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The GIC Levy Proposal for 2005/06

Follow up consultation

22 April 2005

1. Introduction

A Discussion Paper about the 2005/06 GIC levy was circulated on 29 March 2005 with a request for responses by 15 April 2005. The GIC has considered the responses and appreciates the constructive submissions received. It is circulating this follow up paper to respond to issues raised, to advise of modifications to the levy proposals, and to provide additional detail on implementation of the proposed levies.

The GIC would be grateful for any final comments by 2 May.

2. Key submissions

A summary of the submissions is provided in Appendix A, together with the GIC's commentary. The GIC has identified three issues to provide a detailed response to in this paper:

(1) some submissions sought further information about the GIC budget and the basis of allocating these costs to the two major work areas, wholesale and retail;

(2) some submissions indicated a preference for a per customer retail levy to replace the 12c/GJ proposal; and

(3) one submission suggested that the GIC collects the wholesale levy at transmission injection points rather than offtake points. This is discussed in the Implementation section of this paper.

3. GIC responses

3.1 Basis of approach

The GIC notes that in considering its approach to the recovery of the levy, it is following Treasury guidelines. These guidelines require an approach that endeavours to recover levy payments from the "beneficiaries" of the activities the levy will fund.

3.2 The budget and cost allocations

In setting levies where there are costs that are common to two or more work areas, the usual way of allocating costs to a specific work area is to identify what costs would be **avoided** if that area of work were abandoned. At this stage, while the costs of the GIC (and in particular its Board, CEO, secretariat and technical advice) are not completely clear, it is not possible to identify specific avoidable costs for the retail- and wholesale-related activities. The GIC's best estimate of the amounts that would fall away if either area were dropped are expected to be approximately equivalent.[1]

These avoidable costs do not represent the total GIC budget. There are overheads, that will be avoided only if both activities were discontinued and the GIC closed.

The GIC strategic plan and budget will be published when they are submitted to Government for approval. To provide an indication of the GIC's preliminary budget for the 2005/06 financial year, the following information is provided:

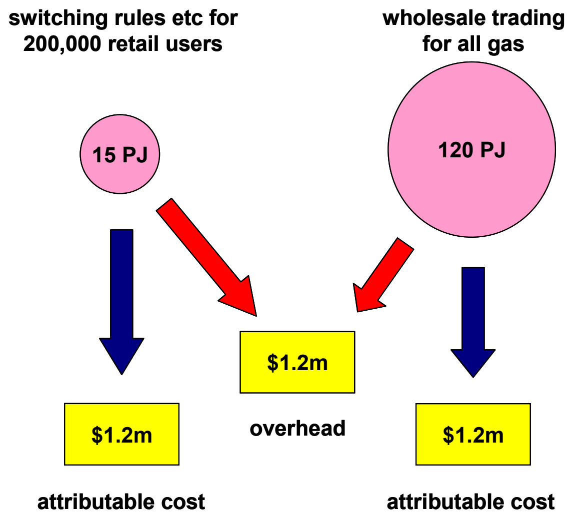
• Personnel costs	$0.8 million
• Board costs	$0.3 million
• Other operating costs	$0.3 million
• External advisers	$0.6 million
• Working groups	$1.0 million
• Partial recovery of expenses since 22 December 2004	$0.6 million
Total	$3.6 million

At this stage, it appears that the avoidable costs associated with the two work areas will each be about a third of total GIC costs and the overheads the remaining third. To avoid a cross subsidy, the levy from each area must thus exceed one third of GIC costs. At the same time, however, between them they must contribute the total.

In approaching the construction of the levy, the GIC has assumed that total wholesale gas traded is approximately 120PJ p.a. and that sales of gas to retail consumers is approximately 15 PJ.

Given that the levy from each area covers the relevant incremental cost, the remaining task is to share the overheads in a way that reflects the benefits expected from the two areas of GIC activity.

In the absence of any clear guide as to the likely scale of user benefits, the GIC has attributed half the overheads and hence half of total GIC costs to each area. Thus the retail and wholesale levies have been designed so that each recovers $1.8m for the 2005/06 year.



[1] The work involved in managing the two retail working parties has been provisionally estimated as similar to that in the wholesale area. Even though there are two retail working groups planned, finding a model contract is not expected to be difficult and the wholesale area has potential for expansion into open access considerations and the outage contingency planning.

3.3 An ICP retail levy

Some submissions suggested that all the GIC costs attributed to retail activities should be recovered from retailers on a per customer basis (per Installation Control Point or "ICP").[2]

The GIC **costs** attributed to retail activities would not appear to be directly related to either the GJ consumed by small consumers[3] or the number of small users supplied by individual retailers.[4]

The relevant consideration, consistent with Treasury guidelines, is then how the **benefits** of the GIC's retail work streams will be shared amongst small consumers. It would appear unlikely that the benefits derived by a 25 GJ pa household would be the same as that derived by a 1,000 GJ pa hotel.

- Strong competition could provide benefits from lower retailer variable costs and pressure on retailers' variable margins and thus lower $/GJ **prices** for gas. In this instance the benefit to users depends on volume and a cents/GJ levy is indicated.
- Better retail switching processes could lower retailers' costs per customer and lead to a drop in fixed charges. They may also improve service quality. In this instance, an $/ICP levy is indicated.

The GIC's view is that the 12c/GJ retail levy proposed in its initial discussion paper in relation to small consumers should not be totally **replaced** by an ICP levy. Such a change, in the GIC's view, would replace a mechanism that assumes too direct a relationship between benefits and volumes, with a mechanism that assumes that every customer will benefit equally, irrespective of volume.

GIC acknowledges, however, the benefit of providing some recognition of the benefits that are not directly related to volumes. Accordingly, the GIC proposes to partially adopt the ICP levy suggested in submissions to the initial discussion paper and recover half the costs attributed to retail-related activities in this way, instead of relying solely on a 12c/GJ retail levy. The structure proposed by the GIC is then

- a 6c/GJ levy (on retail sales to small consumers), and
- a levy on all retailers of $4 per small consumer ICP.

On the assumption that levies are passed through to consumers, this retail levy approach affects the distribution of total contributions amongst households and other small consumers in the mass market below the 10 TJ pa threshold. Major users (paying just the wholesale levy) are unaffected.

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[2] Some larger customers have more than one ICP.

[3] Small consumers are defined in the Gas Act as being a sonsumer who is supplied with less than 10 TJ of gas per annum.

[4] Even the industry costs associated with registries, information exchange protocols etc are unrelated to customer numbers or GJ consumption levels. These systems all display substantial economies of scale. A computer based registry can record 200 or 200,000 customers.

The tables below set out the final incidence of the levies on the assumption that they are all passed through to users. The bottom row in each table is the new GIC proposal.

shares of total GIC costs			
retail option	**households**	**small industrial & commercial users**	**major users incl. generators**
12c/GJ	26%	30%	44%
$8/ICP	45%	11%	44%
6c/GJ + $4/ICP	36%	20%	44%

Another way of comparing the retail levy options as they affect small users is through their average cents/GJ contribution to total wholesale and retail costs. The average household uses 25 GJ pa and the average small industrial and commercial consumers uses about 1 TJ pa, ie 1,000 GJ pa.

average contributions			
retail levy option	**households**	**small industrial & commercial users**	**major users incl. generators**
12c/GJ	13.5c/GJ	13.5c/GJ	1.5c/GJ
$8/ICP	33.5c/GJ	2.3c/GJ	1.5c/GJ
6c/GJ + $4/ICP	23.5c/GJ	7.9c/GJ	1.5c/GJ

The GIC views the combination of a 6c/GJ levy and a $4/ICP charge as better reflecting the possible relationships between the fixed and variable components.

The amounts per household and per small business are not large in any event. If the levies were all passed on, the new proposal would cost the average gas using household $5.88 pa (in the context of about $800 pa spent on gas) and the average 1,000 GJ pa small business $79 pa (in the context of gas costs of about $10,000 pa).

3.4 The 10 TJ boundary

Retailers have pointed out a potential for awkwardness arising from the abrupt boundary between a 9.99 TJ customer for whom they will be levied say, $1,200, and a 10.1 TJ user for whom they will pay nothing. However, there is no reason for retailers to pass on the levy to final users with the same abrupt cut-off. Next year, there will be better data available enabling a finer graduation of levies across user consumption classes and thus no perverse effects from customers moving across the 10 TJ boundary between now and then.

GIC has also considered the possibility of abandoning the 10 TJ “small user” boundary on advice that some larger users will still benefit from the GIC organisation of registry and switching working groups. Despite the measure of arbitrariness in the cut-off, it was agreed that **some** boundary was necessary to allow for the fact that users larger than 10 TJ generally have individually negotiated gas sales contracts and will be less dependent on good switching mechanisms in achieving good terms and conditions of supply; they have more countervailing power that small users buying on a tariff. The GIC discussed the possibility of confining the retail levy to distribution networks but this was seen as unworkable as some major users are supplied off distribution networks while some are connected directly to the transmission grid.

4. Implementation

The GIC convened an *ad hoc* working group to confirm the details of how different levy options could be implemented. The working group comprised the Reconciliation Code allocation agent, billing and reconciliation specialists from Contact, Vector, NGC and Genesis, and the GIC’s legal and policy advisors. Based on this advice, the GIC now proposes to alter somewhat the collection point of the wholesale levy and the information on which the 2005/06 wholesale and retail levies are based.

4.1 2005/06 Wholesale Levy

The working group’s view was that there may from time to time be uncertainty as to the ownership of gas at grid offtake points and that it would be easier to define the obligation to pay the wholesale levy with reference to a sale of gas further upstream. Contact made a submission to the same effect.

The GIC therefore proposes that the 2005/06 wholesale levy be paid by gas **buyers** at the first point of sale from the gas producer. This may be a reseller buying from a producer (and on-selling to retailers) or a retailer buying from a producer directly (and on-selling to end users) or a major user buying from a producer.[5] In the case of Maui, the first point of sale of gas is from the Maui partners to the Crown, so the GIC proposes that for Maui gas, the 2005/06 wholesale levy will be paid by the purchaser from the Crown. Here the buyers will include Methanex, Contact and NGC.

So as to deal with settled quantities, the working group further recommended that the 2005/06 wholesale levy obligation be calculated on the basis of the total gas purchases made in the quarter before the last completed quarter, and be paid in three equal monthly instalments (eg the three payments in the quarter to 30 September would be based on gas sales in the quarter to 31 March). The GIC proposes to accept this recommendation. Regulations are expected to provide for the first payments of the wholesale levy to be made by 20 July 2005.

[5] Direct wholesale buyers are “industry participants” and so can be levied under the Act.

The GIC will seek government approval for the levy regulations to allow GIC to access quarterly sales figures from producers (or in the case of Maui gas, from the Crown) for the purposes of levy verification.

4.2 The 2005/06 Retail levy

The cents/GJ component

The GIC proposes to accept the recommendation of the implementation working group that the cents/GJ component of the retail levy for the 2005/06 year be based on the gas volumes supplied during the last completed gas year ending 30 September 2004. These volumes are now settled and the intention is that retailers will be required to pay (in 12 equal monthly instalments commencing 20 July 200) in respect of their sales during the year to 30 September 2004 to consumers who used less than 10 TJ in that year.[6]

The GIC will also recommend that the levy regulations allow the GIC to access retailers' sales figures for users above 10 TJ pa and to reconcile the totals with the allocation agent that operates under the gas Reconciliation Code.

The ICP component

The GIC proposes that the ICP component of the 2005/06 levy be based on the small user ICP numbers associated with each retailer as at the end of the last gas year (ie as at 30 September 2004). It is proposed that payment can be made in 12 equal monthly instalments with first payment by 20 July.

NGC Transmission and the local distribution networks will have a record of customer numbers at this time that can be used for verification. The GIC will recommend that the levy regulations allow GIC to access this snapshot customer number information from networks for the purposes of levy verification.

5. Summary

The GIC proposes to recommend to Government

- a wholesale levy of 1.5c/GJ on all gas purchased from producers (or from the Crown in the case of Maui gas), paid by the buyers in three equal monthly instalments, on the basis of total gas purchases in the quarter before the last completed quarter
- a retail levy paid by all retailers in respect of sales to, and numbers of, small consumers consuming less than 10 TJ pa (based on sales volumes in the last gas year to 30 September 2004 and small customer (ICP) numbers as at the end of that year) and comprising 6c/GJ and $4/ICP.

[6] The simplifying approach of making one calculation of the annual obligation was recommended by the Federation of Family Budgeting Services.

6. Consultation

The GIC invites you to comment on this amended proposal, the cost allocation described, the collection method, and any other new issues raised by the paper. Please send your comments by Tuesday, 3 May to:

The Secretariat
Gas Industry Company Limited
P O Box 10 646, WELLINGTON.

Attention: Richard Longman

or email richard.longman@gasindustry.co.nz

APPENDIX A Summary of submissions

The following table attempts to bring together succinctly how many respondents expressed similar views. The subsequent landscape tables outline each submitter's key points together with a commentary.

A.1 Summary

Recommendation	Vector	NGC	Mighty River	Contact	Genesis	Wanganui	Ballance	MEUG	Residential
wanted to see budget	✓		✓				✓	✓	
want cost disciplines		✓	✓				✓		
ensure levy pass through		✓	✓	*					
prevent levy pass through							✓		✓
use ICP levies for retail		✓		✓		✓		✓	
get info powers for levy		✓		✓					
tax fund some activities			✓						
repay levies if costs vary					✓				
reduce plan & levy now									
more application points								✓	
GIC sunset clause							✓		

* Contact not persuaded that inability to pass on the levy is a problem

Key:

- **wanted to see budget** – levy proposal should have been complemented by budget to explain the origin of the cost estimate and justify initial allocations
- **want cost disciplines** – GIC planning should show controls on bureaucratic cost growth, especially when the levy is reviewed
- **ensure levy pass through** – delay levy onset until tariffs can be increased and ensure that pass through from point of collection is not prevented by contracts
- **prevent levy pass through** – industry participants will get most of the benefit of GIC activities and should carry costs by not passing on the levy
- **use ICP levies for retail** – recover part or all of costs attributed to retail from a single $/ICP levy or a set of such levies graded by consumption level

- **get information powers for levy** – levy regulations should provide for GIC to get necessary information from allocation agent and networks
- **tax fund some GIC activities** – some powers like regulation enforcement should be funded from general taxation
- **repay levies if costs vary** – adjust future levies to wash up any major variations in GIC spending from initial allocations
- **reduce plan and levy now** – some work streams are not required, can be abandoned now, and the budget and levy lowered accordingly
- **more application points** – consider more combinations of wholesale levy application points amongst wholesale buyers and sellers
- **GIC sunset clause** – set an expiry date by which key measures must be in place and thereafter seek a fresh mandate from industry

A.2 Main points of submissions

Vector	
The proposal to government should be supported by thorough analysis in the terms defined by Treasury and Audit Office Guidelines and the Regulation Review Committee's principles. Vector probably would have preferred to see such analysis in the discussion paper.	GIC agrees that the levy recommendations to the Minister will have to be comprehensively justified. GIC has been discussing with officials exactly what is required and has parallel legal advice. The levy has been designed with the relevant principles in mind.
Include the strategic plan and budget in the consultation. Without this, the process may not comply with 43ZZC (or 43ZZD?) of the Act. The key is relating costs to outputs.	Response in this paper.
Wanted statement of approach to cost allocation, the initial 50/50. The Audit Office Guidelines also require a clear identification of outputs and an allocation of costs to these.	Response in this paper, to the level of precision possible.
Warns that the Regulation Review Committee could expect to see a clear relationship between the levy and the service being received by the person paying it.	This is potentially problematic but unavoidable. The GIC clearly believes that the benefits flowing to consumers from its work will far outweigh the costs of the company, and for that matter, the costs that will be carried by the industry in working with GIC. But the levy will arguably not be paid by the primary beneficiary of the GIC "service"; it will be collected from a retailer or wholesaler.
Verify that there are no cross subsidies	Discussed in this paper
Compare GIC levy recommendations with those of similar bodies overseas and with earlier NZ gas sector levies.	A good idea for the recommendations paper.

NGC	
Endorses Vector view about need for rigour in levy justification.	
The point of collection should be chosen to ensure that payer is **not** prevented from passing the levy downstream.	It is hard to find a collection point where we could be sure of this outcome without gaining access to all sales contracts; such blockages are potentially unfair to some sellers but amounts are modest.
Prefers a set of $/ICP levies graded by consumption levels to cover both wholesale and retail – so long as it doesn't delay implementation	To set the right $ levels, a substantial data gathering exercise would be required to identify customer numbers in different consumption classes from all retailers and networks. This may be feasible at the next levy review. A simple two-part approach is dealt with in this paper.
Wanted to see GIC budget to understand basis for the levy.	Response in this paper.
Wants future GIC costs to be reported and matched to activities.	The GIC Board and government will determine an appropriate monitoring and reporting regime.
Approves of GIC acquiring information gathering powers in the regulations for the purposes of the levy.	The allocation agent and the networks hold retailer information on condition that it is kept confidential; GIC will need the regulations to provide powers to access this information (while still maintaining confidentiality).
Some costs should be allocated to other areas like open access, the complaints scheme and the National Gas Outage Contingency Plan	Most of the costs attributable to work streams will be carried by the firms providing participants for the working groups. As other work areas open up in future years, GIC will need to determine whether the pattern of likely **benefits** has changed
Genesis	
Annual review should allow for future levies to recover contributions if it is found that GIC activities and costs vary substantially from initial allocations.	Agreed. For example, the second year wholesale levy may be 1c/GJ but could be reduced further if wholesale activity in first year had been much less that expected and retail much more, with the offsetting amount added to the second year retail levy to "wash up" the imbalance.

Mighty River Power	
GIC should seek government funding for some activities like rule compliance monitoring and enforcement. Refers to Scott paper on Electricity Commission roles.	Dr Scott's paper recommends a separation of activities between those properly undertaken by an industry body and those the proper domain of government. This is a decision for Government not GIC.
GIC should give close attention to cost control especially at the times the levy is reviewed.	Agreed. Of particular interest to industry directors.
The imposition of the levy should be delayed to allow retail tariffs to be increased at the same time.	With the legislation requiring that only industry participants are levied, it is hard justify designing the levy and planning its implementation so that there is **no** industry participant contribution.
Contact	
Agree with wholesale levy structure but suggest collection at first point of sale after production.	Discussed in this paper.
Retail levy should be a single universal $8/ICP since all customers will benefit equally from GIC activities.	Discussed in this paper.
Drop the 10 TJ pa boundary for the retail levy.	Discussed in this paper.
Any inability to pass on the levy (because of particular sales contracts) is not an issue.	Most gas sales contracts apparently have a standard provision that any government imposed levies or taxes will be passed on but there are apparently exceptions.
GIC should get necessary customer numbers etc from NGC and the allocation agent.	Discussed in this paper.
Wanganui Gas	
Favours $/ICP approach for retail levy.	Discussed in this paper
Levies will make gas less competitive.	The levies are very small relative to prevailing tariffs.
Retailers will incur additional administrative costs in collecting and paying the levy	Agreed. GIC has sought to minimise retail compliance costs by relying on existing data for the GJ and ICP numbers.

Ballance	
7 PJ pa user resents the $105,000 impost; unconvinced about consumer benefit from GIC activities; favours a levy mechanism that ensures that the industry participants carry a fair share of the burden	The only way to minimise pass through is for major gas sector businesses to agree on (possibly different) fixed contributions for the first year. Such an agreement has not been forthcoming. Regulations could specify some fixed proportional pass through in existing fixed price contracts but this would be unfair relative to contracts that allow complete pass through.
MEUG	
Wanted to see GIC budget (including company advances and the interest provisions for repayment) to understand basis for the levy.	Discussed in this paper.
GIC should determine offsetting reductions in vote: Energy and consequent reductions in gas Energy Resources Levy and the MED safety service Gas Levy.	The Energy Resources Levy is a royalty and not a cost recovery mechanism. The Gas Levy funds the government's energy safety service as it relates to gas and there is, as yet, no direct link to GIC activities.
Want more clarity about which pipelines are included in the wholesale levy and rules for new pipelines.	Hopefully the Discussion Paper makes clear the intention that regulations will apply the wholesale levy to all gas supplies to all users.
GIC retail costs should be recovered using a $/ICP levy.	Discussed in this paper.
Residential consumer groups (summary)	
Commentators speaking for residential users were not overly alarmed by any of the cents/GJ or $/ICP levy option amounts *per se* but were not convinced about the consumer benefits from GIC activities; they favour a levy mechanism that ensures that the industry participants carry a fair share of the burden.	See comment on Ballance submission above
One submission was that the retail activity costs were out of proportion to the benefit consumers might get.	

APPENDIX B Addressees for discussion paper

Stephen Barrett	Chief Executive	Contact Energy Ltd
Murray Jackson	Chief Executive	Genesis Power Ltd
Ron Rosenberg	Chief Executive Officer	Multigas (NZ) Ltd
Stephen Parker	National Manager	Gas Association of NZ
Trevor Goodwin	Chief Executive	Wanganui Gas Ltd
Richard Tweedie	Chief Executive Officer	Todd Energy
Peter Reidy	Chief Executive	Nova Gas Ltd
Doug Heffernan	Chief Executive	Mighty River Power
Harvey Weake	Chief Executive	Methanex New Zealand Ltd
Michael Butler	Energy Manager	Fonterra Co-operative Group
Bruce Chapman	Government Relations	Carter Holt Harvey
Graeme Everett	Energy Manager	Norske Skog Tasman
Dick Whitelaw	Energy Coordination Manager	NZ Steel Ltd
Fred Staples	GM Pulp Division	Pan Pac Forest Products Ltd
Ralph Matthes	Executive Director	MEUG
Tom Tetenburg	Allocation Agent	Tetenburg & Associates
Mark Franklin	Chief Executive Officer	Vector Ltd
Steven Boulton	Chief Executive	Powerco Ltd
Peter Whitehouse	Adviser Environment & Technology	Business NZ
Bryan Crawford	Chief Executive	Natural Gas Corporation
Wilhelm Alheit	Logistics Manager	ACI Glass Packaging NZ
Dave Bennett	Chief Executive	Austral Pacific Energy Ltd
Len Houwers	General Manager	Ballance Agri-Nutrients (Kapuni)
Kevin Johnson	Executive Director	Bridge Petroleum Ltd
Tai Ruwhiu	General Manager	Greymouth Petroleum
Ray Garbutt	Engineering Manager	Heinz Wattie's Ltd
Thomas Zengerly	General Manager	The New Zealand Refining Co Ltd
Gordon Ward	General Manager	NZOG Services Ltd
Steve Hounsell	Managing Director	OMV New Zealand
Paul Zealand	Chairman	Shell NZ Ltd
Don Morgan	Chief Executive	Swift Energy NZ Ltd
Clyde Bennett	NZ Asset Manager	Tap Oil Ltd
Kerry Starling	Manager Procurement	Tenon Ltd
Lianne Meiklejohn	Group Supply Manager	Fletcher Building Limited
Ewen Gardiner	General Manager	Tatua Co-op Dairy Co Ltd
John Rampton	Chief Analyst, Gas & Oil Resources	Ministry of Economic Development
Dr Mike Patrick	Executive Officer	PEPANZ
Dennis McGowan	General Manager	Westech Energy
Ajit Bansal	General Manager	Shell (Petroleum Mining)
Liz MacPherson	General Manager	Ministry of Consumer Affairs
David Russell	Chief Executive	Consumers Institute
Graham Stairmand	President	Grey Power
Eileen Imlach	Consumer Affairs Commentator	NZ Council of Women
Raewyn Nielsen	Executive Officer, New Zealand Federation of Family Budgeting Services	
Louise May	Social Policy Mgr, New Zealand Association of Citizens Advice Bureaux	
Bernie Harris	Sec'y, Federation of Wellington Progressive and Ratepayers Associations	