Recommendation on Gas (Levy of Participants) Regulations 2013

Date issued: April 2013

GAS INDUSTRY COMPANY LIMITED

184468.4

About Gas Industry Co.

Gas Industry Co is the gas industry body and co-regulator under the Gas Act. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

www.gasindustry.co.nz

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Executive summary

For eight years, the gas industry – from processing facilities, through transmission, distribution, and retail – has been governed by a unique co-regulatory model. Gas Industry Co Limited, a specially established 'industry body', facilitates the nexus between Government and industry to deliver improved governance arrangements for participants and consumers in gas markets. Gas Industry Co's role was established in 2004 under Part 4A of the Gas Act 1992. Gas Industry Co is required to have regard to the objectives and outcomes in the April 2008 Government Policy Statement on Gas Governance (the GPS). The principal statutory objective of any formal gas governance arrangement is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner. Accordingly, under the Gas Act and GPS, the industry body pursues objectives and outcomes that seek:

- efficiency and reliability in the delivery of gas to consumers;
- improved competition in the gas industry; and
- reporting on the current state and performance of the gas industry.

The Company's recommendations for gas governance arrangements must also be 'consistent with the Government's gas safety regime'.

In consultation with the industry, the Company develops an annual work programme (published as its 'Statement of Intent')[1] and the associated funding requirements. The Statement of Intent for FY2014 accompanies this Levy Recommendation and fully describes the Company's FY2014 work programme. The Company's operating costs are met by a combination of market fees (charged pursuant to particular governance arrangements) and an industry levy (imposed by the regulations recommended here).

This paper recommends that the Minister proposes regulations for the necessary levy funding to support the key elements of Gas Industry Co's work programme to the end of financial year 2014 (30 June 2014).

While Gas Industry Co is a privately held company, it operates as a not-for-profit organisation and undertakes the performance of a public function. As such, the Company's activities are to a large extent 'stakeholder driven' and thus submissions and feedback from stakeholders were sought on its proposed work programme[2].

[1] The Statement of Intent was formerly called the 'strategic plan'. An amendment to the Gas Act in December 2012 changed the title of this document but not its content, which covers Gas Industry Co's proposed scope of operations.

[2] Note: the Government is a key stakeholder. In particular, it sets the legislative and policy framework, particularly through Part 4A of the Gas Act and the GPS, but does not formally submit on Gas Industry Co proposals. However, the Company maintains a close working relationship with the Minister and officials to ensure policy is developed in line with Government objectives.

In performing its statutory role, the Company's corporate strategic goal is to *optimise the contribution of gas to New Zealand* and its purpose is to *provide leadership for the Gas Industry and the New Zealand Gas Story*. The following strategic objectives have then been used to frame the proposed FY2014 work programme:

- Build efficient, competitive, and confident gas markets.
- Facilitate efficient use of, and timely investment in, infrastructure.
- Deliver effectively on Gas Industry Co's accountabilities as the industry body Build and communicate the New Zealand Gas Story (includes review of industry performance)

In its Briefing to Incoming Minister Heatley[3], MBIE described Gas Industry Co's planned scope of operations for FY2012 and beyond as "an ambitious work programme including issues such as wholesale market development and transmission capacity allocation and investment processes".

The proposed FY2014 work programme includes managing regulatory requirements, particularly in maintaining and developing existing gas governance regulations, and also seeks to address Government and industry priorities through key workstreams.

The industry has been fully consulted on the FY2014 work programme and associated costs. Gas Industry Co received feedback on draft proposals at the Co-regulatory Forum held at Gas Industry Co's offices on 22 November; published a formal Statement of Proposal; and considered submissions on that; resulting in the Statement of Intent and the associated levy recommendations set out in this paper being endorsed by the Gas Industry Co Board of Directors. In summary, the proposals:

- involve a high level of continuity in terms of progressing or finalising multi-year workstreams; and
- attracted a high level of industry agreement or acceptance.

With the competing demands of a finite budget and the Government's desire to reduce costs imposed on levy payers, it is necessary to prioritise the projects that comprise the work programme. Priority is driven by a matrix of, firstly, statutory and policy requirements; secondly, maintaining momentum on existing and committed projects; and thirdly, attending to new work that is seen as a priority by stakeholders. The Company has reviewed its work programme accordingly and, following consultation with stakeholders, considers that all proposed workstreams meet a priority need for the gas industry[4].

When consulting with industry and Government to develop the current year's work programme and associated levy (FY2013), we anticipated a 'step up' in activity and therefore in cost/levy for this year, particularly driven by priority work in relation to critical contingency management and gas

[3] http://www.med.govt.nz/about-us/ministers/briefings-to-incoming-ministers-1/briefings-to-incoming-ministers/BIM-Energy-pdf

[4] It should be noted, however, that any unforeseen priority/urgent issues arising during the year may require a reduced focus on, or even deferral of, planned workstreams.

transmission arrangements. Our expected end-point for this year (FY2013) confirms good progress on that priority work and that the additional cost/levy has been well justified. A detailed report on progress is included with this Recommendation as Appendix A.

We are pleased to report that we expect the FY2014 work programme can be achieved at a lower cost than required for this current FY2013 year.

Estimated FY2014 work programme costs are $6,141,152 (FY2013: $6,357,307)[5]. These costs will be met by market fees, raised under specific gas governance regulations ($1,615,025), and by the levy funding requirement ($4,133,974) recommended in this paper.

Recommendation

Accordingly, Gas Industry Co recommends that the Minister propose the making of regulations to enable the collection of a FY2014 Levy on Gas Industry Participants of $4,133,974.

The proposed levy rates for FY2014 are:

- a retail levy of $5.90 per ICP (a 5% reduction on FY2013), and
- a wholesale levy rate of 1.63 cents per GJ of gas (a 6% reduction on FY2013).

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[5] Work Programme Costs also include the non-cash amortisation expense for the industry assets (gas registry and downstream reconciliation system). This expense is met from pre-funded reserves and does not affect the levy funding requirement, but it must be tracked as an expense each year for accounting purposes.

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1 Strategic Direction and Work Programme

1.1 Introduction

The Government and the gas industry have implemented a unique co-regulatory model in which an 'industry body' facilitates the nexus between Government and industry to deliver improved governance arrangements for participants and consumers in gas markets. Gas Industry Company Limited was established in 2004 to perform the role of the 'industry body' as set out in Part 4A of the Gas Act and, together with stakeholders, sets an annual strategic work programme and consults on the associated funding requirements.

Industry body

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.

1.2 Gas Act, Government Policy Objectives, and Strategic Goals

The overall purpose of Part 4A of the Gas Act is to 'provide for the governance of the gas industry'. Gas Industry Co seeks to achieve this through developing gas governance arrangements[6] that meet the objectives of the Gas Act and of the Government Policy Statement on Gas Governance (issued April 2008, the 'GPS').

The statutory objective of any formal gas governance arrangement is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner. Other objectives set down in the Gas Act are:

- the facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure and competitive market arrangements;
- barriers to competition in the gas industry are minimised;

[6] The Gas Act provides for the making of regulations or rules; however, Gas Industry Co is required to consider all reasonably practicable options for achieving the objectives of any regulations it might consider. As such, we generally refer to 'gas governance arrangements', which includes rules, regulations, and any voluntary arrangements developed with the industry.

- incentives for investment in gas processing facilities, transmission, and distribution are maintained or enhanced; and
- delivered gas costs and prices are subject to sustained downward pressure.

The GPS expands the principal objective to include consideration of fairness and environmental sustainability. It also sets out specific tasks or outcomes that the Government wants achieved for the gas industry. For example, the GPS requested that the industry body address the contractual relationship between retailers and small consumers, which led to the development of the Retail Gas Contracts Benchmark scheme. The GPS can be found on the Company's website[7].

In establishing its annual work programme, Gas Industry Co determines those issues facing the industry that require immediate attention, and also seeks guidance from the April 2008 GPS. The GPS lists the outcomes that the Government wishes Gas Industry Co to pursue and against which it should report. The GPS forms a key input into the development of Gas Industry Co's work programme for FY2014.

1.3 Strategy

To help deliver on the above legislative and policy framework, the Board of Gas Industry Co has set a strategy for the Company that that reflects the co-regulatory model for the industry and identifies objectives in key areas that will enable it to fulfil its role as a co-regulator and the 'industry body' under part 4A of the Gas Act.

Strategic Goal: Optimise the Contribution of Gas to New Zealand

Natural gas has made a key contribution to New Zealand since the development of the industry from the 1960s. There is a continuing and important future role for gas, particularly in terms of providing energy security and supporting the New Zealand economy, all consistent with environmental sustainability goals. However, there is a range of scenarios as to future supply and demand. The challenge, in line with Government energy policy, is how New Zealand can make the most of its gas resources, for the benefit of all New Zealanders.

Purpose: Provide leadership for the Gas Industry and the New Zealand Gas Story

The gas industry is dependent on a range of players, from upstream explorers and producers through to customers; on competitive markets; and ongoing investment of all stages. Gas Industry Co, with its statutory role as the industry body, is well-positioned to understand and analyse issues facing the gas industry from all of these viewpoints. Gas Industry Co will be a leader in making the next phase in the New Zealand Gas Story a success.

Objectives:

[7] http://gasindustry.co.nz/sites/default/files/publications/Government_Policy_Statement_on_Gas_Governance_-_April_2008.pdf

- Build efficient, competitive, and confident gas markets;
- Facilitate efficient use of, and timely investment in, gas infrastructure;
- Deliver effectively on Gas Industry Co's accountabilities as the gas industry body; and
- Build and communicate the NZ Gas Story (includes review of industry performance).

1.4 FY2014 Work Programme

The Company must then consider the work programme necessary to achieve the requirements of the legislative and policy framework. The Company's strategy and work programme for FY2014, and an indication of further activity in FY2015 and FY2016, will be published before the start of the next financial year (1 July 2013) as the Company's Statement of Intent[8].

Annual Work Programme

Each year the Company develops an indicative work programme and determines the expect cost of that work; it consults on that work programme and the associated levy funding requirements to meet the costs; and then makes a recommendation to the Minister for regulations requiring industry participants[9] 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.

With the competing demands of a finite budget and the Government's desire to restrain costs imposed on levy payers, it is necessary to prioritise the projects that comprise the work programme. Priority is driven by a matrix of necessity including the need to meet statutory obligations), maintaining momentum on existing and committed projects, and attending to new work that is seen as a priority by stakeholders and the Company.[10]

In its Briefing to Incoming Minister Heatley[11], MBIE described Gas Industry Co's planned scope of operations for FY2012 and beyond as "an ambitious work programme including issues such as wholesale market development and transmission capacity allocation and investment processes". These key work streams, such as transmission capacity and the review of critical contingency management, continue to dominate our work programme.

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[8] A draft Statement of Intent has been forwarded to the Minister together with this Recommendation.

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

[10] It should be noted, however, that any unforeseen priority/urgent issues arising during the year may require a reduced focus on, or even deferral of, planned workstreams.

[11] http://www.med.govt.nz/about-us/ministers/briefings-to-incoming-ministers-1/briefings-to-incoming-ministers/BIM-Energy-pdf

Statutory accountability

Gas Industry Co has a number of statutory accountabilities that arise from:

- obligations under the various rules and regulations that Gas Industry Co previously recommended and now administers; and
- specific tasks defined by the GPS.

Gas Industry Co monitors and administers these regulations, and manages service providers appointed to act under these arrangements (including the Allocation Agent, Registry Operator, Rulings Panel, Investigator, and Critical Contingency Operator).

Gas Industry Co also must meet various statutory reporting requirements and respond to requests for advice from the Minister on matters affecting the gas sector. Examples of the statutory actions to be taken by the Company include the publication of the Statement of Intent, presentation of a formal Annual Report to Parliament, meeting all obligations under the Companies Act 1993, and undertaking consultation on the development of an annual levy recommendation.

Given that the abovementioned roles are statutory obligations, they must be given a high priority in the work programme. Funding for the first of these is from a combination of market fees and levy, and for the second, funding is from the levy.

Gas Transmission Investment Programme (GTIP)

Late in FY2011, major end users and other industry stakeholders requested that Gas Industry Co lead a focussed project addressing gas transmission capacity issues, particularly in respect of the North Pipeline owned and operated by Vector. The work now coordinated in the GTIP commands a high priority for stakeholders from the gas industry, end users, and Government. Moreover, a number of those stakeholders are supporting that programme of work by committing their own resources (for example, providing members for working groups and expert panels).

A small increase in levy funding was required for the current year (FY2013) to progress this priority work. Then-Minister Heatley gained Cabinet Committee approval for that increase (just under $340,000), subject to pursuing good progress with priority gas transmission issues. We can report that the GTIP projects have moved forward substantially this year; the earlier identified issues with potential congestion or constraint on the North Pipeline have reduced and the focus is now on how transmission capacity should be more efficiently allocated. We have reported regularly to Minister Heatley and to the industry on this, and can provide any further details required.

Following from this progress, we are able to forecast a decreased levy funding requirement for FY2014, compared with FY2013. Overall, the projected total work programme costs are among the lowest to be recommended by Gas Industry Co in the last five years.[12]

Other ongoing/Committed workstreams

There are a number of other significant workstreams that Gas Industry Co has previously committed to and have been developed in response to stakeholder concerns and/or Ministerial requests. Examples include:

- evaluating small consumer retail contracts on an annual basis against published benchmarks;
- developing principles for network Use of System Agreements (UoSAs) and evaluating UoSAs against those benchmark principles; and
- undertaking reviews of existing gas governance arrangements to ensure they continue to be fit for purpose and recommending changes where improvements can be made efficiently.

Regarding the above items, an initial assessment of distribution arrangements is being undertaken in the current year. Funding is required for a follow-up assessment in February 2014, with the expectation that future assessments would be conducted on an as-needed basis. Following three years of assessments, and with substantial improvement being made in customer contracts, we will be conducting a review of the successful retail contracts assessment scheme to determine how best to continue this workstream.

1.5 FY2014 Work Programme Costs

A list of the FY2014 workstreams and associated costs is set out below, together with a comparison to FY2013. Further detail of workstreams, with descriptions of relevant deliverables, can be found in the Statement of Intent FY2014-16 (which has been provided separately to this document).

Total expenditure for the FY2014 work programme described in the draft Statement of Intent is estimated at $6,141,152. The work programme budget is based on all activities to be undertaken by the industry body in FY2014[13]. Some of these activities will be funded through market fees charged pursuant to specific gas governance regulations or rules (estimated to be $1,615,025 in FY2014), but the majority of Gas Industry Co's funding comes from the levy ($4,133,974).

[12] Detailed information about the GTIP work can be found in the draft Statement of Intent, the Quarterly Reports supplied to the Minister, and on the Gas Industry Co website.

[13] Work Programme Costs also include the non-cash amortisation expense for the industry assets (gas registry and downstream reconciliation system). This expense is met from pre-funded reserves and does not affect the levy funding requirement, but it must be tracked as an expense each year for accounting purposes.

	FY2014 (to 30/06/14) Work Programme Costs	FY2013 (to 30/06/13) Work Programme Costs
Critical Contingency Management	483,000	483,000
Critical Contingency Management Review	(Part of 'Rule Changes')	30,000
Gas Processing	0	25,000
Compliance	18,000	39,000
Infrastructure Access	80,000	
- *Balancing*		0
- *Gas Quality*		50,000
- *Interconnection*		45,000
- *Industry Facilitation*		45,000
GTIP	430,000	490,000
Statutory Accountability	12,000	12,000
Gas Story	22,500	13,750
Information Gathering	5,000	0
Total Wholesale Costs	***1,050,500***	***1,232,750***
Switching	292,025	292,025
Reconciliation	750,000	723,900
Compliance	72,000	156,000
Distribution Contracts	30,000	25,000
Rule Changes	100,000	75,000
Consumer Issues	20,000	40,000
Insolvent Retailers	20,000	50,000
Bridge Commitments	10,000	50,000
Statutory Accountability	12,000	12,000
Information Gathering	5,000	0
Gas Story	22,500	13,750
Total Retail Costs	***1,333,525***	***1,437,675***
Board	262,460	282,460
Corporate Consultancy	130,000	110,000
Salaries	2,199,142	2,205,930
Organisational Support	773,372	724,688
- System amortisation	392,153	363,804
Total Other Costs	***3,757,127***	***3,686,882***
Total Expenses	**6,141,152**	**6,357,307**

Notes to Work Programme Costs FY2013 and FY2014:

1. Total Wholesale and Retail Costs comprise the direct costs of consultants and service providers (some of which may be met from market fees). Workstreams with no direct costs will be resourced through internal staff time.

2. The Salaries figure includes provision for one extra FTE in the Corporate Services Group, expected to be filled in FY2014.

3. The 'Gas Story', 'Statutory Accountability', Rule changes, compliance, and information gathering line items relate to both the wholesale and retail aspects of the Company's operations. Thus, the costs of these workstreams have been split between the two funding components and appear twice in the table above.

4. The system amortisation expense is pre-funded and is off-set at the end of the year from an equity reserve provisioned for this purpose. The expense must be accounted for in the total costs, but it does not influence the overall levy funding requirement.

2 Work Programme Costs and Levy

2.1 Maximising value

Levy Principles

Setting the levy in any given financial year, Gas Industry Co must consider its obligations under the Gas Act and the GPS and take into account the obligations on the Board under company law. The Board takes the view that each year's levy should cover the costs reasonably expected to be incurred by Gas Industry Co in that year. Any surplus in funds is generally returned to levy payers after the year-end accounts are adopted at the Company's Annual General Meeting.

Using Government guidelines for the setting and justification of levies, Gas Industry Co has developed a set of general principles covering our levy on gas industry participants to ensure discipline and transparency in the process. We have particularly based our principles on guidelines set by MBIE with respect to levy-raising powers. The principles are available on the Gas Industry Co website and have been used to assess and determine the proposed structure and level of the FY2014 levy.

Gas Industry Co is not a government department or a Crown entity, and is funded by a levy imposed on industry participants. However, the public nature of the Company's core role requires it to submit its operations and budget proposals to scrutiny and consultation. Ultimately, the Company should be sufficiently resourced to respond to issues in the gas market that have been identified as priorities by industry and/or the Government.

Workstream benefits

Gas Industry Co's Board and Management are committed to delivering value for money. One example of the value received by industry for Gas Industry Co's efforts involved the Downstream Reconciliation Rules. Due to the scrutiny and enforcement provisions encapsulated in these rules, about $2.5 million of unaccounted-for gas has been eliminated on an annual basis. This sum represents an ongoing, annual saving to industry.

Gas Industry Co seeks to deliver consumer benefits through industry efficiencies that are gained in accordance with the Government's preference for 'better regulation, less regulation'. The Company aims to produce the best governance arrangements for gas markets, and is required by the Gas Act to consider all reasonably practicable non-regulatory options and only resort to regulation where necessary.

Costs savings programme

The Company is conscious of needing to seek savings where possible and deliver value for money on the work programme. In developing the work programme costs estimate, and with every expenditure decision made during the year, Gas Industry Co looks to spend its levy funding in the most efficient manner.

Based on the savings made to-date in FY2013, we have been able to assume ongoing reductions in organisational support costs into FY2014. Organisational support costs (including governance) have reduced from over $2 million in FY2012 to the anticipated $1.8 million in the coming financial year.

2.2 Levy Calculation

Total Work Programme costs for the current financial year are expected to be below, but close to, the budgeted $6,357,307.

The industry was fully consulted regarding the FY2014 work programme and associated costs. Gas Industry Co received feedback on draft proposals at the Co-regulatory Forum held at Gas Industry Co's offices on 22 November; published a formal Statement of Proposal; and considered submissions on that paper. As a result, the draft Statement of Intent and the associated levy recommendation set out in this paper have been endorsed by the Gas Industry Co Board of Directors.

In summary, the proposals:

- involve a high level of continuity in terms of progressing or finalising multi-year workstreams; and
- attracted a high level of industry agreement or acceptance.

While addressing a similar work programme to the current year, the total cost of operation for FY2014 is forecast to reduce to a level of $6,141,152. The amount required to be funded from the levy on participants is $4,133,974 (allocated against two workstream categories: 'wholesale' and 'retail'). This is a decrease of $165,604 (3.85%) from the FY2013 levy requirement of $4,299,578.

The difference between the total cost of the work programme ($6.1m) and the levy funding requirement ($4.1m) is met by a combination of market fees (raised under specific gas governance arrangements) and equity reserves set aside to meet the depreciation costs of computer systems established under governance arrangements in previous years.

The following allocation methodology has been used to calculate the levy in previous years, and is assessed as remaining appropriate for FY2014:

- Direct costs are allocated across two areas of activity: retail (eg consumer switching, retailer reconciliations, etc) and wholesale (gas processing, transmission pipelines, etc).
- Indirect costs are allocated between the retail and wholesale areas of activity on a proportional basis.
- Costs recovered through market fees are deducted from the relevant areas of activity.
- The retail and wholesale levies are set to recover the allocated costs in each area.
- Based on recent information from the Switching Registry, the Company will assume an ICP count of 260,000 for the purposes of calculating the retail component of the levy.
- Wholesale levies will be collected at a rate of 1.63c/GJ based on an assumption of 160,000,000GJ (160PJ) of gas volumes during the year.
- The Board has set a policy requiring the refund of surplus levy funds at the end of a financial year, unless those funds are deemed necessary to support operations in the following year.

The gas volume assumption used is based on a forecast of expected gas volumes for the current year, and discussions with industry participants as to expected levels of gas volume purchases in FY2014. Gas Industry Co is currently expecting that reported gas volumes for this year will be approximately 162PJ (slightly higher than the 155PJ budgeted for the year). This takes into consideration lower gas volume purchases by some major participants for electricity generation, but also accounts for a continued increase in methanol production activity by Methanex. We are also cognisant of Todd Energy's planned operation of a new 'peaker' generation facility, which may affect gas volumes in FY2014. Against this, other major gas consumers have indicated significant decreases in their forecast consumption through FY2014.

Gas Industry Co's policy is to set a slightly conservative estimate of gas volumes to ensure it mitigates the risk of insufficient revenue collection, and bearing in mind the Company's policy of generally refunding any surpluses to levy payers. As such, the figure of 160PJ has been chosen to accommodate the expected fluctuations – both up and down – in gas volumes in FY2014.

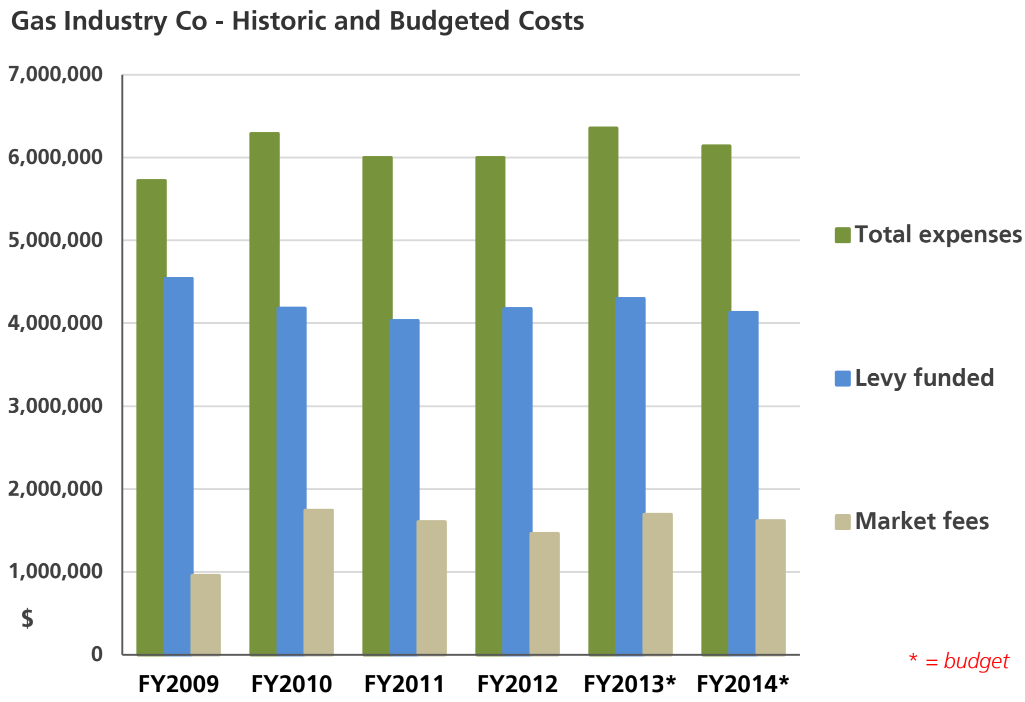
Based on the above methodology, the FY2014 levy funding requirement is:

	FY2014		
	Retail	Wholesale	Total
Direct Costs	715,954	1,673,032	2,388,987
Proportion of Direct Costs to Total Costs	*30.0%*	*70.0%*	
Indirect Costs	968,048	926,974	1,895,023
Work Programme Costs not met by market fees	**1,684,003**	**2,600,007**	**4,284,009**
Less Amortisation on Industry Assets (met from equity reserves)	(150,035)	-	(150,035)
	(150,035)	**-**	**(150,035)**
Total Levy Funding Requirement	**1,533,968**	**2,600,007**	**4,133,974**
Basis of apportionment	*per ICP*	*per GJ*	
Number	260,000	160,000,000	
Levy Unit	*$/ICP*	*c/GJ*	
Levy Rate	**$5.90**	**1.63**	
Projected Levy Revenue	**1,533,968**	**2,600,007**	**4,133,974**

2.3 Conclusion

Gas Industry Co considers that the proposed levy is reasonable, having regard to the Company's Statement of Intent, Annual Report, indicative work programme, the GPS objectives and outcomes, submissions from industry participants, and past expenditure.

The chart below shows the Company's actual expenditure over FY2009-12 and projected expenditure for FY2013 and FY2014. Costs have remained within a narrow range (around the $6m mark), even taking into account the increased activity over the past two years to cover key priority projects sought by all stakeholders. These are expected to be lower in FY2014 and the Company will aim to continue this downward trend over the next few years.

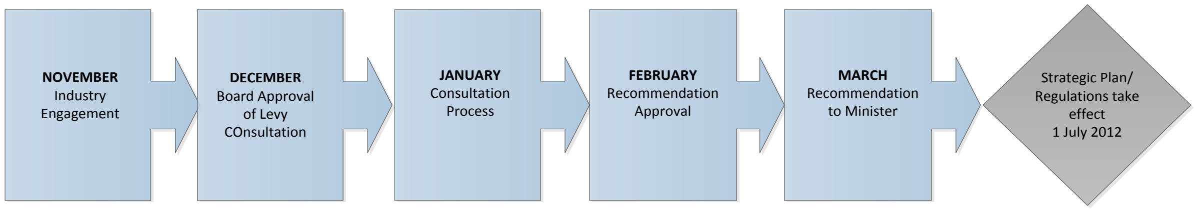

Gas Industry Co - Historic and Budgeted Costs
7,000,000
6,000,000
5,000,000
4,000,000
3,000,000
2,000,000
1,000,000
$
0
FY2009
FY2010
FY2011
FY2012
FY2013*
FY2014*
Total expenses
Levy funded
Market fees
* = budget

3 Consultation Process and Outcomes

One of the conditions to be met before a levy recommendation can be accepted by the Minister is that the industry body has consulted with industry participants on the levy rate or amount (section 43ZZD(2)(b)). Gas Industry Co undertakes extensive consultation with the industry and other stakeholders, not just with respect to the amount of the levy required, but also on the elements of the work programme on which that levy is based.

The Company's Board, which includes industry representation along with a majority of Independent Directors, subjects the work programme and levy proposal to thorough scrutiny.

The diagram below outlines the process undertaken to develop this recommendation for levy regulations. This operates in parallel with the development of the Company's Strategic Plan.



3.1 Consultation on FY2014 Levy

Gas Industry Co consults on all aspects of its work programme and engages with a broad spectrum of stakeholders, including MED, other regulators, gas and electricity industry participants, and major end-users. Our process for the levy consultation includes end users who account for approximately 75% of gas consumption in New Zealand.

The consultation process commenced early, with a Co-regulatory Forum in November at which industry participants and other stakeholders receive an indicative briefing on the proposed work programme for the next financial year. Often, MBIE officials are also in attendance. This meeting was aimed at learning about the work priorities held by industry participants, which would then have to be balanced with government requirements. Feedback during the Forum, while instructive and supportive, did not provide any specific direction on how the Company might differently prioritise its work programme.

The Board has also issued a standing invitation to the Minister of Energy to talk with Directors at their November meeting about issues relevant to the industry and the development of the work programme and levy proposal for the next financial year.

In December 2012, Gas Industry Co released a Statement of Proposal on the FY2014 Strategy, Work Programme, and Levy. This paper:

- set out Gas Industry Co's strategic direction and the rational for that mission;
- described the work that Gas Industry Co would undertake in FY2014 and the estimated costs;
- outlined the calculation of the levy funding requirement for FY2014; and
- proposed the levy for FY2014.

The Statement of Proposal indicated a Work Programme Cost (WPC) of $5,995,684 (a decrease from the FY2013 projection of $6,357,307), and a Levy Funding Requirement (LFR) of $4,190,624 (compared with the FY2013 figure of $4,299,578). Gas Industry Co called for submissions from interested parties as a precursor to the formulation of this Recommendation to the Minister for the required levy regulations. Submissions closed on 8 February 2013.

The consultation paper was sent to stakeholders and was also published on the Company's website. Submissions on the consultation paper were received from: Genesis Energy, Methanex New Zealand, Mighty River Power, Contact Energy, Powerco, and Vector. Participants were invited to express interest in a further workshop to discuss the proposed levy at the end of January 2013, but there was insufficient demand for this to take place.

Submitters on the consultation paper generally supported the work programme and budget, with several congratulating Gas Industry Co on achieving a decrease in the levy funding requirement. This was in line with views expressed by industry participants who attended the November 2012 Co-regulatory Forum. One submitter asked that more detailed costs breakdowns be supplied; Gas Industry Co will review the amount of information provided in its levy consultation papers with a view to ensuring appropriate transparency.

A summary of all of the issues raised in the FY2014 levy consultation submissions is set out in the Submissions Analysis Paper, which will be available from the Gas Industry Co website.

As a result of consultation, Gas Industry Co removed one proposed workstream from the FY2014 work programme (Metering). This has led to the reduction of the proposed levy funding requirement to $4,133,974.

However, in preparing this recommendation and the associated draft Statement of Intent, an error was discovered in our calculation of the total Work Programme Costs that appeared in the consultation paper. The error was in the provision for the amortisation of the industry assets (gas registry and downstream reconciliation system), which must be shown as an expense for accounting purposes.

This expense is a non-cash item and is off-set by existing equity reserves. As such, the nominal increase in the total Work Programme Costs to $6,141,152 has no effect on the associated levy funding requirement.

3.2 Conclusion on consultation

The consultation process has appropriately tested Gas Industry Co's proposed work programme and associated levy and, this year, led to a reduction in the proposed levy funding requirement. Gas Industry Co considers it has fulfilled its statutory obligation to consult with industry participants on the proposed levy.

4 Other Information

4.1 Additional sources of funding

In addition to its levy funding, Gas Industry Co also receives funds from:

- Shareholder fees, which are set aside as an equity reserve (see section 4.2 below). The annual fee is set by the Board and is currently $5,000 per shareholder. There are nine (9) shareholders at the date of this recommendation.
- Market fees, which are fees charged pursuant to specific regulations. These cover the costs of service providers and some external consultants and are taken into account in setting the annual levy funding requirements. The Gas (Switching Arrangements) Rules 2008, the Gas (Downstream Reconciliation) Rules 2008, the Gas Governance (Critical Contingency Management) Regulations 2008, and the Gas Governance (Compliance) Regulations 2008 contain market fee provisions.

4.2 Equity reserves

Gas Industry Co's equity balance is made up of three components:

- Industry Advances Reserve;
- Industry Amortisation Reserve; and
- Retained Earnings (comprising shareholder fees).

The **Industry Advances Reserve** represents the net over-recoveries of levies from previous years. Gas Industry Co has determined that it should refund overpaid levies as soon as the annual accounts have been received by shareholders at the Annual Meeting. This is also consistent with the treatment of over-recoveries collected under the various Market Fee arrangements. This policy encourages a predictable and stable levy by removing from the levy calculations any variability resulting from a fluctuating level of reserves.

The first such refund, at the end of FY2010, was made to levy payers in November 2011, amounting to approximately $1.5 million. The surplus at the end of FY2011 amounted to approximately $364,000. This was retained during FY2012 to meet the costs of an expanded work programme (GTIP) and other unfunded workstreams (CCM Regulations review). As some of this fund was required to meet those costs, the remainder of this reserve amount – around $286,000 – was returned to levy payers in December 2012.

The **Industry Amortisation Reserve** represents the unexpended amortisation on capital items purchased with market fees, such as the Switching Registry and Downstream Reconciliation system. There is an ongoing annual amortisation cost associated with these assets, which is met from the amortisation reserve. Over time, the value of the assets and the reserve will both reduce to zero.

Retained earnings are the accumulation of the shareholders' annual fees, set aside as a reserve against future contingencies and do not impact on the levy calculation.

4.3 Minimal impact on consumers

The levy is paid directly to Gas Industry Co by industry participants; however, it is recognised that consumers ultimately bear that impost through delivered gas prices that are set in a competitive market – one that is not only competitive within the gas sector but also against other fuel options – thereby limiting the ability of retailers to 'pass on' the levy. References in this paper to 'levy payers' are to those industry participants that directly pay the levy to Gas Industry Co.

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

User Type	Residential	Commercial	Industrial
Typical Annual Usage (GJ)	25	1,000	1,000,000
Estimated Annual Gas Bill	$850	$10,500	$7,000,000
Annual Retail Levy	$5.90	$5.90	$5.90
Annual Wholesale Levy	$0.41	$16.30	$16,300
Total Annual Levies	**$6.31**	**$22.20**	**$16,305.90**
% of annual Gas Bill	0.74%	0.21%	0.23%

5 Recommendation

Gas Industry Co, after consulting with industry participants, considers that this recommendation for levy regulations meets the requirements of the Gas Act, and that (as per the criteria in the Gas Act) the levy amount sought is reasonable, having regard to the Company's strategic plan, its current financial position, and the GPS objectives and outcomes. As described earlier in this recommendation, Gas Industry Co considers the levy represents good value for money.

Accordingly, Gas Industry Co recommends to the Minister that levy regulations be made by the Governor-General under section 43ZZE of the Gas Act for the financial year from 1 July 2013 to 30 June 2014 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 based on one twelfth of the annual retail levy of $5.90 for each ICP for each retail customer.
- From every person who is an industry participant on the first day of each month, a wholesale levy rate of 1.63c/GJ based on gas purchases made directly from gas producers during the previous month.