Recommendation to the Minister of Energy on the 2007/08 Gas Industry Company Levy

19 March 2007

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1 Executive Summary

Section 43ZZB of the Gas Act 1992 (the "Act") enables 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 Gas Industry Co. The levy is to recover the estimated costs of 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 2008. The recommendations were developed following the issuing of a discussion paper on the levy proposal, and consideration of submissions on that paper (see Section 4 and Appendix C).

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

- the current Wholesale levy of 1.78 cents/GJ, to be 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 1.93 cents/GJ, and be calculated monthly on the buyer's total gas purchases up to and including the last day of the previous month;
- the current Retail levy of $6.30/ICP/year be increased to $8.18/ICP/year, to be paid in respect of every ICP (network interconnection point) supplied by each retailer at the end of the previous month; and
- these new levies come into effect on 1 July 2007.

In aggregate the levies are estimated to meet the Gas Industry Co's revenue requirement of $4.8m for the 2007/08 year. This has increased from a $3.8m target in the 2006/07 year, largely as a result of the various work streams entering a period of high development costs, to cover a shortfall in costs from 2006/07, and to properly meet the Company's corporate costs (for which it is considered inadequate provision was made in 2006/07).

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]	$780.00	$10,500.00	$7,000,000.00
Annual Retail levy	$8.18	$8.18	$8.18
Annual Wholesale levy	$0.48	$19.30	$19,300.00
Total Annual levy	$8.66	$27.48	$19,308.18
% of gas bill	1.11%	0.26%	0.27%

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

[2] These are approximate. All these amounts are calculated exclusive of GST. Any customer's actual gas bill will depend on a number of factors such as location, load profile, retailer tariff options etc.

2 Background

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

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, 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 Gas Industry Co's work programme and 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 Gas Industry Co's position on these.
- Section 5 reviews the outcomes being sought by Government, as described in the Government Policy Statement, and Gas Industry Co's 2007/08 Work Programme which has been designed to progress the industry towards those outcomes.
- Section 6 explains Gas Industry Co's expected costs for 2007/08 and how the 2007/08 Levy revenue requirement has been derived from those costs.
- Section 7 sets out Gas Industry Co's recommendation with respect to the 2007/08 levy.

The four appendices provide additional information as follows:

- Appendix A is a summary of the Work Programme.
- Appendix B is a copy of the January 2007 levy discussion paper.
- Appendix C summarises the submissions received in response to the January 2007 levy discussion paper.
- Appendix D is a list of parties with whom Gas Industry Co consulted.

4 Consultation

Gas Industry Co issued a discussion paper on 15 January 2007 for the purpose of consultation on the proposed levy and certain specific issues in relation to the levy process. Due to the timing constraints for the drafting and submission of regulations to be approved by Cabinet, submissions had to be received by 29 January 2007. A list of the parties to whom Gas Industry Co sent the discussion paper for submissions is attached as Appendix D.

Submissions were received from:

- Genesis Energy
- Contact Energy
- Vector
- Ministry of Consumer Affairs
- Wanganui Gas
- Mighty River Power
- MEUG

In past years Gas Industry Co has also received submissions from Ballance Agri-nutrients, Methanex and the National Council of Women. All of those organisations were contacted by Gas Industry Co to confirm that none of them wished to make a submission on the 2007/08 levy. Due to the time constraints no workshop was held, but general discussions were undertaken with officials from MED and Ministry of Consumer Affairs, and specific discussions were held with Genesis, Vector and MRP on the issues outlined below.

A summary of the issues raised in the discussion paper, and the results of the consultation on them, is set out below.

4.1 Structure of levy for 2007/08 financial year

All submitters agreed that the structure of the levy properly reflects the levy setting principles enunciated in the paper, and in particular that the fixed retail and variable wholesale levy approach strikes an appropriate balance between administrative simplicity and economic efficiency.

- The split of costs between the wholesale and retail work programmes is done on the following basis:
- Direct costs are as much as possible allocated to each of the wholesale and retail work programmes.
- Costs which cannot be so allocated are split evenly between the retail and wholesale work programmes.

The rationale for the split is that, as far as possible, costs should be allocated on the basis that the user/causer pays whilst retaining administrative simplicity. This was the approach adopted in previous years.

All submitters agreed that costs should be allocated as accurately as possible to the work programmes to which they relate.

However, some issues were raised with respect to the split of unallocated costs. Both Wanganui Gas and MCA considered that unallocated costs should be split in proportion to the allocation of costs between the wholesale and retail work programmes. While this is arguably a purer economic result there is a risk that it could lead to considerable year on year variability. By contrast, Contact considered that although the equal split of unallocated costs appears arbitrary it has the advantage of simplicity. MEUG agreed with the split on the basis that there does not appear to be a better approach. Genesis considered that the split of unallocated costs is merely an accounting exercise over which Gas Industry Co should have operational discretion.

The increase in the retail programme this year (26.1%, compared with 23.4% for wholesale) is largely results from provision for additional work on distribution contracts in 2007/08 and a shortfall in provision for work on consumer issues in 2006/07. In addition, in 2007/08 there will be a substantial amount of implementation work on switching and reconciliation arrangements following recommendations being made to the Minister in 2006/07. The increase, combined with a static number of retail ICPs and an increased growth in wholesale gas volumes, results in a higher proportion of the overall levy falling on retail customers. However, Gas Industry Co expects the pressure on the Retail levy to significantly lessen in following years once both switching and reconciliation arrangements have been implemented and are no longer funded through the levy.

Arguably the need for effective retail and wholesale market arrangements arises from the activity of all market participants. During this largely development stage of Gas Industry Co's work programme, its work could be said to have a high "common good" element which 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 the less benefit it is likely to derive from Gas Industry Co's retail work streams.

The recommended levy broadly reflects this distribution of benefits, as can be seen from the diagram below:

How the levy is shared between consumer groupings									
	Residential			Commercial/Industrial			Major Users		
	ICP TJ	$m	%	ICP TJ	$m	%	ICP TJ	$m	%
Retail Levy ($8.18/ICP/yr)	230,000	$1.881	92	20,000	$0.164	8	10	$0.000	0
Wholesale Levy (1.93c/GJ)	6,000	$0.116	4	38,000	$0.733	26	101,000	$1.949	70
Total (2007/08)		$1.997	41		$0.897	19		$1.949	40
Total (2006/07)		$1.551	41		$0.451	12		$1.780	47
Total (2005/06)		$1.351	38		$0.749	21		$1.500	42

At a meeting with MCA officials prior to receipt of MCA's formal submission it was acknowledged by MCA that changing the methodology used to apportion costs for the 2007/08 financial year would require additional analysis and consultation by Gas Industry Co which could not be achieved during the current levy round. MCA advised Gas Industry

Co that it was prepared to accept the 2007/08 levy proposal on the basis that this issue would be re-visited prior to the next levy round.

Gas Industry Co considers that this is an issue for which there are equal arguments on both sides. On balance, Gas Industry Co does not believe that a change is appropriate for the 2007/08 financial year as further consultation would be required which is likely to delay implementation of the levy and add additional costs to levy payers. However, Gas Industry Co intends to consult on this issue at the next available opportunity.

4.2 Change reference quantities for wholesale levy

It was proposed in the levy consultation paper to change the basis on which the wholesale levy is calculated. At present the levy is calculated for any given month using gas volumes from the quarter before the previous quarter. From 1 July 2007 it is proposed to calculate the levy using the previous month's gas volumes.

Contact, MEUG, Wanganui Gas and Vector all agreed with the proposal to change the reference quantities for the calculation of the wholesale levy. Vector in particular was very supportive of this move which allows it to pass on the levy to its customers at the same time as it is invoicing them for the gas on which the levy is based.

Genesis expressed some concern that such a change could increase the complexity of the levy payments and therefore increase administration costs to participants. Genesis also considered that, if such a change is made, provision should be made for "wash-ups" for previous months. Genesis did not, however, submit that it would not be physically possible to implement the change.

Gas Industry Co accepts that there may be an increased need for levy payers to alter their levy payments from time to time to take account of adjustments to gas quantities made in a previous month. Indeed, this is a process which is already undertaken on occasion by levy payers at present. However, Gas Industry Co considers that this increased need is outweighed by the benefit to levy payers of being able to pay levies in a more timely fashion, particularly in respect of short term trades of gas.

Gas Industry Co therefore considers that the change to reference quantities is appropriate.

4.3 Provision of comparison of previous years' costs with previous budget figures

During consultation on the 2006/07 levy, submissions were made requesting that Gas Industry Co provide additional budget and work programme information.

The Gas Industry Co Board has a statutory obligation to report on progress against the GPS. The Board therefore considers that its detailed work programme and budget are properly matters of consideration for it. Additional information relating to Gas Industry Co's financial performance, including details of directors' fees and salary ranges for certain employees are published each year in Gas Industry Co's Annual Report.

In the 2007/08 levy consultation paper, Gas Industry Co provided stakeholders with a table providing a comparison between 2005/06 actuals, the 2006/07 budget and the 2007/08 budget.

All submitters agreed that it was useful to provide a comparison of previous years' costs with budget figures. However, many submissions were received requesting that Gas Industry Co provide even more financial information, some of it very detailed. It was suggested by on submitter that, in not providing such detailed information, Gas Industry Co may not have complied with its statutory obligation to consult on the levy.

Gas Industry Co is confident that it provided sufficient information in the January 2007 levy consultation paper to satisfy its statutory obligation of consultation with stakeholders.

Further specificity is problematic because Gas Industry Co is not able to fully anticipate the range and scale of projects implied by the GPS so far in advance of the design and submission process. It is accepted that levy payers may also find it difficult to form a view on the budget without having any foresight about the range and scale of those same projects.

Gas Industry Co has contacted each of MRP, Vector and Genesis to discuss the issues raised in their submissions. MRP, Genesis and Vector have confirmed with Gas Industry Co that they are agreeable to the Company recommending the 2007/08 levy at the level proposed in the January 2007 levy consultation paper provided that Gas Industry Co consults with them further on their requests for additional information on the Company's budget and work programme. Suggested improvements include publishing additional budget information on the website as well as reporting on progress against the published budget at Gas Industry Co's regular meetings with stakeholders during the year.

Gas Industry Co has agreed to contact Genesis, Vector and Mighty River Power within the next month to initiate further discussions in this area.

4.4 Proposed increase in levy

All submitters expressed confidence in Gas Industry Co and its work programme. All submitters except MEUG accepted the need for Gas Industry Co to increase the level of the levy in light of the greater level of forecast activity, provided that Gas Industry Co continues to deliver the expected improvements for the gas industry.

Taking into account the issues discussed in sections 4.2 and 4.3 above, Gas Industry Co considers that the proposed levy rate is reasonable, having regard to Gas Industry Co's Strategic Plan, its Annual Report, and the GPS objectives and outcomes.

4.5 Conclusion

Gas Industry Co considers that it has fulfilled its obligation to consult with industry participants on the proposed levy.

5 Objectives and Work Programme

5.1 Government's Policy Objective

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

a) 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.*

b) 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.*

c) 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.*

5.2 Gas Industry Co's Work Programme

A summary of Gas Industry Co's 2007/08 Work Programme as presented in the January 2007 levy consultation paper is attached as Appendix A.

6 Costs, Budget and Levy

6.1 Costs

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. 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.

The increase in levy revenue requirement from $3.780m budgeted for the current year to $4.843m budgeted for the 2007/08 year is 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;
- shortfall in revenue from previous financial years (approx $0.2m); and
- the decision to apply shareholder fees to reserves rather than operating expenses.

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. Even taking into account a predicted increase in wholesale gas volumes, at the time of preparing the levy consultation paper it was expected that there was likely to be a net under-recovery of around $0.2m in revenue from the 2006/07 levy. This amount needs to be recovered through the 2007/08 levy.

In addition, 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. Unallocated corporate costs include an amount to cover unexpected additional legal and/or consulting fees, for example, if the Company has to take or defend legal proceedings.

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, or expand existing work streams where submissions indicate additional work is required. While the Act provides for Gas Industry Co to include any under-recovery in a given year in the following year's levy, the Board considers it prudent for the Company to build reserves over time to provide for contingencies. Arrangements have therefore been made with the Company's shareholders to extend the term of the loans which initially funded the Company while cash reserves are accumulated over a 5 year period from shareholders' annual fees. The proposed 2007/08 levy does not include allowance for cash reserves.

6.2 Budget

Budget projections for the 2007/08 financial year are presented in the table below, categorised into the three main activity areas: Corporate, Retail and Wholesale. Within each of these activity areas, the work is further subdivided into individual work streams which relate directly to the Work Programme and include an estimated apportionment of salaries. is the Work Programme is summarised in Appendix A.

Unallocated costs, including the Corporate Accountability work programme and overheads (rent, Board, office, HR etc) are added to this. Finally, Gas Industry Co recognises that it 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).

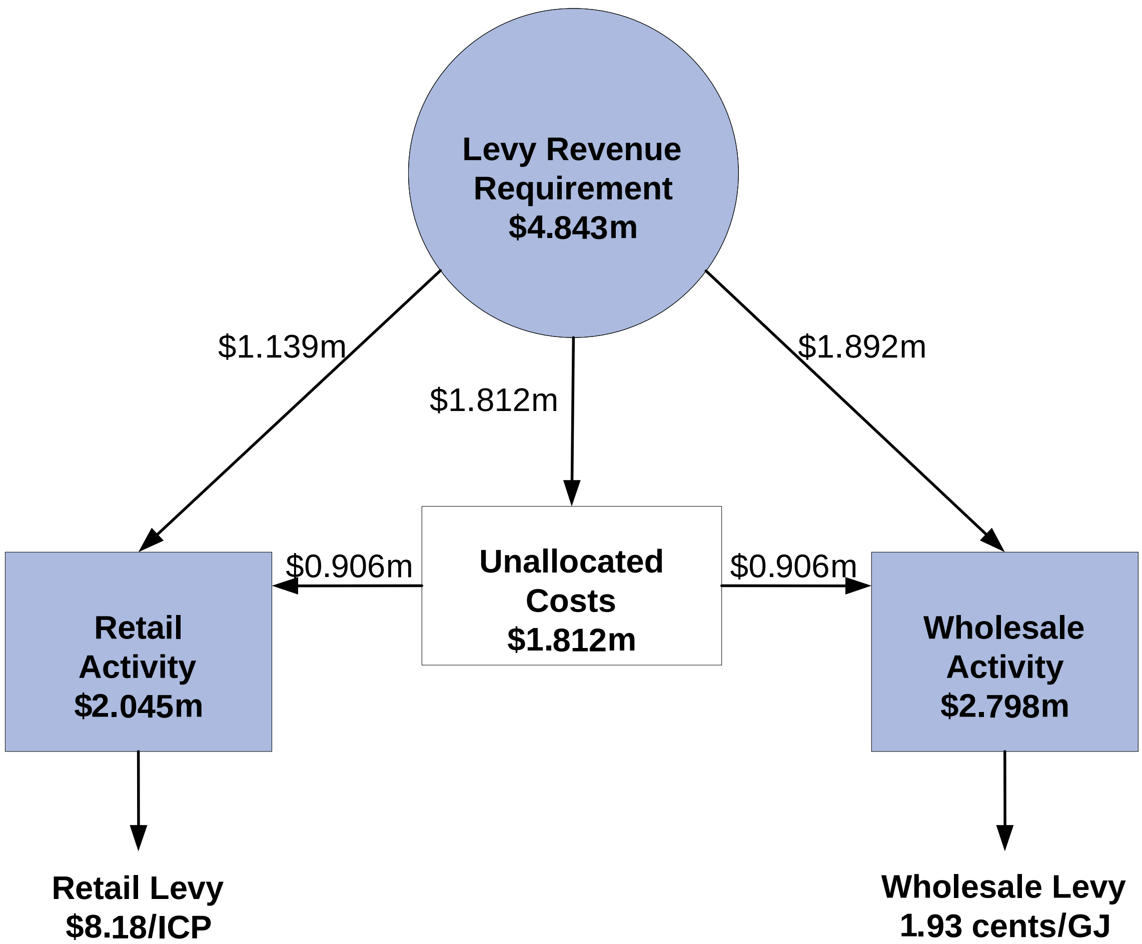
Work Programme	2007/08 Budget
Retail work programme	
Switching and Registry	242,036
Compliance and Enforcement	101,295
Reconciliation	263,917
Consumer Issues	283,335
Distribution Contracts	248,145
Total Retail work programme	***1,138,728***
Wholesale work programme	
Open Access Review	688,456
Wholesale Market Development	474,586
Access to Processing Facilities	167,304
Gas Emergency Arrangements	342,760
Compliance and Enforcement	219,231
Total Wholesale work programme	***1,892,337***
Total work programme costs	**3,031,065**
Unallocated costs	
Accountability and Governance	801,881
Levy Process	72,800
Total Corporate accountability	***874,681***
Accumulated cash reserves	90,000
Overheads	941,476
Contribution to loss brought forward	14,912
less non levy income	-108,634
Total unallocated costs	**1,812,435**
Total levy revenue requirement	**4,843,500**

6.3 Levy

Based on an allocation methodology which:

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

the levy revenue requirement of $4.843m results in the following levies:



The derivation of these levies from the budget projections is as follows:

The retail cost allocation of $2.045m is calculated by adding the budgeted cost 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.

Similarly, costs directly attributable to wholesale are $1.892m. Adding the $0.906m share of 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.

6.4 Conclusion

Gas Industry Co considers that the proposed levy is reasonable, having regard to Gas Industry Co's strategic plan, Annual Report and the GPS objectives and outcomes.

7 Recommendation

Gas Industry Co recommends to the Minister of Energy that levy regulations be made by the Governor-General under section 43ZZE of the Gas Act 1992 for the financial year from 1 July 2007 to 30 June 2008 requiring payment in each month of that year:

- From every gas retailer who is an industry participant on the last day of each month a retail levy of $8.18 per annum for each ICP for each retail customer; and
- From every person who is an industry participant on the first day of each month a wholesale levy of 1.93 cents on each gigajoule of gas purchased by the industry participant directly from gas producers during the previous month.

Appendix A: 2007/08 Work Programme

In the context of the co-regulatory model and the specific policy objectives described above, Gas Industry Co presents the following Work Programme for the 2007/08 financial year. The Board of 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.

Retail Work Programme

a) Switching and Registry

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.

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. The 2007/08 levy includes the costs of implementation of the new registry, although there is some uncertainty about when this expenditure will be incurred.

b) Retail Compliance and Enforcement

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.

To implement the compliance regime, the Gas Industry Co needs to develop procedures for the Rulings Panel, appoint a Market Administrator (most likely from within Gas Industry Co staff) and appoint a barrister to the Rulings Panel. In the event that the Switching Arrangements are delayed, compliance arrangements may be needed for the other work streams or alternatively the Company may need to appoint a barrister to assist with dispute resolution for emergency management – gas outage arrangements. Therefore Gas Industry Co has allowed for this work stream in the budget although the timing is uncertain.

c) Reconciliation

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.

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.

d) *Consumer Issues*

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.

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.

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. Appropriate allowance for these activities has been made in the “Consumer Issues” section of the budget.

e) *Distribution Contracts*

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.

Wholesale Work Programme

a) *Open Access Review*

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; Vector Transmission Code (VTC); Balancing; and Legal Framework.

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 VTC work streams will be managed by Vector Transmission, with Gas Industry Co monitoring progress. A Capacity forum is planned for June 2007.

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 VTC will replace Vector's Transmission Services Agreements when they expire in Q2.

In addition, 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.

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

b) Wholesale Market Development

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.

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.

c) Access to Processing Facilities

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.

d) Gas Emergency Arrangements

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.

e) Wholesale Compliance and Enforcement

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

a) *Accountability and Governance*

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 a also a significant amount of liaison required between Gas Industry Co and government agencies, particularly the Ministry of Economic Development.

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 two 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.

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.

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.

b) *Levy Process*

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 come 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.

Appendix B: January 2007 levy discussion paper

GAS INDUSTRY COMPANY LIMITED

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.

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 the 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 Company's budgeted revenue requirement of $4.843m. This represents an increase of $1.063m on the revenue of $3.780m which was the Company'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 the Company'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, the 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 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 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 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 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.

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 for approval;
- the Minister 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.

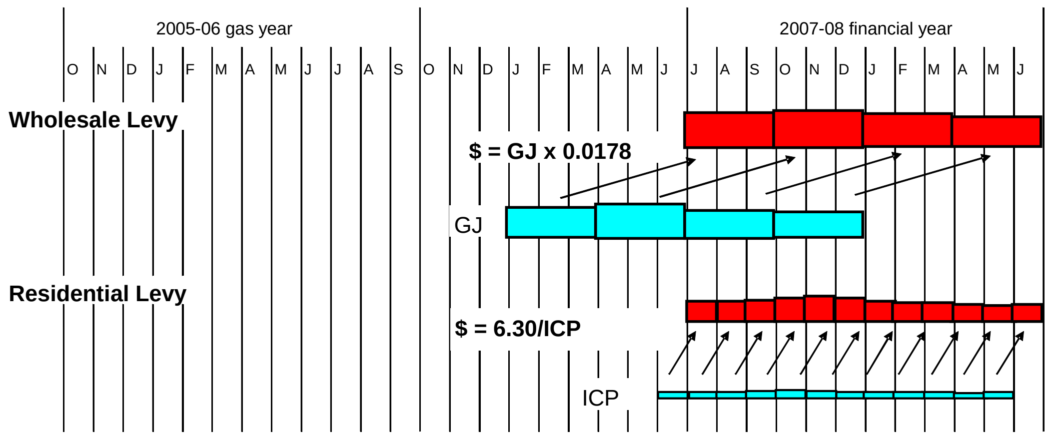
Retail Gas Levy

$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 Guidelines[1], Audit Office Guidelines[2] and Standing Order 382, in respect of the setting of levies.

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[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 statue:
- 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, the Gas Industry Co primarily aims to achieve a balance between administrative simplicity and economic efficiency. The 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. The 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

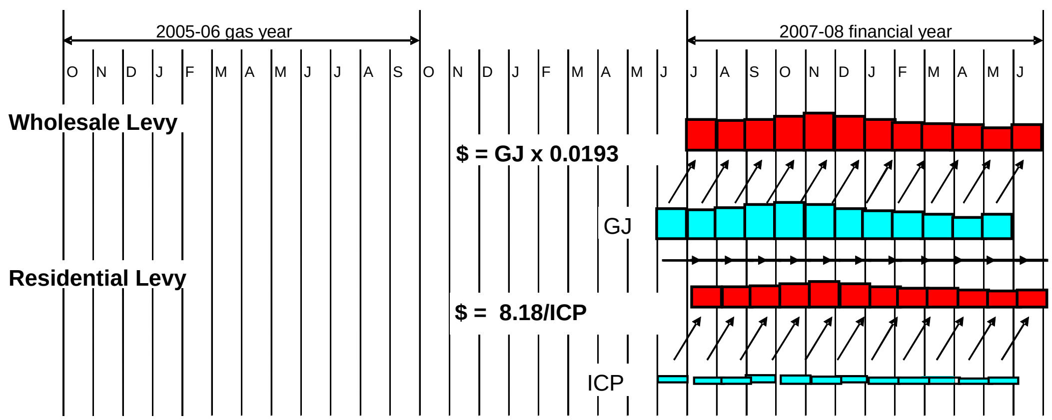
5.1 In response to stakeholder submissions last year, the reference quantity for the retail levy was changed from that for the previous gas year to the number of ICPs referable to each retailer on the last day of the previous levy month. The 10TJ threshold for the retail levy was removed at the same 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

- the 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, the 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 the 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 the Gas Industry Co to keep any surplus which should, instead, be paid back to levy payers. Contact, on the other hand, submitted that the 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 the Gas Industry Co to discuss with officials what legislative changes would be required, if any, and whether any changes need to be made to the Company'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 the 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 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 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 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 The 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. The Gas Industry Co has the following tools available to meet these objectives:

Power	Description
Recommend Governance Regulations & Rules	• The Gas Industry can recommend gas governance regulations and rules to the Minister. • 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	• The 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	Section 43ZL(2)(f) of the Gas Act requires Gas Industry Co to report regularly to the Minister on: • 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 the Gas Industry Co thinks fit or the Minister 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 the 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 the 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 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 in March 2007.

Reconciliation

6.10 The Gas Industry Co is expected to propose "… the development of protocols and standards applying to… balancing and reconciliation" (Item 9 of the GPS). The 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 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 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 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 the Gas Industry Co may be required to issue a consumer issues report on matters identified by the Minister 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 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 the 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;
- The Gas Industry Co will consult on options for a legal framework during Q2, with a recommendation being made to the Minister in Q4.
- A VTOC will replace Vector's Transmission Services Agreements when they expire in Q2.

MPOC

6.18 The 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 the 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 the 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 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 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 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, the 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 the 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 a also a significant amount of liaison required between the Gas Industry Co and government agencies, particularly the Ministry of Economic Development.

6.27 Section 43ZQ of the Gas Act requires the 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 The 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, the 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 paras 6.23 and 6.24 above). Where appropriate those roles will need to be funded from the levy. The Gas Industry Co also receives requests from the Minister 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 come into effect 28 days later. In the February 2006 levy discussion paper the Gas Industry Co estimated that the annual cost of the Levy Process to the Company 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 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 **Distribution Contracts**				Commerce Commission Determination.	Commence project on distribution contracts.	Discussion paper on 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 **Open Access Review**		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 **Wholesale Market Development**		Recommendation to Minister on Wholesale Market arrangements.	Issue RFP for service provider for trading platform	Appoint service provider for trading platform.		“Go live”	
C3 **Access to Processing Facilities**		“Go live” (voluntary)		“Go live” (regulated)			
C4 **Gas Outage Contingency Plan**		Recommendation to Minister on Gas Emergency Arrangements.		“Go live”		Audit of compliance	

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 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 the 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 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 & 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

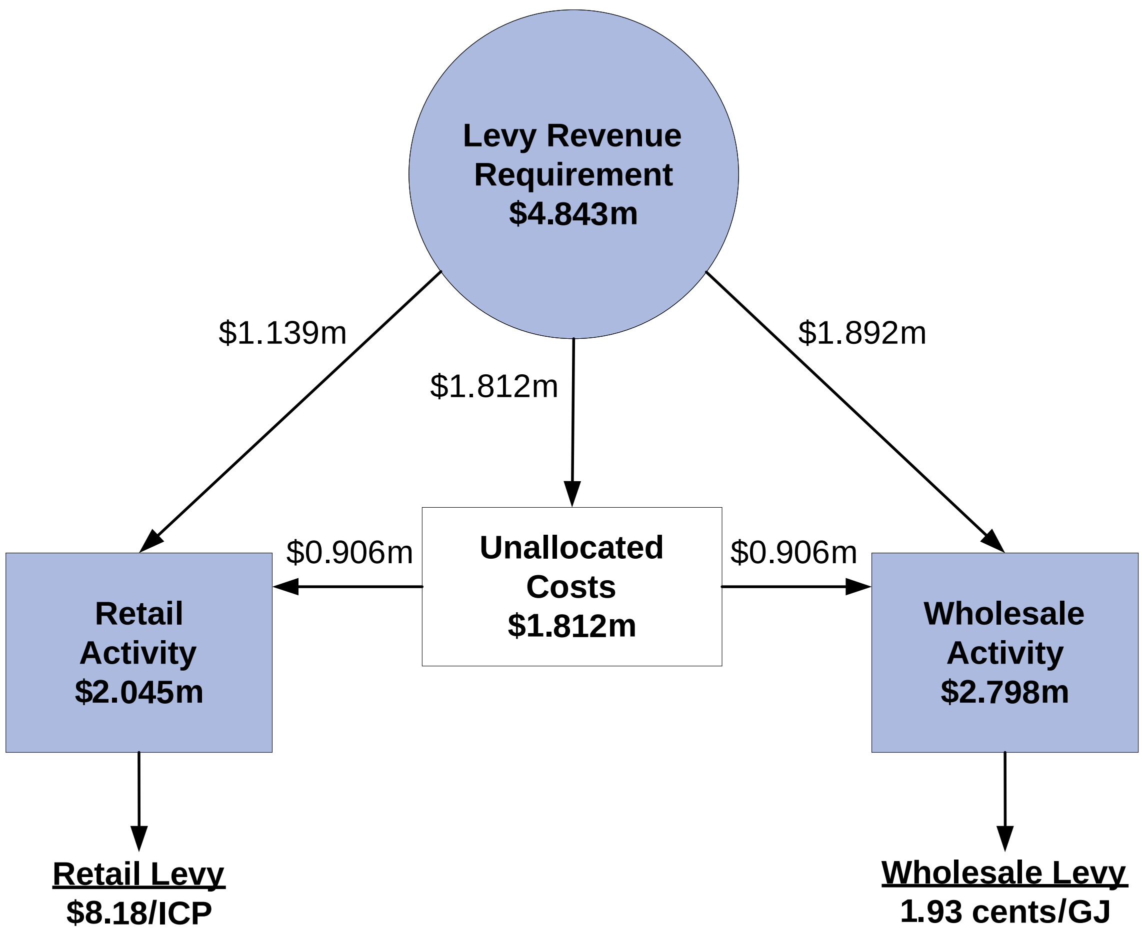
7 Proposed levy

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, and 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.



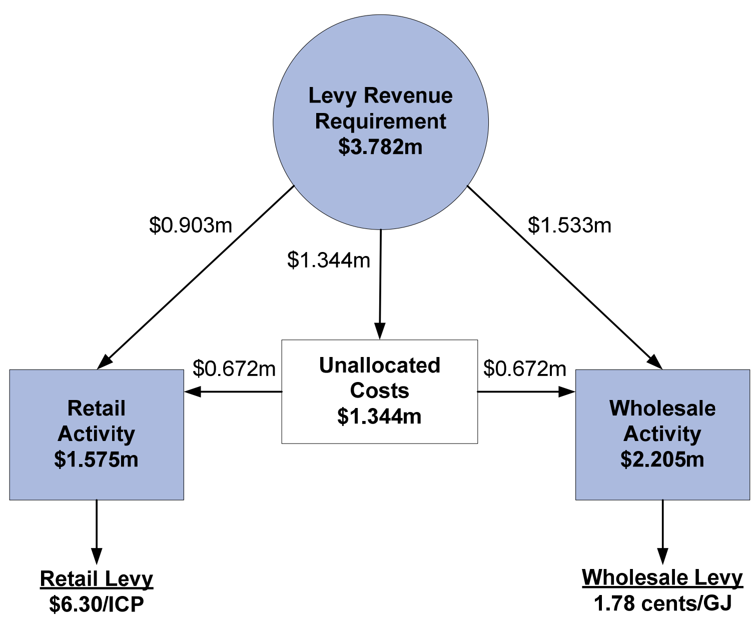
7.4 The derivation of these levies from the Section 6 budget projections is as follows.

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, 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?	

Appendix C: Summary of submissions

Q1: Do you agree with the proposal not to alter the structure of the levy for the 2007/08 financial year?	
Company	**Comment**
Contact Energy Ltd	Contact agreed with the principle of levy setting summarized in the Consultation Paper and considers that the basis for setting the 2006/07 reasonably reflects those principles. Contact agrees with the proposal not to alter the structure of the levy for the 2007/08 financial year.
Genesis Energy Ltd	Yes. Genesis Energy places a high value on certainty over time and considers that the current methodology should be retained until such time as a clear quantitative net benefit can be demonstrated for making changes. Changing the levy methodology year-on-year imposes a hidden, but material cost on industry participants.
MEUG	Yes
Mighty River Power Ltd	Yes. Mighty River Power agrees that the fixed c/GJ (retail) and variable $/ICP (wholesale) approach strikes an appropriate balance between administrative simplicity and economic efficiency.
Ministry of Consumer Affairs	Yes
Vector Ltd	Levy Structure In answer to Q1, Vector generally supports the structure of the levy remaining the same, but has some concerns that arise from a lack of transparency of previous GIC performance against budget (as outlined below).
Wanganui Gas Ltd	Yes

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?	
Company	**Comment**
Contact Energy Ltd	Contact agrees with the proposal 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. That will help simplify administration processes required to calculate and approve the levy. It will also mean the levy payments better match gas sales.
Genesis Energy Ltd	No. Genesis Energy does not believe that the Gas Industry Company has provided sufficient justification to change the reference quantities to the prior month. The justification for the change of methodology is the "significant time lag between when the gas was taken and when the levy on that gas becomes payable"…which would then "result in a mismatch between income earned in respect of that gas, and the income from which the levy is paid". In Genesis Energy's view, changing to the proposed methodology would increase the complexity of the levy payments and therefore increase administration costs to participants. In comparison, the current methodology allows all parties to budget sufficiently as consumption numbers are known well in advance. Genesis Energy would also expect that the current methodology would be beneficial to the Gas Industry Company to enable it to better forecast income. As identified in 5.6 of the discussion paper, historic data is relatively stable whereas the most recent data is more likely to change. Finally, as outlined in response to Q1 above, it is Genesis Energy's strong preference that the issue of the levy methodology remains settled until such time as a clear quantitative net benefit can be demonstrated for changing it. If the methodology remains a 'live' issue after this consultation process, Genesis Energy would suggest that the Gas Industry Company decouple it from consideration of the 2008/09 levy by addressing it earlier as a separate issue. Should the move to the proposed methodology be made, Genesis Energy would strongly encourage each payment be inclusive of any wash-ups for previous months.

MEUG	Yes. MEUG further suggest the GIC publish the monthly gas volumes at the same time monthly invoices are posted. This will have the dual advantage of first, allowing parties including end consumers to better reconcile their individual levy costs each month. And second, this would be a modest step to increasing transparency in the gas industry. On the latter point MEUG note that at present there is very little timely information on gas volumes in the public domain and no information at all on wholesale gas prices.
Mighty River Power Ltd	Mighty River Power acknowledges the GIC's desire to alter the manner in which the wholesale levy is calculated to address concerns about mismatch between the period in which income is earned and the period in which the levy is paid. Mighty River Power is largely indifferent to this proposal. However, we believe that here may be one potential disadvantage of this approach. This pertains to prospective changes to the manner in which downstream gas is reconciled[2] - if changes to the manner in which gas is reconciled go ahead (i.e. retailers to go to wash ups) then the requirement to pay a levy on the previous month's gas purchased will create administrative difficulties depending on the length of wash up period – i.e. the amount of levy paid may change subsequent to reconciliation requiring some kind of settlement. This problem may be greater under a consecutive monthly levy arrangement than under a quarter before the last quarter approach. **Over-and under-recovery of costs** Mighty River Power agrees that over- and under-recovery of costs in one financial year should be provided for in the following financial year and that this is consistent with section 43ZZC(3) of the Gas Act. **Two year levy review period** Mighty River Power agrees with the Ministry of Economic Development that the Gas Act as presently worded restricts the levy process to an annual one. Mighty River Power is supportive of an amendment to the Gas Act to allow for a two yearly review period.
Ministry of Consumer Affairs	The Ministry has no particular position on this question. It affects equity between wholesalers, and administrative convenience for wholesalers, but does not materially affect consumers. We leave this matter to those more directly affected.
Vector Ltd	In answer to Q2, Vector fully supports the move from the use of the previous quarter consumption to calculate the wholesale portion to one where current consumption is used. This resolves the current problem where customers continue to be billed for their GIC levy months after a supply contract expires and all other billing has ceased.
Wanganui Gas Ltd	Yes it appears to us to make sense to have the levy collection as closely aligned to the previous month as possible. However as we

[2] MRP – Signaled in the GIC's discussion paper entitle "Reconciliation of downstream gas quantities" dated 11 January 2007.

	simply pay the wholesale levy to our Gas Wholesaler we cannot comment on how difficult this type of alignment will be.

Q3: Do participants consider that it is useful to provide a comparison of previous years' costs with the budget figures?	
Company	**Comment**
Contact Energy Ltd	Contact agrees that it is helpful to compare: • the previous year's actual costs; • budget costs for the current year; and • budget costs for the year in which the proposed levy will apply.
Genesis Energy Ltd	As a matter of principle, as much financial detail as possible should be included in order for participants to satisfy themselves that the 'price' that participants are being charged for the Gas Industry Company's deliverables are being managed appropriately. Indeed, consistent with the second leg of the 'test' outlined in the covering letter, Genesis Energy considers that there is a relationship between the quantity and quality of information provided by the Gas Industry Company and the overall level of the proposed levy. In other words, that the obligation on the Gas Industry Company regarding the information it provides becomes more stringent as its levy proposals increase over time. In terms of the specific question, Genesis Energy would consider it useful for the Gas Industry Company to provide a comparison of previous years' actual costs with the current years budget figures. However, more importantly, Genesis Energy considers that the most relevant piece of financial information is the forecast outturn for the current year. It is this number that will enable participants to meaningfully assess on the appropriateness of the following years (in this case 2007/08) budget forecast on which the proposed levy is based. Other aspects of relevance to the quality of the financial information that should be provided are: 1. is it unclear from the information provided which of the proposed deliverables give rise to the major cost increases and which are minor in terms of cost impact. In other words, it is unclear what the specific drivers are to the increased request – is the Gas Industry Company: a. increasing the volume of its output delivery? Or b. delivering the same volume of outputs but they are just more expensive? 2. participants need to be able to assess any changes in the price of the Gas Industry Company's deliverables over time. To this extent, it is important that the outputs are fully priced and do not exclude 'unallocated' costs. Excluding such costs means that the final price for the outputs delivered can be subject to wild swings from year to year if the Gas Industry Company alters its allocation methodology at its discretion and it therefore becomes impossible for participants to understand the full price of the outputs that the Gas Industry Company is delivering; and 3. it is disappointing to note in paragraph 5.17 of the discussion paper that participants are directed to the Annual Report published in 2006. Although participants were able to gain more detail for previous years there was no useful comparison with the proposed budgets

	for the 07/08 financial year in which to make a more informed decision. However, to focus on the provision of financial information in isolation of robust information on the underpinning deliverables will only provide an inadequate picture and prevent participants from providing the Gas Industry Company with well-informed feedback. Indeed, in Genesis Energy's view, the levy proposal is simply the combined outcome of the Gas Industry Company's proposed budget and work programme. The key issue for the Gas Industry Company is the level of detail of its work programme which it considers (and indeed which industry participants consider) is sufficient to enable informed analysis of the Gas Industry Company's proposed levy rate or amount. In general, Genesis Energy considers the work programme information to be inadequate and this, in turn, is reflected in the inadequate financial information provided. More specifically: 1. there is no information: a. on the outputs that have been and are expected to be delivered by the end of the current financial year. To this extent, it is difficult to tell if the Gas Industry Company has delivered or simply carried over the delivery of outputs into the new financial year; b. regarding what participants are 'buying' for the levy payment. It is unclear from the lists provided on pages 17 – 19 what is actually being purchased. Invariably, the proposed activities are just that – activities when what is required is a description of the actual output being delivered (and therefore purchased). In general, what has been described is the process of delivery (for example – "consult", "implement", "form", "appoint", "develop" whereas the outcome would be described as complete, conclude etc); and c. on the Gas Industry Company's priorities to the extent that it appears that all of its proposed work is of equal and high priority which
Genesis Cont	Must be delivered in the 2007/08 financial year. This is implausible given the extent to which the Gas Industry Company can control its work programme; Genesis Energy considers that within the work programme, the key outputs (or projects) once described should be priced; and it would be also appropriate, in order to form a meaningful view on the Gas Industry Company's proposals, for the Gas Industry Company's 'business-as-usual' outputs within each work programme to also be described and priced. This is considered to be particularly pertinent given the expectation over time of the Gas Industry Company's outputs to shift from being project dominated to more routine in nature (for example, market monitoring, ongoing rule development to keep them flexible and adaptive to new technologies etc etc). In essence, Genesis Energy considers that to attempt to separate "the merits of the levy" from "the content of the work programme or budget."3 misunderstands the objective of consultation on the "levy rate or amount" as set out in section 43ZZD(2) and what it implies in terms of the quality and quantity of information to be provided to participants. Genesis Energy recognises that there is, of course, a balance to the level of detail to be provided by the Gas Industry Company. Genesis Energy's two 'tests' are intended to help in this regard. Genesis Energy has also provided a tentative outline that may assist the Gas Industry Company in regard to the appropriate level of output and financial disclosure that would, in its view, meet the two tests. This is attached as Appendix Two.

MEUG	Yes. The GIC should err to being more transparent and accountable than being less so because it is in the privileged position of being able to propose mandatory levies on the gas market.
Mighty River Power Ltd	Yes it is useful to provide a comparison of previous years actual costs with budgeted costs. However, the extent to which that caparison is useful depends on the level of financial information provided. In this respect, Mighty River Power is unable to critically assess whether the amounts sought for each work stream, work programme and total levy are justified because of the lack of granularity in the information provided. [See answer to Q6 for more detail on this issue.]
Ministry of Consumer Affairs	Yes. The Ministry considers there are two key elements to the consideration of levies: the total amount collected, and how that amount is calculated and administered. Providing information on the previous year's costs against budget provides a useful basis for assessing the scale of future requirements and thus the total amount to be collected. <u>Further</u>, in relation to 5.17, whilst the detailed work programme is a matter for the Board, there should be enough information available to enable stakeholders to be comfortable with the range and scale of projects to be funded through the levy. This would involve presenting a little more detail than is included in the current discussion paper.
Vector Ltd	
Wanganui Gas Ltd	Yes

Q4: Do you agree with the allocation of costs between the wholesale and retail work programmes?	
Company	**Comment**
Contact Energy Ltd	We agree that GIC costs should be allocated as far as possible to retail activity or wholesale activity in accordance with the classification of the components of the HIC work programme as retail activity or wholesale activity. It is clear that retail activity generates a work programme that has very little or no benefit for wholesale activity. Examples of that are the switching and registry project, the reconciliation project and the distribution contracts project.
Genesis Energy Ltd	No. There would appear to be no apparent justification for describing the area of corporate accountability as a separable work programme but not allocating it a portion of the unallocated costs. This should either be subsumed within the area of unallocated costs and then allocated across the retail and wholesale workstreams, or separately described as a set of identifiable outputs to be delivered, allocated a portion of the 'true' unallocated costs and recovered as a separate revenue requirement. Ultimately how the Gas Industry Company allocates and recovers its revenue is up to it, but it needs to be based on logical financial analysis of the underlying drivers of the business and what it delivers.
MEUG	Yes the allocation methodology used for 2006/07 is still appropriate
Mighty River Power Ltd	
Ministry of Consumer Affairs	Yes
Vector Ltd	
Wanganui Gas Ltd	Yes

Q5: Do you agree that unallocated costs should be split evenly between retail and wholesale?	
Company	**Comment**
Contact Energy Ltd	Splitting unallocated costs evenly between retail activity and wholesale activity appears arbitrary but has the advantage of simplicity. There are other ways to split these costs such as in proportion to the cost of the retail work programme and the wholesale work programme. However, it is difficult to determine whether that is fairer and in any event the outcome would not be greatly different. In the interest of simplicity Contact supports the even split.
Genesis Energy Ltd	Subject to the response to Q4 above, the allocation of 'unallocated costs' is merely an accounting exercise over which the Gas Industry Company should (and rightfully so) have operational discretion. However, as also noted above, Genesis Energy's interest is in understanding the full 'price' of the outputs being delivered by the Gas Industry Company over time and not in how its overheads or input costs are allocated. To this extent, the allocation methodology is only relevant to the degree to which it fails to reflect the underlying drivers of the business and what it delivers and in doing so inappropriately influences the price of the outputs being delivered. Genesis Energy considers that the Gas Industry Company is more than capable of coming up with an efficient accounting allocation mechanism that is consistent with the FRS requirements, and appropriate to the fundamental economic drivers of its business and the outputs it delivers. However, having said that, the Gas Industry Company provides no justification for the even split which suggests that it is driven more by ease of implementation rather than logical financial analysis of the contributing factors. Genesis Energy would like to see more detail with regards to these unallocated costs in order to determine which outputs they should ultimately be allocated across, and why.
MEUG	There doesn't appear to be a better approach and therefore MEUG agree with retaining the current split.
Mighty River Power Ltd	
Ministry of Consumer Affairs	No. The allocation has been made on a 50:50 split. A rationale that has been put to us is that this acknowledges the flow-on effect of benefits. However, this approach erodes the principles expressed in section 4.1 of the discussion paper, in particular the principles of rationality and that the user/causer pays. Broadly, the unallocated costs would be more accurately attributed in proportion to the total retail and wholesale costs respectively, and we consider that is the basis that should be used. Thus the retail work programme costs represent 38% of the total work programme costs and should therefore attract 38% rather than 50% of the unallocated costs.
Vector Ltd	
Wanganui Gas Ltd	No WGL believes that the unallocated costs should be proportionally split between the two work streams based on the work program for each particular year.

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?	
Company	**Comment**
Contact Energy Ltd	Contact at this time does not have any significant concern about the increase in expenditure forecast of the 2007/08 financial year. The GIC currently has a significant work programme reflecting the initial development stage of construction of an improved framework for the gas industry and the move from closed arrangements dominated by a few players and a single supply contract to an open environment with diverse supply arrangements. Over the next couple of years we expect the GIC work programme to deliver a number of beneficial changes to the industry. However, if GIC is unable to deliver the improvements we will have concerns about the level of GIC expenditure.
Genesis Energy Ltd	See Genesis Energy's covering letter. Since the implementation of the levy, retail fees have increased by 104.5% and wholesale by 28.7%. On the face of it, although the Gas Industry Company has taken up the challenge to engage the industry and pushed forward with specific work streams the increases do not appear to have yet been matched with completed workstreams with regard to wholesale markets, switching & registry and reconciliation work programmes. Genesis Energy's agreement to the proposed levy increase is, therefore, a conditional one. Along with the need to see improved information, Genesis Energy will also closely monitor (as a part of its on-going assessment of value-for-money) the degree to which the Gas Industry Company completes its forecast deliverables in a timely manner. Genesis Energy also suggests that greater industry input into the Gas Industry Company's priority setting would be appropriate – perhaps something akin to the 'big picture' priority setting exercise undertaken by the Electricity Commission. This would greatly assist participants in their ability to comment on the value-for-money of future levy proposals.
MEUG	No. MEUG is very disappointed in the level of information provided to justify the proposed 28% increase in funding levels. Even if the GIC were proposing no increase in funding, the level of information provided would not meet the requirements we would expect of, for example, the Electricity Commission when it consults on its proposed budget. Some examples of the shortcomings in the information supporting the proposed budget follow: 1. Consideration should have been given to capitalising the work in implementing switching, registry and reconciliation processes and charging parties using those services rather than fund through the GIC levy. 2. MEUG would want a lot more information to believe that work on consumer issues will increase from a budget in 2006/07 of $125,000 to $283,335 in 2007/08 (an increase of 127%). Holding forums and working on disconnection issues should be a relatively modest cost because the GIC should be able to leverage of the already significant improvements the Electricity Commission has been able to advance with electricity retailers on this topic. Most gas retailers are also electricity retailers. MEUG believe the proposal to spend $248,145 on a model gas distribution contract is highly speculative given the Commerce Commission control regime will take some time to bed in. Assuming a final control regime is in place mid to late 2007 then we expect the affected gas companies will probably want to dedicate resources to working out how they will operate in the new environment rather than work on model distribution contracts. MEUG suggest the GIC should plan on commencing work on model distribution contracts no earlier than 2008/09.
Mighty River Power Ltd	Section 43ZZD Gas Act sets out various conditions for the recommendation by the GIC of levy regulations. Subsection 2 provides that if these conditions are met the Minister must accept the GIC's recommendation. One of these conditions is that the GIC *"has consulted with industry participants on the levy rate or amount".* Accordingly, the GIC is required to satisfy a statutory obligation to consult with

	industry participants should it wish to met the conditions prescribed in section 43ZZD(2).[3] In respect of a statutory obligation to consult the Court of Appeal decision in *Wellington Airport Limited v Air New Zealand*[4] provides guidance. In that case the Court of Appeal stated that:[5] for consultation to be meaningful, there must be made available to the other party sufficient information to enable it to be adequately informed so as to be able to make intelligent and useful responses. Applied to the present case - section 43ZZD(2)(b) requires that the GIC give industry participants sufficient information about the proposed levy to make "intelligent and useful responses" to the proposal – in other words, there must be enough information so that industry participants can form a view about whether the proposed expenditures are prudent and justifiable. The question becomes: has the GIC provided sufficient information to give industry participants the ability to properly review the levy proposal? The GIC noted in the Levy Paper that some submitters had suggested that the GIC should provide additional financial information. In response to submitters concerns the GIC stated: 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 the merits of the levy proposed rather than on the content of the work programme or budget. In our view, the GIC misses the point when it suggests that, the fact the levy discussions are on the merits of the levy proposed negates the need to provide a budget. The levy proposal is an aggregation of the detailed budget items. Accordingly, the merits of the levy proposal can only be assessed with reference to the content of the detailed budget and work programme. In this respect, Mighty River Power sees no reason why industry participants should not be provided with the same budgetary information as the Board. The requirements of good consultation, as noted above, mean that the GIC should provide the information underlying the levy proposal such that submitters can fully consider its propriety – much in the same way as the Board would make the same assessment. This approach also accords with the principle of being an open consistent and transparent regulator. Further, the consultation process facilitates the oversight by industry participants of the GIC, thereby giving the GIC the opportunity to receive critical analysis of the detail underpinning its levy proposal. Industry participants have not been able to fulfil this function because of the inadequacy of information provided by the GIC.

[3] MRP - We note that the section does not mandatory require the GIC to consult. Rather the section requires that the GIC must consult to fulfill the conditions provided in subsection (2). We trust that given the GIC has consulted with industry participants that it wishes to do so in a manner that satisfies section 43ZZD(2)(b).

[4] MRP - [1993] 1 NZLR 671 (CA).

[5] MRP - Ibid at 676.

	only provides figures to work stream
Mighty River Power (Cont)	In essence, Mighty River Power is unable to critically evaluate the relationship between the monies sought by the GIC and the various costs provided by the GIC to a sufficient level of granularity. In particular: a. Although 2005/06 actual figures are provided, the Levy Paper does not provide an analysis of how 2005/06 actual expenditures compared with budgeted amounts, i.e. what is the explanation for differences; b. The GIC does not provide updated budget (including actual costs) for the 2006/07 financial year; c. A significant cause of our inability to contrast actual figures with budget figures is the generality of the information provided - the GIC level. A break down of costs is required to gain visibility of what money is actually being spent on; d. The lack of information provided makes it impossible to draw inferences from this year's performance to date through to the forecast expenditure for the new financial year. To address the above concerns, Mighty River Power recommends that the GIC provide the following information as part of its future levy consultations: a. A detailed budget that includes specific costs broken down beyond the work stream level, i.e. to income expense group categories. b. Actual prior year figures verse prior year budgeted figures together with analysis. This analysis should explain if any variance between actual and budgeted figures is due to timing of planned activities (work deferred or brought forward) or permanent cost savings or over-runs. c. Actual prior year figures verse current year budgeted figures together with analysis. This comparison should identify differences in work being undertaken between years. d. Sensitivity analysis. This analysis should provide information on how budgeted costs would fluctuate given changes in key factors. One of the objects of this analysis is to identify the key drivers behind the GIC's levy proposal and provide a frame of reference for industry participants to make an assessment.
Ministry of Consumer Affairs	Yes; we accept the need to provide for a greater level of activity.
Vector Ltd	In answer to Q6, while Vector appreciates the need for the GIC to be sufficiently resourced to carry out the work required, Vector believes consideration is needed of the effect on gas consumers and stakeholders of such a considerable increase in levy fees, and believes there is a need for a more measured approach and recognition of issues at play in the wider regulatory environment. 6. One work stream in particular stands out in this regard - model distribution contracts. Given the uncertainty pf outcomes and resulting high probability of change in incentives on gas distribution companies (and corresponding shape of any contracts) emerging from the Minister of Commerce's review of Parts 4, 4A and 5 of the Commerce Act, it is appropriate to wait until the 2008-09 year to proceed on this issue. Vector believes such a significant budget for this work stream is not appropriate at this time.

Wanganui Gas Ltd	Yes but with reluctance. Whilst WGL appreciates that the levy is and will be driven by the work program for the year ahead it has to be recognised that the proposed increase in the retail levy is in percentage terms almost 30%. Such an increase although only $1.88 per customer over the year will result in some customers questioning such a large percentage increase which the Gas Industry Company may need to respond to. Customers may be more willing to accept such increases of they see the levy varying both up and down depending on the work program which we accept is difficult to demonstrate given that the Gas Industry Company is only in its third year of operation. It should also be remembered that ultimately the customer pays for both the Wholesale and Retail levies. The almost 30% increase in the retail levy and an 8% increase in the Wholesale Levy is simply another increase that the customer has to pay for his or her gas on top of the increases in compliance, transportation and wholesale gas costs being incurred by retail companies.

Further Opening or Closing comments from submitters.	
Company	**Comment**
Genesis Energy Limited	Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide comments to the Gas Industry Company on the “Levy Discussion Paper” dated January 2006. Genesis Energy has reviewed the discussion paper and is pleased to have the opportunity to respond to the issues it raises. In general, Genesis Energy welcomes the Gas Industry Company’s approach to the consideration of the issues associated with the setting of its annual levy. It is clear that the Gas Industry Company is, to a certain extent, ‘learning by doing’ with respect to its own finances, the costs of providing its deliverables, and fulfilling its legislative obligation to consult. While Genesis Energy does not agree with all of the Gas Industry Company’s conclusions,[6] it nonetheless considers that the Gas Industry Company should continue to transparently ‘front-footing’ these issues with industry participants. Before getting into the detail responses to what the Gas Industry Company is proposing to do in 2007/08 and how much this is proposed to cost, Genesis Energy wishes to raise an over-arching issue. This issue is the degree of the Gas Industry Company’s accountability to those participants who pay the levy (accountability which is implied in the Gas Industry Company’s legislative obligation to consult), and how that is being, or should be fulfilled in practical terms. Genesis Energy acknowledges that the level of explicit accountability to industry participants is low. However, putting aside those issues associated with what duties a legislative obligation to consult entails in law[7] Genesis Energy considers that there is essentially a two-pronged ‘test’ against which the

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[6] Genesis - Genesis Energy’s responses to the specific questions posed by the Gas Industry Company consultation paper are attached to this letter as Appendix One.

[7] Genesis - Genesis Energy doubts that the Gas Industry Company would be unfamiliar with the duties set out the 1993 Court of Appeal case Wellington International Airport Limited et al v Air New Zealand et al, 1 NZLR 671 regarding consultation.

	reasonableness of the Gas Industry Company's fulfilment of its accountability to industry participants can be assessed. These are whether the information provided by the Gas Industry Company in its levy paper is: 1. sufficient to reasonably allow industry participants to comment meaningfully on the Gas Industry Company's levy proposal and its value for money; and 2. appropriate to the absolute level of the request being made. Genesis Energy has applied this framework in considering the issues raised in the consultation paper. Genesis Energy's overall assessment is that from the information provided by the Gas Industry Company it is unable to conclude whether the levels of expenditure proposed (and result in a $1.063m increase in the proposed levy) are either justified or prudent. This view is largely derived from the inadequate workstream information and the 'disconnect' between the workstream information and the financial information. For example, it is impossible to derive a proposed budget of $101,295 (excluding a portion of unallocated costs) for the compliance and enforcement workstream in the table on page 22 from either the description in paragraph 6.9 or the two comments in B2 on page 18. Conversely, from the nature of the expected deliverables for the switching and registry, and reconciliation workstreams, Genesis Energy considers these budgets to be relatively light. Further information on the views outlined here is provided in the Appendices attached. As a result, Genesis Energy is extremely reluctant to agree to the proposed increase. Specifically, Genesis Energy's increase in costs from the 06/07 to the 07/08 financial years, for both retail and wholesale, will be in excess of $300,000.00. This is a significant increase that will be borne ultimately by Genesis Energy's customers. Despite this reluctance, Genesis Energy recognises that there is a significant amount of work to be pursued by the Gas Industry Company over the coming year and accordingly Genesis Energy will reluctantly agree to the proposed budget. However, having said that, Genesis Energy wishes to put the Gas Industry Company on notice that unless significant improvements are made in the quality of the information the Gas Industry Company provides when seeking future levy increases – Genesis Energy's support of future budget proposals is unlikely to be forthcoming. Clear evidence of the Gas Industry Company's delivering on its expected outputs will be key to this.
Mighty River Power Ltd	**Introduction** Thank you for the opportunity to comment on the Gas Industry Company's (GIC's) "Levy Discussion Paper", January 2007 (Levy Paper). No part of our submission is confidential and we are happy for it to be publicly released. Mighty River Power is concerned about the statements the GIC has made in the Levy Paper around provision of financial information. We are disappointed that the GIC has not provided an updated budget (including actual costs) for the 2006/07 financial year. In particular we are disappointed about the lack of detailed budget information provided in the Levy Paper. Without detailed budget information we are not able to fully assess the merits of the large increase in levy payments sought by the GIC. Given the above, the tone of this submission is critical of the GIC. Despite this, we continue to support the GIC and consider that the GIC is doing a good job overall. We do not wish our criticism to be received by the GIC as an indication that Mighty River Power considers the levy payments sought are

	not justified. Our position is that the GIC has failed to provide adequately detailed financial information resulting in Mighty River Power not being able to properly review the GIC's levy proposal. **Conclusion** Mighty River Power respectfully reminds the GIC that the consultation provisions in the Gas Act are designed to provide an extra level of oversight of the GIC's levy process, over and above that of the Board. This is to provide an extra safeguard against escalating regulatory costs. Mighty River Power has not been able to provide this oversight because the GIC has not provided adequately detailed financial information. Accordingly, we recommend that the GIC implement the recommendations at paragraph 22 above.
Vector Ltd	Vector welcomes the opportunity to submit on the Gas Industry Co's (GIC) proposed levy arrangements and work schedule for the 2007-08 year. Vector also appreciates the extension provided but for the record notes the time allowed to submit was short, given the magnitude of the issues. Vector questions the need for such a swift and potentially less thorough process when the new financial year does not start until July. Vector would also comment that the GIC has now successfully established itself as the gas sector's co-regulator, and is well placed to contribute to continued development in the sector. However, Vector believes a key risk to be managed this coming year will be to ensure that the rush to pursue outcomes driven by a desire to satisfy deadlines does not compromise achieving the best solutions. Transparency Vector supports the GIC's endeavours to be as open and transparent as possible (para 6.27), understands that variations occur (6.40) and that there is a need for contingencies. However, it appears to Vector that the GIC could improve its openness through developing appropriate processes to deal with variations. One improvement would be to reconcile the GIC's actual costs against predicted forward work programmes and adjusting the forward levy accordingly, taking any variations into account. This would ensure all contingent spending was appropriately allocated over time. This should also apply to any unallocated costs, which may, in retrospect be allocated to wholesale or retail matters. Vector understands there have been several requests for Board minutes to be made public in the interests of transparency. Vector does not support full disclosure of minutes as they are a record for directors, and may become compromised if their purpose is broadened. However, Vector does support the public release, where appropriate, of issues discussed, noted and agreed at Board meetings.

Appendix D: Parties Consulted

Age Concern

AGL

Arete Limited

Austral Pacific Energy

Balance Agri Nutrients

Bay of Plenty Electricity

Bell Gully

Blue Scope Steel

BRG

Bridge Petroleum

Carter Holt Harvey

Castalia

CGNZ

Clifford Chance Law Office

Commerce Commission

Concept Consulting

Consumers Institute

Contact Energy ltd

Craftware Computing Ltd

E-Gas

Electricity and Gas Complaints Commission

Electricity Commission

Energy Efficiency and Conservation Authority

Energy Link Ltd

Exergi

Fletcher Building Ltd

Four Winds Communication

Gas Association of New Zealand

Gas Net

Genesis Energy

Greymouth Petroleum

Greypower

Heinz Watties Ltd

Kensington Swan

Kerridge & Partners

KPMG

LPG Associations of New Zealand

Major Electricity Users Group

Marsh Limited

Maui Development Ltd

M-Co

Methanex New Zealand

Mighty River Power

Ministry of Consumer Affairs

Ministry of Economic Development

Multigas (NZ) Ltd

National Council of Women

New Zealand Oil and Gas Ltd

NZPWC

NZRC

New Steel

Nova Gas Ltd

NZ Water and Wastes Association

O-I New Zealand Ltd

OMV New Zealand Ltd

Pan Pac Forest Products Ltd

Parliament

Parsons Brincerhoff Associates

PB World

PEPANZ

Powerco Ltd

Pricewaterhouse Coopers

RBZ Energy Ltd

Richard Clarke QC

Russell McVeagh

SBT Group

Shell (Petroleum Mining) Ltd

Shell Todd Oil Services Ltd

Simpson Grierson

Stigley & Co

Strata Energy Consulting

Swift Energy Ltd

Tap Oil Ltd

Tatua Co-op Dairy

The Australian Gas Light Company

Thorndon Chambers

Todd Energy Ltd

TWS Consulting Ltd

Vector Ltd

VUW School of Economics and Finance

Wanganui Gas Ltd

Westech Energy