Recommendation on Gas (Levy of Participants) Regulations 2012

March 2012

GAS INDUSTRY COMPANY LIMITED

177362.3

About Gas Industry Co.

Gas Industry Co is the gas industry body and co-regulator under the Gas Act. Its role is to:

- develop arrangements, including regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- develop these arrangements with the principal objective to ensure that gas is delivered to existing and new customers in a safe, efficient, reliable, fair and environmentally sustainable manner; and
- oversee compliance with, and review such arrangements.

Gas Industry Co is required to have regard to the Government's policy objectives for the gas sector, and to report on the achievement of those objectives and on the state of the New Zealand gas industry.

Gas Industry Co's corporate strategy is to 'optimise the contribution of gas to New Zealand'.

The paper was prepared by Greig Hinds.

Executive summary

The Gas Act 1992 ('Gas Act') provides for the Government and an approved industry body to co-regulate the gas industry (see Part 4A of the Act). Gas Industry Co was formed to be the body responsible for developing and recommending gas governance arrangements, which may include rules and regulations. These arrangements cover a range of areas relating to the gas industry including wholesale markets and processing, transmission and distribution networks, retail market development, and consumer protection.

Each year, Gas Industry Co develops a work programme that will achieve the strategic goals set out in the its corporate strategy, which is together directed to achieve the objectives and outcomes sought by the Gas Act and the Government Policy Statement on Gas Governance (April 2008, 'GPS'). The Board of Gas Industry Co has set a strategy for the Company that reflects the unique co-regulatory model for the industry and identifies objectives in key areas that will enable it to fulfil its role as a co-regulator and the 'industry body' under part 4A of the Gas Act. The Company's strategy and work programme for FY2013, and an indication of further activity in FY2014 and FY2015, will be published before the start of the next financial year (1 July 2012) as the Company's Strategic Plan[1].

Section 43ZZB of the Gas Act provides for Gas Industry Co to recommend to the Minister of Energy that regulations be made requiring industry participants to pay a levy to Gas Industry Co. This paper presents recommendations on the amount, and implementation of the levy for the financial year ending 30 June 2013.

Gas Industry Co is not a government department or a Crown entity, and is funded by the industry, but the public nature of its core role requires it to submit its operations and budget proposals to scrutiny and consultation. Gas Industry Co's Board and Management are committed to delivering value for money, including through industry arrangements that provide for cost savings and industry/economic growth, and by putting downward pressure on corporate costs.

These recommendations were developed after consulting with stakeholders on strategic priorities; developing a work programme and budget to address those priorities; issuing a formal Statement of Proposal on the levy funding requirement; holding workshops; and considering submissions on that paper.

The work programme can be divided into three categories:

- Statutory accountabilities - work that must be undertaken to monitor and administer existing gas governance arrangements or to meet the legislative obligations of the industry body;

[1] A draft Strategic Plan has been forwarded to the Minister together with this Recommendation.

- Gas Transmission Investment Programme - these are a suite of priority strategic projects designed to improve the efficiency of the gas transmission system and to assist with achieving the goal of resilience and security of supply set out in the New Zealand Energy Strategy; and
- Ongoing/committed workstreams - work that is currently underway and supported by the industry; has arisen from unforeseen events; or has been specifically requested by the Minister.

The work programme accordingly reflects a continuation of the current year's expanded scope of work, which includes a number of new items requested by industry and discussed with the Ministry of Economic Development ('MED'). Expenditure for FY2012 is now forecast to be $6,257,024. Gas Industry Co has projected its total cost of operation for FY2013 to be similar to FY2012, at $6,357,307. The amount required to be funded from the levy on participants is $4,299,578 (allocated against two workstream categories: 'wholesale' and 'retail'), which is an increase of $337,913 from the FY2012 levy requirement of $3,961,665. The difference between the total cost of the work programme and the levy funding requirement is met by a combination of market fees (raised under specific gas governance arrangements) and equity reserves set aside to meet the depreciation costs of computer systems established under governance arrangements in previous years.

Gas Industry Co, after consulting with industry participants, considers that the recommendation for levy regulations set out in this paper meets the requirements of the Gas Act and that the levy amount sought is reasonable, having regard to the Company's Strategic Plan, its current financial position, and the GPS objectives and outcomes. The levy regulations will empower Gas Industry Co to collect an annual retail levy component of $6.23 per ICP (retail customer) and a wholesale levy component of 1.74c/GJ.[2]

Accordingly, Gas Industry Co recommends that the Minister propose the making of regulations to enable the collection of the FY2013 Levy on Gas Industry Participants.

[2] A GJ or Giga-joule is approximately 278 Kwh and a domestic customer will use 20-30GJ per annum

Contents

1 Strategic Plan and Work Programme

1.1 Introduction

The Government and the gas industry have implemented a unique co-regulatory model in which an 'industry body' facilitates the nexus between Government and industry to deliver improved governance arrangements for participants and consumers in gas markets. Gas Industry Company Limited was established in 2004 to perform the role of the 'industry body' as set out in Part 4A of the Gas Act and, together with stakeholders, sets an annual strategic work programme and consults on the associated funding requirements.

Industry body

Gas Industry Co is responsible for developing and recommending gas governance arrangements, which may include rules and regulations. These arrangements cover a range of areas relating to the gas industry, including wholesale markets and processing, transmission and distribution networks, retail market development, and consumer protection.

1.2 Gas Act and Government's Policy Objectives and Strategic Goals

The overall purpose of Part 4A of the Gas Act is to 'provide for the governance of the gas industry'. Gas Industry Co seeks to achieve this through developing gas governance arrangements[3] that meet the objectives of the Gas Act and of the Government Policy Statement on Gas Governance (issued April 2008, the 'GPS').

The statutory objective of any formal gas governance arrangement is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner. Other objectives set down in the Gas Act are:

[3] The Gas Act provides for the making of regulations or rules; however, Gas Industry Co is required to consider all reasonably practicable options for achieving the objectives of any regulations it might consider. As such, we generally refer to 'gas governance arrangements', which includes rules, regulations, and any voluntary arrangements developed with the industry.

- the facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs, by providing access to essential infrastructure and competitive market arrangements;
- barriers to competition in the gas industry are minimised;
- incentives for investment in gas processing facilities, transmission, and distribution are maintained or enhanced; and
- delivered gas costs and prices are subject to sustained downward pressure.

The GPS expands the principal objective to include consideration of fairness and environmental sustainability. It also sets out specific tasks or outcomes that the Government wants achieved for the gas industry. For example, the GPS requested that the industry body address the contractual relationship between retailers and small consumers, which led to the development of the Retail Gas Contracts Benchmark scheme. The GPS can be found on the Company's website[4].

In establishing its annual work programme, Gas Industry Co determines those issues facing the industry that require immediate attention, and also seeks guidance from the April 2008 GPS. The policy statement lists the outcomes that the Government wishes Gas Industry Co to pursue and against which it should report. The GPS forms a key input into the development of Gas Industry Co's work programme for FY2013.

1.3 Strategy

To help deliver on the above legislative and policy framework, the Board of Gas Industry Co has set a strategy for the Company that that reflects the unique co-regulatory model for the industry and identifies objectives in key areas that will enable it to fulfil its role as a co-regulator and the 'industry body' under part 4A of the Gas Act.

Strategic Goal: Optimise the Contribution of Gas to New Zealand

Natural gas has made a key contribution to New Zealand since the development of the industry from the 1960s. There is a continuing and important future role for gas, particularly in terms of providing energy security and supporting the New Zealand economy, all consistent with environmental sustainability goals. However, there is a range of scenarios as to future supply and demand. The challenge, in line with Government energy policy, is how New Zealand can make the most of its gas resources, for the benefit of all New Zealanders.

[4] http://gasindustry.co.nz/sites/default/files/publications/Government_Policy_Statement_on_Gas_Governance_-_April_2008.pdf

Purpose: Provide leadership for the Gas Industry and the New Zealand Gas Story

The gas industry is dependent on a range of players, from upstream explorers and producers through to customers; on competitive markets; and ongoing investment of all stages. Gas Industry Co, with its statutory role as the industry body, is well-positioned to understand and analyse issues facing the gas industry from all of these viewpoints. Gas Industry Co will be a leader in making the next phase in the New Zealand Gas Story a success.

Objectives:

- Build efficient, competitive, and confident gas markets;
- Facilitate efficient use of and timely investment in gas infrastructure;
- Deliver effectively on Gas Industry Co's accountabilities as the gas industry body; and
- Build and communicate the NZ Gas Story (includes review of industry performance).

1.4 FY2013 Work Programme

The Company must then consider the work programme necessary to achieve the requirements of the legislative and policy framework. The Company's strategy and work programme for FY2013, and an indication of further activity in FY2014 and FY2015, will be published before the start of the next financial year (1 July 2012) as the Company's Strategic Plan[5].

Annual Work Programme

Each year the Company develops an indicative work programme and budget; consults on that work programme and budget and the associated levy funding requirements; and then makes a recommendation to the Minister for regulations requiring industry participants[6] 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.

With the competing demands of a finite budget and the Government's desire to restrain costs imposed on levy payers, it is necessary to prioritise the projects that comprise the work programme. Priority is driven by a matrix of necessity including the need to meet statutory obligations), maintaining momentum on existing and committed projects, and attending to new work that is seen as a priority by stakeholders and the Company.

[5] A draft Strategic Plan has been forwarded to the Minister together with this Recommendation.

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

In its Briefing to the Incoming Minister[7], MED described Gas Industry Co's planned scope of operations as "an ambitious work programme including issues such as wholesale market development and transmission capacity allocation and investment processes".

Statutory accountability

Gas Industry Co has a number of statutory accountabilities that arise from:

- obligations under the various rules and regulations that Gas Industry Co previously recommended and now administers; and
- specific tasks defined by the GPS.

Gas Industry Co monitors and administers these regulations, and manages service providers appointed to act under these arrangements (including the Allocation Agent, Registry Operator, Rulings Panel, Investigator, and Critical Contingency Operator).

Gas Industry Co also must meet various statutory reporting requirements and respond to requests for advice from the Minister on matters affecting the gas sector. Examples of the statutory actions to be taken by the Company include the publication of the Strategic Plan, presentation of a formal Annual Report to Parliament, meeting all obligations under the Companies Act 1993, and undertaking consultation on the development of an annual levy recommendation.

Given that the abovementioned roles are statutory obligations, they must be given a high priority in the work programme. Funding for the first of these is from a combination of market fees and levy, and for the second, funding is from the levy.

Gas Transmission Investment Programme (GTIP)

Late in FY2011, major end users and other industry stakeholders requested that Gas Industry Co lead a focussed project addressing gas transmission capacity issues, particularly in respect of the North Pipeline owned and operated by Vector. The work now coordinated in the GTIP commands a high priority for stakeholders from the gas industry, end users, and Government. Moreover, a number of those stakeholders are supporting that programme of work by committing their own resources (for example, providing members for working groups and expert panels).

The extra work required in FY2012 was unplanned and thus unbudgeted in developing the levy for the current year. The Board agreed to apply surplus funds from FY2011 – which otherwise likely

[7] http://www.med.govt.nz/about-us/ministers/briefings-to-incoming-ministers-1/briefings-to-incoming-ministers/BIM-Energy-pdf

would have been returned to the industry – to cover the expected increase in current year expenditure.

Ongoing/Committed workstreams

There are a number of projects that Gas Industry Co has previously committed to and have been developed in response to stakeholder concerns and/or Ministerial requests. Examples include:

- evaluating small consumer retail contracts on an annual basis against published benchmarks;
- developing principles for network Use of System Agreements (UoSAs) and evaluating UoSAs against those benchmark principles; and
- undertaking reviews of existing gas governance arrangements to ensure they continue to be fit for purpose and recommending changes where improvements can be made efficiently.

In addition, Gas Industry Co consulted (retrospectively) on the urgent regulations that were put in place in late calendar 2010 to address possible customer stranding with the liquidation of E-Gas. The regulations would have been triggered in the event that the liquidator was unable to sell E-Gas's customer base. Numerous submissions from industry advocated different solutions to this issue, suggesting that the issue of retailer insolvency is a priority matter to be advanced. Given that this workstream was not budgeted for in the current year (FY2012), it is likely that only limited progress will be made before 30 June 2012. Accordingly, this is a priority project for FY2013.

A full list of the FY2013 workstreams, with descriptions of any deliverables, can be found in the Gas Industry Co Strategic Plan FY2013-15.

2 Budget and Levy

2.1 Maximising value

Levy Principles

Setting the levy in any given financial year, Gas Industry Co must consider its obligations under the Gas Act and the GPS and take into account the obligations on the Board under company law. The Board takes the view that each year's levy should cover the costs reasonably expected to be incurred by Gas Industry Co in that year. Any surplus in funds is generally returned to levy payers after the year-end accounts are adopted at the Company's Annual General Meeting.

A set of general principles covering levy setting has been developed by Gas Industry Co based on guidelines set by MED with respect to levy-raising powers. The principles are available on the Gas Industry Co website and have been used to assess and determine the proposed structure and level of the FY2013 levy.

Gas Industry Co is not a government department or a Crown entity, and is funded by the industry, but the public nature of its core role requires it to submit its operations and budget proposals to scrutiny and consultation. Nonetheless, the Company should be sufficiently resourced to respond to issues in the gas market that have been identified as priorities by industry or the Government.

Gas Industry Co's Board and Management are committed to delivering value for money. One example of the value received by industry for Gas Industry Co's efforts involved the Downstream Reconciliation Rules. Due to the scrutiny and enforcement provisions encapsulated in these rules, about $2.5 million of unaccounted-for gas has been eliminated on an annual basis. This sum represents an ongoing, annual saving to industry. Similarly, the GTIP work seeks to allow opportunities for efficient growth in the Auckland region. Also, the industry body has maintained downward pressure on its corporate costs (reducing them from over $2 million in FY2012, to $1.8 million in the coming financial year).

Gas Industry Co seeks to deliver consumer benefits through industry efficiencies that are gained in accordance with the Government's preference for 'better regulation, less regulation'. The Company aims to produce the best governance arrangements for gas markets, and is required by the Gas Act to consider all reasonably practicable non-regulatory options and only resort to regulation where necessary.

2.2 Levy Calculation

The FY2013 work programme reflects a continuation of the current year's expanded scope of work that includes a number of new items requested by industry and discussed with the Ministry of Economic Development ('MED'). Expenditure for FY2012 is now forecast to be $6,257,024.

Gas Industry Co has projected its total cost of operation for FY2013 to remain essentially flat from this figure, at $6,357,307. The amount required to be funded from the levy on participants is $4,299,578 (allocated against two workstream categories: 'wholesale' and 'retail'), which is an increase of $337,913 from the FY2012 levy requirement of $3,961,665. The difference between the total cost of the work programme and the levy funding requirement is met by a combination of market fees (raised under specific gas governance arrangements) and equity reserves set aside to meet the depreciation costs of computer systems established under governance arrangements in previous years. Market fees are also forecast to reduce in FY2013.

The following allocation methodology has been used to calculate the levy in previous years, and is assessed as remaining appropriate for FY2013:

- Direct costs are allocated across two areas of activity: retail (eg consumer switching, retailer reconciliations, etc) and wholesale (gas processing, transmission pipelines, etc).
- Indirect costs are allocated between the retail and wholesale areas of activity on a proportional basis.
- Costs recovered through market fees are deducted from the relevant areas of activity.
- The retail and wholesale levies are set to recover the allocated costs in each area.
- Based on information from the Switching Registry, the Company will continue to assume an ICP count of 258,000 for the purposes of the levy calculation.
- Wholesale levies will be collected at a rate of 1.68c/GJ based on an assumption of 155,000,000GJ (155PJ) of gas volumes during the year.
- The Board has set a policy requiring the refund of surplus levy funds at the end of a financial year, unless those funds are deemed necessary to support operations in the following year.

The gas volume assumption used is based on a forecast of expected gas volumes for the current year, and discussions with industry participants as to expected levels of gas volume purchases in FY2013. Gas Industry Co is currently expecting that reported gas volumes for the year will be approximately 145PJ (slightly lower than the 150PJ budgeted for the year) and there are indications that this volume will fall again in FY2013. However, Gas Industry Co has also been advised that Methanex intends to re-commission a second methanol train for production, which will see its use of gas substantially increase. Gas Industry Co has always set a prudent and conservative estimate to ensure it mitigates the risk of insufficient revenue collection. As such, the figure of 155PJ has been chosen to accommodate the expected fluctuations – both up and down – in gas volumes in FY2013.

Based on the above methodology, the FY2013 levy funding requirement is:

	FY2013		
	Retail	**Wholesale**	**Total**
Direct Costs	1,272,849	1,563,224	2,836,073
Proportion of Direct Costs to Total Costs	*44.9%*	*55.1%*	
Indirect Costs	699,280	1,128,029	1,827,310
Total Work Programme Costs	**1,972,129**	**2,691,253**	**4,663,382**
Amortisation on Industry Assets	(363,804)	-	(363,804)
	(363,804)	**-**	**(363,804)**
Total Levy Funding Requirement	**1,608,325**	**2,691,253**	**4,299,578**
Basis of apportionment	*per ICP*	*per GJ*	
Number	258,000	155,000,000	
Levy Unit	*$/ICP*	*c/GJ*	
Levy Rate	**$6.23**	**1.74**	
Projected Levy Revenue	**1,608,325**	**2,691,253**	**4,299,578**

2.3 FY2013 Budget

Total expenditure for the FY2013 work programme described in the draft Strategic Plan is estimated at $6,357,307. The work programme budget is based on all activities to be undertaken by the industry body in FY2013. Some of these activities will be funded through market fees charged pursuant to specific gas governance regulations or rules (estimated to be $1,693,925 in FY2013), but the majority of Gas Industry Co's funding comes from the levy ($4,299,578).

The following table compares the FY2013 Levy Budget with the FY2012 forecast end of year position.

	FY2013 Budget	FY2012 Forecast
	YE 30/06/13	YE 30/06/12
Critical Contingency Management	483,000	560,004
Critical Contingency Management Review	30,000	50,000
Gas Processing	25,000	10,000
Compliance	39,000	39,000
Balancing	0	15,125
Gas Quality	50,000	29,560
Interconnection	45,000	2,600
Industry Facilitation	45,000	25,000
GTIP	490,000	323,142
Statutory Accountability	12,000	0
Gas Story	13,750	35,000
Information Gathering	0	13,543
Rule Changes	0	0
Total Wholesale Costs	***1,232,750***	***1,102,974974***
Switching	292,025	285,468
Reconciliation	723,900	723,900
Compliance	156,000	156,000
Distribution Contracts	25,000	20,013
Rule Changes	75,000	50,397
Consumer Issues	40,000	40,198
Insolvent Retailers	50,000	70,000
Bridge Commitments	50,000	0
Statutory Accountability	12,000	0
Direct Use of Gas	0	20,000
Small Consumer Proposition	0	5,000

Information Gathering	0	13,543
Gas Story	13,750	35,000
Total Retail Costs	***1,437,675***	***1,419,519***
Board	282,460	282,460
Corporate Consultancy	110,000	105,000
Salaries	2,205,930	2,154,646
Overhead	1,088,492	1,192,425
Total Other Costs	***3,686,882***	***3,734,531***
Total Expenses	**6,357,307**	**6,257,025**

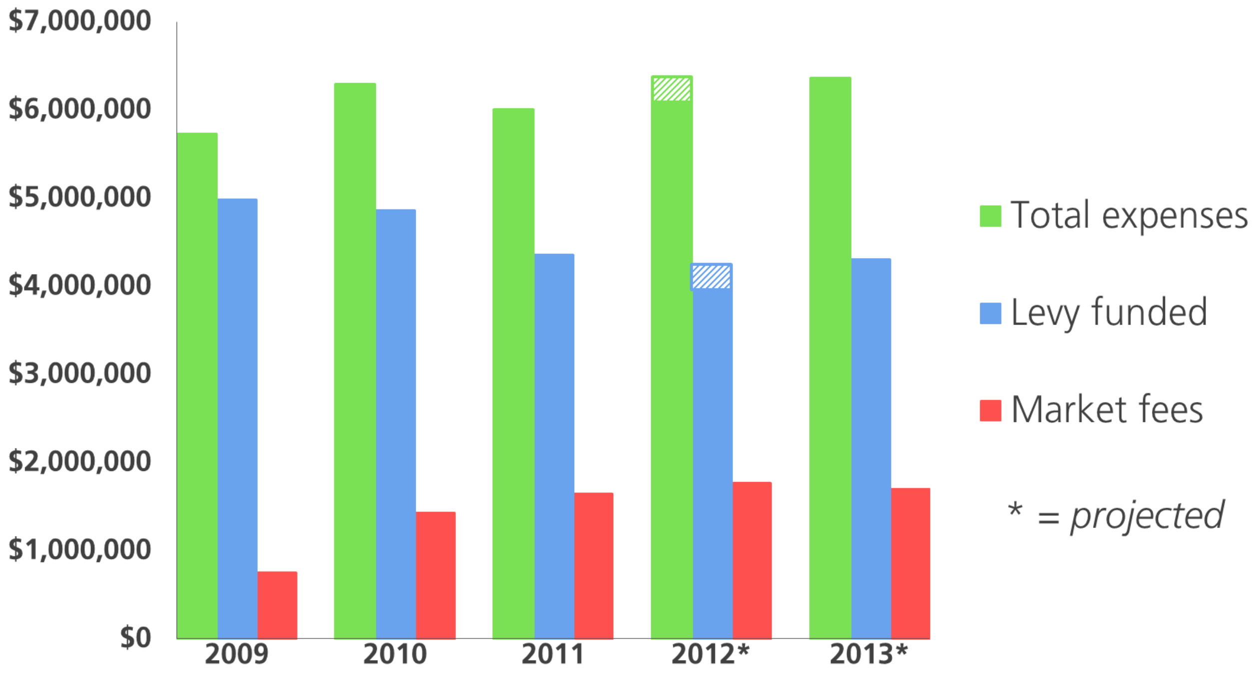
Notes:

1. Total Wholesale and Retail Costs comprise the direct costs of consultants and service providers (some of which may be met from market fees). Workstreams with no direct costs will be resourced through internal staff time.
2. The Salaries figure includes provision for one extra FTE in the Operations Group, expected to be filled in FY2013.
3. The 'Gas Story', 'Statutory Accountability', Rule changes, compliance, and information gathering line items relate to both the wholesale and retail aspects of the Company's operations. Thus, the costs of these workstreams have been split between the two funding components and appear twice in the table above.

2.4 Conclusion

Gas Industry Co considers that the proposed levy is reasonable, having regard to the Company's Strategic Plan, Annual Report, indicative work programme and budget, the GPS objectives and outcomes, submissions from industry participants, and past expenditure. In particular, it should be recognised that the Company is pursuing an expanded work programme at the request of the industry. It aims to achieve this through a flat cost structure (in that the expected end-point for FY2012 expenditure is similar to the total costs proposed for FY2013).

The chart below shows the Company's actual expenditure over FY2009-11 and projected expenditure for FY2012 and FY2013. Costs have remained within a narrow range and, taking into account the unplanned increase in costs for FY2012 (as a result of external requests), are expected to remain flat into the financial year.



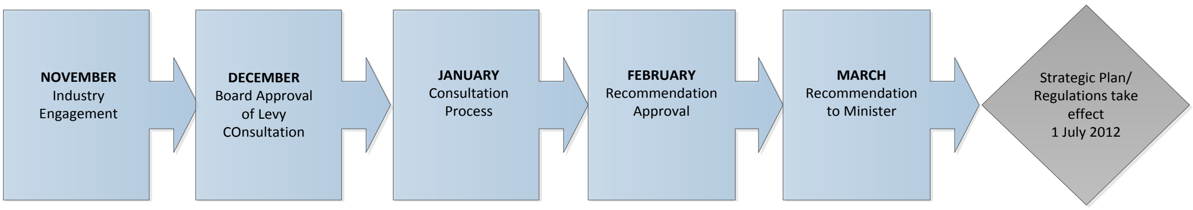
Note: The hatched areas in FY2012 represent the forecast increase in expenditure and the corresponding amount of surplus funds required to meet that increase.

3 Consultation Process and Outcomes

One of the conditions to be met before a levy recommendation can be accepted by the Minister is that the industry body has consulted with industry participants on the levy rate or amount (section 43ZZD(2)(b)). Gas Industry Co undertakes extensive consultation with the industry and other stakeholders, not just with respect to the amount of the levy required, but also on the elements of the work programme on which that levy is based.

The Company's Board, which includes industry representation along with a majority of Independent Directors, subjects the work programme and levy proposal to thorough scrutiny.

The diagram below outlines the process undertaken to develop this recommendation for levy regulations. This operates in parallel with the development of the Company's Strategic Plan.



3.1 Consultation on FY2013 Levy

Gas Industry Co consults on all aspects of its work programme and engages with a broad spectrum of stakeholders, including MED, other regulators, gas and electricity industry participants, and major end-users. Our process for the levy consultation includes end users who account for approximately 75% of gas consumption in New Zealand.

During the FY2012 levy consultation, Gas Industry Co initiated earlier engagement on its strategic priorities with both levy payers and officials. The FY2013 levy process was undertaken on the same basis.

Initially, a letter from the Chief Executive to all industry participants was sent at the start of November 2011. Participants were asked for their assessment of the three key strategic priorities they thought Gas Industry Co should be concentrating on during FY2013. From those responses, Gas Industry Co was comfortable that its indicative work programme was addressing all the key issues of concern to the industry. Any matters raised by participants that were not included in the work programme were either outside the Company's mandate (such as marketing use of gas by small consumers), or will be substantially addressed in this current financial year (such as the review of the need for arrangements regarding insolvent retailers, or examining 'lessons learned' from the Maui pipeline outage).

The letter was followed up with a co-regulatory forum in mid-November 2011 with participation invited from both industry participants and MED officials. Forum participants were taken through a presentation of Gas Industry Co's assessment of work required to be undertaken in FY2013 and the available sources of funding. The Company noted that this meeting was to learn about the industry priorities, which would then have to be balanced with government requirements. Feedback during the forum, while instructive and supportive, did not provide any specific direction on how the Company might differently prioritise its work plan.

The forum attendees confirmed the suitability of the work programme; no item was seen as unnecessary or irrelevant, nor was any new work item suggested.

In December 2011, Gas Industry Co released a Statement of Proposal on the FY2013 Strategy, Work Programme, and Levy. This paper:

- set out Gas Industry Co's strategic direction and the rational for that mission;
- described the work that Gas Industry Co would undertake in FY2013 and the estimated costs;
- outlined the calculation of the levy funding requirement for FY2013; and
- proposed the levy for FY2013.

The Statement of Proposal indicated a Work Programme Cost (WPC) of $6,357,307 (a slight increase from the FY2012 forecast end-position of $6,257,024), and a Levy Funding Requirement (LFR) of $4,299,578 (compared with the FY2012 figure of $3,961,665). Gas Industry Co called for submissions from interested parties as a precursor to the formulation of this Recommendation to the Minister for the required levy regulations. Submissions closed on 10 February 2012.

The consultation paper was sent to stakeholders and was also published on the Company's website. Submissions on the consultation paper were received from: Genesis Energy, Methanex New Zealand, Mighty River Power, Powerco, and Vector. The Company also held a levy workshop on 2 February 2012. 19 industry participant organisations were represented.

Submitters on the consultation paper generally supported the work programme and budget, with only one submitter expressly noting the extent to which Gas Industry Co costs have increased since establishment. This was in line with views expressed by industry participants who attended the November 2011 Co-regulatory Forum. A summary of all of the issues raised in the FY2013 levy consultation submissions is set out in the Submissions Analysis Paper, which will be available from the Gas Industry Co website.

Late in the consultation process, Gas Industry Co raised the possibility of changing the method for collecting the wholesale component of the levy so as to mitigate the risk of over- and under-collection arising from fluctuations in annual gas volumes. This was not fully supported by the industry due to concerns around uncertainty of levy rate and compliance costs. Gas Industry Co has taken note of the industry comments on this proposal and will not proceed with a change this year. Gas Industry Co will consider whether other related changes, which might improve efficiency and benefit the industry, could be made in future.

3.2 Conclusion on consultation

The consultation process has appropriately tested Gas Industry Co's proposed work programme and budget. Gas Industry Co considers it has fulfilled its obligations to consult with industry participants on the proposed levy.

4 Other Information

4.1 Additional sources of funding

In addition to its levy funding, Gas Industry Co also receives funds from:

- Shareholder fees, which are set aside as an equity reserve (see section 4.2 below). The annual fee is set by the Board and is currently $10,000 per shareholder.
- Market fees, which are fees charged pursuant to specific regulations. These cover the costs of service providers and some external consultants and are taken into account in setting the annual levy funding requirements. The Gas (Switching Arrangements) Rules 2008, the Gas (Downstream Reconciliation) Rules 2008, the Gas Governance (Critical Contingency Management) Regulations 2008, and the Gas Governance (Compliance) Regulations 2008 contain market fee provisions.

4.2 Equity Reserves

Gas Industry Co's equity balance is made up of three components:

- Industry Advances Reserve;
- Industry Amortisation Reserve; and
- Retained Earnings (comprising shareholder fees).

The Industry Advances Reserve represents the net over-recoveries of levies from previous years and has traditionally been used to offset levies in subsequent financial years, as provided for in the Gas Act (section 43ZZC(3)). While the Gas Act provides this as a mechanism for returning over-recovered levies, it is not a mandatory provision.

Although this policy has generally suited Gas Industry Co by providing a method to return overpaid levies without undue risk to its liquidity, it has also reduced the transparency of its costs to the industry. For example, the change in the FY2012 levy was disproportionate to the change in Gas Industry Co's underlying costs because of the fluctuating level of reserves. Therefore, Gas Industry Co considers it is more practicable to refund overpaid levies as soon as the annual accounts have been received by shareholders at the AGM. This is also consistent with the treatment of over-recoveries collected under the various Market Fee arrangements. Gas Industry Co is of the view that this policy will encourage a predictable and stable levy by removing from the levy calculations any variability resulting from a fluctuating level of reserves. The last refund made to levy payers was an amount of approximately $1.5 million paid in November 2010. The surplus at the end of FY2011 amounted to approximately $364,000. This was retained during FY2012 to meet the costs of an expanded work programme and other unfunded workstreams.

The Industry Amortisation Reserve represents the unexpended amortisation on capital items purchased with market fees, such as the Switching Registry and Downstream Reconciliation system. There is an ongoing annual amortisation cost of $363,804 associated with these assets. This annual cost will be met from the amortisation reserve and, over time, the value of the assets and the reserve will both reduce to zero.

Retained earnings are the accumulation of the shareholders' annual fees, set aside as a reserve against future contingencies and do not impact on the levy calculation.

4.3 Minimal impact on consumers

While the total amount of levies is significant, the effect on individual consumers is not at all large. The following tables provide an estimate of the effect of the proposal on an average gas bill if the levies are entirely passed through to customers.

User Type	Residential	Commercial	Industrial
Typical Annual Usage (GJ)	25	1,000	1,000,000
Estimated Annual Gas Bill	$850	$10,500	$7,000,000
Annual Retail Levy	$6.23	$6.23	$6.23
Annual Wholesale Levy	$0.44	$17.40	$17,400
Total Annual Levies	**$6.67**	**$23.63**	**$17,406.23**
% of annual Gas Bill	0.78%	0.23%	0.25%

.

5 Recommendation

Gas Industry Co, after consulting with industry participants, considers that this recommendation for levy regulations meets the requirements of the Gas Act, and that (as per the criteria in the Gas Act) the levy amount sought is reasonable, having regard to the Company's strategic plan, its current financial position, and the GPS objectives and outcomes. As described earlier in this recommendation, Gas Industry Co considers the levy represents good value for money.

Accordingly, Gas Industry Co recommends to the Minister that levy regulations be made by the Governor-General under section 43ZZE of the Gas Act for the financial year from 1 July 2012 to 30 June 2013 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 based on one twelfth of the annual retail levy of $6.23 for each ICP for each retail customer.
- From every person who is an industry participant on the first day of each month, a wholesale levy of 1.74c/GJ based on gas purchases made directly from gas producers during the previous month.