



Consultation Paper
Levy Discussion Paper

January 2007

The Gas Industry Co was formed to be the co-regulator under the Gas Act. As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
 - the operation of gas markets;
 - access to key infrastructure; and
 - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

Authorship

This discussion paper has been prepared by Nicole MacFarlane of Gas Industry Co.

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1 Executive Summary

- 1.1 The Gas Act provides for the Gas Industry Company Limited (Gas Industry Co) to recover its costs through levies on industry participants. Such levies are to be struck each year. This consultation document:
- reviews last year's levy development process;
 - addresses the general principles of setting levies;
 - discusses particular issues pertinent to the 2007/08 levy;
 - describes the work which Gas Industry Co will undertake in the 2007/08 year; and
 - proposes the levy for the 2007/08 financial year.
- 1.2 The proposed levy is intended to recover the Gas Industry Co's budgeted revenue requirement of \$4.843m. This represents an increase of \$1.063m on the revenue of \$3.780m which was Gas Industry Co's budgeted revenue requirement for the 2006/07 financial year. The higher revenue requirement is broadly due to increased work programme costs for both the wholesale and retail work streams, additional provision for corporate costs, and the need to recover the shortfall in revenue from earlier years. A more detailed discussion of Gas Industry Co's work programme and budget is set out in Section 6 of this paper.
- 1.3 It is not proposed to change the structure of the levy for this year apart from changing the reference period for the wholesale levy to the previous month's gas take. The 2007/08 levy uses the same cost allocation methodology as was used last year to set the existing levy. This methodology involves allocating the directly attributable costs to each of the wholesale and retail work programmes, and equally sharing all other costs between those programmes ("unallocated costs").
- 1.4 Applying this cost allocation methodology to the 2007/08 budget projections, the allocation of costs directly attributable to the retail work programme increases from \$0.903m to \$1.139m, while the allocation of costs directly attributable to the wholesale work programme increases from \$1.533m to \$1.892m. In addition, unallocated costs have increased from \$1.344m to \$1.812m.
- 1.5 Taking into account a projected increase in the volume of wholesale gas to 145PJ in 2007/08, but with the estimated number of ICPs remaining at the same level, these cost allocations result in an increase in the wholesale levy to \$0.0193/GJ and an increase in the retail levy to \$8.18/ICP.
- 1.6 Note that the projected volume and ICP numbers for the 2007/08 year used in levy calculations are estimates extrapolated from the current year's data.

2 Introduction and Call for Submissions

- 2.1 Comment is invited on the proposed levy and other issues discussed in this paper. For convenience the matters on which we are seeking comment are listed below:
- whether you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year, including the allocation of allocated and unallocated costs between the wholesale and retail work programmes;
 - whether you would support a move to using more recent reference quantities for the calculation of the wholesale levy;
 - whether participants find it useful to provide a comparison of previous years' costs with the budget figures; and
 - whether you support the level at which it is proposed to set the levy for 2007/08.
- 2.2 Following consultation, Gas Industry Co will issue a final Levy Decision Paper which will summarise the submissions, review the information and set out a final levy structure. The levy recommendation will then be sent to the Minister of Energy with a view to Levy Regulations being given effect before the start of the 2007/08 financial year.
- 2.3 Gas Industry Co invites submission on the proposal by **5pm on 29 January 2007**. Please note that, due to the tight timeframes required for the drafting and submission of regulations to be approved by Cabinet, submissions received after this date may not be able to be considered.
- 2.4 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 Gas Levy Proposal" in the subject header to submissions@gasindustry.co.nz, and one hard copy of the submission should be posted to the address below:
- Nicole MacFarlane
Gas Industry Co
PO Box 10-646
Wellington
- 2.5 Gas Industry Co prefers to undertake its functions with a high degree of transparency. Accordingly, please be aware that any information provided to the Gas Industry Co may be discussed with, or provided to, other parties UNLESS you specify that information is provided to the Gas Industry Co as 'Commercial in Confidence', in which case you should specify the information that is confidential and the reasons.
- 2.6 Submissions will be published on the Gas Industry Co website.

3 Review of 2006/07 Levy Development

3.1 By Order in Council dated 26 June 2006, the Gas (Levy of Industry Participants) Regulations 2006 were passed into law and came into effect 28 days later. The process which led to this outcome involved:

- Gas Industry Co developing a number of options for the 2006/07 levy;
- Gas Industry Co liaising with MED to set a timetable for the levy setting process;
- Gas Industry Co drafting a discussion document;
- consultation on the levy options proposed in the discussion document, including a workshop;
- consideration by Gas Industry Co of submissions received on the discussion document;
- preparation by Gas Industry Co of a further discussion document on an additional levy option;
- consultation on the levy option proposed in the further discussion document;
- consideration by Gas Industry Co of submissions on the further discussion document;
- Gas Industry Co finalising the levy proposal and issuing a decision paper to the industry;
- Gas Industry Co working with officials to develop draft Regulations;
- Gas Industry Co submitting the levy recommendation to the Minister of Energy for approval;
- the Minister of Energy granting approval and submitting the Regulations to Cabinet for approval; and
- gazetting of the Regulations following Cabinet approval.

3.2 This process extended over eight months due to the need to consult on an additional levy option. The final form of levy for the 12 month period from 1 July 2006 to 30 June 2007 was:

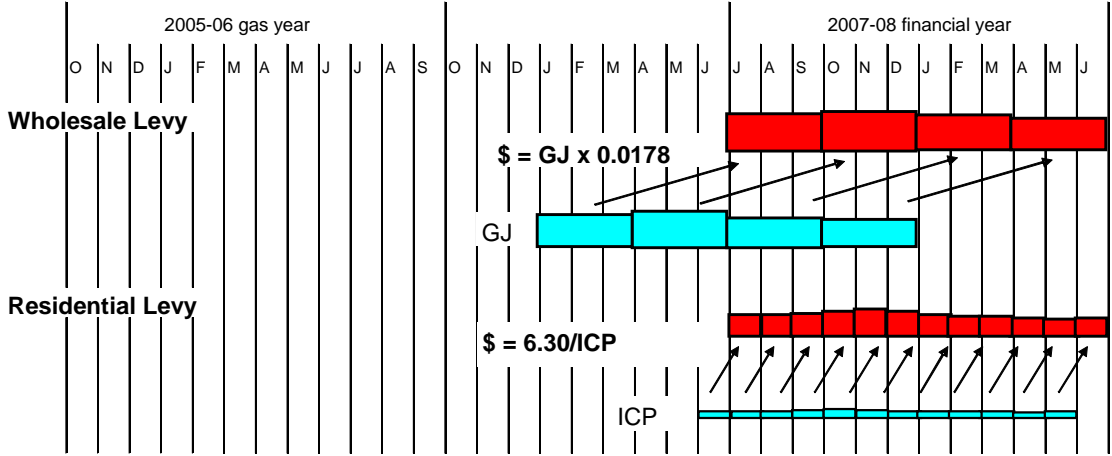
Wholesale Gas Levy

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

Retail Gas Levy

\$6.30/ICP payable by the retailer supplying each ICP.

- 3.3 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” (i.e. 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.
- 3.4 The amount of retail levy payable by each contributor is calculated as an annual amount and collected in equal monthly payments. The ICP numbers are those attributable to each retailer on the last day of the previous month.
- 3.5 These levy arrangements are illustrated below.



3.6 It was originally anticipated that levies would raise \$3.780m in the 2006/07 financial year. Direct costs were attributed where possible and common costs were split equally between the wholesale and retail activities. In 2006/07 a larger amount was required to be attributed to wholesale activities resulting in the wholesale levy being increased from 1.50c/GJ in the 2005/06 financial year. As a result of submissions, the retail levy was changed to a fully fixed amount of \$6.30/ICP per annum.

4 Principles of Levy Setting

4.1 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 our purposes. The principles 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 transaction costs for the 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 levy 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 organisation collecting the levy.

4.2 These principles capture the essential elements of the Treasury Guidelines¹, Audit Office Guidelines² and Standing Order 382, in respect of the setting of levies.

¹ Treasury Guidelines for Setting Charges in the Public Sector, December 2002.

² Guidelines on Costing and Charging Public Sector Goods and Services, May 1989.

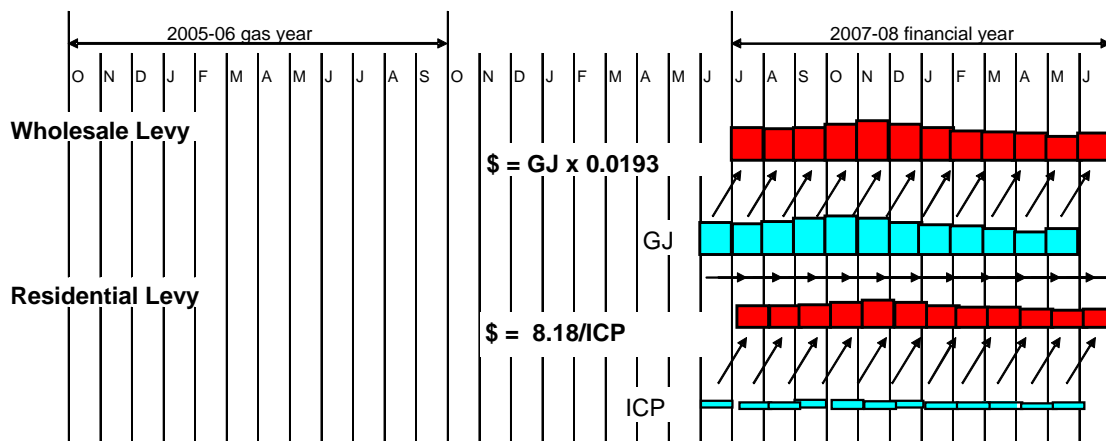
- 4.3 The Treasury Guidelines promote equity, efficiency and cost minimisation by helping to identify the relevant economic considerations. They set out a framework for evaluating charging options.
- 4.4 The Audit Office Guidelines are intended to assist in identifying the preferred user charge option. They provide a checklist of issues on which to base a sound analysis and a range of charging options. Like the Treasury Guidelines, they encourage the efficient allocation of resources, 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.
- 4.5 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:
- is not in accordance with the general objects and intentions of the statute under which it was made;
 - trespasses unduly on personal rights and liberties;
 - appears to make some unusual or unexpected use of the powers conferred by the statute under which it is made;
 - 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;
 - excludes the jurisdiction of the courts without explicit authorisation in the enabling statute;
 - contains a matter more appropriate for parliamentary enactment;
 - is retrospective where this is not expressly authorised by the empowering statute;
 - was not made in compliance with particular notice and consultation procedures prescribed by statute; and
 - for any other reason concerning its form or purport, calls for elucidation.
- 4.6 In setting the levy, Gas Industry Co primarily aims to achieve a balance between administrative simplicity and economic efficiency. Gas Industry Co considers that these aims were achieved when the retail levy was re-set in 2006/07 to a fully fixed amount and the 10TJ threshold removed, while the wholesale levy was retained as fully variable. Gas Industry Co therefore does not propose to alter the structure of the levy for the 2007/08 financial year.

Q1: Do you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year?

5 Issues relating to 2007/08 levy

Reference quantities

- 5.1 In response to stakeholder submissions last year, the reference quantity for the retail levy was changed from that for the previous gas year to the number of ICPs referable to each retailer on the last day of the previous levy month. The 10TJ threshold for the retail levy was removed at the same time.
- 5.2 The question of whether the wholesale levy should be similarly altered was left for consultation in this levy period.
- 5.3 At present, the wholesale levy is calculated in respect of gas purchased from producers during the quarter before the last completed quarter. There is therefore a significant time lag between when the gas is taken and when the levy on that gas becomes payable. This can result in a mismatch between the income earned in respect of that gas, and the income from which the levy is paid. In addition, such a time lag can cause anomalies in respect of short term trades of gas, and where purchasers move in and out of the wholesale gas market.
- 5.4 It is therefore proposed that the reference quantity for the wholesale levy be changed to the gas purchased during the month prior to the month in which the levy is payable.
- 5.5 The proposed levy arrangement is illustrated below.



- 5.6 Adopting this “most recent data” approach does have some disadvantages. These are:
- historic data is relatively stable. The most recent data is more likely to be subject to correction in the next month; and

- Gas Industry Co's monthly levy invoice could only be calculated after other gas transactions have been invoiced (or at least when the data for those transactions has been prepared).

5.7 However, on balance, Gas Industry Co considers that using the previous month's data for the wholesale levy more fairly achieves the principles set out in Section 4 above, in particular those of administrative simplicity and equity.

Q2: *Do participants consider that it is appropriate to change the reference quantities for calculating the wholesale levy from the quarter before the last quarter to the quantity used during the previous month?*

Over- and under-recovery of costs

- 5.8 The Gas Act empowers Gas Industry Co with the ability to provide for the over- or under-recovery of a levy in one financial year in the levy set for a subsequent financial year (section 43ZZC(3)).
- 5.9 Submissions were made by Contact and Methanex in response to the February 2006 levy consultation paper on this issue. Methanex considered that, since the levy was set to recover costs, there should be no need for Gas Industry Co to keep any surplus which should, instead, be paid back to levy payers. Contact, on the other hand, submitted that Gas Industry Co should provide for over- and under-recoveries in the manner prescribed by the Gas Act.
- 5.10 Gas Industry Company notes that the Methanex proposal would imply a "wash-up" invoice at the end of each financial year to address any under-recoveries. In the interests of administrative simplicity, it is considered preferable to roll any over- or under-recoveries into the following financial year.
- 5.11 Gas Industry Co therefore agrees with Contact that over- and under-recoveries in one financial year should be provided for in the following year's levy, which is consistent with the approach in the Gas Act.

Two yearly levy review period

- 5.12 In the discussion paper on the 2006/07 levy, submissions were sought on the possibility of moving to a two yearly levy review period. Support was received from the industry for Gas Industry Co to discuss with officials what legislative changes would be required, if any, and whether any changes need to be made to Gas Industry Co's existing budgeting processes to provide sufficient fiscal assurance for a multi-year levy.
- 5.13 The Gas Act states that:
-The levy regulations must apply only to the financial year in respect of which the levy regulations are made....*
- 5.14 While it is arguable that the wording of the Act does not restrict the levy process to an annual one, officials have made it clear to Gas Industry Co that they consider the Gas

Act requires the levy to be reviewed annually. An amendment to the Gas Act would therefore be required to allow for a two yearly review period. Officials have advised that they would not support such an amendment to the Act at this point in time.

Provision of increased financial information

- 5.15 In the February 2006 consultation paper, Gas Industry Co included a table showing budgeted unallocated costs and costs of the various work streams, along with a breakdown of its proposed work programme for each work stream.
- 5.16 During the consultation process some submitters suggested that Gas Industry Co should provide additional budget information in future levy consultation documents.
- 5.17 The Board has a statutory obligation to report on progress against the GPS. Gas Industry Co therefore considers that its detailed work programme and budget are properly matters of consideration for its Board, and that the focus of the levy discussions should be on the merits of the levy proposed rather than on the content of the work programme or budget. A statement of Gas Industry Co's financial performance, including actual 2005/06 costs, details of directors' fees and salary ranges for certain employees are published each year in its Annual Report, the most recent of which was published in September 2006.
- 5.18 One submitter suggested that Gas Industry Co should include two year cost projections in its budget figures. Gas Industry Co considers that such projections would be difficult to estimate with any certainty. In addition, because Gas Industry Co's ability to progress policy design is dependent on the views of its stakeholders, it is not able to, nor should it, predict likely outcomes so far in advance.
- 5.19 Gas Industry Co agrees that it may be useful for stakeholders to be provided with a comparison of previous years' costs with the budget figures. These figures are provided in Section 6. Stakeholders should note that direct comparisons are not easy to make given the variation in the development stages of the work streams from year to year, and the need to provide for over- or under-recovery of costs from previous years.

Q3: Do participants consider that it is useful to provide a comparison of previous years' costs with the budget figures?

6 Gas Industry Co 2007/08 Work Programme and Budget

Mandate for Work Programme

- 6.1 Governance of New Zealand's gas sector is effected through a co-regulatory partnership between the Government and an industry body, the Gas Industry Co. Under the Gas Act, the Gas Industry Co has the power to recommend to the Minister of Energy non-regulatory arrangements, rules or regulations on a range of matters affecting the gas industry.
- 6.2 The co-regulatory model for gas has a number of similarities with more traditional regulatory regimes, but also some important differences. Key features of the model are:
- the Minister of Energy is restricted in what regulations or rules he/she can make in a number of areas without first receiving a recommendation from the industry body, or at least providing a reasonable opportunity for the industry body to make a recommendation;
 - the Minister of Energy can only accept or reject a recommendation;
 - the industry body can recommend regulations/rules or non-regulatory arrangements where these are the most reasonably practicable option;
 - there is an expectation of input from industry participants to the development of arrangements through industry groups and consultation processes;
 - the industry body is a private company; and
 - the appointment of directors of the industry body, the majority of whom are independent, is voted upon by industry shareholders.
- 6.3 The combination of the Gas Act, any Gas Policy Statement (GPS) which the Minister of Energy may issue from time to time, and the Constitution of the Gas Industry Co provide the framework within which the Gas Industry Co is required to operate in developing gas market arrangements.

Government Policy Statement on Gas Governance

- 6.4 In October 2004, the Government issued a GPS on Gas Governance, which replaced the previous Statement and provided for:

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.*

Role of Gas Industry Co

- 6.5 Gas Industry Co is charged with the task of developing arrangements governing the gas industry to achieve the objectives of the Gas Act and the GPS. Gas Industry Co has the following tools available to meet these objectives:

Power	Description
Recommend Governance Regulations & Rules	<ul style="list-style-type: none"> Gas Industry can recommend gas governance regulations and rules to the Minister of Energy. In certain areas, including wholesale markets, transmission and distribution networks, regulations and rules cannot be made by the Government except in accordance with a recommendation of Gas Industry Co.
Industry Arrangements	<ul style="list-style-type: none"> Gas Industry Co can develop pan-industry arrangements (not supported by rules or regulations), subject to the terms of its constitution and to any necessary approvals of the Commerce Commission under the restrictive trade practices provisions of the Commerce Act.
Reports to the Minister of Energy	<p>Section 43ZL(2)(f) of the Gas Act requires Gas Industry Co to report regularly to the Minister of Energy on:</p> <ul style="list-style-type: none"> the performance and present state of the New Zealand gas industry; Gas Industry Co's performance and achievement of its objectives; and any other matters Gas Industry Co thinks fit or the Minister of Energy requests in writing, which currently includes access arrangements to transmission pipelines.

6.6 It is in the context of the co-regulatory model and the specific policy objectives described above that Gas Industry Co presents the following Work Programme for the 2007/08 financial year. The Board of the Gas Industry Co has approved the programme which it believes will effectively deliver on its obligations under the Gas Act and GPS. For brevity the quarters of the 2007/08 financial year are referred to as Q1 to Q4. Further details of the milestones for each work stream are set out in the table following.

Retail Work Programme

Switching and Registry

6.7 In Item 11 of the GPS, Gas Industry Co is invited to make recommendations regarding "The standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised." A draft Statement of Proposal for Switching Arrangements was issued for consultation in August 2006, with a number of submissions being received. It is envisaged that a recommendation will be made to the Minister of Energy on switching rules in March 2007.

6.8 However, the implementation of the switching rules is likely to be delayed by the need to amend s43G(2)(c) of the Gas Act. It is expected that a registry service provider will be appointed within 3 months of the switching rules being gazetted.

Compliance and Enforcement

- 6.9 A set of regulations for compliance and enforcement of the proposed switching rules has been developed, and it is proposed that a recommendation in respect of those regulations will be made to the Minister of Energy in March 2007.

Reconciliation

- 6.10 Gas Industry Co is expected to propose "... the development of protocols and standards applying to... balancing and reconciliation" (Item 9 of the GPS). Gas Industry Co released a discussion paper in June 2006 identifying issues with both upstream and downstream reconciliation and allocation issues. At this stage it is proposed to only proceed with downstream reconciliation arrangements, in respect of which it is proposed that a recommendation on a preferred framework will be made to the Minister of Energy by 30 June 2007.
- 6.11 In the 2007/08 financial year, it is expected that consultation on a preferred option will be undertaken in Q1, and a recommendation made to the Minister of Energy by the end of Q2, with implementation of the recommended arrangements being carried out during Q3 and Q4.

Consumer Issues

- 6.12 Among other objectives, Item 5 of the GPS includes "The quality of gas services and in particular trade-offs between quality and price, as far as possible, reflect customer preferences". During 2006/07, the EGCC regime was extended to include landowner/occupier disputes, and a project team was formed to further develop arrangements for disconnection and reconnection of supply. It is proposed that a recommendation will be made to the Minister of Energy to accept the EGCC as an approved complaints resolution system under the Gas Act by 31 May 2007.
- 6.13 Further consumer issues forums are scheduled to take place in June 2007 and June 2008. It is anticipated that Gas Industry Co may be required to issue a consumer issues report on matters identified by the Minister of Energy for stakeholder consultation during the 2007/08 year.
- 6.14 It is also envisaged that the work undertaken by the project team on arrangements for disconnection and reconnection of supply will require consultation with the industry on a proposed solution in Q2, with a recommendation going to the Minister of Energy in Q4.

Wholesale Work Programme

Open Access Review

- 6.15 One of the GPS Item 5 objectives is "The facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure...". A Transmission Review issues paper was released in June 2006. The submissions on this paper resulted in a revised work programme being published in October 2006 which established five sub-work streams to be progressed during the

balance of 2006/07, through into 2007/08: Legacy; Capacity; VTOC; Balancing; and Legal Framework.

6.16 Most of the work on the Legacy work stream will be undertaken during 2006/07, culminating in the issuing of a Legacy transition paper in June 2007. The first Balancing forum was held in November 2006. The Capacity and VTOC work streams will be managed by Vector Transmission, with Gas Industry Co monitoring progress. A Capacity forum is planned for June 2007.

6.17 In 2007/08 it is envisaged that:

- a Balancing Review issues paper will be released for consultation in Q2, with an options paper being published in Q3;
- Gas Industry Co will consult on options for a legal framework during Q2, with a recommendation being made to the Minister of Energy in Q4; and
- a VTOC will replace Vector's Transmission Services Agreements when they expire in Q2.

MPOC

6.18 Gas Industry Co has accepted a request by MDL to undertake certain operational roles under MPOC, which will principally involve evaluating and recommending on requests for changes to the MPOC arrangements.

6.19 In 2007/08 it is envisaged that Gas Industry Co will be expected to resolve a number of change requests on a timely basis.

Wholesale Market Development

6.20 Among the matters which Item 9 of the GPS calls on Gas Industry Co to make proposals on are "The development of protocols and standards applying to wholesale gas trading..." and "development of a secondary market for the trading of excess and shortfall quantities of gas". Considerable work is being done on the development of options for a voluntary wholesale market trading platform in 2006/07, with the intention that a recommendation be made to the Minister of Energy by June 2007.

6.21 In 2007/08 the focus will be on implementation of the proposed arrangements. Assuming that the tender process indicates that the proposed option is feasible, it is envisaged that a service provider for the trading platform will be appointed in Q2, with a view to a "go-live" date in Q4.

Access to Processing Facilities

6.22 Another GPS Item 9 objective is the development of "Protocols that set reasonable terms and conditions for access to gas processing facilities". A discussion paper on Access to Gas Processing Facilities was issued in August 2006. A recommendation for an information disclosure regime was made to the Minister of Energy in December 2006, with implementation being in June 2007 if agreement to a voluntary regime can be reached, or Q2 if regulation is required.

Gas Emergency Arrangements

- 6.23 An overall Government objective, included in Item 5 of the GPS is that “Risks relating to security of supply, including transport arrangements are properly and efficiently managed by all parties”. Under the current work programme, it is planned that a recommendation on gas emergency arrangements will be made to the Minister of Energy by the end of June 2007. In 2007/08 the focus will be on implementing the new arrangements, with a targeted “go-live” date in Q2. A complete audit of industry participants’ compliance with the new arrangements will be carried out in Q4.

Distribution Contracts

- 6.24 Work on this work stream has been deferred until a final determination is made by the Commerce Commission on authorisation of the supply of controlled services by Vector and Powerco. It is currently envisaged that such a determination will be made by 31 October 2007. Assuming that a determination is issued by that date, Gas Industry Co intends to commence a project on distribution contract issues in Q3, with a view to issuing a discussion paper for consultation in Q4.

Compliance and Enforcement

- 6.25 For the 2006/07 financial year, no allocation was made to the wholesale work stream for work on compliance and enforcement. It is envisaged that in 2007/08 work will need to be undertaken to investigate and develop some form of compliance and enforcement programme for the wholesale market, gas emergency management and a governance framework in respect of open access. The extent of work required will depend largely on the form of those arrangements, i.e. industry agreement or rules/regulations. However, it is anticipated that much of the work already undertaken in respect of switching will be applicable to these arrangements.

Corporate Work Programme

Accountability and Governance

- 6.26 The Corporate section of the Work Programme consists of the various activities which arise because Gas Industry Co is a private company with certain statutory and constitutional obligations under the Gas Act, GPS and Companies Act. A large part of this is the monthly, quarterly and annual reporting of the company activities to its Board and the Minister of Energy. There is also a significant amount of liaison required between Gas Industry Co and government agencies, particularly the Ministry of Economic Development.
- 6.27 Section 43ZQ of the Gas Act requires Gas Industry Co to prepare a strategic plan each year for that financial year and at least the 2 following financial years. There is also a requirement to report on the efficiency and performance of the energy sector. To do so, a Baseline Review has been developed during the 2006/07 financial year against which subsequent reviews can be referenced.
- 6.28 Gas Industry Co operates in an open and inclusive way. This involves pro-active communication with interested parties on the activities of the company and current issues. This will partly be achieved through regular industry forums. It is likely that

the format of these will be flexible. For example in mid January a forum will be held to present this paper to industry and consumer group representatives, ahead of submissions being made on the levy.

- 6.29 In addition to the planned work programme, Gas Industry Co is from time to time requested by the industry to undertake roles relating to industry arrangements such as the Maui Pipeline Operating Code (see paragraphs 6.23 and 6.24 above). Where appropriate those roles will need to be funded from the levy. Gas Industry Co also receives requests from the Minister of Energy to investigate, and consult on, particular issues of relevance to the gas industry, for which provision needs to be made.

Levy Process

- 6.30 Although it could be viewed as another component of the accountability and governance work stream, the Levy Process has been identified as a separate work stream because of the need for a disciplined process leading to the timely release of levy regulations. The Levy Process is an annual one which begins around the middle of each financial year when work plans and budgets are prepared for the next financial year. The process ends with the Gazetting of Regulations which then comes into effect 28 days later. In the February 2006 levy discussion paper Gas Industry Co estimated that the annual cost of the Levy Process to Gas Industry Co is around \$100,000. In 2007/08 additional provision has been made for consultation on potential changes to the structure of the levy to accommodate proposed new industry arrangements.
- 6.31 The Work Programme Summary set out overleaf provides a narrative description of the various work streams which comprise the programme, and a presentation of the major milestones in tabular form. For ease of reference the four quarters of the 2007/08 year are highlighted in the table. For continuity, columns are also included for the last two quarters of the current financial year and for the whole 2008/09 year. The table is divided into three categories: Corporate, Retail, and Wholesale.

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 work stream will involve consultation which may lead to recommendations being made to the Minister of Energy 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 the outcome may differ from that anticipated. 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.

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 07	Apr-Jun 07	July-Sep 07 (Q1)	Oct-Dec 07 (Q2)	Jan-Mar 08 (Q3)	Apr-Jun 08 (Q4)	2008-09
A1 Accountability and Governance	Issue Quarterly Report.	Issue Quarterly Report.	Issue Quarterly and Annual Reports.	Issue Quarterly Report. Hold AGM.	Issue Quarterly Report.	Issue Quarterly Report.	Issue Quarterly Report.
		Develop and issue Strategic Plan.				Develop and issue Strategic Plan.	
				Develop 2008/09 Budget and Work Programme.			
				Hold Industry Workshop.			Hold Industry Workshop.
A2 Levy Process	Invoice levies monthly. Consult on 07/08 Levy Proposal. Recommendation to Minister on 07/08 Levy.	Invoice levies monthly. Gazetting of Levy Regulations.	Invoice levies monthly. New Levy Regulations implemented.	Invoice levies monthly. Forecast Levy Revenue. Develop 08/09 Levy Proposal.	Invoice levies monthly. Consult on 08/09 Levy Proposal. Recommendation to Minister on 08/09 Levy Proposal.	Invoice levies monthly. Gazetting of Levy Regulations.	Invoice levies monthly. New Levy Regulations implemented.

B - Retail Work Programme (subject to Government policy direction, consultation outcomes and funding)							
	Jan-Mar 07	Apr-Jun 07	July-Sep 07 (Q1)	Oct-Dec 07 (Q2)	Jan-Mar 08 (Q3)	Apr-Jun 08 (Q4)	2008-09
B1 Switching and Registry	Recommendation to Minister on Switching Rules.			Amendment to Gas Act.	Form Registry implementation team. Switching Rules gazetted. Issue registry service provider RFP.	Appoint Registry service provider.	"Go live".
B2 Compliance and Enforcement	Recommendation to Minister on Compliance and Enforcement Regulations.				Compliance and Enforcement Regulations gazetted.		
B3 Reconciliation	Discussion paper on downstream reconciliation arrangements.	Recommendation to Minister on preferred framework for downstream reconciliation arrangements.		Recommendation to Minister on downstream reconciliation arrangements.	Implement downstream reconciliation arrangements.		"Go live".
B4 Consumer Issues		Hold Consumer Issues Forum. Discussion paper on disconnection arrangements.		Consult on preferred option for disconnection arrangements.		Hold Consumer Issues Forum. Recommendation to Minister on disconnection arrangements.	

B5				Commerce Commission Determination.	Commence project on distribution contracts.	Discussion paper on distribution contracts.	
Distribution Contracts							

C - Wholesale Work Programme (subject to Government policy direction, consultation outcomes and funding)							
	Jan-Mar 07	Apr-Jun 07	July-Sep 07 (Q1)	Oct-Dec 07 (Q2)	Jan-Mar 08 (Q3)	Apr-Jun 08 (Q4)	2008-09
C1		Discussion paper on Legacy transition. Hold Capacity forum. Options paper on Legal Framework.		Discussion paper on Balancing issues. Consult on preferred option for Legal Framework.	Options paper on Balancing issues.	Recommendation to Minister on Balancing issues. Recommendation to Minister on Legal Framework.	Implement Legal Framework.
C2		Recommendation to Minister on Wholesale Market arrangements.	Issue RFP for service provider for trading platform.	Appoint service provider for trading platform.		"Go live".	
C3		"Go live" (voluntary.)		"Go live" (regulated).			
C4		Recommendation to Minister on Gas Emergency Arrangements.		"Go live".		Audit of compliance.	
Access to Processing Facilities							
Gas Outage Contingency Plan							

The 2007/08 Budget

- 6.32 In considering how to set the levy in any given financial year, in addition to the obligations in the Gas Act and the GPS, Gas Industry Co must take into account the obligations of the Board under company law.
- 6.33 The Board takes the view that each year's levy should cover all of the costs reasonably expected to be incurred by Gas Industry Co in that year.
- 6.34 The annual levy setting process requires Gas Industry Co to forecast its costs for the following financial year up to 20 months in advance of incurring the expenditure, and before it has fully analysed and consulted upon the issues. For this reason, a level of conservatism is appropriate.
- 6.35 Gas Industry Co started out in its first year in a significant negative equity position (\$1.095m). It has therefore had to recover from that position at the same time as making substantial loan repayments to some of its shareholders and progressing an ambitious work programme.
- 6.36 Even taking into account a predicted increase in wholesale gas volumes, the above situation means there is likely to be a net under-recovery of around \$0.2m in revenue from the 2006/07 levy. This amount will need to be recovered through the 2007/08 levy.
- 6.37 Gas Industry Co has had to significantly increase its budgeted costs for the 2007/08 year, both in respect of the work streams, many of which are coming into periods of increased development costs, and in respect of unallocated corporate costs for which it is considered that insufficient provision was made in 2006/07. A good example of unbudgeted internal costs which have been incurred in 2006/07 is the unexpected resignation of a director and a senior adviser, the replacement costs of whom are estimated to exceed \$60,000.
- 6.38 It is also recognised that greater provision needs to be made for Gas Industry Co being required to undertake new work programmes during the financial year. Examples of those are where the industry requests Gas Industry Co to undertake roles in relation to industry arrangements such as MPOC, and requests by the Minister of Energy to investigate, and consult on, issues of relevance to the gas industry. Provision is therefore being made for Gas Industry Co to carry a consultancy contingency to cover such events.
- 6.39 Budget projections for the 2007/08 financial year are presented in the table below, categorised by work streams. Unallocated costs, including the Corporate Accountability work programme, overheads (rent, Board, office, HR etc) and contingency reserves are added to this. Finally, we recognise that Gas Industry Co does have some other sources of income (from member fees, interest etc).

The remaining balance is the total amount which has to be raised through the levy (\$4.843m).

- 6.40 A comparison with 2005/06 actual costs and the 2006/07 budget is also provided. In looking at the numbers, it is important to note that there can be a significant variation on work stream forecasts from year to year depending on what stage each work stream is up to at any given time. In addition, each year's budget is reviewed by the Board during that year which may result in allocations being varied where changes in work priorities or other contingencies arise. This may also result in a reasonably significant variation in the actual figures from those budgeted.
- 6.41 Further, any under or over recovery from the previous financial year has to be taken into account. For example, the 2007/08 budget for the Consumer Issues work stream includes an amount which results from a request by the Minister of Energy for additional work in 2006/07 for which there was no budget. This amount therefore has to be recovered in 2007/08.
- 6.42 The increase in levy revenue requirement from \$3.780m budgeted for the current year to \$4.843m budgeted for the 2007/08 year is therefore largely due to the:
- various work streams either continuing in, or entering into, periods of increased development;
 - need to budget for additional staffing costs, including HR expenses;
 - need to budget for unforeseen and unexpected contingencies; and
 - shortfall in revenue from previous financial years.

	2005/06 Actual	2006/07 Budget *	2007/08 Budget
Switching and Registry	323,894	248,000	242,036
Compliance and Enforcement	153,065	192,000	101,295
Reconciliation	139,770	267,000	263,917
Consumer Issues	162,104	125,000	283,335
Distribution Contracts	38,039	71,000	248,145
Retail work programme	816,872	903,000	1,138,728
Compliance and Enforcement	-	-	219,231
Open Access Review	281,776	575,000	688,456
Wholesale Market Development	495,672	621,000	474,586
Access to Processing Facilities	119,561	126,000	167,304
NGOCP	159,516	191,000	342,760
Quality Standards	13,333	20000	-
Wholesale work programme	1,069,858	1,533,000	1,892,337
Total work programme costs	1,886,730	2,436,000	3,031,065
Accountability Framework	660,431	578,000	801,881
Levy Process	59,236	60,000	72,800
Corporate accountability	719,667	638,000	874,681
Creation of contingency reserves	-	-	100,000
Creation of equity reserves	-	-	90,000
Overheads	913,834	629,000	841,476
Contribution to loss brought forward	763,517	196,000	14,912
less non levy income	-335,937	-118,634	-108,634
Total unallocated costs	2,061,081	1,344,366	1,812,435
Total levy revenue requirement	3,947,811	3,780,366	4,843,500

*Budget published in Feb 2006 Discussion Paper

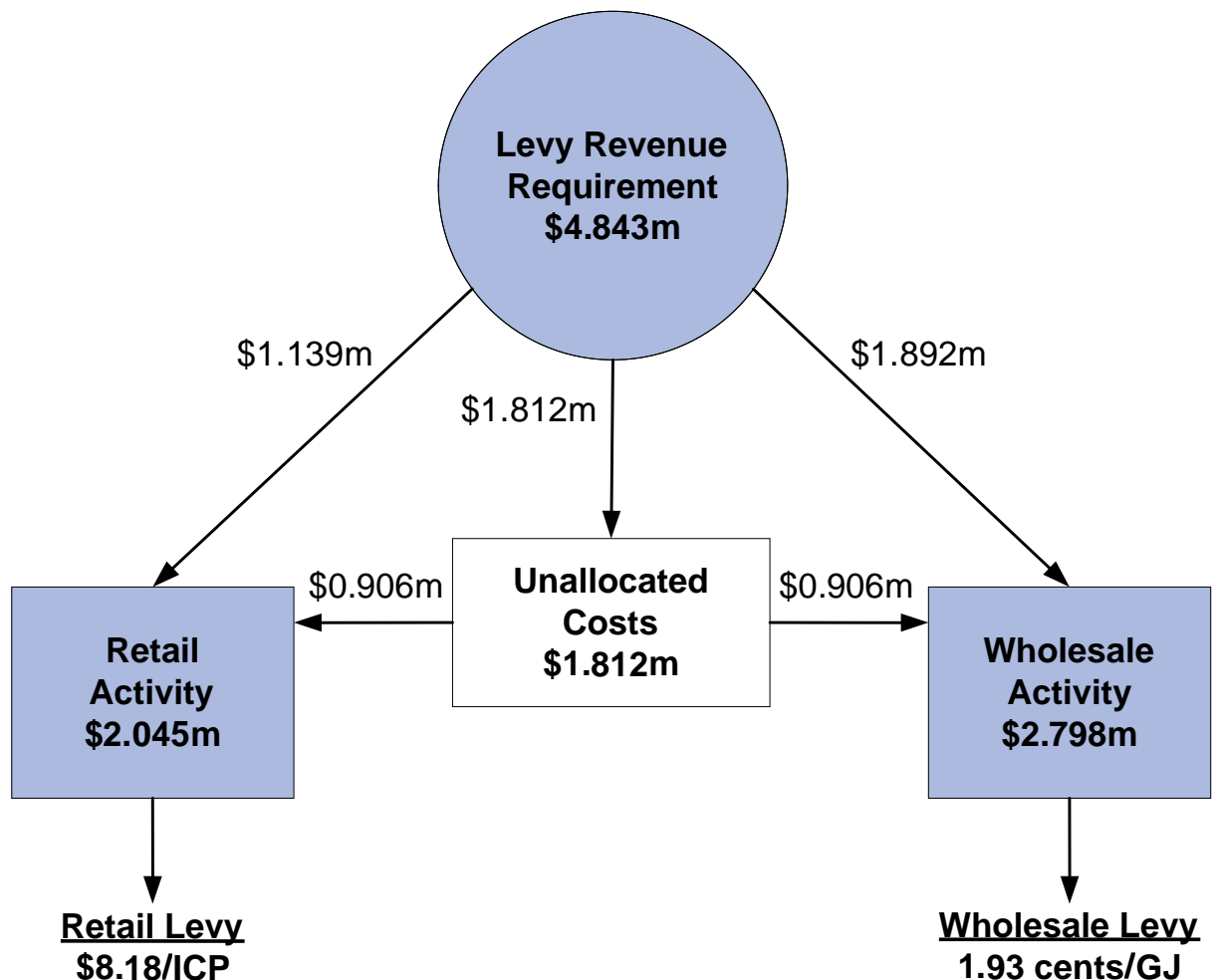
7 Proposed levy

7.1 The existing levy is based on an allocation methodology which:

- allocated direct costs to retail or wholesale areas of activity;
- split the unallocated costs evenly between the retail and wholesale areas of activity; and
- set retail and wholesale levies to recover the allocated costs in each area.

7.2 The rationale was that, where possible, costs should be directly allocated to the activity area to which they related. For 2006/07 unallocated costs included such items as rent, Board expenses, IT, printing, stationery, legal and personnel costs not directly attributable to a particular activity area.

7.3 For 2007/08, it is proposed that costs be allocated in same manner. The cost allocation is shown below.



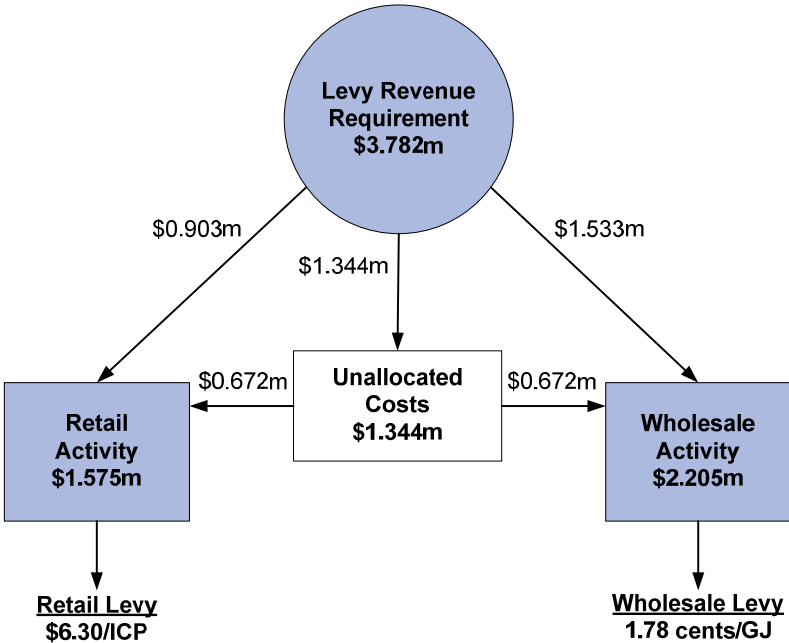
7.4 The derivation of these levies from the Section 6 budget projections is as follows.

7.5 The retail cost allocation of \$2.045m is calculated by adding the budgeted costs directly attributable to retail activities, of \$1.139m, to half of the unallocated costs. The unallocated costs are all the costs which are not direct, i.e. \$4.843m less \$1.139m of retail direct costs less \$1.892m of wholesale direct costs. This gives unallocated costs of \$1.812m, and adding half of this to the retail direct costs gives a total of \$2.045m for retail activities. Dividing this by the estimated number of ICPs, 250,000, makes the retail levy \$8.18/ICP per annum.

7.6 Similarly, costs directly attributable to wholesale are \$1.892m. Adding the \$0.906m share of the unallocated costs gives a total of \$2.798m. Dividing this total by the anticipated quantity of gas to be purchased from producers, 145 PJ, makes the wholesale levy 1.93c/GJ. The anticipated quantity of gas is calculated on the basis of the following usage:

- electricity generation 86 PJ;
- methanol production 13 PJ;
- industrial and commercial 38 PJ;
- residential 6 PJ; and
- operational use 2 PJ.

7.7 By way of comparison, the cost allocations for 2006/07, as recommended to the Minister of Energy, were:



Q4: Do you agree with the allocation of costs between the wholesale and retail work programmes?

Q5: Do you agree that unallocated costs should be split evenly between retail and wholesale?

Q6: Do you agree that it is appropriate to increase the levy for 2007/08 to the levels set out above given the requirements of the proposed work programme and Gas Industry Co's statutory obligations?

Appendix A: Recommended Format for Submissions

To assist the Gas Industry Co in the orderly and efficient consideration of stakeholders' responses, a suggested format for submissions has been prepared. This is drawn from the questions posed throughout the body of this consultation document. Respondents are also free to include other material in their responses.

Submission prepared by:

(company name and contact)

QUESTION	COMMENT
Q1: Do you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year?	
Q2: Do participants consider that it is appropriate to change the reference quantities for calculating the wholesale levy from the quarter before the last quarter to the quantity used during the previous month?	
Q3: Do participants consider that it is useful to provide a comparison of previous years' costs with the budget figures?	
Q4: Do you agree with the allocation of costs between the wholesale and retail work programmes?	
Q5: Do you agree that unallocated costs should be split evenly between retail and wholesale?	
Q6: Do you agree that it is appropriate to increase the levy for 2007/08 to the levels set out above given the requirements of the proposed work programme and Gas Industry Co's statutory obligations?	