered the introduction of market fees had materially altered the levy structure. Another suggested that if all retail costs were included in the retail levy it would be easier to pass these costs on to customers. Another suggested the imposition of market fees might be outside the powers in the Act.

Gas Industry Co response

The Company has previously considered introducing a separate annual levy on pipeline companies. We elected not to pursue it, because we consider the levy would be passed onto shippers and end up being paid by the same people, and in the same proportions, as the current wholesale levy.

Gas Industry Co wants the costs of the new gas governance arrangements to be obvious. Industry has previously emphasised the importance of the Company being transparent about the total costs of its activities, which is why both sets of fees were disclosed in the Consultation Paper.

However, the inclusion of market fees in the Consultation Paper led some submitters to believe those fees are open to further consideration. This is not correct. The arrangements for setting and collecting market fees are specific to the respective rules and regulations. These arrangements include similar checks and balances to those undertaken in developing the annual levy, including the requirement to consult with affected parties and to publish information about expected costs.

Market fees exist primarily to allow Gas Industry Co to enter into service provider contracts with terms exceeding one year. Having market fees gives the Company and potential service providers confidence to enter into long-term contracts with each other. The Company believes that long-term arrangements, such as the five-year contract for the registry operator, result in lower overall costs for the industry, because they remove a significant element of risk from the service providers' viewpoint.

Gas Industry Co has no view about retailers listing all of their input costs on invoices to their customers.

Gas Industry Co does not believe market fees are outside of the powers of the Gas Act.

3.4 Focus on Costs

What the submissions said

Most submitters were looking for evidence that the Company's proposed activities would provide clear, tangible benefits to the industry. Two submissions made extensive comment on their analysis of the total increase, including items outside the annual levy, such as market fees. Other submissions emphasised the need for Gas Industry Co to be demonstrating value for money.

Gas Industry Co response

Gas Industry Co accepts that an unavoidable consequence of the new gas governance arrangements coming into effect is that GIC's total funding requirement (ie levies plus market fees) has increased relative to the previous year. The costs associated with the new arrangements and recovered by Gas Industry Co are easily identified and completely transparent. However, the benefits arising from these arrangements (including costs savings by individual companies), are less readily identifiable.

Levy payers are reminded that Gas Industry Co is required to undertake an assessment of the costs and benefits associated with its proposal when making each recommendation to the Minister. As a general rule, a policy recommendation is made only when the benefits exceed the net present value of the costs. Therefore, the ongoing gas governance arrangements are expected to deliver cost savings.

In preparing its assessments of the costs and benefits, Gas Industry Co relies on savings estimates quantified by industry participants. Gas Industry Co also relies on competition to ensure those benefits flow on to consumers.

Therefore, although costs are being imposed, they bring benefits. Appendix C reviews the cost benefit assumptions of some of the existing governance arrangements.

Second Consultation

Gas Industry Co issued an amended Consultation Paper on 2 March 2009, reflecting changes made to its work programme arising from the first consultation. Submissions on the amended consultation paper closed on 13 March 2009.

Submissions on the Consultation Paper were received from:

- Contact Energy;
- Genesis Energy;
- Mighty River Power;
- Powerco; and
- Vector Ltd.

A summary of the issues raised in these submissions is set out below.

3.5 General Issues Raised

There were fewer responses to this consultation but all respondents supported Gas Industry Co's efforts to review the FY2010 Levy and respond to stakeholders concerns.

3.6 Policy Priorities

All respondents agreed with Gas Industry Co's identified policy priorities for FY2010.

3.7 Gas Industry Co Roles

All parties supported the concept of the levy being used to fund the roles Gas Industry Co is required to undertake under the approved gas governance arrangements.

3.8 Review the Effectiveness of Rule Changes

The majority of responses were supportive.

3.9 Industry Facilitative Roles

The majority of respondents supported levy funds being used to support Gas Industry Co's role as an industry facilitator.

3.10 Levy Funding Requirement

All respondents supported the annual levy funding requirement for FY2010.

3.11 Proposed Annual Levy for FY2010

All respondents supported the proposed annual levy for FY2010. However, whilst Vector supported the proposed annual levy for FY2010, it did not support the one-off fee for the Gas (Downstream Reconciliation) Rules 2008 establishment costs.

3.12 Conclusion

Gas Industry Co considers it has fulfilled its obligations to consult with industry participants on the proposed levy.

4 Costs, Budget and Levy

4.1 Costs

In considering how to set the levy in any given financial year, Gas Industry Co must consider its obligations under the Act and the GPS. Gas Industry Co must also take into account the obligations on the Board under company law. The Board takes the view that each year's levy should cover all of the costs reasonably expected to be incurred by Gas Industry Co in that year.

Gas Industry Co's total funding requirement for FY2010 is estimated at $7.77 million, a 2% decline on forecast expenditure for FY2009, but a 60% increase on its FY2008 funding requirement. The majority of this increase (70%) reflects the costs associated with the five new sets of gas governance arrangements implemented during FY2009 ($2.015 million).

After adjusting for these costs and the one-off recovery of establishment costs incurred in FY2009 relating to the Downstream Reconciliation rules, Gas Industry Co's baseline funding requirement has declined by 2.8% relative to FY2008.

The decrease in expenditure in FY2010 relative to the FY2009 forecast is largely because of:

- scaling back of planned policy development work; and
- carrying over levy over-recoveries from previous years.

4.2 Budget

Table 3 Actual and Budget Expenditure

	FY2009 Budget	FY2009 Forecast	FY2010 Budget
Effective operation of the co-regulatory model			
Corporate Services	822,214	1,140,094	726,290
Co-regulatory Framework	107,823		
Legal	198,490	367,694	171,087
Compliance and Enforcement	183,247	267,735	265,519
Strategic Issues for the gas industry	627,486	209,000	100,000
Improvement of consumer outcomes	251,137	125,970	223,598
Market Services			
Switching and Registry	208,887	1,169,360	481,390
Downstream Reconciliation	192,402	1,820,250	1,066,344
Market Operations			342,363
Development of wholesale market arrangements			
Wholesale Market	307,739	376,780	120,709
Outage and Contingency Management	327,803	417,573	753,411
Review of infrastructure access arrangements			
Access to Gas Processing Facilities	29,597	36,793	13,369
Transmission Access	618,187	475,356	
Upstream Reconciliation	207,015	80,543	
Distribution Access	186,647	65,543	
Balancing			424,771
Interconnection			77,150
MPOC / VTC Changes			244,437
Other			124,991
Sub Total	**4,268,674**	**6,552,691**	**5,135,429**
Board Costs	261,980	355,209	327,342
Overheads	496,448	1,032,889	1,257,200
Total	**5,027,102**	**7,940,789**	**6,719,970**

Key features of the indicative budget for FY2010 are:

- The Corporate Services budget will decrease in FY2010 reflecting cost saving initiatives and lower employee numbers.
- The legal budget will decrease in FY2010 reflecting an assumed decrease in the level of strategic legal advice required now five gas governance arrangements are in place.
- The budget for Transmission Access has been split into smaller work streams, including balancing and interconnection.
- Work in relation to Market Services will become significant in FY2010. The budget for this work stream reflects the significant service provider fees now being incurred, the new roles Gas Industry Co is required to undertake under the approved rules and regulations and ongoing development work.

4.3 Levy Calculation

The following allocation methodology has been used to calculate the levy:

- Direct costs are allocated to the retail or wholesale areas of activity;
- Indirect costs are allocated between the retail and wholesale areas of activity on a proportional basis;
- Costs recovered through dedicated fees are deducted from the relevant areas of activity;
- Other revenue is allocated between the retail and wholesale areas of activity on a proportional basis;
- Levy over-recoveries are allocated to the area of activity to which they relate; and
- The retail and wholesale levies are set to recover the allocated costs in each area.
- Historically, Gas Industry Co has assumed a total active ICP count of 250,000 for levy calculations. Following the establishment of the Switching Registry, the Company has been able to independently confirm that there are approximately 292,000 ICPs. Of these, 252,000 have the status of Active Contracted, indicating there is a customer at the ICP who has a contract with the retailer. Those are the ICPs on which the retail levy is paid. Gas Industry Co will therefore continue to assume an ICP count of 250,000 for the purposes of the levy calculation.
- Wholesale volumes for the FY2009 year were estimated at 145PJ for the purposes of levy calculation. Year to date figures submitted to Gas Industry Co as part of the levy returns, indicate this volume is likely to be achieved. Given the uncertain economic outlook for FY2010, Gas Industry

Co considers it prudent to maintain an estimated wholesale gas volume of 145PJ for the purposes of the levy calculation.

Based on the above allocation methodology, the Company's levy funding requirement of $4.018m results in the following levies.

Levy Calculation

	FY2010		
	Retail	**Wholesale**	**Total**
Direct Costs	2,202,429	2,035,623	4,238,052
Proportion of Direct Costs to Total Costs	*52%*	*48%*	
Indirect Costs	1,039,464	1,442,454	2,481,919
Total Work Programme Costs	**3,241,894**	**3,478,077**	**6,719,971**
Deduction of Market Fees	(1,345,090)	(670,310)	(2,015,400)
Under (Over) Recovery of Levy	(296,131)	(389,972)	(686,103)
	(1,641,221)	**(1,060,282)**	**(2,701,503)**
Total Levy Funding Requirement	**1,600,673**	**2,417,795**	**4,018,468**
Volume Units	*ICPs*	*GJ*	
Volume	250,000	145,000,000	
Levy Unit	*$/ICP*	*cent/GJ*	
Levy Rate	**6.40**	**1.67**	
Projected Levy Revenue	**1,600,673**	**2,417,795**	**4,018,468**

4.4 Conclusion

Gas Industry Co considers that the proposed levy is reasonable, having regard to the Company's Strategic Plan, Annual Report, indicative work programme and budget, the GPS objectives and outcomes, and submissions from industry participants.

5 Recommendation

Gas Industry Co recommends to the Minister that levy regulations be made by the Governor-General under section 43ZZE of the Gas Act 1992 for the financial year from 1 July 2009 to 30 June 2010 requiring payment in each month of that year:

- From every gas retailer who is an industry participant on the last day of each month a retail levy of $6.40 per annum for each ICP for each retail customer; and
- From every person who is an industry participant on the first day of each month a wholesale levy of 1.67 cents on each gigajoule of gas purchased by the industry participant directly from gas producers during the previous month.

Gas Industry Co further recommends to the Minister that levy regulations be made by the Governor-General under section 43ZZE of the Gas Act 1992 for the financial year from 1 July 2009 to 30 June 2010 requiring:

- From every person who is an industry participant on the first day of July 2009, a special one-off Gas (Downstream Reconciliation) Rules 2008 Establishment Costs levy totalling $1,052,500, levied in proportion to the average of allocated gas volumes between October 2008 and March 2009.

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Appendix A Indicative Work Programme and Budget for FY2010

Policy Development

In the policy area, Gas Industry Co is committed to a range of work designed to improve the fundamentals of gas markets in New Zealand. We propose to focus our efforts in the short term on the transmission access work stream, in particular balancing and interconnection. We will also progress work on consumer issues as a medium priority, particularly the joint project with the Electricity Commission on the approval of a dual fuel consumer complaints scheme. This prioritisation and the deferral of other work programmes results in a reduction of the budget.

Gas Industry Co also proposes to discuss ongoing priorities with the Minister, given the change of Government. However the financial effect of any change is uncertain. The FY2010 budget will therefore maintain a provision for additional tasks or revised priorities the Government may request as a result of potential changes to existing policies.

Subject	Activities and Milestones	Estimated costs
Policy Priorities	• Complete recommendations to Minister on policy priorities areas in accordance with published policy process. The policy priorities are:	
	o Pipeline Balancing; and	$421,275
	o Interconnection.	$76,150
	• Progress work on Consumer Issues, including the complaints resolution scheme.	$73,974
	• Industry engagement on strategic priorities and alignment with Gas Industry Co's work programme.	$129,422
	Total	**$700,821**

Market Services

With a range of gas governance arrangements now in place, Gas Industry Co's role becomes predominantly one of a market service provider to the gas industry. The specific nature of these activities, in relation to each of the approved arrangements, is listed in the table below.

Gas Industry Co also undertakes a significant amount of work across the retail, wholesale and pipeline work areas which may best be termed 'facilitative'. Examples of this work include: the Maui pipeline over-pressure forums; transmission code change roles; and various seed papers and forums in respect of the transition to the new contingency arrangements.

These facilitative roles are funded from the Gas Industry Co annual levy and this seems appropriate because:

- the benefits are often spread more widely than those who may be directly involved;
- individually, the pieces of work are relatively small and the administrative costs involved in recovering fees would be unnecessarily burdensome; and
- funding from the annual levy overcomes any free-riding issues (provided Gas Industry Co does not get involved in work which is only for the benefit of a very few participants).

Feedback from industry participants indicates that these roles are valued and that Gas Industry Co is viewed as the appropriate body to undertake them. Accordingly, the budget includes allowances for the cost of these roles. The alternative would be for Gas Industry Co to either withdraw from these roles or to begin charging industry participants directly for undertaking such work (eg by recovering costs under the MPOC and VTC arrangements).

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. Establish a framework for a review of the effectiveness of the new arrangements and progress any rule changes resulting from that review or industry requests. The Company will also need to make decisions on exemptions and assist with enforcement, market education and administration.	$1,258,554
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. Establish a framework for a review of the effectiveness of the new arrangements and progress any rule changes resulting from that review or industry requests.	$557,053
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. Review effectiveness of arrangements and make changes as necessary.	$312,809

Approved Gas Governance Arrangement	Description of Market Administration Role	Estimated direct cost
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.	$15,649
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. In the plan year it will also need to establish a framework for a review of the effectiveness of the new arrangements and progress any rule changes resulting from that review or industry requests.	$886,039
Wholesale Market (Trial)	The activity is expected to include overseeing the operation of a market trial and then evaluating the results.	$141,292
Other Market Services	Industry facilitation roles including MPOC/VTC changes	$365,833
Total		**$3,537,229**

Corporate support

Over the last 12 months Gas Industry Co has been steadily building its capability to meet its new statutory requirements and the needs of its stakeholders who expect a high level of transparency and corporate accountability. Currently its 'Corporate' cost component includes: the costs of stakeholder communications and internal governance; the 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 Company intends to constantly review the nature and extent of the corporate support function to ensure it is being provided in the most efficient and cost-effective manner.

	Estimated FY2010
Board	$327,342
Corporate	$1,983,490
Legal	$171,087
Total	**$2,481,919**

Comparison of FY2009 budget corporate costs with FY2009 Forecast

The table below compares the budget and forecast amounts of corporate costs for FY2009 with the estimates for FY2010. The table shows the significant under-estimation of corporate costs in the FY2009 levy compared with the current forecast, arising mainly for the following reasons:

Increase in employee numbers: At the time the FY2009 levy budget was prepared, the total headcount of Gas Industry Co was assumed to remain steady for the financial year. Subsequent to that decision being made, it became apparent that the Company's role under the approved gas governance arrangements would be more extensive than first envisaged. In addition, the Company decided to build up its internal capability by recruiting and developing staff, rather than relying on external consultants. This policy saw staff number rise from twelve to nineteen.

Capital Expenditure: During FY2009 two significant items of expenditure were undertaken, the development of a company wide project management methodology and the rebuild of the Gas Industry Co website. In the normal course of events, both sets of expenditure would have been capitalised and depreciated over their useful life. However, our Auditors advised that because of the unique way Gas Industry Co is structured and funded, it was doubtful the expenditure used to fund these projects could be capitalised. They advised the Company to expense them in their entirety.

Rent – During FY2009 Gas Industry Co's lease on their premises in the State Insurance Tower expired and the Company was faced with a substantial rise in its rental costs.

	Budget FY2009	Forecast FY2009	Estimated FY2010
Board	261,980	355,209	$327,342
Corporate	1,318,662	2,320,696	$1,983,490
Legal	198,490	367,694	$171,087
Total	**1,779,132**	**3,043,599**	**$2,481,919**

Appendix B Consultation Information: Parties Consulted

Parties Consulted

Age Concern

Commercial Chambers

Energy Link Ltd

AGL

Commerce Commission

Exergi

Arete Limited

Concept Consulting

Fletcher Building Ltd

Auckland Gas Company

Consumers Institute

Four Winds Communication

Austral Pacific Energy

Contact Energy Ltd

Gas Association of New Zealand

Bay of Plenty Electricity

Craftware Computing Ltd

Gas Net

Bell Gully

Degussa Peroxide Ltd

Genesis Energy

BRG

E-Gas

Greymouth Gas NZ Ltd

Bridge Petroleum

Electricity and Gas Complaints Commission

Greymouth Petroleum

Carter Holt Harvey

Electricity Commission

Greypower

Castalia

Energy Direct NZ

Heinz Watties Ltd

Clifford Chance Law Office

Energy Efficiency and Conservation Authority

HP Consulting & Integration

J H Vernon Consultancy

New Zealand Oil and Gas Ltd

PEPANZ

Kensington Swan

New Zealand Refining Co Ltd

Powerco Ltd

LECG

Neil Walbran Consulting Ltd

Pricewaterhouse Coopers

Loyalty NZ Ltd

New Zealand Steel

RBZ Energy Ltd

LPG Association of New Zealand

NGC Metering Ltd

Russell McVeagh

Major Electricity Users Group

Norske Skog Tasman Ltd

Shell (Petroleum Mining) Ltd

Marsh Limited Nova Gas Ltd

Shell Todd Oil Services Ltd

Maui Development Ltd

NZ Water and Wastes Association

Simpson Grierson

M-Co

NZX

Stigley & Co

Methanex New Zealand

O-I New Zealand Ltd

Strata Energy Consulting

Mighty River Power

OMV New Zealand LtdSwift Energy Ltd

Ministry of Civil Defence and Emergency Management

On Gas Industrial & Commercial

Tap Oil Ltd

Ministry of Consumer Affairs

Origin Energy NZ

Tatua Co-op Dairy

Ministry of Economic Development

Pan Pac Forest Products Ltd

Tetenburg & Associates

Ministry of Research, Science & Technology

Parliament

The Australian Gas Light Company

Multigas (NZ) Ltd

Parsons Brinkerhoff Associates

Thorndon Chambers

National Council of Women

Penshaws Ltd

Todd Energy Ltd

Transpower

Wanganui Gas Ltd

Westech Energy

Vector Ltd

Submissions Received – First Consultation

- CHH Pulp & Paper (Roger Kestle)
- Contact Energy Ltd (Jan de Bruin)
- Energy Direct NZ (Tara Gannon)
- Genesis Energy (John Carnegie)
- Methanex New Zealand Ltd (Matthew Gardner)
- Mighty River Power (Robert Allen)
- Nova Gas Ltd (Charles Teichert)
- Origin Energy Ltd (Tony Bissell)
- Powerco Limited (Paul Goodeve)
- Vector Limited (Nathan Strong)

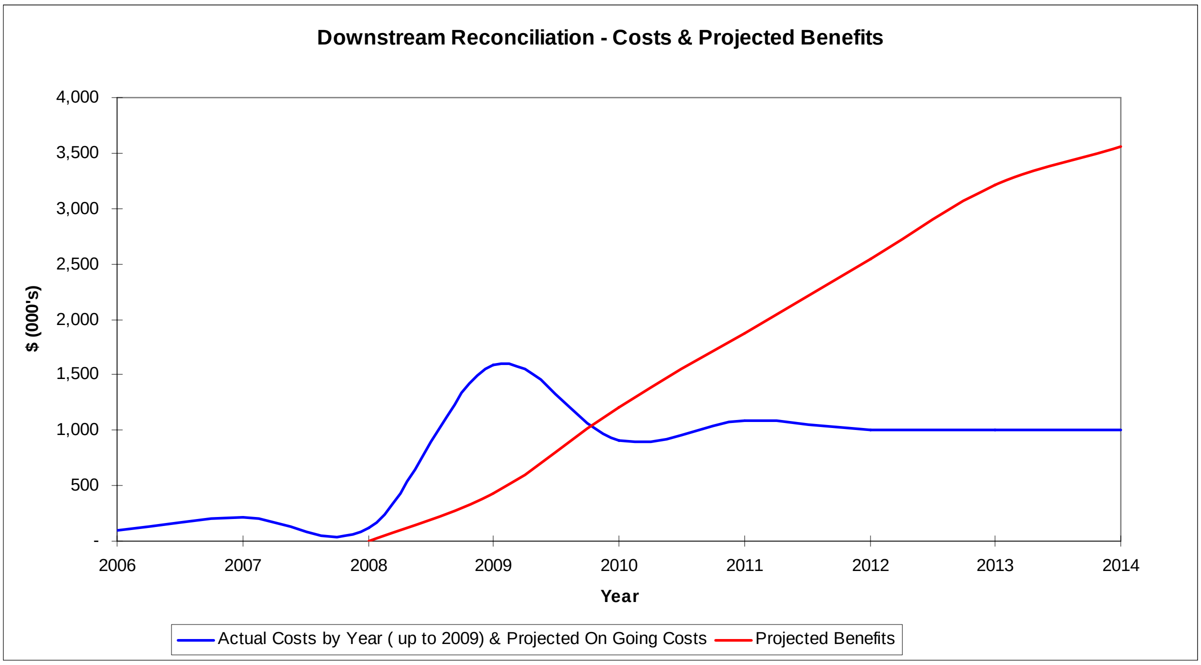
Submissions Received – Second Consultation

- Contact Energy Ltd (Jan de Bruin)
- Genesis Energy (John Carnegie)
- Mighty River Power (Robert Allen)
- Powerco Limited (Charlotte Salathiel)
- Vector Limited (Nathan Strong)

Appendix C Estimated Benefits of Gas Governance Arrangements

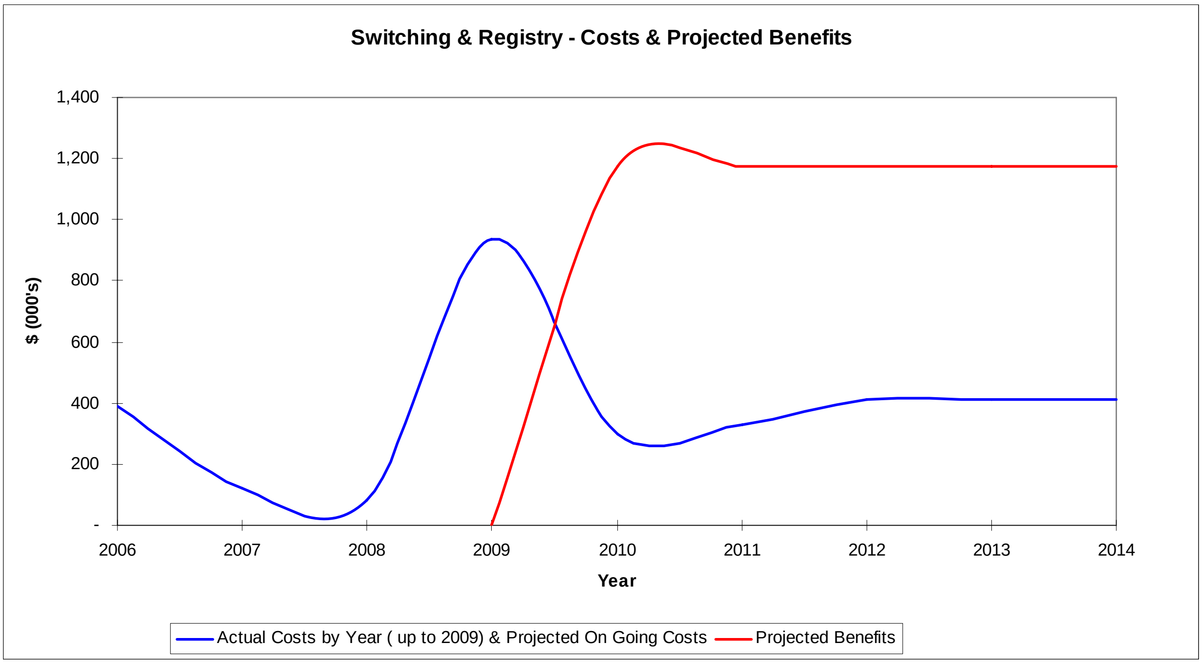
Reconciliation

Total implementation costs were $1,052,500 plus ongoing operational costs estimated at $904,000 per annum. The cost benefit analysis showed the regulated option having a $2.4 million net benefit, relative to implementing the arrangements by way of a pan-industry agreement. However, the NPV in both cases was significantly positive at $14.8 million under the regulated option and $12.3 million under the pan-industry agreement. The original analysis allowed for $2 million per annum of operational costs (relative to doing nothing) in each of the first two years which was double the actual service provider costs. Service provider costs were understated in the remaining years - $100,000 per annum versus actual costs of $900,000 - but even if these were taken into account, the NPV in both cases remains positive relative to the status quo and does not change the relativity between the regulated option and the pan-industry agreement.



Switching

Total implementation costs were $1,075,360 plus ongoing operational costs estimated at $300,000 per annum. Against these costs, industry advice was the average net present value of benefits arising from savings in switching costs would be approximately $392K.



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Critical Contingency

Industry advice was that improved outage and contingency management arrangements may increase economic efficiency through lowering the cost of supplying gas, increasing the quantity of gas traded and lowering its price, and encouraging investment developing the industry further, which may also reduce gas supply costs over time. In terms of its economic impact, Gas Industry Co advice was that an improved critical contingency scheme would be responsible for the industry avoiding in excess of $1million per annum in costs associated with the impacts of outages.

The graphs demonstrate there is a lead time during which there are only costs, as the policy development work proceeds through options analysis, consultation and recommendation to the Minister of Energy and Resources. Then, as the various rules and regulations are implemented, the benefits begin to be realised and offset the costs.