



**SUPPLEMENTARY
LEVY DISCUSSION PAPER**

March 2006

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SUPPLEMENTARY 2006/07 LEVY DISCUSSION PAPER

1 Reason for this Supplementary Levy Discussion Paper

The February Levy Discussion Paper anticipated that the Gas Industry Co would now be issuing its analysis of submissions on the paper and forwarding a recommendation to the Minister. However, it has been decided that a short supplementary consultation is required for the reasons discussed below.

A number of submissions received on the Levy Discussion Paper proposed that the best option for the Retail levy was a fully fixed (per ICP) levy. Gas Industry Co did not include this option in its original paper. However, on consideration of the arguments put forward in support of a fully fixed Retail levy, we believe that it has merit and should be introduced, subject to consideration of any other issues arising through this consultation process.

In addition, since issuing the Levy Discussion Paper, Gas Industry Co has received some of the estimated quantity data requested from levy payers. On the basis of this information it wishes to revise its estimate of the annual quantity of gas purchased from producers from 115 PJ to 124 PJ. The information received did not support any revision to the retail quantities.

This consultation document:

- Provides analysis of the fully fixed (per ICP) Retail levy proposal;
- Describes the new Option 5 – fully fixed (per ICP) Retail levy option, as it would be applied for the 2006/07 year; and
- Sets out a re-statement of all the levy options, modified for the new Wholesale volume estimates and including the new Option 5.

If you wish to review the submissions made on the February Levy Discussion Paper, they are available on the Gas Industry Co website at:

<http://www.gasindustry.co.nz/Consultation.html>

The quantity data provided to the Gas Industry Co is treated as confidential and is not available on the website.

2 Call for submissions

Some submitters have already made their preference for a fully fixed Retail levy option clear. However, even if you were one of those submitters, some aspects of the fully fixed option presented in this paper (Option 5) may not exactly accord to your preferred approach. Therefore, it would be helpful if you could confirm your support for the particular Option 5 proposal as set out in this supplementary paper.

If you do not support Option 5, either because you have a preference for another option or because you disagree with some aspects of the Option 5 proposal, please let us know.

We do not expect submitters to restate positions previously set out in their submissions, however, a clear statement of your preferred Option would be appreciated.

Gas Industry Co invites comments on:

1. Which, of Section 6 Updated Levy Options 1, 2, 3, 4 or 5 you prefer; and
2. Any additional comments you wish to make in respect of the new Option 5.

Following consultation the Gas Industry Co will issue a final Levy Decision Paper which will summarise the submissions on both the original and this supplementary Levy Discussion Paper, review the information and set out a final levy structure. The levy recommendation will then be sent to the Minister with a view to Levy Regulations being given effect before the start of the 2006/07 financial year, if possible. You should be aware that this supplementary consultation does put this timetable under pressure and it may be that the levy will need to be applied retrospectively.

Gas Industry Co invites submissions on this Supplementary Levy Discussion Paper by **5pm on 11 April 2006**. This will enable your feedback to be considered at the Gas Industry Co Board meeting on 12 April and reduce the risks to the levy timetable. Please note that submissions received after this date may not be able to be considered.

As before, the Gas Industry Co's preference is to receive submissions in electronic form (Microsoft Word format and pdf) and to receive one hard copy of the electronic version. The electronic version should be emailed with the phrase "Submission on Supplementary Gas Levy Proposal" in the subject header to info@gasindustry.co.nz, and one hard copy of the submission should be posted to the address below:

Ian Wilson
Gas Industry Co
PO Box 10-646
Wellington

The Gas Industry Co prefers to undertake its functions with a high degree of transparency. Accordingly, please be aware that any information provided to the Company may be discussed with, or provided to, other parties UNLESS you specify that information is provided to the Company as 'Commercial in Confidence', in which case you should specify the information that is confidential and the reasons.

Submissions will be published on the Gas Industry Co website.

3 Analysis of the fully fixed (per ICP) Retail levy option proposal

A criticism of the February Levy Discussion Paper was that it did not consider a fully fixed (per ICP) retail levy option. Options 1 and 2 proposed fixed/variable (ie per ICP and per GJ) Retail levies, while Options 3 and 4 proposed fully variable (per GJ) Retail levies.

Submitters argued that a fully fixed option would bring significant benefits such as:

- greater predictability of levy rate and levy revenue, independent of factors which might influence volumes (such as the weather);
- elimination of the 10TJ issue (if the levy is applied to all ICPs rather than just the less than 10TJ customers);
- elimination of the timing issue since the amount payable by each retailer would be based on the number of its ICPs at the end of that billing period rather than the number of ICPs at the end of the previous gas year;
- improved efficiency since the ICP numbers are more easily verified and tracked than volumes, and administrative costs will therefore be lower; and
- improved equity since there is a better match between the amount of levy each retailer pays to Gas Industry Co and the amount of levy that retailer passes on to its customers.

These claims are analysed in this section.

A full description of the new Option 5 – fully fixed retail levy proposal is presented in Section 5 and a re-statement of all the options, modified for the new Wholesale volume estimates and including the new Option 5, is presented in Section 6.

3.1 Greater predictability of levy rate and levy revenue

In some ways it is misleading to consider the current levy as having a fixed and variable component. It is true that the levy is stated as: 6.00 Cents/GJ and 4.00 \$/ICP, and, if retailers choose to pass the levy through to end users in this form then the amount payable by each end user will vary with its consumption. However, the Gas Industry Co recovers the levy from the retailer based on historic information which is fixed. In fact the retail levy is calculated based on the aggregate GJs sold by the retailer to its less than 10 TJ customers in the previous gas year (ie the previous 1 October to 30 September year), and the number of ICPs it supplied at the end of that year. This amount is then collected in 12 equal monthly instalments. So there is no variability in the Gas Industry Co's Retail levy revenue within a year.

As discussed in the February Levy Discussion Paper (Section 6.4 Reference Quantities) the lag between the previous gas year and the particular billing period in which the levy is being passed through to end users, can become a significant issue. Several submissions on the paper agreed that this lag exposed retailers to unacceptable risks, particularly when their sales volumes and/or customer numbers changed significantly during the period.

The difficulty with addressing the lag issue is that, with the current levy structure, it would result in the Gas Industry Co's Retail levy revenue varying month on month depending largely on the weather. When compared to this alternative, a fixed Retail levy does provide greater predictability of revenue. ICP numbers do not vary much from month to month, so a levy which is fully fixed would result in relatively stable

revenue for the Gas Industry Co with the added benefit that retailers could match their levy income to their levy expense.

The variation of ICP numbers between years is likely to be more stable than year on year GJ deliveries. It follows that, if allocated retail costs did not change, the fully fixed option would result in a more stable levy rate.

It is understood that stability and predictability are both highly valued by retailers and their customers.

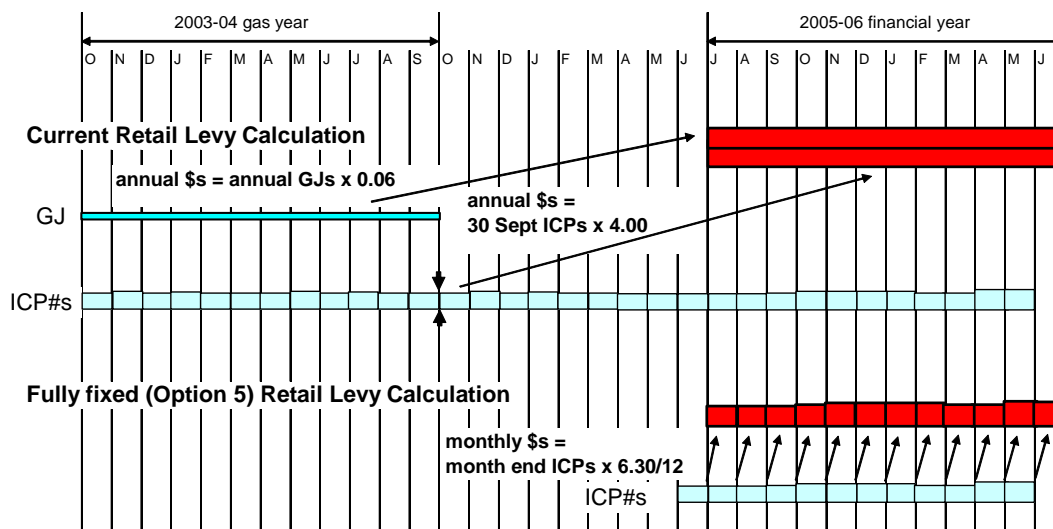
3.2 Elimination of the 10TJ issue

Section 6.3 of the February Levy Discussion Paper explained the apparent unfairness caused by the Retail levy only applying in respect of end users taking less than 10TJ of gas per year. In the 2005-06 year, the amount of Retail levy attributable to a 10TJ/year user was \$4 + 10,000 GJ × \$0.06/GJ = \$604. The amount of Retail levy attributable to a user taking slightly more than 10TJ/year would be nil.

If the Retail levy was to be fully fixed, then the difference between the amount of levy attributable to a user taking less than 10TJ/annum and one taking more would only be the amount of the fixed levy. This would substantially reduce the 10TJ anomaly. However, it has been suggested in submissions that if we go further than this and apply the Retail levy to all ICPs, the anomaly would be eliminated altogether. This would have the added benefit that there would be no need for retailers to assess whether any particular end user fell into the less than 10 TJ category or not. While such administrative simplifications may not seem significant in isolation, we are told by retailers that they do all contribute to reducing costs.

3.3 Elimination of the timing issue

This matter is discussed in 3.1 above. 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 to be recovered from customers. This reduces risk for retailers. No doubt retailers were seeking to manage this risk, so improved matching should reduce costs.

In the future, if 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.

3.4 Improved efficiency through lower administrative cost

Lower administrative cost is cited by submitters as a benefit of the fully fixed Retail levy option. It is hard to put a firm value on this but easy to point to why this might be so.

- 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.
- The way in which retailers pass the levy through to their customers is likely to be more straightforward and consistent than at present.
- 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.

3.5 Improved equity

Any tariff change brings about a redistribution of costs, so it unlikely that all parties will agree that it is equitable. A table is provided in Section 5 which provides a comparison of the proposed Option 5 against the current levy and the Option 1 levy, for variously sized customers.

4 Volume estimates

As mentioned in the February Levy Discussion Paper, to improve the quality of its quantity estimates, Gas Industry Co requested all levy payers to provide updated estimates of their GJ and ICP quantities applicable to the 2006/07 levy calculation. However, not all participants have replied, primarily due to confidentiality concerns. On the basis of the information received, we do not believe there is any good reason to revise the retail GJ or ICP estimates. However, on the basis of the information provided, we consider it is reasonable to revise the wholesale quantity estimate from 115PJ to 124PJ.

5 Fully fixed Retail Levy proposal – Option 5

Option 5 proposes that:

- The cost allocated to the Retail levy is recovered from a single per ICP charge;
- The Retail levy be recovered across all ICPs, not just the less than 10 TJ/annum customers;
- The Retail levy be charged each month based on the number of ICPs at the end of the previous month; and
- The Wholesale levy remains as calculated for Options 2, 3 and 4.

For completeness, the Option 5 calculations are set out below.

Retail Allocation Base	250,000	ICPs
Retail Cost Allocation	\$1.575	Million
Retail Levy	6.3	\$/ICP/year
Wholesale Allocation Base	124,000	TJ
Wholesale Cost Allocation	\$2.205	Million
Wholesale Levy	1.78	cents/GJ

If this option were adopted the effect of the change would be quite different for small and large users as illustrated in the table below. The current Levy and the Option 1 Levy have been included for comparison.

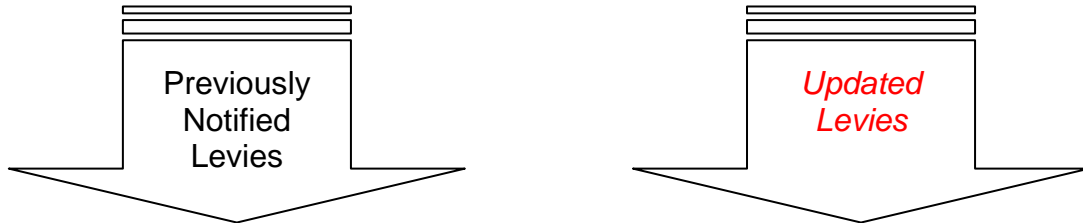
	GJ/annum	Current Levy \$/year	Option 1 Levy \$/year	Option 5 Levy \$/year
Retail Levy				
Small Residential User	5	4.30	4.30	6.30
Medium Residential User	25	5.50	5.50	6.30
Large Residential User	40	6.40	6.40	6.30
Small Commercial User	25	5.50	5.50	6.30
Medium Commercial User	5,000	304.00	304.00	6.30
Large Commercial User	10,000	604.00	604.00	6.30
Wholesale Levy				
Small Wholesale Purchaser	1,000,000	15,000.00	16,200.00	17,800.00
Medium Wholesale Purchaser	5,000,000	75,000.00	81,000.00	89,000.00
Large Wholesale Purchaser	20,000,000	300,000.00	324,000.00	356,000.00

Notice that, when compared to the current levy and the Option 1 levy, Option 5 tends to increase the cost attributable to Small and Medium Residential users, and on all purchases from producers. The cost attributable to Medium and Large Commercial Users falls substantially.

To put the fixed Retail levy into perspective, \$6.30/year is less than 2 cents/day. On average, retailers charge residential gas users fixed charges of around \$1/day.

6 Changes from February Levy Discussion Paper

As noted above, Gas Industry Co has received additional quantity data requested from levy payers. On the basis of this information received, we do not believe there is any good reason to revise the retail GJ or ICP estimates. However, we consider that the wholesale quantity estimate should be revised upwards from 115PJ to 124PJ.



Option 1 - Only adjust the Wholesale levy

Retail	6.00	Cents/GJ
	4.00	\$/ICP
Wholesale	1.74	Cents/GJ

Retail	6.00	Cents/GJ
	4.00	\$/ICP
<i>Wholesale</i>	<i>1.62</i>	<i>Cents/GJ</i>

Option 2 - No change to current allocation methodology

Retail	5.80	Cents/GJ
	3.28	\$/ICP
Wholesale	1.92	Cents/GJ

Retail	5.80	Cents/GJ
	3.28	\$/ICP
<i>Wholesale</i>	<i>1.78</i>	<i>Cents/GJ</i>

Option 3 - Fully Variable Retail Levy

Retail	11.59	Cents/GJ
Wholesale	1.92	Cents/GJ

Retail	11.59	Cents/GJ
<i>Wholesale</i>	<i>1.78</i>	<i>Cents/GJ</i>

Option 4 - Split retail levy into fully variable Residential and Commercial levies

Residential	19.45	Cents/GJ
Commercial	6.20	Cents/GJ
Wholesale	1.92	Cents/GJ

Residential	19.45	Cents/GJ
Commercial	6.20	Cents/GJ
<i>Wholesale</i>	<i>1.78</i>	<i>Cents/GJ</i>

Notes

1. The Wholesale levies are lower than in the February Levy Discussion Paper because the estimated wholesale volume for the 2006/07 financial year has been 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.

new Option 5 - Fully fixed Retail levy

<i>Retail</i>	<i>0.00</i>	<i>Cents/GJ</i>
	<i>6.30</i>	<i>\$/ICP</i>
<i>Wholesale</i>	<i>1.78</i>	<i>Cents/GJ</i>

7 Summary

This paper advised of a new levy option – Option 5 – and updates all options for new quantity estimates.

The Gas Industry Co has included the new option because of the strong arguments in its favour put forward by many parties consulted on the February Levy Discussion Paper.

The principal benefits of Option 5 are:

- Costs will be reduced because:
 - The levy is simpler and will be more easily calculated, applied, administered and audited;
 - The risk faced by retailers, because levies are currently based on historic (gas year) quantities but recovered from gas users in the current billing period, will be removed.
- The intuitively unfair 10TJ anomaly is eliminated;
- Retailers are more likely to pass the levy through to gas users in a consistent, transparent and readily verifiable manner.

Gas Industry Co finds these benefits to be robust and compelling and encourages submissions on the proposed options.

Subject to consultation feedback on this supplementary discussion paper, the Gas Industry Co proposes to recommend Option 5:

- A fully fixed Retail levy of 6.3 \$/ICP, which applies to all ICPs and will be charged each month based on the number of ICPs at the end of the previous month; and
- A Wholesale levy of 1.78 cents/GJ.