



Gas Industry Co FY2010 Levy Workshop 28 January 2009

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Corporate Services Manager



Key Dates

- 5 February** Closing date for submissions.
- 19 February** Report on submissions and proposed Levy are presented to the GIC board.
- 12 March** Levy recommendation is presented to the Minister.
- April** Levy proposal is confirmed by Cabinet.
- 29 June** Levy regulations take effect.



Contents of Presentation

- **Strategic Overview**
- **Work Programme and Budget**
- **Development of the FY2010 Levy**
- **Levy 2010**



Strategic Overview



Strategic Overview

- **Gas Industry Co was established to undertake the role of the industry body envisaged under amendments to the Gas Act in 2004.**
- **In particular, the Company was originally set up with the intention of delivering the policy tasks set out in the Government Policy Statement on Gas Governance (GPS).**
- **Since 2003 three GPSs have been issued, the latest in April 2008.**



Strategic Overview

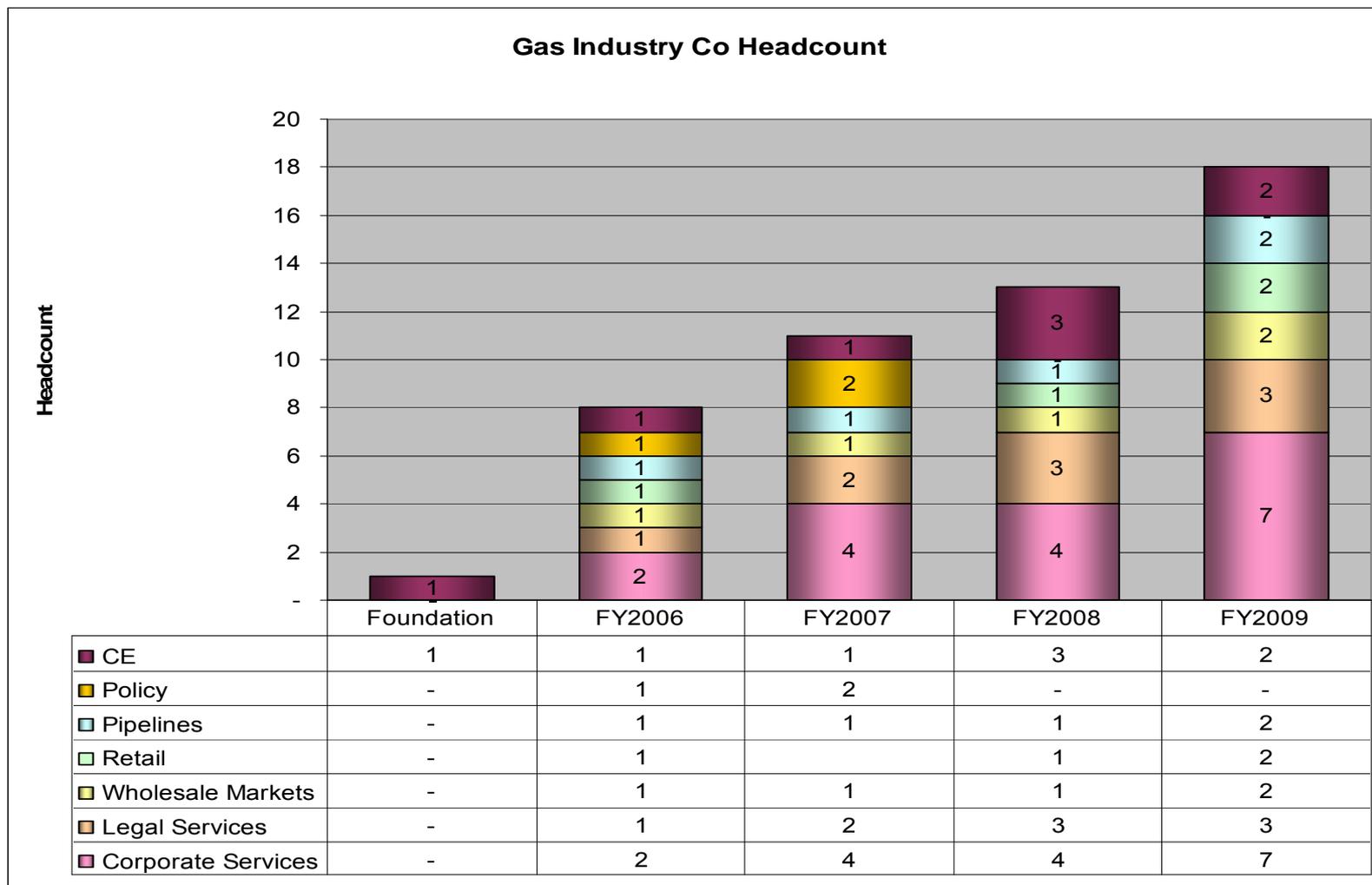
The complexity of the issues and process has required a far more extensive policy development organisation than was probably envisaged by the industry, government and possibly the Gas Industry Steering Committee.



Work Programme	Phases					
Compliance In Progress	Overview	Consultation	SoPs and Recommendations	Compliance Procedures	Compliance Determinations	
Consumer Complaints In Progress	Overview	Consultation				
Consumer Issues In Progress	Overview	Consultation				
Critical Contingency Management In Progress	Overview	Consultation	Statement of Proposal	Recommendation	Market Administration	
Direct Use of Gas In Planning	Overview					
Distribution Access In Planning	Overview					
Downstream Reconciliation In Progress	Overview	Consultation	SoP and Recommendation	Establishment	Market Administration	Exemptions
Gas Industry Company Levy Completed	Overview	Consultation	Recommendations	Regulations		
Gas Processing Facilities Information Disclosure In Progress	Overview	Consultation	Statement of Proposal	Establishment	Market Administration	
Interconnection In Progress	Overview					
Levy 2010 In Progress	Overview	Consultation				
MDL Memorandum of Understanding Completed	Overview					
MPOC Change Request 20 June 2008 Completed	Overview	Draft Recommendation	Final Recommendation			
MPOC Change Request 21 May 2008 Completed	Overview	Draft Recommendation	Final Recommendation			
Specification for Reticulated Natural Gas Completed	Overview	Consultation	Recommendation			
Switching and Registry In Progress	Overview	Consultation	Statement of Proposal	Recommendation	Establishment	Market Administration
Transmission Access Framework Completed	Overview	Consultation	Statement of Proposal			
Transmission Pipeline Balancing In Progress	Overview	Consultation				
Upstream Reconciliation In Planning	Overview					
Vector Memorandum of Understanding Completed	Overview					
Vector Short-term Capacity In Planning	Overview	Research				
VTC Change Request Appeal 12 December 2008 In Progress	Overview	Submissions				
VTC Change Request Appeal 9 October 2008 In Progress	Overview	Draft Recommendation				
Wholesale Market In Progress	Overview	Consultation	Recommendation	Establishment	Market Administration	



Strategic Overview





Strategic Overview

•Six gas governance recommendations were introduced in FY2009:

- Gas (Switching Arrangements) Rules 2008
- Gas (Processing Facilities Information Disclosure) Rules 2008
- Gas (Downstream Reconciliation) Rules 2008
- Gas Governance (Compliance) Regulations 2008
- Gas Governance (Critical Contingency Management) Regulations 2008
- Wholesale Market Trial



Strategic Overview

- **By the close of FY2010, Gas Industry Co expects the majority of its GPS work streams to be in implementation**
- **Consequently, Gas Industry Co is about to undergo a step-change in its focus and function**



Strategic Overview

A strategic planning process focused solely on the broad premise of delivering the GPS has reached a point of diminishing returns.

The Company has developed its resources and capabilities to the point where it can now legitimately consider what future role is implied for it as the industry co-regulator.



Strategic Overview

- **Gas Industry Co assumes an incremental change in the role it currently undertakes.**
- **The Company will move through a series of step-changes from policy development through to market operations and, ultimately, monitoring market performance.**
- **These step-changes drive a strategic change agenda for the Company to enable it to take on each role at the appropriate time.**



Strategic Overview

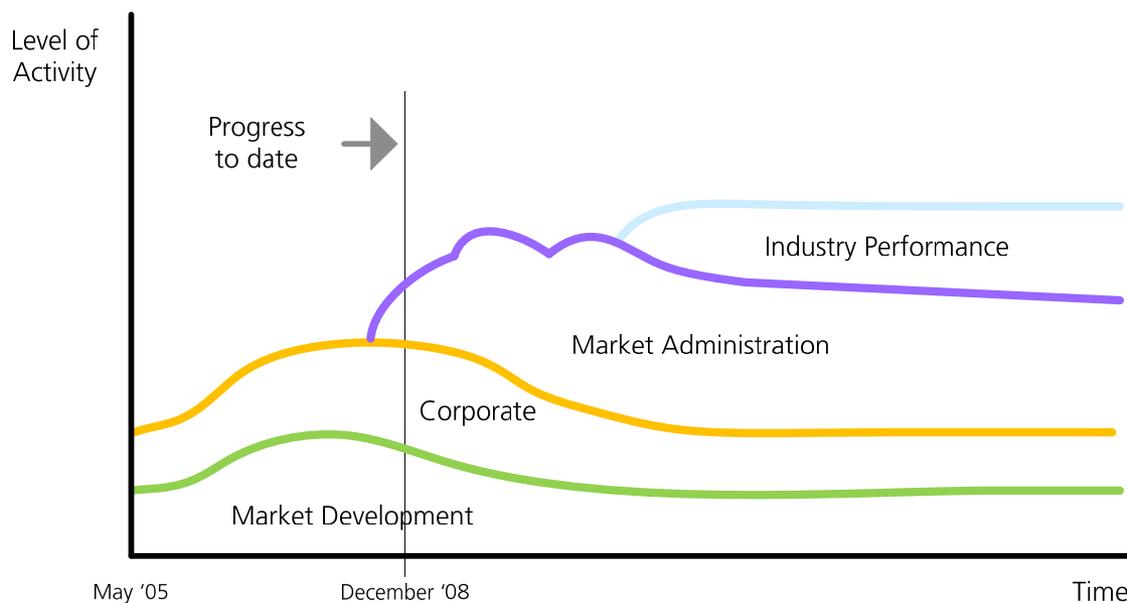
Because of these changes, the Company has reorganised its work programme into three major work areas:

- **Market development (which incorporates policy development)**
- **Market administration**
- **Industry performance**

Underpinning and supporting these work areas is the corporate function



Evolution Of The Co-Regulatory Model





Strategic Overview

DRIVERS FOR CHANGE

- **Less intensive policy development activity as market administration begins to consume more of the company's time and resources**
- **However, policy development will continue to be required, so consistency in ongoing policy development work is needed**
- **Legal work will become more operational in nature**



Strategic Overview

DRIVERS FOR CHANGE

- **Requirement to transfer institutional knowledge from work stream leaders to junior staff**
- **Need to lessen reliance on external consultants**
- **Platform for future delivery of Market Analysis needs to be laid**



Core Business

Strategic Overview

Gas Industry Co will need to focus on:

- Enhancing and protecting our policy development expertise.
- Efficiently administering regulatory arrangements for and on behalf of the industry.
- Building in-house capability for advice on strategic issues and market performance.
- Aligning the organisation to support core business.

- Enhance and protect our policy development expertise
- Administer regulatory arrangements.
- Provide high quality industry specific advice
- Align the organisation

- The policy work does not disappear
- Market administration is an increasing focus of our activity
- Statutory requirement to advise Minister
- Fit for purpose



Strategic Overview

Strategic Priorities for FY2010

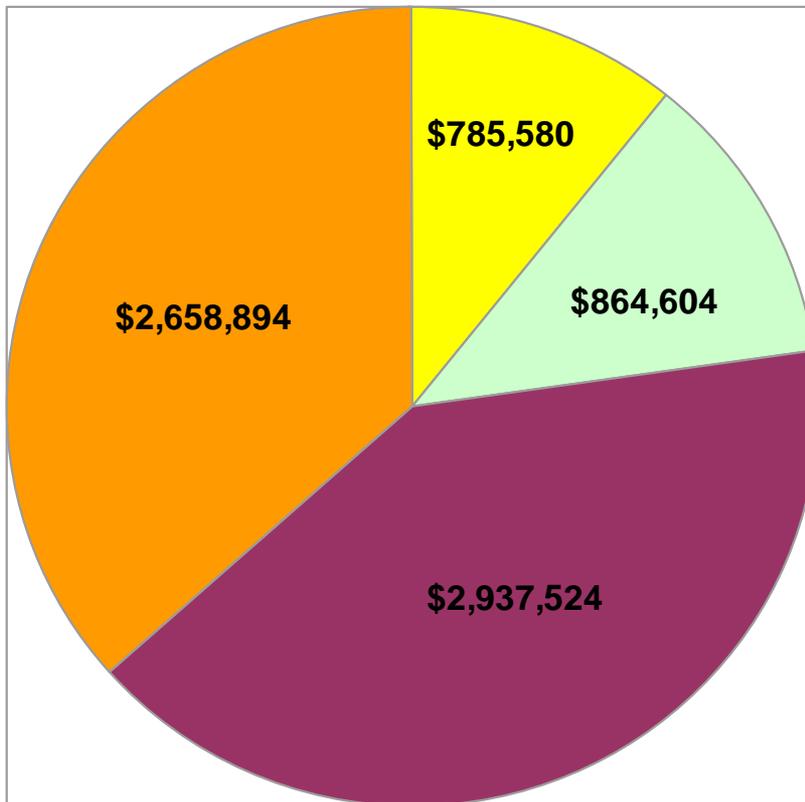
- **Complete recommendations to the Minister on balancing, interconnection, retail contracts and consumer complaints resolution by the end of FY2010**
- **Develop a framework for monitoring industry performance, measuring the impact of the GPS interventions and assessing data requirements**
- **Develop capability and systems to efficiently administer all approved gas governance arrangements on behalf of the industry**



Work Programme and Budget



FY2010 Budget Analysis

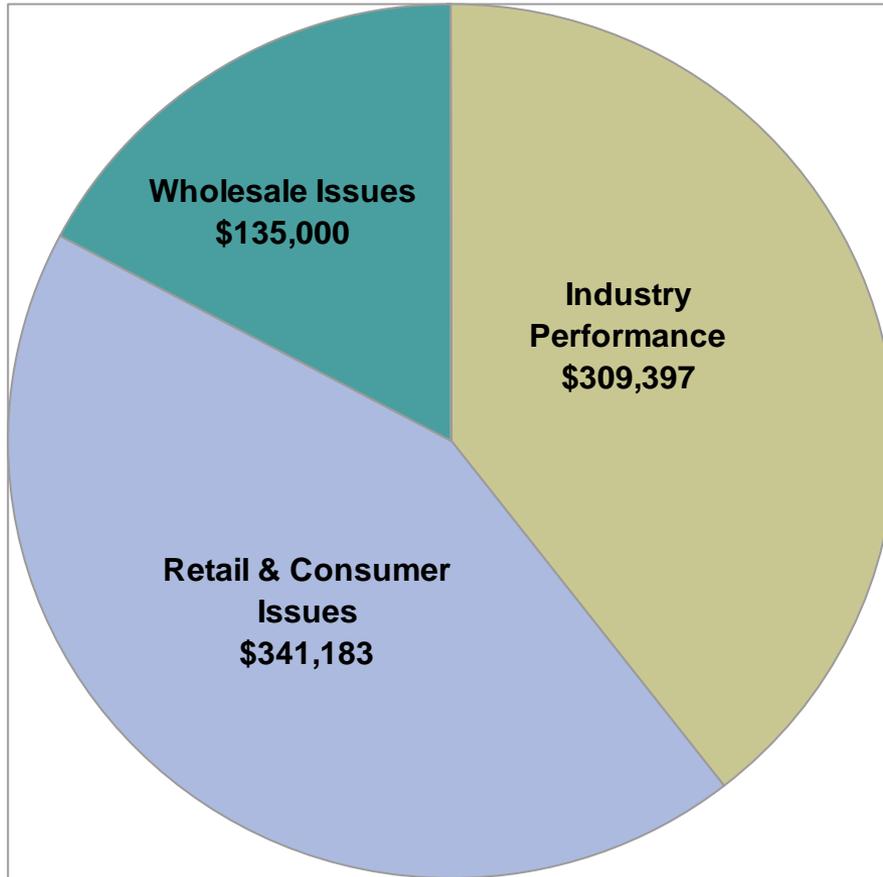




Market Development

The company needs utilise its extensive policy development experience to ensure all existing and future gas governance arrangements retain their relevance and effectiveness in the face of changing market conditions.

Market Development





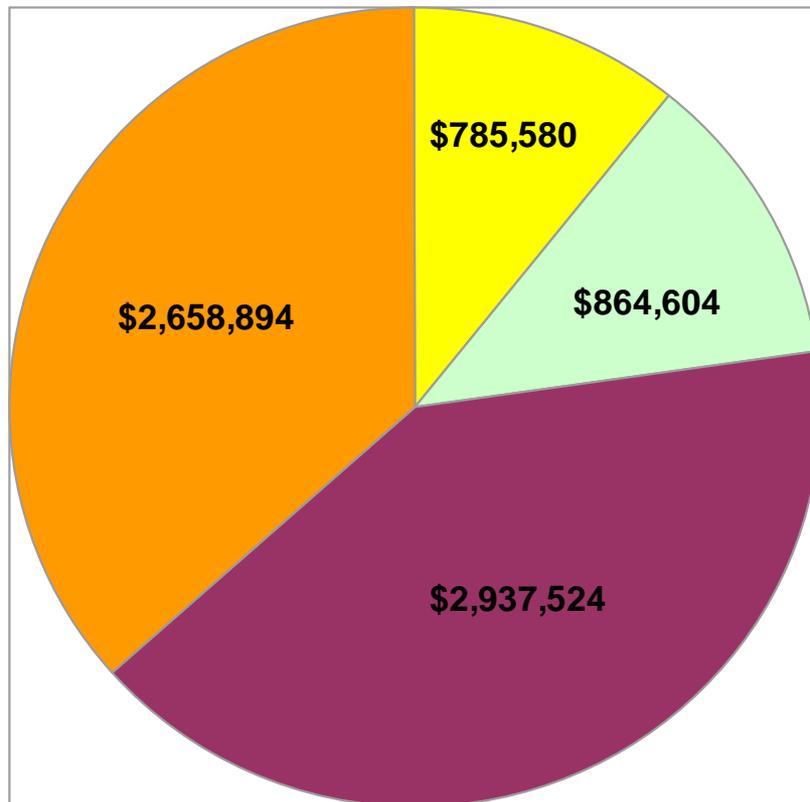
Market Development

Market Development

Market Development			
Description	Activities	Outputs	Desired Outcome
Incorporates policy development and industry performance review for retail and wholesale markets and improvements to consumer outcomes.	<ul style="list-style-type: none"> •Best practice analysis. •Market analysis. •Problem definition. •Stakeholder consultation. •Solution development. •Rule review and revision. 	<ul style="list-style-type: none"> •Policy guidelines. •Framework for assessing industry performance. •Report on Direct Use of Gas. •Strategic advice on performance of gas markets. •Recommendations on •Consumer complaints resolution. •Retail Contracts. •Retail market rule changes. •Wholesale market rule changes. •Compliance regulation changes. 	<ul style="list-style-type: none"> •Best practice policy development. •Gas sector contributes to achieving Government's goals in NZES. •Barriers to retail and wholesale competition are minimised. •Downward pressure on prices. •Improved consumer outcomes.
Total Budget			\$785,580



FY2010 Budget Analysis

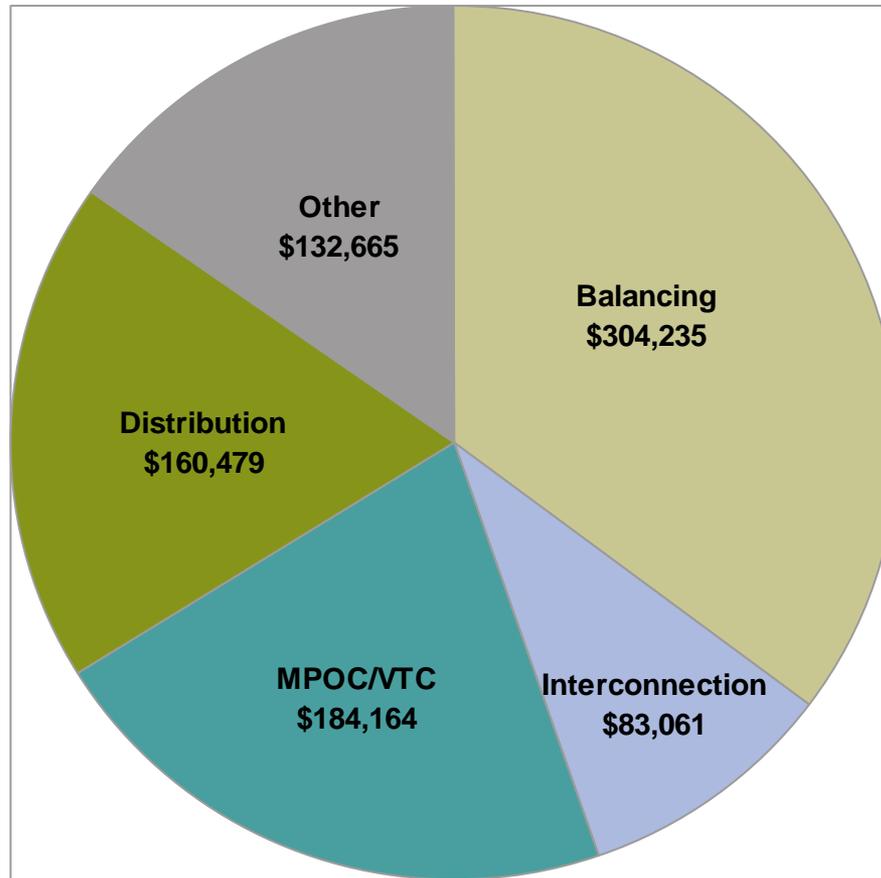




Market Development – Pipeline Access

Gas Industry Co needs to complete its remaining policy development work - in particular the work associated with ensuring access to pipeline networks on reasonable terms and conditions.

Pipeline Access



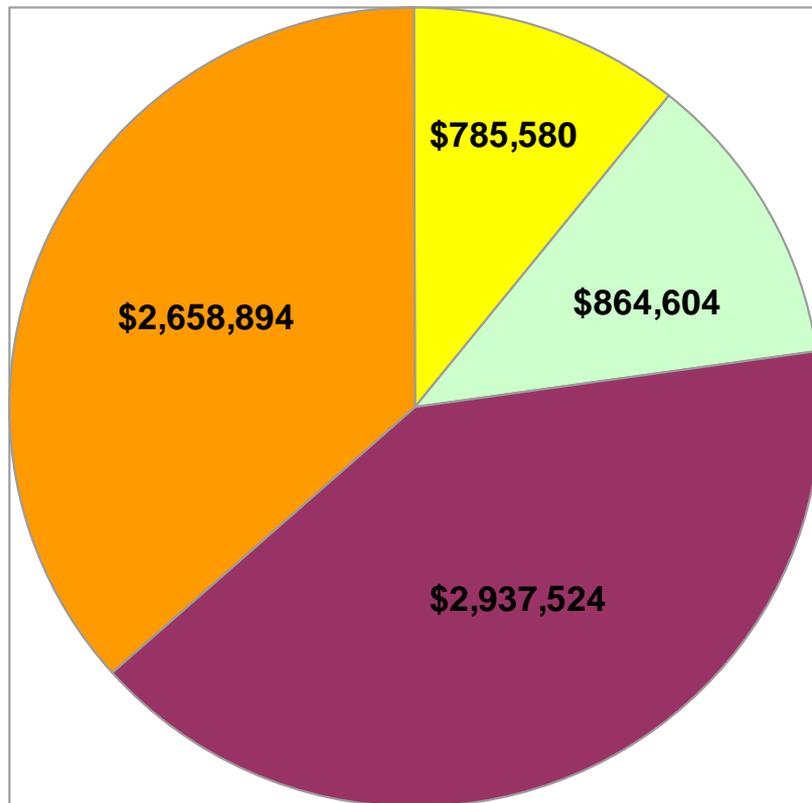


Pipeline Access

Pipeline Access			
Description	Activities	Outputs	Desired Outcome
Policy development, market performance and industry roles relating to transmission and distribution pipelines.	<ul style="list-style-type: none"> •Best practice analysis. •Market analysis. •Problem definition. •Stakeholder consultation. •Solution development. •Rule review and revision. •Facilitation of industry discussions. 	<ul style="list-style-type: none"> •Recommendations on: <ul style="list-style-type: none"> •Balancing; •Interconnection; •Upstream reconciliation; and •Distribution. •MPOC and VTC rule changes and appeals recommendation. 	<ul style="list-style-type: none"> •Improved transmission and distribution access.
Total Budget			\$864,604



FY2010 Budget Analysis





Market Administration

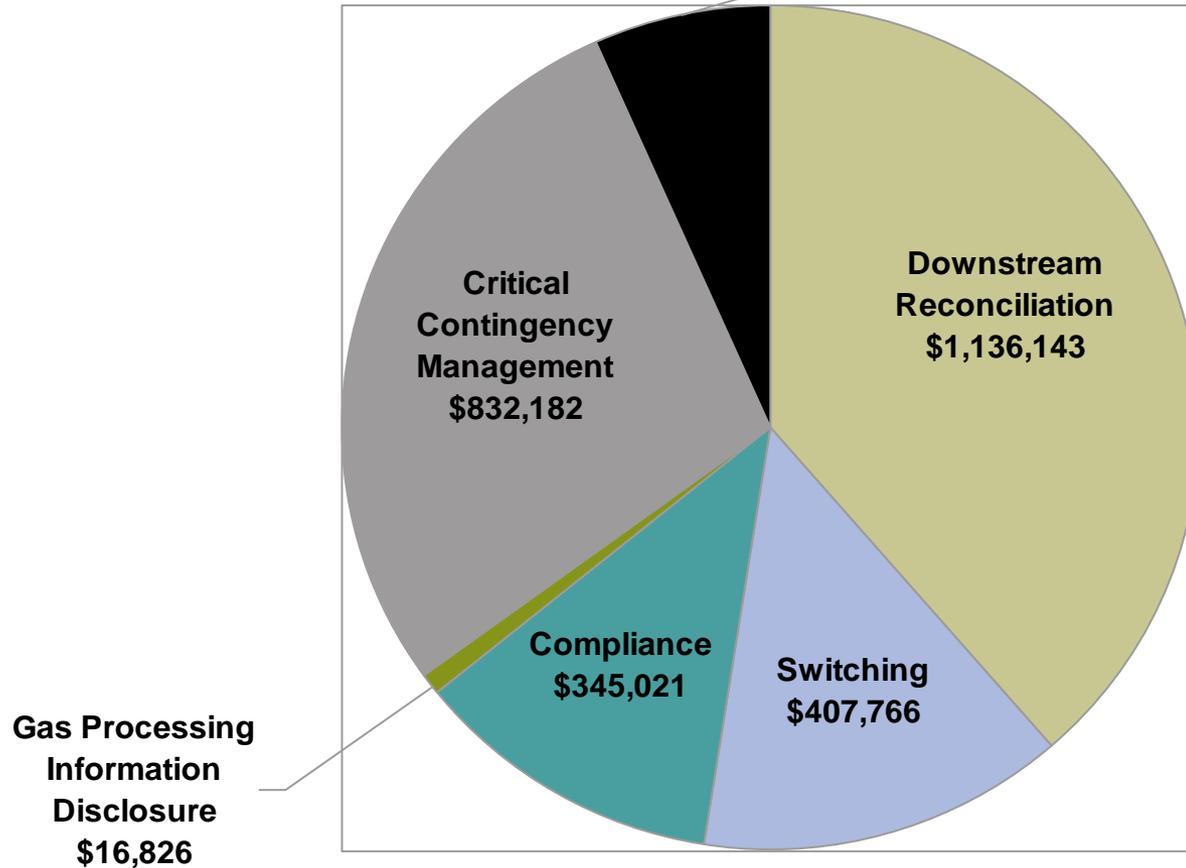
The significant number of gas governance arrangements approved in the last financial year, as well as those likely to be implemented during FY2010, mean Gas Industry Co must now add market administration activities to its core work.

This work area encompasses managing the performance of service providers, estimating and collecting fees, collecting and publishing information, determining technical detail, appointing experts and auditors, and approving contingency plans.

Market Administration



Wholesale Market
Trial
\$199,586



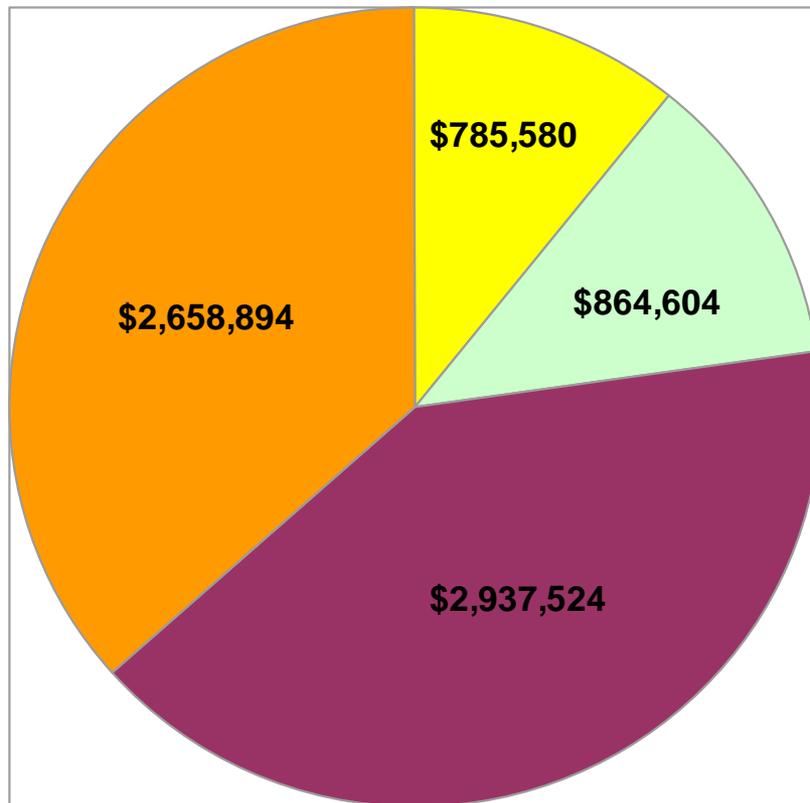


Market Administration

Market Administration		
Activities	Desired Outcomes	
<ul style="list-style-type: none"> •Engagement of service providers and other persons required by regulations. •Monitoring and management of appointed personnel. •Industry Body roles in regulations. •Compliance and enforcement. 	<ul style="list-style-type: none"> •Cost-effective market administration. •Achievement of the purpose of gas governance arrangements, eg: •Faster and more reliable customer switching; •More accurate and efficient reconciliation; •Timely and efficient resolution of rule breaches; •More information about availability of gas processing facilities; •Greater certainty on the physical and commercial outcomes of outage and contingency events; •More efficient and transparent short-term gas trading in wholesale market. 	
Total Budget		\$2,937,524



FY2010 Budget Analysis



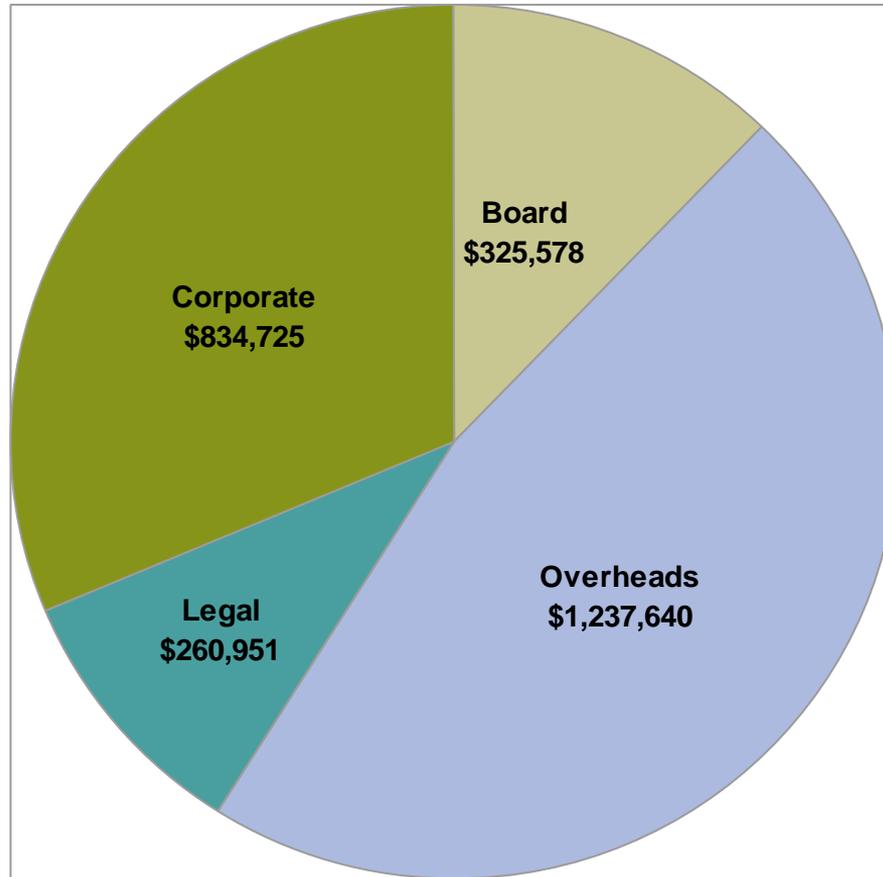


Corporate

Although Gas Industry Co is a small organisation in terms of budget and staff numbers, its role means it has the organisational, financial reporting, governance and communication requirements of a much larger entity.

Corporate support activities in FY2010 will include stakeholder communications, internal governance, finance, human resources, project management, IT infrastructure, administrative support and premises management.

Corporate





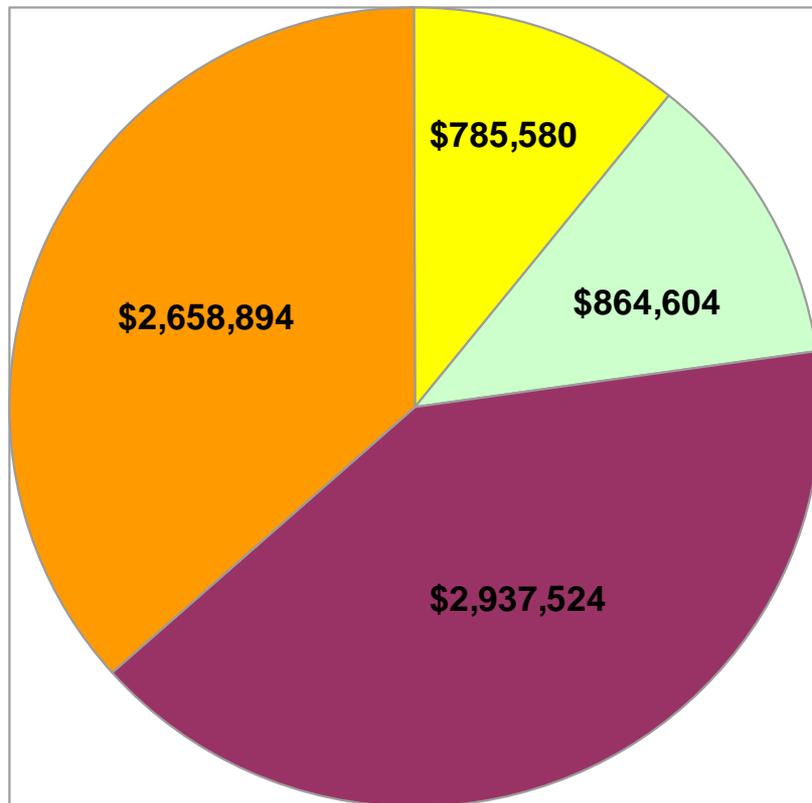
Corporate

Corporate

Corporate			
Description	Activities	Outputs	Desired Outcome
Finance, human resources, information technology, communications, administrative support, property management and internal governance.	<ul style="list-style-type: none"> •Board and management reporting, internal governance. •Advice on non-work stream legal issues. •Annual meeting of shareholders. •Industry forum, Consumer forum. •Website and external communications. 	<ul style="list-style-type: none"> •Monthly Board reports. •Management reporting. •Project reporting. •Business planning. •Annual Report. •Strategic Plan. •Levy consultation. •Quarterly reports to Minister. 	<ul style="list-style-type: none"> •Gas Industry Co operates efficiently and effectively. •Compliance with the accountability framework set out in the Gas Act, Companies Act, Financial Reporting Act, GPS and constitution. •Stakeholders informed of the activities of the Company.
Total Budget			\$2,658,894



FY2010 Budget Analysis





Question 4

Do you consider that any other items in the external work programme should be included in the Company's strategic priorities for FY2010?



Development of the FY2010 Levy



Levy Structure

Work Areas	Description
Wholesale	Work on those parts of the gas supply chain upstream of distribution comprises the wholesale gas aggregated work stream including pipeline access
Retail	Work on consumer issues, retail markets and distribution comprises the retail gas aggregated work stream
Corporate	Work broadly related to gas governance, rather than to one of the two aggregated work streams, as well as the indirect costs of GIC's governance, general support services and infrastructure



Levy Structure

The existing levy structure levy will be retained:

Per ICP retail levy

Per GJ wholesale levy



Question 1

Do you agree with the proposal not to alter the structure of the Levy for the FY2010 financial year?



Funding Policy Implementation

Current Policy

- **Company policy has been to recover the implementation costs of gas governance arrangements by market fees, unless those costs were expected to be immaterial and therefore recovered from the annual Levy.**
- **However, the Downstream Reconciliation establishment costs – which were far greater than industry expectations initially indicated – proved this approach could provide cash-flow difficulties for Gas Industry Co.**



Funding Policy Implementation

- **To mitigate this risk, Gas Industry Co will in future apply a standardised approach, funding all development costs via a market fee.**
- **Previously, a portion of internal costs were recovered by way of market fees.**
- **To simplify matters, the Company proposes to use market fees to recover only the external costs of its service providers, with the internal costs of administering these regulatory arrangements met from the general Levy.**



Funding Policy Implementation

New Policy

- **Gas Industry Co will fund the direct external costs of the development, establishment and ongoing operating for gas governance arrangements through specified market fees.**
- **The internal costs of the Company in developing, establishing and administering gas governance arrangements will be funded from the general Levy.**
- **The Levy for FY2010 has been calculated on the assumption that market fees will recover only those direct external costs likely to be incurred.**



Question 3

Do you agree with the proposed policy for funding the establishment, implementation and ongoing administration costs of gas governance arrangements?



Market Fees

In addition to the Levy, Gas Industry Co will continue to fund gas governance arrangements, implementation and operations through specified market fees.

For FY2010, four classifications of market fees will be charged to industry participants, in accordance with previously published guidelines. They are:



Market Fees

Regulations	Cost Type	Amount
Switching	Service Provider Contract	260,000
	Other External Direct Costs	40,000
Reconciliation	Service Provider Contract	830,000
	Other External Direct Costs	74,000
Compliance	Rulings Panel and Investigator	166,400
	Other External Direct Costs	45,000
Critical Contingency Management	Service Provider Contract	600,000
Total		2,015,400



Market Fees

Switching and Registry: the ongoing fees of the registry operator.

Downstream Reconciliation: the ongoing fees of the allocation agent appointed under the Downstream Reconciliation rules.

Compliance and Enforcement: the costs of the Rulings Panel and investigators.

Critical Contingency Management: the costs associated with the ongoing fees of the Critical Contingency Operator and any industry experts.



Downstream Reconciliation Establishment Costs Levy

In FY2009, Gas Industry Co had unbudgeted development costs of \$1,052,500 as a result of implementing the Gas (Downstream Reconciliation) Rules 2008.

The Board agreed these costs should be recovered in the annual Levy for FY2010, and a letter of advice was sent to industry participants in September 2008.



Downstream Reconciliation Establishment Costs Levy

There are two options for recovery of these establishment costs in the annual Levy:

- **An increase in the FY2010 retail levy, which is payable by retailers on a per ICP basis; or**
- **A separate one-off levy, which is payable by retailers on the basis of their proportionate share of allocated gas quantities.**



Downstream Reconciliation Establishment Costs Levy

Increase in FY2010 retail levy

Under the existing Levy structure, if the unbudgeted downstream reconciliation establishment costs were included in the retail levy, they could be charged to retailers on a per ICP basis.

This would result in an increase over and above any other proposal, of \$4.21 per ICP in FY2010.



Downstream Reconciliation Establishment Costs Levy

One-off Special-Purpose Levy

This spreads the costs between the retailers on the same basis used to allocate the ongoing operational costs in the Gas (Downstream Reconciliation) Rules 2008.

The allocated volumes are based on the first six months of the gas year (1 October 2008 – 1 April 2009).

The levy would be invoiced on 1 July 2009.



One-Off Special Purpose Levy

Gas Industry Co's preference is to use this option.

- **It is consistent with existing rules on the allocation of the ongoing costs involved in Downstream Reconciliation.**
- **It is consistent with an assumption the allocation of ongoing costs reflects the respective utility of the system to users.**
- **Replicates the method likely to have been used if provision had been made for the recovery of the development costs in the current rules.**



Question 2

Do you agree with the proposal to recover the establishment costs of the Gas (Downstream Reconciliation) Rules 2008 by way of a one-off Special Purpose Levy calculated on the same basis used to allocate the ongoing operational costs?



Levy Under- and Over-Recoveries

Section 43ZZC of the Gas Act allows for the annual Levy to either deduct past over-recoveries or add past under-recoveries.

For clarity, past over-recoveries of the levy are now reported as an “Industry Advances Reserve” in our annual accounts.



Statement of financial position

As at 30 June 2008

	Notes	Actual 2008 \$	Actual 2007 \$	Budget 2008 \$
ASSETS				
Current assets				
Cash and cash equivalents	6	1,345,609	977,956	613,226
Trade and other receivables	7	150,098	11,366	2,468
Taxation receivable	5	7	8	-
Total current assets		1,495,714	989,330	615,694
Non-current assets				
Property, plant and equipment	8	178,401	213,989	196,993
Total non-current assets		178,401	213,989	196,993
Total assets		1,674,115	1,203,319	812,687
LIABILITIES				
Current liabilities				
Trade and other payables	9	508,250	428,493	385,187
Unsecured shareholder loan	10	-	62,500	-
Redeemable shares	11	9	9	10
Total current liabilities		508,259	491,002	385,197
Non-current liabilities				
Unsecured shareholder loans	10	-	337,500	337,500
Total non-current liabilities		-	337,500	337,500
Total liabilities		508,259	828,502	722,697
EQUITY				
Industry Advances Reserve	12	1,065,857	374,817	89,990
Retained Earnings	12	100,000	-	-
Total equity		1,165,857	374,817	89,990



Levy Under- and Over-Recoveries

Gas Industry Co proposes to apply the balance of the Industry Advances Reserve to the subsequent Levy-setting process.

For example, an over-recovery in FY2009 would be reported on by September 2010 and the adjustment included in the Levy-setting process for FY2011. This would be the earliest possible date that any over- or under-recovery could be applied.



Levy Under- and Over-Recoveries

For FY2010, Gas Industry Co has applied the balance of its Industry Advances Reserve, as at FY2008, to the Levy-funding requirement calculation, reducing it by \$686K.



Levy Structure

Indirect costs allocation based on the proportion of direct costs consumed by each work stream (excluding service provider costs).

Market fees used to fund the external implementation and ongoing costs of gas governance arrangements.

Levy over-recoveries applied at the earliest possible date.



FY2010 Budget Analysis

	Direct External	Direct Salaries	Direct Total	Overhead	Market Fees	Total
Retail Work Programme Costs						
Downstream Reconciliation	904,000	232,143	1,136,143	324,733	(904,000)	556,876
Switching	300,000	107,766	407,766	142,221	(300,000)	249,988
Industry Performance 50/50	125,000	29,699	154,699	148,893		303,592
Distribution	60,000	100,479	160,479	154,457		314,936
Retail & Consumer Issues	200,000	141,183	341,183	328,380		669,563
Compliance	141,090	41,456	182,546	137,535	(141,090)	178,991
Total Retail Work Programme Costs	1,730,090	652,726	2,382,816	1,236,219	(1,345,090)	2,273,945
Wholesale Work Programme Costs						
Critical Contingency Management	600,000	232,182	832,182	223,469	(600,000)	455,651
Wholesale Market	.	199,586	199,586	192,097		391,683
Industry Performance 50/50	125,000	29,699	154,699	148,893		303,592
Wholesale Issues	135,000	-	135,000	129,934		264,934
Gas Processing	-	16,826	16,826	16,194		33,020
Balancing	120,000	184,235	304,235	292,819		597,054
Interconnection	30,000	53,061	83,061	79,944		163,005
MPOC / VTC	80,000	104,164	184,164	177,253		361,417
Other	55,000	77,665	132,665	127,687		260,352
Compliance	70,310	92,165	162,475	34,384	(70,310)	126,549
Total Wholesale Work Programme Costs	1,215,310	989,582	2,204,892	1,422,674	(670,310)	2,957,256
Total Work Programme Costs	2,945,400	1,642,308	4,587,708	2,658,894	(2,015,400)	5,231,202

Allocation of Expenditure by Levy Income Stream



Retail Expenditure	Total
Industry Performance	303,592
Downstream Reconciliation	1,460,876
Switching	549,988
Retail & Consumer Issues	669,563
Distribution	314,935
Compliance (80% of total)	320,080
Total	3,619,034
Wholesale Expenditure	
Industry Performance	303,592
Critical Contingency Management	1,055,651
Wholesale Market Trial	391,683
Wholesale Issues	264,934
Gas Processing	33,020
Balancing	597,054
Interconnection	163,005
MPOC / VTC	361,417
Other Pipelines	260,352
Compliance (20% total)	196,859
Total	3,627,567
Total Retail and Wholesale	7,246,602



Retail Funding Comparison

Source of Income	FY2009	FY2010	Comment
Retail Funding Requirement	\$1,951,389	\$2,273,946	FY2010 now includes all GIC internal costs of market administration.
Market fee for Switching & Registry establishment costs	\$1,075,360	0	
One-off annual levy for Downstream Reconciliation establishment costs	0	\$1,052,500	
Ongoing Market Fees	\$1,603,891 †	\$1,345,090	FY2009 included a portion of GIC direct costs which are now part of the levy.
Gross Retail Revenue Requirement	\$4,630,640	4,671,536	
<i>less over-recoveries and interest</i>	(\$95,612)	(\$296,131)	Proportionate share of Industry Advances Reserve as at FY2008.
Net Retail Funding Comparison	4,535,028	\$4,375,405	

† Estimated per annum basis. Estimated costs for FY2009 are \$1,097,188



Wholesale Revenue Comparison

Source of Income	FY2009	FY2010	Comment
Wholesale Revenue Requirement	\$3,028,388	\$2,957,256	FY2010 now includes all GIC internal costs of market administration.
Ongoing Market Fees (per annum basis)	\$653,547‡	\$670,310	FY2009 included a portion of GIC direct costs which are now part of the levy.
Gross Wholesale Revenue	3,681,935	3,627,566	
<i>less over-recoveries and interest</i>	(\$437,897)	(\$389,972)	Proportionate share of Industry Advances Reserve as at FY2008.
Net Wholesale Funding Comparison	\$3,244,056	\$3,237,594	

‡Estimated per annum basis. Estimated costs for FY2009 are \$123,547



Comparison of FY2010 Costs

Two significant items of expenditure are one-offs – the establishment costs of \$1,075K for the switching project and \$1,053K for the reconciliation rules.

The reconciliation establishment costs were incurred in FY2009 but will be recovered in FY2010 under the proposals previously described.

Other items of increase are of a permanent nature and relate to the step change in the Company's activities as it takes on new market administration work, and improves its corporate accountability and support systems.



Question 5

Do you have any comment on the levy funding requirement for FY2010?



Levy 2010



Levy Funding Requirement

Calculation of the FY2010 levy funding requirement is based on the following methodology:

- **Allocation of direct costs to each work stream;**
- **Allocation of indirect costs based on the proportion of total direct costs of each work stream;**
- **Deduction of revenue from market fees from the relevant work streams;**
- **Allocation of a proportion of the Industry Advances Reserve balance to the retail and wholesale areas of activity.**



Levy Funding Requirement

	Retail	Wholesale	Total
Work Programme Direct Costs	2,382,816	2,204,892	4,587,708
Work Programme Indirect Costs	1,236,219	1,422,674	2,658,894
Sub-total	3,619,035	3,627,567	7,246,602
<i>Less Over Recovery from Prior Levies</i>	(296,131)	(389,972)	(686,103)
Sub-total	3,322,904	3,237,595	6,560,499
<i>Less Market Fee Recovery</i>	(1,345,090)	(670,310)	(2,015,400)
Total Levy Funding Requirement	1,977,815	2,567,284	4,545,099



Retail and Wholesale Levies for FY2010

	2009/10		
	Retail	Wholesale	Total
Direct Costs	2,382,816	2,204,892	4,587,708
<i>Proportion of Direct Costs to Total Costs</i>	<i>51.9%</i>	<i>48.1%</i>	
Indirect Costs	1,236,219	1,422,674	2,658,894
Total Work Programme Costs	3,619,035	3,627,567	7,246,602
Deduction of Market Fees	(1,345,090)	(670,310)	(2,015,400)
Allocation of Other Revenue	-	-	-
Under (Over) Recovery of Levy	(296,131)	(389,972)	(686,103)
	(1,641,221)	(1,060,282)	(2,701,503)
Total Retail Levy Funding Requirement	1,977,815	2,567,284	4,545,099
Volume Units	<i>ICPs</i>	<i>GJ</i>	
Volume	250,000	145,000,000	
Levy Unit	<i>\$/ICP</i>	<i>cent/GJ</i>	
Levy Rate	7.91	1.77	
Projected Levy Revenue	1,977,815	2,567,284	4,545,099



Proposed Levy

The proposed levy rates for FY2010 are therefore:

- **Retail levy of \$7.91 per annum payable on each ICP. This is an increase of 6.6% on the FY2009 rate, which was \$7.42 per annum payable on each ICP;**
- **Wholesale levy of 1.77 cents per GJ of gas purchased directly from gas producers. This is a 1% reduction on the FY2009 rate, which was 1.79 cents per GJ; and**
- **A special one-off Gas (Downstream Reconciliation) Establishment Costs Levy of \$1,052,500 levied in proportion to allocated gas volumes.**



Comparison With Previous Years

Year	Retail Levy	Wholesale Levy
FY2008	\$8.18 per ICP	1.93 cents per GJ
FY2009	\$7.42 per ICP	1.79 cents per GJ
FY2010	\$7.91 per ICP	1.77 cents per GJ



Question 6

Do you have any comment on the proposed levy for FY2010?