GAS INDUSTRY COMPANY LIMITED

Recommendation to the Minister of Energy on the 2006/07 Gas Industry Company Levy

2 May 2006

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1 Executive Summary

The Gas Act 1992 (the Act) enables the industry body for the gas industry, namely the Gas Industry Company Ltd (Gas Industry Co), to recommend to the Minister of Energy that levy regulations be made requiring industry participants[1] to pay a levy to the industry body (s43ZZB). The levy is to recover the estimated costs of the Gas Industry Co exercising its functions as the industry body (s43ZZC). This paper presents recommendations on the amount, design and implementation of the levy for the financial year ending 30 June 2007. These were developed following two rounds of stakeholder consultation (see Section 8 and Appendix G) and a Levy workshop.

The Gas Industry Co's recommendations to the Minister of Energy are that:

- the current Wholesale levy of 1.50 cents/GJ, paid on all gas purchased from producers (or from the Crown in the case of Maui gas) by the buyers of that gas, be increased to 1.78 cents/GJ. The levy will continue to be calculated quarterly and paid monthly, based on the party's total gas purchases in the quarter before the last completed quarter (for example, the three monthly payments in July, August and September 2005 will be based on gas sales for the quarter to 31 March 2005);
- the current Retail levy of 6c/GJ plus $4/ICP/year be changed to a Retail levy of $6.30/ICP/year and that this be paid in respect of every ICP (network interconnection point), not only in respect of end users consuming less than 10 TJ pa, as at present. The levy will be calculated monthly on the basis of the number of ICPs supplied by each retailer at the end of the previous month (not on quantities from the previous October year, as at present); and
- these new levies come into effect on 1 July 2006.

In aggregate the levies are estimated to meet the Gas Industry Co's revenue requirement of $3.8m for the 2006/07 year. This has increased from a $3.6m target in the 2005/06 year, largely as a result of the various workstreams entering a period of high activity. While the total quantum is significant, the levy amounts are not large relative to customers' annual gas bills. For example, if the levies were all passed through to customers, the effect of this proposal relative to average gas bills would be:

User type	Residential	Commercial	Industrial
Typical Annual usage	25GJ	1,000GJ	1,000,000GJ
Annual gas bill[2]	$750.00	$10,000.00	$7,000,000.00
Annual Retail levy	$6.30	$6.30	$6.30
Annual Wholesale levy	$0.45	$17.80	$17,800.00
Total Annual levy	$6.75	$24.10	$17,806.30
% of gas bill	0.90%	0.24%	0.25%

All these amounts are calculated exclusive of GST.

[1] In legislation, "industry participants" includes retailers, distributors, producers, pipeline or meter owners, wholesalers and major upstream buyers.

[2] These are approximate. Any customer's actual gas bill will depend on a number of factors such as location, load profile, retailer tariff option etc..

2 Background

Amendments to the Gas Act 1992, introduced in 2004, provided for the co-regulation of the gas industry by the Government and an industry body. The Gas Industry Co was established by the gas industry to fulfil the role of the industry body as set out in the Gas Act. The Gas Industry Co was approved as the industry body by Order in Council on 22 December 2004.

The Gas Industry Co is responsible for proposing arrangements, which may include rules and regulations, in a range of areas relating to the gas industry including wholesale markets and processing, transmission and distribution networks, and retail and consumer protection. Where appropriate, the Gas Industry Co may ultimately be involved in the implementation of market arrangements and in the surveillance and enforcement of market rules. The principal source of funding for this work is through a levy on industry participants. The quantum and structure of this levy are based on the Gas Industry Co budget, stakeholder consultation and analysis.

3 Overview of paper

This paper is structured as follows:

Section 4 reviews the consultation process, the issues which emerged and the Gas Industry Co's position on these.

Section 5 reviews the outcomes being sought by Government, as described in the Government Policy Statement, and the Gas Industry Co's 2006/07 Work Programme which has been designed to progress the industry towards those outcomes.

Section 6 explains how the 2006/07 Levy revenue requirement has been derived from the budget, why the amount is reasonable, and what constraints there are on the Gas Industry Co to ensure that it manages its costs in a disciplined manner.

Section 7 discusses the Levy design. After describing the principles of levy setting, the beneficiaries of the activities being funded are identified and issues in relation to the current level structure and the benefits of the recommended structure are explained. The matters raised in submissions are also discussed together with the Gas Industry Co's reasons for adopting or rejecting the suggestions received.

Section 8 describes in detail how the costs have been allocated and develops recommended levies.

Section 9 explains how the proposed levies meet the principles of levy setting.

Section 10 offers some concluding comments.

The seven appendices provide additional information as follows:

Appendix A is a summary of the Work Programme.

Appendix B is a summary of the Levy Options presented in the consultation papers.

Appendix C and D are summaries of the submissions received in response to the February and March levy consultation papers.

Appendix E is an outline Regulatory Impact Statement (RIS).

Appendix F is a Business Compliance Cost Statement (BCCS).

Appendix G is a list of parties consulted with.

4 Consultation

4.1 Discussion Papers and Workshop

The first Gas Levy Discussion Paper was circulated on 24 February with a request for responses by 17 March. The paper discussed the merits of four levy Options.

Levy Option 1 was a pragmatic option which gave weight to administrative simplicity and low year-on-year volatility. It proposed that the Retail levy be left unchanged and that the balance of the required revenue be recovered through the Wholesale levy.

Options 2, 3 and 4 all used the same cost allocation methodology as was used last year. This resulted in $1.575m of costs being allocated to the Retail activity and $2.205m being allocated to Wholesale activity in each case. The difference between these three options was that each proposed a somewhat different recovery mechanism for the Retail costs. This resulted in different Retail levy options. The Wholesale levy options were the same in each case.

Option 2 proposed that the current Retail levy arrangement - where half the allocated cost is recovered on a per GJ levy and half on a per ICP levy - was retained.

Option 3 proposed that the allocated cost be recovered from a single per GJ Retail levy.

Option 4 proposed that the allocated cost be recovered from two levies – a Residential per GJ levy and a Commercial per GJ levy.

In light of the first round of submissions and discussions at a Gas Levy Workshop hosted by the Gas Industry Co, the Gas Industry Co decided to issue a follow up consultation paper which proposed a further Retail levy option and an amendment to the estimate of wholesale gas sales on which the quantum of the Wholesale levy was based. This Supplementary Gas Levy Discussion Paper was circulated on 29 March with a request for responses by 11 April.

Option 5, like options 2, 3 and 4, allocated $1.575m to Retail activity and $2.205m to Wholesale activity. It differed from the other options in that it proposed that the Retail levy would recover the allocated cost from a single per ICP Retail levy, and that the Wholesale levy would be calculated on a volume base of 124PJ rather than 115PJ.

The levy Options presented in the discussion papers are summarised in Appendix B.

The submissions relating to the first and second papers are summarised in Appendix C and D respectively.

Both consultation papers were sent to the stakeholders listed in Appendix G.

The substantive issues raised through the consultation process are discussed below and in Section 7 and are summarised in Appendices C and D.

4.2 Consumers' Opinions

Consultation documents and workshop invitations were sent to consumer organisations and a number of large users. The consumer organisations were: the Consumers Institute, the Federation of Wellington Progressive & Residents Associations, Grey Power, the National Council of Women (NCWNZ) of New Zealand, the Major Electricity Users Group (MEUG)[3] and the Ministry of Consumer Affairs.

Of the consumer organisations only the NCWNZ and MEUG made formal submissions. In informal discussions with representatives of the other groups it is understood that the quantum of the levy for small users (less than 2 cents/day) was a major factor in their

[3] MEUG also represents major gas users.

choosing not to make formal submissions. The NZ Association of Citizen Advice Bureaus also noted that the proposal did not raise social policy concerns for them.

The Electricity and Gas Complaints Commission commented that it had no view on the quantum of the levy but believed that any change which simplified it and made it easy to understand was likely to be welcomed by gas customers.

A common concern commented on by a number of users who did make submissions was the cost of the levy review process. For example, Ballance agri-nutrients (a major petrochemical customer) believed that *"The cost of this work-stream is out of proportion to the size of the levy proposed and is distracting to the work that the GIC is charged to complete."*

Similarly NCWNZ considered that *"… NCWNZ favours the proposal of a change from a yearly levy to a two year levy. This decision was made to provide more stability for consumers to be able to budget. Costs to industry of the yearly reviews would add to the overall costs to consumers."*

The concept of a two-year levy review was proposed in the discussion papers to reduce the average cost of the levy review process. Although this was supported in submissions, discussion with officials suggest that it would not be appropriate at the current stage of the Gas Industry Co's development. It has therefore not been recommended to the Minister.

NCWNZ was also concerned about the lack of consistency in the way in which the levy was being passed through from retailers to their customers. The Minister, in a letter dated 9 November 2005, has already asked the Gas Industry Co to address concerns over transparency of consumer bills. Transparency of the levy will be considered as part of that work, together with the transparency of other levies and of the transmission and distribution components of the price. However, in the meantime, the levy which is recommended is much simpler for retailers to pass through to their customers in a consistent, unambiguous and transparent way, should they choose to do so. No doubt this was a consideration of the NCWNZ in supporting the proposal.

MEUG and Contact Energy (a major gas consumer in the electricity generation sector), both felt that gas consumers should be entitled to more information about Gas Industry Co's budget. Gas Industry Co believes that its work programme and budget are properly matters for its Board to consider. The focus of the levy discussions should be on the merits of the various levy design options rather than on the content of work programme or budget. There are already a number of cost disciplines on the Gas Industry Co's budget which are discussed in Section 6.3. However, a comparison with the previous year's costs will be provided in future levy discussion papers.

Methanex, the largest consumer in the petrochemical sector, and Contact Energy both raised the issue of over recovery of costs. Methanex believed that any over recovery should be returned to those who paid while Contact Energy believed that any over- or under-recovery should be rolled into the following year's levy calculation. Gas Industry Co agrees that this is a matter which does need to be addressed. The company has been fortunate that at its inception shareholders provided loans which have given it a buffer against unexpected fluctuations of revenues and/or costs. This issue will be fully addressed in next year's levy consultation.

4.3 Industry Opinions

Following the release of Gas Industry Co's February discussion paper Retailers argued that the best levy option for addressing the issues highlighted in respect of the current levy was a fully fixed (per ICP) Retail levy. This was not an option which the Gas Industry Co had proposed in its February paper. On consideration of the arguments put forward in support of a fully fixed Retail levy, Gas Industry Co believed that they had merit and should be consulted on. By this time Gas Industry Co had also received new estimated quantity data from levy payers. On the basis of this information it revised the estimated annual quantity of gas purchased from producers from 115 PJ to 124 PJ.[4] These were the matters which were addressed in the March discussion paper.

On analysis the Gas Industry Co is convinced that the administrative simplicity which a fully fixed (per ICP) Retail levy will bring will reduce costs and improve transparency. These are matters which are fully explored in section 7.

5 Objectives and Work Plan

5.1 Government's Policy Objective

In October 2004, the Government issued a Government Policy Statement (GPS) on Gas Governance, which replaced the previous Statement and set out its objectives for the gas industry. These were:

Wholesale Markets and Processing

- *The development of protocols and standards applying to wholesale gas trading, including quality standards, balancing and reconciliation;*
- *The development of a secondary market for the trading of excess and shortfall quantities of gas;*
- *The development of capacity trading arrangements;*
- *Protocols that set reasonable terms and conditions for access to gas processing facilities.*

Transmission and Distribution Networks

- *The establishment of an open access regime across transmission pipelines so that gas market participants can access transmission pipelines on reasonable terms and conditions;*
- *The establishment of consistent standards and protocols across distribution pipelines so that gas market participants can access distribution pipelines on reasonable terms and conditions;*
- *The establishment of gas flow measurement arrangements to enable effective control and management of gas.*

Retail and Consumer Arrangements

- *The standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised;*
- *The development of efficient and effective arrangements for the proper handling of consumer complaints;*
- *The development of model contract terms and conditions between consumers and retailers.*

[4] It is hoped that industry participants do now appreciate how reliant the Gas Industry Co is on the timely provision of this forecast information.

5.2 Gas Industry Co's Work Programme

The Minister will be aware of the Gas Industry Co's 2006/07 Work Programme which was presented in its December Quarterly Report. However, for completeness, an updated version is provided in summary form as Appendix A.

6 Costs

6.1 2006/07 Budget

Budget projections for the 06/07 financial year are presented in the table below, categorised into the three main activity areas: Corporate, Retail and Wholesale. Within these activity areas, the work is further subdivided into individually workstreams which relate directly to the Work Programme referred to in Section 5.2 above and summarised in Appendix A.

It will be seen from the 2006/07 Financial Year Budget Projections that total Work Programme Costs are anticipated to be approximately \$3.074m. Added to this total are Other Corporate Costs (\$0.629m for rent, Board, office etc.) and balance sheet adjustments (\$0.447m loan repayments etc.). Finally, the Gas Industry Co's other sources of income are recognised. These comprise the estimated revenue carry forward from the current year (\$0.251m, which will be applied to the repayment of shareholder loans) and members' fees and interest etc. (\$0.119m). The remaining balance is the total amount which has to be raised through the levy (\$3.780m).

06/07 Financial Year Budget Projections	**($'000)**
Accountability Framework	578
Levy Process	60
Corporate Work Programme	**638**
Switching & Registry	248
Compliance and Enforcement	192
Reconciliation	267
Consumer Issues	125
Distribution Contracts	71
Retail Work Programme	**903**
Open Access Review	575
Wholesale Market Development	621
Access to Processing Facilities	126
Gas Outage Contingency Plan	191
Quality Standards	20
Wholesale Work Programme	**1,533**
Total Work Programme Costs	3,074
Other Corporate Costs	629
Loan repayments etc.	447
Total Cash Requirement	4,150
less revenue carry forward	(251)
less Non-levy income	(119)
Total Levy Revenue Requirement	**3,780**

The increase in budgeted costs from $3.6m, budgeted for the current year, to $3.8m, budgeted for the 2006/07 year, is largely due to the various wholesale workstreams entering a period of high activity.

6.2 Reasonableness of Revenue Requirement

Before discussing who the costs should be recovered from, and in what way, it is useful to get a perspective on how substantial the revenue requirement is. The amount is not large in the context of the alternatives or in relation to the total amount customers pay for their gas supply. This should give some confidence that, given a sensible levy structure, the levy should not distort market behaviour.

There are approximately 250,000 gas customers[5]. Therefore, the $3.8m can be thought of as approximately $15/year per customer, or, spread over the total expected gas use of 124 PJ/year in 2006/07, as 0.03 $/GJ.

The $15/year amount can be compared with the annual expenditure on gas of around $750 for an average gas-using household,[6] $10,000 for a typical small business,[7] $7m for a large industrial customer[8] and $120 million for a large power station.[9]

Alternatively, the revenue requirement could be expressed as a charge of $0.03/GJ on every GJ of gas sold. This can be compared to delivered gas prices of the order of $6-8/GJ for industrial users, $8-12/GJ for commercial users and around $30/GJ for residential users.

As another point of comparison, the Electricity Commission levy now raises around $63m (ignoring the purchase of reserve energy) from a sector with a turnover of about $5 billion, a proportion of about 1.3%. Gas sector turnover is estimated to be of the order of $0.75 billion. Hence, the total levy revenue requirement of $3.780m would represent 0.5% of turnover.

6.3 Cost disciplines on Gas Industry Co

The Gas Industry Co is committed to industry based solutions to meet the GPS objectives, achieved at least cost to the industry and consumers. There are strong disciplines in place to prevent unnecessary expansion of the costs of the co-regulatory arrangements. The constraints and scrutiny on Gas Industry Co costs are provided through the Gas Industry Co's:

- Strategic Plan requiring approval by the Minister;
- Constitution limiting the range of its activities;
- Budget and Work Programme being reviewed each year by its Board which comprises industry and independent directors;
- monthly Board meetings where the previous month's financial reports and progress against workstream milestones are reviewed;
- levy proposals being consulted on each year with a wide range of stakeholders (Appendix F); and

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[5] This refers to reticulated natural gas customers in the North Island only. The levy does not apply to bottled gas customers or customers supplied from reticulated LPG networks.

[6] The average household consumes about 25 GJ/year on a tariff of around $30/GJ, of which the fixed charge component is around $1/day.

[7] The average small commercial or industrial user consumes about 1 TJ/year on a tariff of about $10/GJ.

[8] Assuming a 1PJ/year customer with $7/GJ delivered gas.

[9] For example, Otahuhu or TCC would consume around 20 PJ of gas for generation at, say, $6/GJ.

- company accounts being open to all industry stakeholders who provide independent scrutiny.

In addition, it should also be noted that the regulatory function is still contestable. If the Gas Industry Co ceases to meet Government expectations in the key areas of the GPS, the Government can turn the functions over to a modified Electricity Commission (Energy Commission).

7 Levy Design

7.1 Principles of Levy Design

As noted at the outset, the Act provides for the Gas Industry Co to recover its costs through levies on industry participants. Because the levy is imposed by regulations, the levy design must accord with Treasury and Audit Office guidelines for setting such charges,[10] and the principles applied by the Regulation Review Committee.

The Treasury Guidelines promote equity, efficiency and cost minimisation by helping to identify the relevant economic considerations. They set out a framework for evaluating charging options.

The Audit Office Guidelines are intended to assist in identifying the preferred user charge option. They provide a checklist of issues on which to base a sound analysis and range of charging options. Like the Treasury Guidelines, they encourage the efficient allocation of resources and minimising the cost of supply and transactions, and dealing equitably with those who benefit from the output and/or those whose actions give rise to it. They also promote stakeholder consultation and participation in the charge review process wherever possible.

Standing Order 382 provides that a Committee (such as the Regulations Review Committee) should draw the attention of the House to where it considers that a Regulation:

a. is not in accordance with the general objects and intentions of the statue under which it was made;

b. trespasses unduly on personal rights and liberties;

c. appears to make some unusual or unexpected use of the powers conferred by the statute under which it is made;

d. unduly makes the rights and liberties of persons dependent upon administrative decisions which are not subject to review on their merits by a judicial or other independent tribunal;

e. excludes the jurisdiction of the courts without explicit authorisation in the enabling statute;

f. contains matter more appropriate for parliamentary enactment;

g. is retrospective where this is not expressly authorised by the empowering statue:

h. was not made in compliance with particular notice and consultation procedures prescribed by statute;

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[10] Treasury, 2002 “Guidelines for setting charges in the public sector” and Audit Office, 1989 “Guidelines on Costing and Charging Public Sector Goods and Services”

i. for any other reason concerning its form or purport, calls for elucidation.

A central feature of both sets of guidelines is the “beneficiary pays” principle. In the Gas Industry Co setting, this means that different parties in the gas sector should – as far as is feasible – contribute to Gas Industry Co costs broadly in proportion to the benefits they receive from the Gas Industry Co’s activities.

In its consultation paper “Consultation Regarding Levy of Industry Participants under Section 172ZC of the Electricity Amendment Act 2001” the Ministry of Economic Development has set out the principles it believes are appropriate to an overall levy structure. Although these were applied in the context of the electricity market, the principles are general to the setting of levies and can be reasonably adopted for the Gas Industry Co’s purposes since they capture the essential elements of the Treasury Guidelines, Audit Office Guidelines and Standing Order 382, in respect of the setting of levies.

The principles identified are:

Economic efficiency:

- *the levy structure should promote efficient market behaviour (or at least not materially detract from it).*

User/causer pays:

- *where the causes of the costs of providing certain services are identifiable, levies should be structured on a causer pays basis.*

Rationality:

- *where levies are to recover costs that are allocated to participants or participant classes, there should be a relatively strong logical nexus between the participants to whom a levy is imposed and the costs being recovered through that levy.*

Simplicity:

- *the levy structure should not create undue transactions costs for the Commission [/organisation], which implements and administers it, or for the participants who must pay it;*
- *the levy structure should consist of as many individual levies as necessary to recover the costs in an efficient manner taking account of all other criteria; and*
- *the fee structures should be transparent to industry participants.*

Equity:

- *users in similar situations should pay similar amounts; and*
- *competitive neutrality should be preserved. Within a class of participants the allocation of costs should not competitively advantage one participant over another.*

Comprehensiveness/revenue sufficiency:

- *the levies (together with other sources of revenue, such as penalty payments) need to be sufficient to recover the costs borne by the Commission [/organisation].*

7.2 The Beneficiaries of Gas Industry Co activities

The Gas Industry Co believes there are significant cross benefits between its retail and wholesale activities, but that small customers will benefit predominantly from the retail activity and large customers will benefit predominantly from the wholesale activity. The design of the levy reflects this.

For example, the development of wholesale market arrangements will facilitate the trading of gas and improve liquidity for producers, wholesalers and retailers. This should in turn improve competition and provide gas users – even small residential and commercial users - with more flexible supply arrangements. The recommended per unit volume Wholesale levy recognises that the benefits are likely to be proportional to size – large users will benefit proportionately more than small users from these wholesale workstreams.

Similarly, the Gas Industry Co's retail activities will bring some benefits to large users. For example, the development of effective switching arrangements will benefit all users who wish to change their gas retailer. However, it is probable that small users are more likely to engage in changing gas suppliers and might therefore be expected to bear proportionately more of the costs such as those related to Registry development. The recommended per ICP Retail levy recognises that large users will obtain proportionately less benefit from these retail workstreams.

The current levy structure, which was put in place last year, went a long way towards achieving these results. However, as explained below, several issues have been highlighted in regard to it.

7.3 Current 2005/06 Levy

The levy which was recommended to the Minister last year, and finally implemented through the 18 July 2005 Gas (Levy of Industry Participants) Regulations 2005 was:

Wholesale Gas Levy

1.5c/GJ payable by purchasers on all gas purchased from producers.

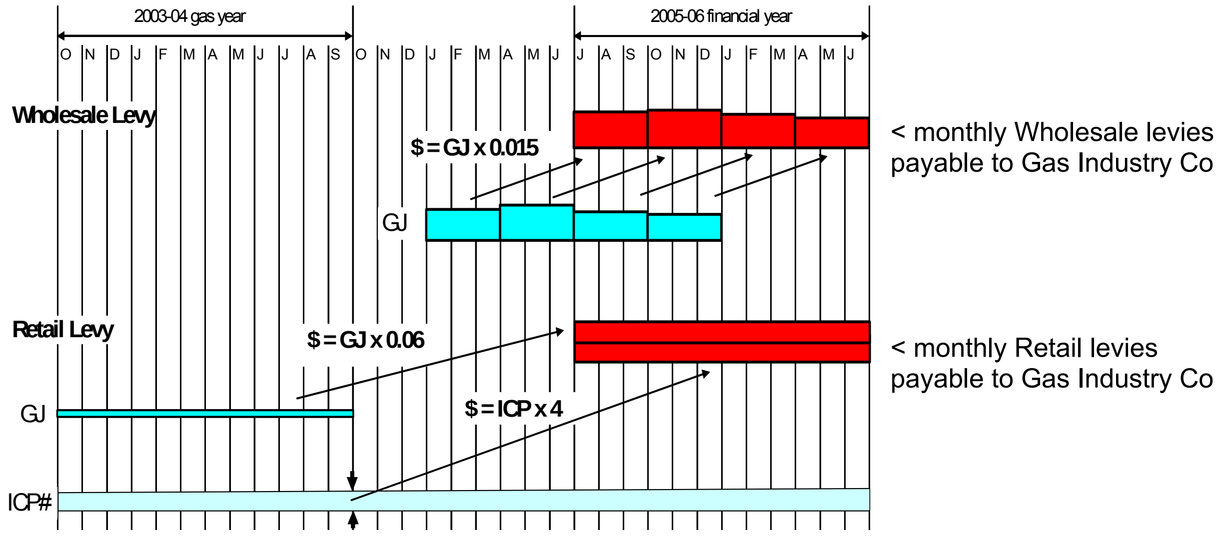
Retail Gas Levy

6c/GJ and $4/ICP/year payable by retailers on all gas supplied to customers taking < 10TJ/annum.

The amount of wholesale levy payable by each contributor is calculated each quarter based on quantities of gas purchased in "the quarter before the last completed quarter" (ie Q3 payments are calculated using Q1 wholesale gas purchases, Q4 using Q2 and so on). The total amount payable in each quarter is collected in equal monthly payments.

The amount of retail levy payable by each contributor is calculated as an annual amount and collected in equal monthly payments. The GJ amounts are the quantities of gas supplied by retailers in the previous gas (1 October to 30 September) year. The ICP numbers are those attributable to each retailer at the end of that previous gas year.

These levy arrangements are illustrated below.



It was anticipated that levies would raise $3.6m in the 2005/06 financial year, half from the wholesale levy and half from the retail levy. The final result will be slightly ahead of this target.

7.4 Issues highlighted in respect of the Current Levy Structure

While the levy structure which was developed in 2005 attempted to address the "beneficiary pays" principle, two particular aspects of the design have caused concern. These problems were anticipated by submissions received in last year's consultation process and were also a theme in this year's consultation round. These issues are described below.

a) 10TJ limit to Retail Levy

Currently the Retail levy only applies to end users who take less than 10TJ of gas a year. An end user who takes slightly more than this pays no Retail levy at all. This is an anomaly which seems intuitively unfair.

When this issue was discussed last year, the Gas Industry Co's view was that there was no reason for retailers to pass on the levy to final users with the same abrupt cut-off. Also, it noted that, since the Retail levy was based on a past gas year, the levy obligation was effectively a fixed cost to each retailer. The Gas Industry Co's conclusion was that, despite the measure of arbitrariness in the cut-off, some boundary was necessary and that the 10 TJ level was practicable and recognised that users above this cut-off generally had individually negotiated gas sales contracts and were less dependent on good switching mechanisms in achieving good terms and conditions of supply.

With experience of the levy it is now clear that most retailers do pass it through to their customers and that the 10TJ anomaly is unfair and administratively costly and should be addressed.

b) Lag of Reference Quantities

A gas industry working group which advised the Gas Industry Co on implementation of the inaugural levy in 2005 believed that accurate information about retail sales was only available at the end of a gas year (the year to 30 September) and not during the course of the gas year. On the basis of this advice, the Gas Industry Co recommended that the retail levy be calculated on the basis of gas sales and ICP numbers in the previous gas year.

This referencing of quantities in the previous gas year can be problematic. Retailers generally wish to recover levies charged to them from their current customers, and charge the levy through to those customers based on the current month's sales and ICP numbers. So there is currently a discrepancy between the amount a retailer pays the Gas Industry Co and the amount that retailer charges on to its customers if it passes the existing levy through in a transparent fashion. This discrepancy may be significant if large changes to a retailer's customer numbers or customer volumes occur.

With experience of the levy it is now clear that this issue continues to be of concern to retailers. There is also evidence that end users are similarly concerned, especially where there is a lack of consistency in the way each retailer might pass the charge through to them.

7.5 Proposed 2006/07 Levy Structure

The issues discussed above and a range of other aspects of the levy were considered by Gas Industry Co during the two rounds of consultation and levy workshop earlier this year. The levy which is now being recommended to the Minister for the year beginning 1 July 2006 is a result of that work. The recommended levies are:

Wholesale Gas Levy

1.78c/GJ payable by purchasers on all gas purchased from producers.

Retail Gas Levy

$6.30/ICP/year payable by each retailer on every ICP it supplied with gas.

The amount of wholesale levy payable by each contributor is calculated each quarter based on quantities of gas purchased in "the quarter before the last completed quarter" (ie Q3 payments are calculated using Q1 wholesale gas purchases, Q4 using Q2 and so on). The total amount payable in each quarter is collected in equal monthly payments.

The amount of retail levy payable by each contributor is calculated as a monthly amount and collected in monthly payments. The ICP numbers are those attributable to each retailer at the end of the previous month.

7.6 How the Recommended Levy addresses the Issues Highlighted in respect of the Current Levy

a) Elimination of the 10TJ anomaly

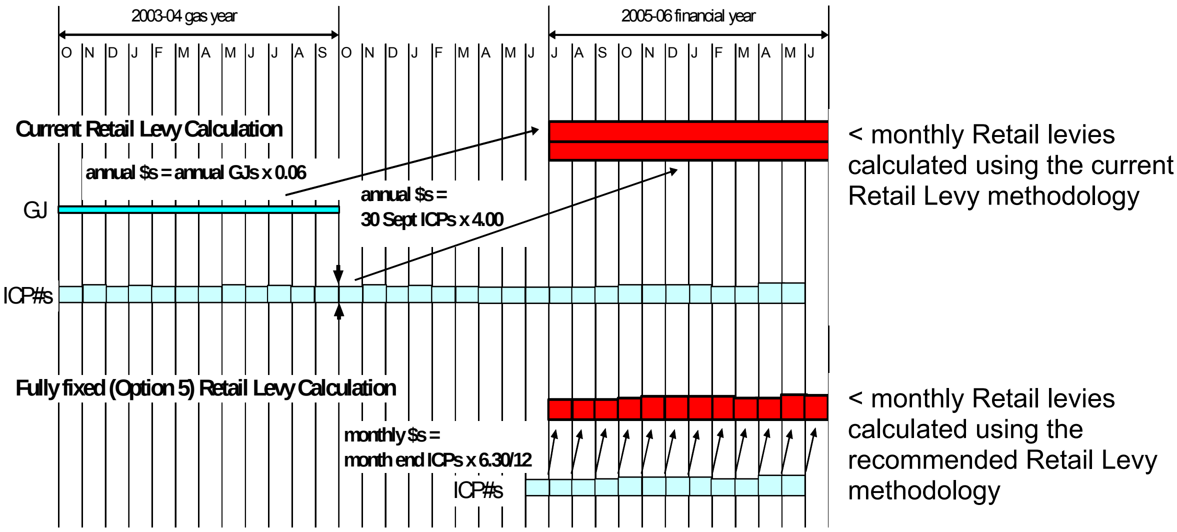
The recommended Retail levy applies a flat $/ICP charge on all ICPs. If adopted, all end users will pay $6.30/ICP/year (1.726 cents/day) regardless of how much gas is consumed. There would no longer be an arbitrary boundary at 10TJ/annum.

Elimination of the 10TJ anomaly brings the benefit that there is no need for retailers to assess if any particular end user fell into the less than 10 TJ category or not. The number of ICP's is also more easily determined and less prone to correction than the

GJ quantities. While such administrative simplifications may not seem significant in isolation, we are told by retailers that they do all contribute to reducing costs. It is expected that the benefits of reduced compliance costs will be passed through to consumers.

b) Elimination of the timing lag

The recommended Retail levy proposes that levy amounts will be based on the number of ICP’s at the end of the previous month (ie the retailer’s billing month) rather than at the end of the previous gas year. The difference in methodology can be illustrated as follows:



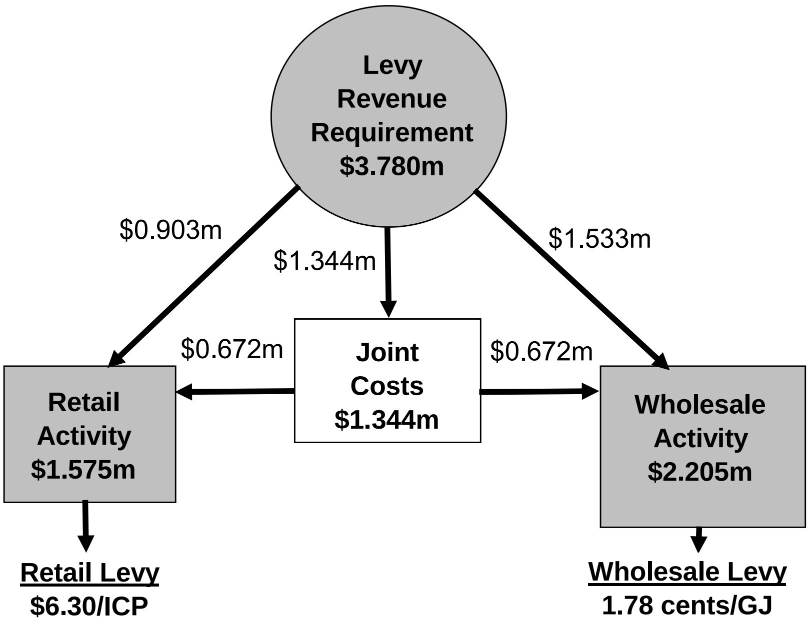
Matching the incidence of the levy to a retailer’s current billing period clearly allows a better match between the amounts to be paid to the Gas Industry Co and the amounts retailers may wish to recover from their customers. This reduces risk for retailers and it would be expected that lower risk would be reflected in lower prices.

Eventually, when reliable registry data becomes available, it would be possible to base the levy on “ICP-days” i.e. accounting for the various customer number changes which take place during a month. For the time being, it is proposed that month end ICP numbers be used.

8 Cost Allocations

The cost allocation methodology underlying the current levy design attributed costs directly where possible and split common costs equally between the wholesale and retail activities. The rationale was that, where possible, costs should be directly allocated to the activity area they related to. Common costs were shared equally between the activity areas. These included such items as rent, Board expenses, IT, printing and stationery and legal and personnel costs not directly attributable to a particular activity area.

Using this same methodology, but updated with the 2006/07 financial year budget projections for costs and volumes, the resulting costs are allocated as shown below:



Retail Allocation Base	250,000	ICPs
Retail Cost Allocation	$1.575	Million
Retail Levy	6.30	$/ICP/year

Wholesale Allocation Base	124,000	TJ
Wholesale Cost Allocation	$2.205	Million
Wholesale Levy	1.78	cents/GJ

The derivation of these levies from the Section 5.1 budget projections is as follows.

The Retail Cost Allocation of $1.575m is calculated by adding the budgeted costs directly attributable to Retail activities, of $0.903m, to half of the joint costs. The joint costs are all the costs which are not direct, i.e. $3.780m less $0.903m of retail direct costs less $1.533 of wholesale direct costs. This gives joint costs of $1.344, and adding half of this to the retail direct costs gives: $0.903m + $0.672m = $1.575m. Dividing this by the number of ICP's, 250,000, gives the Retail tariff of $6.30/ICP/year.

Similarly, costs directly attributable to Wholesale are $1.533m. Adding the $0.672m share of the Joint costs gives $2.205m. Dividing this by the anticipated quantity of gas to be purchased from producers, 124PJ, gives the Wholesale levy of $1.78c/GJ.

9 How the Recommended Levy Accords with the Levy Design Principles

9.1 Economic efficiency

The Gas Industry Co is engaged in the design and implementation of arrangements to achieve Government's policy objectives. In doing this it will consume resources that have alternative uses. Economic efficiency requires that resources are allocated to their highest value use. However, the market arrangements which the Gas Industry Co will develop are in the nature of a common good which it is not possible to subdivide and allocate between users.

Economic theory proposes that the distortionary effect of recovering the cost of a common good will be minimised if it is allocated in proportion to the elasticity of demand for the underlying good. However this approach is not generally considered to be equitable.

In the context of the levy, the Gas Industry Co believes that it is best to consider efficiency in terms of mechanisms to:

- ensure that a quality product is being delivered at reasonable cost (low production cost); and
- ensure that the cost is recovered in an administratively simple manner (low transaction costs).

Supporters of the recommended Retail levy design cited lower administrative costs as a benefit. It is hard to value this benefit but it is easy to understand why lower costs should be expected:

- GJ usage is continually changing and subject to frequent corrections whereas ICP numbers are relatively stable and only subject to correction when customer switches go wrong or connections and disconnections are mis-recorded.
- Reconciling receipts and payments is likely to be much simpler if ICP numbers are the only variable.
- The calculation of the tariff will be simpler and verification of ICP numbers is a much simpler matter than verifying GJ numbers.

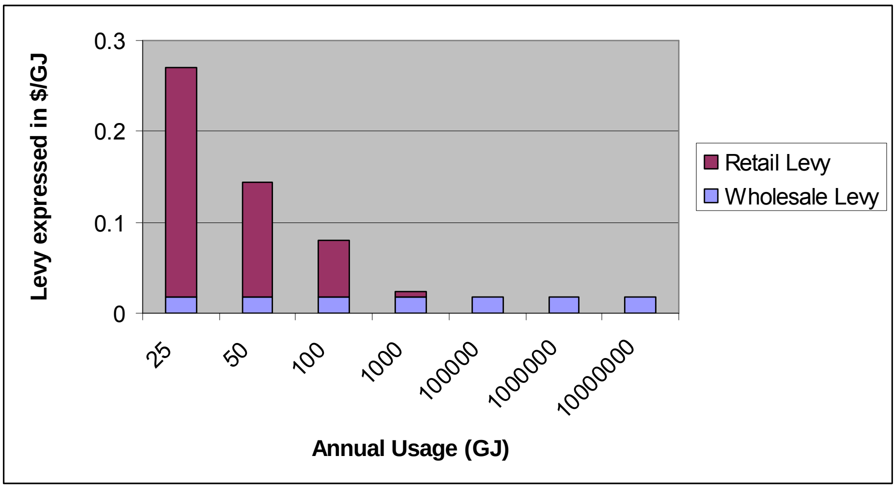
In relation to the cost recovery mechanisms, an efficient way to ensure that all customers share in the costs of the Gas Industry Co's wholesale activities is to levy gas at its first point of sale – when it is purchased from producers – at a variable rate. Accordingly the Wholesale levy applies to all gas purchased from producers at a proposed rate of 1.78c/GJ.

An efficient way to ensure that all customers contribute to the costs of the Gas Industry Co's retail activities is to levy every connection where gas is delivered from a pipeline to an end user (an ICP point). Accordingly, it is proposed that the Retail levy applies to each ICP connection at a rate of $6.30/year.

9.2 User/causer pays

Clearly the need for effective retail and wholesale market arrangements arises from the activity of all market participants. As previously discussed, at this stage of the Gas Industry Co's development its work has a high "common good" element and cannot be said to arise solely from the activity of one party or group. However, a reasonable working assumption is that all users benefit from wholesale activities, proportionate to their sales, and that the larger a user is the less benefit it is likely to derive from the retail activities of the Gas Industry Co.

The recommended levy broadly reflects that distribution of benefits. From the diagram below it can be seen that an average sized residential user will attract a share of the Wholesale levy at the same rate as all other users, $0.0178/GJ. However the Retail levy of $6.30/year, when expressed in $/GJ terms, for an average residential user consuming 25GJ a year, will amount to $0.252/GJ. For larger users the retail levy will be proportionately less. For example the Retail levy attributable to a 1,000GJ per year customer will be $0.0063/GJ.



The incidence of the levies is further illustrated in the table below. For comparison the levy shares have also been calculated using the 2005/06 levies. The Residential share of the levy has increased from 38% to 41% while the Commercial/Industrial share has decreased from 21% to 12%. These effects are substantially due to the recommended removal of the variable component on the Retail levy which will reduce the cost burden on larger users. Major Users, on the other hand, bear more cost, up from 42% to 47%, due to the recommended increase in the Wholesale levy arising from the forecast closure of Methanex and increased Gas Industry Co wholesale work programme activity.

How the levy is shared between consumer groupings									
	Residential			Commercial/Industrial			Major Users		
	ICP TJ	$m	%	ICP TJ	$m	%	ICP TJ	$m	%
Retail Levy ($6.3/ICP/yr)	230,000	$1.449	92	20,000[11]	$0.126	8	10	$0.000	0
Wholesale Levy (1.78c/GJ)	5,750	$0.102	4	18,250	$0.325	15	100,000	$1.780	81
Total (2006/07)		$1.551	41		$0.451	12		$1.780	47
Total (2005/06)		$1.351	38		$0.749	21		$1.500	42

[11] The overall number of ICPs in this category has been estimated. Currently retailers amalgamate the demand at all ICPs related to a particular customer to determine if that customer is a "retail customer" as defined by the Regulations, i.e. a customer taking less than 10TJ in a year. For example, a fast food provider may have many small ICPs throughout the North Island. Currently, if the aggregate demand of that customer at all its ICPs is more than 10TJ, it will not be considered to be a "retail customer" and its retailer will not pay any Retail levy in respect of those ICPs. However, the recommended Retail levy will apply to all ICPs, so this anomaly will be removed. Retailers will no longer have the administrative burden of determining which customers are "retail customers" and will simply apply the Retail levy to all ICPs they supply.

9.3 Rationality

The nexus between the participants who pay the levies and the costs being recovered through those levies is, to some degree, self evident. As discussed above, the need for effective retail and wholesale market arrangements arises from the activity of all gas market participants. However, the retail workstreams – such as the development of switching and registry arrangements – are predominantly driven by the "mass market" while the wholesale workstreams – such as the review of access to processing facilities – are predominantly of interest to larger users.

9.4 Simplicity

As previously discussed the recommendation simplifies the current levy design in a way which submitters believe would reduce transaction costs. The division of the levy into a Wholesale levy and Retail levy mirrors the two main operational areas of the Gas Industry Co's Work Plan and budget. The levy is also transparent, being derived from a simple cost allocation.

9.5 Equity

Any tariff change brings about a redistribution of costs, so it is unlikely that all parties will agree that it is equitable. The table below provides a comparison of the recommended levy against the current levy, for variously sized customers.

Comparison between Current Levy and Recommended Levy

		Current Levy			Recommended Levy			difference	
		Retail Levy	Wholesale Levy	**Total Levy**	Retail Levy	Wholesale Levy	**Total Levy**		
User Type	GJ/year	$/year	$/year	**$/year**	$/year	$/year	**$/year**	$/year	%
SR	5	4.30	0.08	4.38	6.30	0.09	6.39	2.02	46%
MR	25	5.50	0.38	5.88	6.30	0.45	6.75	0.88	15%
LR/SC	40	6.40	0.60	7.00	6.30	0.71	7.01	0.01	0
MC	1,000	64.00	15.00	79.00	6.30	17.80	24.10	-54.90	-70%
LC/SI	20,000	0.00	300.00	300.00	6.30	356.00	362.30	62.30	21%
I	1,000,000	0.00	15,000.00	15,000.00	6.30	17,800.00	17,806.30	2,806.30	19%
LPS	20,000,000	0.00	300,000.00	300,000.00	6.30	356,000.00	356,006.30	56,006.30	19%

All these amounts are calculated exclusive of GST.

Key:		
	SR	Small Residential
	MR	Medium Residential
	LR	Large Residential
	SC	Small Commercial
	MC	Medium Commercial
	SI	Small Industrial
	I	Industrial
	LPS	Large Power Station

When compared to the current levy, the recommended levy tends to increase the cost attributable to small users, but by a very small amount. For example small residential (SR) users would pay an extra $2.02/year. Large users would also pay more. A large power station would pay an extra $56,000/year. However, in a total gas bill of the order of $120m, this is a relatively small proportion (0.05%).

The parties who are advantaged by the recommended levies are the medium sized commercial users. In fact any user who takes more than 40GJ/year and less than 10,000GJ/year will be advantaged.

The reasons why the recommended levy might be considered to improve equity are that:

- there are no arbitrary break points, such as the 10,000GJ/year boundary in the current levy; and
- users in similar situations will pay similar amounts.

9.6 Comprehensiveness/revenue sufficiency

The levies (together with other sources of revenue) are sufficient to meet the Gas Industry Co's revenue requirement as set out in Section 5.1.

10 Conclusions

The Gas Industry Co trusts that these recommendations are clear. A pro forma Regulatory Impact Statement is included as Appendix E and a Business Compliance Cost Statement as Appendix F. If there is any further background or explanation that the Gas Industry Co can provide to assist officials in responding to this paper, please advise:

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Or email ian.wilson@gasindustry.co.nz

Appendix A - Work Programme Summary

Notes:

1. These tables should be read in conjunction with the work stream descriptions provided above.
2. In setting the programme it has been assumed that each workstream will involve consultation which may lead to recommendations being made to the Minister which require new arrangements to be implemented by rules or regulations. Actual outcomes may differ from these assumptions. In particular consultations may be short or protracted depending on the issues raised, and it may be that some matters do not require a pan industry arrangement and others may be addressed by non-regulatory arrangements. Accordingly, while the outcomes may be written for brevity as "Report on issues" or "Implement arrangements" addition of the words "… where required" should be assumed.
3. Government may, from time to time, issue requests or Policy Statements which cause the Gas Industry Co to alter its work programme.

A - Corporate Work Programme

	Jan-Mar 06	Apr–Jun 06	Jly–Sep 06 (Q1)	Oct–Dec 06 (Q2)	Jan–Mar 07 (Q3)	Apr–Jun 07 (Q4)	2007-08
A1 Accountability Framework	Issue Quarterly and Board Reports.	Issue Quarterly and Board Reports.	Issue Quarterly and Board Reports.	Issue Annual, Quarterly and Board Reports.	Board and Quarterly Report.	Board and Quarterly Report.	Board and Quarterly Report.
		Develop and issue Strategic Plan.	Develop and issue Baseline Review.			Develop and issue Strategic Plan.	
				Develop 2007-08 Budget.			
	Hold Industry Workshop.		Hold Industry Workshop.		Hold Industry Workshop.		Hold Industry Workshop.
A2 Levy Process	Invoice levies monthly. Develop and consult on 06-07 Levy Proposals.	Invoice levies monthly. Recommendations to Minister on 06-07 Levy. Gazetting of Levy arrangements.	Invoice levies monthly. New levy arrangements implemented.	Invoice levies monthly. Forecast Levy Revenue.	Invoice levies monthly. Develop and consult on 07-08 Levy Proposals.	Invoice levies monthly. Recommendations to Minister on 07-08 Levy Proposals. Gazetting of Levy arrangements.	Invoice levies monthly. New levy arrangements implemented.

B - Retail Work Programme (subject to Government policy direction, consultation outcomes and funding)

	Jan-Mar 06	Apr–Jun 06	Jly–Sep 06 (Q1)	Oct–Dec 06 (Q2)	Jan–Mar 07 (Q3)	Apr–Jun 07 (Q4)	2007-08
B1 **Switching and Registry**	Issue consultation document on cost benefit of switching options.	Publish decision on preferred Registry development option Develop Registry functional specification and rules. Develop service provider role specification and engagement proposal.	Consult on Registry arrangements and conduct Cost Benefit Analysis. Issue RFP for Service Provider (the appointment of which will be conditional on Ministerial approval of the proposals).	Recommendation on registry arrangements to Minister.		Registry goes live.	Review Registry Operation.
B2 **Compliance and Enforcement**			Develop and consult on proposal.	Recommendations to Minister.			
B3 **Reconciliation**	Develop and consult on short term upstream reconciliation amendments (Gas Transfer Code revisions).	Develop and consult on short term downstream reconciliation amendments (Reconciliation Code revisions).	Short term fixes implemented (Revised Gas Transfer Code and Reconciliation Code operational).	Develop and consult on proposals for long term reconciliation arrangements.		Recommendations on reconciliation to Minister.	Implement new reconciliation arrangements.
B4 **Consumer Issues**		Hold Consumer Issues Forum. Recommendations on consumer contracts to Minister. Landowner disputes added to EGCC scheme.	Develop and consult on Consumer Issues Report.	Initial Report on Consumer Issues to Minister.		Hold Consumer Issues Forum.	
B5 **Distribution Contracts**	Identify any issues with the existing contracts.		Publish issues report.		Develop and consult on Distribution proposals.	Recommendations on Distribution Contracts to Minister.	Implement recommendations (if required).

C - Wholesale Work Programme (subject to Government policy direction, consultation outcomes and funding)

	Jan-Mar 06	Apr–Jun 06	Jly–Sep 06 (Q1)	Oct–Dec 06 (Q2)	Jan–Mar 07 (Q3)	Apr–Jun 07 (Q4)	2007-08
C1 **Open Access Review**		Issues Review released.	Consult on issues review.	Report to Minister on Issues Review.	Recommendations paper issued for consultation (if reqd.).	Preliminary recommendations presented to Minister (if reqd.).	
C2 **Wholesale Market Development**	Develop Concept Design for Wholesale Market.	Consult on and refine Concept Design.	Develop and consult on market arrangements.	Revise arrangements, consult on revision and report outcome to Minister. Issue RFP for Service provider.	Appoint Service Provider and begin development of trading platform. (The appointment of which will be conditional on Ministerial approval of the proposals.) Consult on trading platform design and detailed arrangements.	Recommendation on trading rules presented to Minister.	Wholesale market open for trading.
C3 **Access to Processing Facilities**		Consult on options to achieve GPS outcomes.	Define and consult on preferred option.	Recommendation on access rules or protocols presented to Minister.		Implementation of preferred option.	
C4 **Gas Outage Contingency Plan**	Develop commercial options for contingency situations.	Consult on options and compliance with existing Contingency Plan (NGOCP).	Develop and consult on solutions for contingency events.		Recommendation on contingency arrangements presented to Minister.		Implementation of preferred option.
C5 **Quality Standards**	Consult on Gas Specification Issues.	Recommendations on Specification Issues to Minister.		Implement recommendations.			

Appendix B – Levy Options Consulted On

	As set out in February Levy Discussion Paper			As revised in March Supplementary Levy Discussion Paper	
Option 1 - Only adjust the Wholesale levy					
Retail	6.00	Cents/GJ	Retail	6.00	Cents/GJ
	4.00	$/ICP		4.00	$/ICP
Wholesale	1.74	Cents/GJ	*Wholesale*	*1.62*	*Cents/GJ*
Option 2 - No change to current allocation methodology					
Retail	5.80	Cents/GJ	Retail	5.80	Cents/GJ
	3.28	$/ICP		3.28	$/ICP
Wholesale	1.92	Cents/GJ	*Wholesale*	*1.78*	*Cents/GJ*
Option 3 - Fully Variable Retail Levy					
Retail	11.59	Cents/GJ	Retail	11.59	Cents/GJ
Wholesale	1.92	Cents/GJ	*Wholesale*	*1.78*	*Cents/GJ*
Option 4 - Split retail levy into fully variable Residential and Commercial levies					
Residential	19.45	Cents/GJ	Residential	19.45	Cents/GJ
Commercial	6.20	Cents/GJ	Commercial	6.20	Cents/GJ
Wholesale	1.92	Cents/GJ	*Wholesale*	*1.78*	*Cents/GJ*
			new Option 5 - Fully fixed Retail levy		
			Retail	*0.00*	*Cents/GJ*
				6.30	*$/ICP*
			Wholesale	*1.78*	*Cents/GJ*

Notes

1. The Wholesale levies in the March paper were lower than in the February paper because the estimated wholesale volume for the 2006/07 financial year was increased from 115 PJ to 124 PJ. For example, the Option 1 Wholesale Levy was previously 1.74 cents/GJ and has now reduced to 1.62 cents/GJ.

2. The Option 5 Retail levy is to apply to all ICPs, not just to the “less than 10TJ/annum” ICPs.

Appendix C - Analysis of Submissions on February Levy Discussion Paper

Issue	Submitter	View
Levy Setting Principles	Contact Energy	Appropriate, but no indication of relative importance.
	Genesis Energy	Principles are appropriate.
	Mighty River Power	Levy will have minimal impact on consumption decisions, therefore economic efficiency considerations relatively unimportant. Suggest most important are Simplicity and Minimisation of Admin. Costs.
	Vector	Current regime focuses on precision at the expense of simplicity, equity, ease of implementation etc. Resulting complexity creates uncertainty. Administrative simplicity should be promoted.
Review period	Ballance	Support 2-yearly review because it reduces cost and is less of a distraction from the Gas Industry Co's work.
	Contact Energy	2-yearly review may have merit. Reserve position subject to seeing detail and, in particular, how budgets and unforeseen costs will be managed.
	Genesis Energy	Support 2-yearly review, once Gas Industry Co has experience of forecasting its workflows and budgets.
	Methanex	Support 2-yearly review.
	Mighty River Power	Prefer 2-yearly review.
	National Council of Women	Prefer 2-yearly review because of greater price stability and lower cost.
	Vector	Prefer 2-yearly review because it reduces uncertainty and cost.
	Wanganui Gas	Support 2-yearly review, but not appropriate yet.

Issue	Submitter	View
Retail Levy Fixed/Variable split	Contact Energy	Current 50:50 arrangement complex and cumbersome and difficult to implement (witness different retailer approaches to passing on the levy). A per ICP levy would be simple and equitable and lead to more predictable income for the Gas Industry Co. It would also be easier for retailers to implement and would virtually eliminate the threshold issue.
	Genesis Energy	Support future discussion on moving towards a per ICP retail levy for simplicity.
	Major Electricity Users Group	A fully fixed option for recovery of retail related costs should have been considered.
	Vector	For simplicity, propose a fully fixed option.
	Wanganui Gas	Favour a fully fixed retail levy because it is simple to implement and administer, can be easily matched to billing month and give the Gas Industry Co a relatively fixed income.
10TJ limit	Contact Energy	Problem is likely to create distortions. Problem would go away if retail levy was entirely applied per ICP.
	Genesis Energy	The cost of the no-step solution proposed is likely to outweigh the benefit. Preparation of the data (to allow the Gas Industry Co to calculate an appropriate no-step levy) is likely to take several months.
	Mighty River Power	From an average cost perspective all customers are likely to benefit from the "retail" arrangements. The retail levy should therefore apply to all customers. The distinction between customers who consume more or less than 10TJ/annum should be removed.
	Vector	Problem is removed if retail costs are recovered by a fixed charge to each ICP.
Reference quantities	Contact Energy	Current time lapse imposes significant risk on retailers. Propose moving to current month for the calculation of both retail and wholesale levies.

Issue	Submitter	View
	Genesis Energy	Not a major issue for Genesis, but would support a move to using more recent data if it was not too administratively complex.
	Vector	Current use of historical volumes creates significant problems for retailers. A fully fixed retail levy would ease the change to using current month data.
Budget $s	Contact Energy	Gas consumers should be entitled to more information about Gas Industry Co's budget. It has an obligation to consult on the "levy rate or amount". A comparison with the previous year's budgeted and actual costs should be incuded.
	Major Electricity Users Group	Comparison against 2005/06 year required. This would allow expectations (such as a fall in overhead since start up) to be confirmed. Financial information is not sufficient to test its reasonableness. In particular, Directors fees should be disclosed and the split between consultants and staff costs. 2 year cost projections should also be supplied. Consideration should be given to capitalising costs which give rise to future benefits.
Pass on of costs	National Council of Women	Concerned that there is no consistency in the way retailers are passing the levy cost through to consumers.
Retail & wholesale allocation	Wanganui Gas	Difficult because of cross over of working group responsibilities.
Timing	Contact Energy	Retailers require a minimum of 2 months' notice before any levy change takes effect.
Volume estimates	Methanex	Gas Industry Co estimate of 115 PJ is too low. Methanex may take up to 20 PJ and power stations may take more gas. 140 PJ is more likely.
Wash-up	Contact Energy	Any over- or under-recovery should be rolled into the following year's levy calculation. This would be simple and practical. Managing credits or debits to past customer accounts is too costly to manage. Also, further consideration should be given to building up an operational reserve.
	Methanex	Levies recover cost so no need to keep any surplus. Need a means of re-distributing.

Issue	Submitter	View
Incidence of Wholesale Levy	Vector	Proposes that the wholesale levy only applies to gas supplied to power stations. This would avoid the need for retailers to pass two charges – the wholesale and retail levies – through to customers.
Preferred Option	Ballance	Option 1.
	Contact Energy	First choice - Fully fixed retail levy, Second choice - Option 1
	Genesis Energy	Option 1, because of its simplicity. But support further discussion on fully fixed retail levy to further simplify administration.
	Major Electricity Users Group	A fully fixed Retail levy option should have been considered.
	Mighty River Power	Option 1, because of its simplicity. Option 4, least preferred.
	National Council of Women	Option 3, the fully variable retail levy, was considered more efficient and lower cost option.
	Vector	First choice - Fully fixed retail levy, Second choice - Option 1. Current Wholesale/Retail regime difficult to administer and adds cost.
	Wanganui Gas	First choice - Fully fixed retail levy, Second choice - Option 1, Third choice - Option 3

Appendix D - Analysis of Submissions on March Supplementary Levy Discussion Paper

Issue	Submitter	View
Preferred Option	Contact Energy	Supports Option 5. Simpler to implement and more equitable in practice.
	Genesis Energy	Supports Option 5. Provides best balance of efficiency, predictability and fairness.
	Major Electricity Users Group	Supports Option 5.
	Mighty River Power	Supports Option 5 since it provides the simplest allocation methodology. However, would also be comfortable with Option 1. Note that Option 1 could have been adapted to address the 10TJ issue, the Retail tariff could simply have been applied to all customers. Also note that Option 5 benefits industrial and commercial customers relative to low-use consumers.
	National Council of Women	Supports Option 5.
	Vector	Supports Option 5. Best trade-off between precision, simplicity, equity and ease of implementation.
	Wanganui Gas	Supports Option 5.
Wholesale Levy	Contact Energy	The wholesale levy should also be calculated based on the previous month's data. This would eliminate the quantity risk associated with the time lag.
	Vector	The wholesale levy should also be calculated based on the previous month's data. This would eliminate the quantity risk associated with the time lag.
Notice of Change	Contact Energy	Requires two month's minimum notice of any change – one month to program changes into customer data base and 30 days notice to customers of change.

Issue	Submitter	View
Implementation	Genesis Energy	In the absence of a central registry, retailer records will need to be relied on to determine ICP numbers. This will require a view to be taken on how to treat switches in process.

Appendix E – Regulatory Impact Statement

— ***Statement of the nature and magnitude of the problem and need for Government action***

Section 43ZZB of the Gas Act 1992 authorises the industry body (Gas Industry Co) to recommend regulations that will require industry participants to pay a levy to the industry body.

— ***Statement of the policy objectives(s)***

The levy is to be used to meet costs as specified under section 43ZZC of the Gas Act 1992. The levy is to comply with the conditions set out in section 43ZZD of the Gas Act 1992.

— ***Statement of feasible options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s)***

Given that an industry body is necessary to pursue the Government's policy objectives, and that the Gas Industry Co has been given that responsibility, the question is how best to fund the company. In its February and March 2006 discussion papers, the Gas Industry Co sought stakeholder views on a total of five alternative levy options. After careful consideration of submissions on these matters, the Gas Industry Co has determined the preferred levy option which is recommended in this paper.

— ***Statement of the net benefit of the proposal, including the total regulatory costs (administrative, compliance and economic costs) and benefits (including non-quantifiable benefits) of the proposal***

The Work Plan and related Financial Year Budget Projections presented in this paper provide a comprehensive statement of the outcomes and related costs.

The Gas Industry Co assumes that the amendments to the Gas Act presuppose that benefits to the gas sector will outweigh the costs of the industry body appointed to achieve the objectives of the GPS on Gas Governance.

— ***Statement of consultation undertaken***

Industry stakeholders including officials have been consulted as described in Section 8.

— ***Business compliance cost statement***

A Business Compliance Cost statement is included as Appendix F.

Appendix F – Business Compliance Cost Statement

Sources of compliance costs

Compliance costs are expected to arise from: the calculation of levy obligations, adjustments to retail billing systems where levies are passed on, maintenance of systems to pay Gas Industry Co, and handling complaints and inquiries in relation to the levies. Mostly these costs would accrue to gas retailers. However, retailers have advised that the administrative simplification resulting from the Retail levy recommendation made in this paper will bring about cost savings.

Parties likely to be affected

The levies apply to retailers and buyers of gas from producers.

Retailers are currently: Auckland Gas, Contact Energy, Direct Energy, e-Gas, e-Gas 2000, Genesis Energy, Mercury Energy (Mighty River Power), NGC Energy (Vector), Nova Gas and Wanganui Gas. The smallest retailers are $13m turnover businesses.

Buyers at first point of sale include Contact Energy, Fonterra, Genesis Power, Methanex, Multigas, Nova Gas, SBT Group (Taranaki By-Products) and Vector with the smallest spending about $50m/year on gas.

Estimated compliance costs

It is likely that the bulk of the compliance costs were incurred when the levy was first introduced last year. This year the time estimated for parties to adjust their systems to the new levy arrangements is estimated to be around three hours for each retailer and each party buying gas directly from a producer. At an incremental staff cost of around $120/hr, the cost could be of the order of $360 for each retailer and wholesale buyer. In addition there may be some upswing for a month or two in customer inquiries and complaints when the levy adjustments are passed through. This could add a personnel cost or degrade the existing inquiries service for all callers. One extra person diverted to complaints for a month might cost $3,000. The subtotal might then be $3,360 per retailer, which is small relative to their businesses. Total compliance costs may be $33,600 across ten retailers, plus $2,880 across the major buyers. The overall total could be around $36,480, small in the context of the $3.8m being raised.

Long term implications

The most likely levy changes in future years will be alterations to the levels of the different components of the original levy (as work areas and expected benefit distributions change), rather than the adoption of new bases. As a result, compliance costs should be substantially lower in future years.

Level of confidence in compliance cost estimates

The above estimates may be an overestimate of compliance costs. Retailers have advised that administrative cost savings can be expected from the simplification of the Retail levy. No allowance has been made for this in the compliance cost estimate.

The key compliance cost issues raised in consultation

The major issue was the administrative cost associated with the Retail levy being partially recovered on a per GJ basis, and being based on historic quantities rather than current quantities. These matters have been addressed in the recommended levy.

Overlapping compliance requirements

The 2c/GJ gas levy for the Energy Safety Service is charged on retailers' current sales volumes. The recommended Retail levy is based on retailers' current ICP numbers. Gas Industry Co has not attempted to harmonise the data requirements because the overwhelming advice from retailers is that a per ICP Retail levy is preferred.

Steps taken to minimise compliance costs

Persuasive arguments that a per ICP Retail levy will, among other benefits, bring reduced compliance costs have convinced the Gas Industry Co to recommend this levy option. Accordingly the recommended Retail levy abandons the per GJ component in favour of a single per ICP levy.

Appendix G – Parties Consulted With

Name	Position	Organisation
Wilhelm Alheit	Logistics Manager	ACI Glass Packaging New Zealand
Mike Mitchell	Manager	Auckland Gas Company
Rick Webber	Chief Executive	Austral Pacific Energy Ltd
Len Houwers	General Manager	Ballance Agri-Nutrients (Kapuni) Ltd
David Bulley		Bay of Plenty Electricity
Kevin Johnson	Executive Director	Bridge Petroleum Ltd
James Flexman	Executive	Carter Holt Harvey
David Russell	Chief Executive	Consumers Institute
David Hunt	Chief Executive	Contact Energy Limited
Liz Kelly	Manager Fuels & Major Contracts	Contact Energy Limited
Simon Coates	Regulatory Affairs Manager	Contact Energy Limited
Judi Jones	Commissioner	Electricity & Gas Complaint Commission
Ray Garbutt	Heinz Wattie's Ltd	Engineering Manager
Bernie Harris		Federation of Wellington Progressive & Residents Associations
Lianne Meiklejohn	Group Supply Manager	Fletcher Building Limited
Michael Butler	Energy Manager	Fonterra Co-operative Group
Stephen Parker	National Manager	Gas Association of NZ
Thomas Zengerly	The New Zealand Refining Co Ltd	General Manager
John Carnegie	Regulatory Affairs Manager	Genesis Energy Limited
Murray Jackson	Chief Executive	Genesis Energy Limited
Fred Staples	GM Pulp Division	Pan Pac Forest Products Ltd
Graham Stairmand	President	Grey Power
Tai Ruwhiu	Manager	Greymouth Petroleum
Ajit Bansal	Chairman	Maui Development Limited
Harvey Weake	Chief Executive	Methanex New Zealand Ltd
Ralph Matthes	Executive Director	MEUG
Doug Heffernan	Chief Executive Officer	Mighty River Power Limited
John Gilkison	Regulatory Strategist/Policy Analyst	Mighty River Power Limited
Liz MacPherson	General Manager	Ministry of Consumer Affairs
Hanh Le	Policy Analyst	Ministry of Economic Development
John Rampton	Chief Analyst, Gas, Oil & Other Resources	Ministry of Economic Development
Ron Rosenberg	Chief Executive Officer	Multigas (NZ) Ltd (e-Gas)
Eileen Imlach	Convener, Consumer Affairs Standing Committee	National Council of Women of New Zealand
Peter Reidy	Chief Executive	Nova Gas Ltd
Louise May	Social Policy Manager	NZ Association of Citizens Advice Bureau
Raewyn Nielsen		NZ Federation of Family Budgeting Services
Gordon Ward	General Manager	NZOG Services Ltd
George Goodsir	Commercial and Legal Manager	OMV New Zealand Limited
Grant A King	Managing Director	Origin Energy

Name	Position	Organisation
Dr Mike Patrick	Chief Executive	PEPANZ
Richard Krogh	Chief Operating Officer	Powerco Limited
Dean Stockwell	General Manager	SBT Group
Ajit Bansal	General Manager	Shell (Petroleum Mining) Company Limited
Alan Cunningham	Chief Executive	Swift Energy New Zealand Limited
Clyde Bennett	NZ Asset Manager	Tap Oil Ltd
Ewen Gardiner	SH26 Tatuanui	Tatua Co-op Dairy Co Ltd
Richard Tweedie	Chief Executive Officer	Todd Energy
Mark Franklin	Chief Executive Officer	Vector Limited
Paul Hodgson	Manager Regulatory Affairs	Vector Limited
Trevor Goodwin	Chief Executive	Wanganui Gas Limited
Dennis McGowan	Manager	Westech Energy