Wholesale Levy Assurance - Analysis of Submissions on options

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1. Analysis and conclusions

In September 2016, Gas Industry Co consulted on an Options Paper – *Wholesale Levy Assurance* – that described a significant issue in respect of wholesale levy returns: the inability to independently verify whether those returns are accurate. Submissions were received from seven parties.

Submitters were asked whether they agreed that the current approach for collecting the wholesale levy does not provide adequate assurance that returns are accurate and that changes are required. None of the submitters considered that no change was required, but a number cautioned that any change should be simple and low-cost.

The Paper offered a number of options to address this problem. The options fell broadly under two headings:

(A) Introduce new means for verifying wholesale levy returns

There are two options that would seek to correct the shortcomings of the existing approach by allowing verification of wholesale levy return data:

Option 1: provide for Gas Industry Co to obtain an independent source of data for comparison with industry participants' wholesale levy returns by requiring gas producers to provide data on monthly sales volumes by customer; or

Option 2: periodically audit wholesale levy payers' returns, to incentivise accurate returns as well as provide a high level of assurance that this is the case.

(B) Base the wholesale levy on data independent of levy payers

These options are similar to the approach to the current retail levy (which uses data from the gas registry). The third and fourth options would seek to base the wholesale levy on:

Option 3: transmission billing volumes, sourced from the transmission service provider (TSP); or

Option 4: a combination of downstream reconciliation volumes and deliveries to transmission-connected customers, sourced from the allocation agent.

Submitters offered a range of views on which of the options they preferred. Four submitters favoured Option 1 (and some suggested that the incidence of the wholesale levy be moved so that gas producers themselves pay that levy), and three favoured Option 3 (which Gas Industry Co indicated was its preference in the Options Paper).

Gas Industry Co can see the intuitive appeal of Option 1 - it appears to offer information from a source independent of the levy payers and at minimal cost or inconvenience to the gas producers (aside from the initial cost/effort to amend their systems to provide a monthly report). However, the particular issue that was the impetus for the Options Paper involved an integrated gas producer/shipper/retailer. In that case Option 1 would have failed to provide a source of independent information. That lack of independence arises from a very real conflict of interest, and the lack of transparency of upstream data means that conflict is unable to be offset without additional data. Accordingly, Option 1 is not a reliable solution in certain circumstances.

Submitters who rejected Option 3 cited several concerns:

1. the cost allocation of the wholesale levy could potentially be changed which could possibly require some changes to contracts;
2. gas transported in private pipelines would not directly be captured so a separate set of arrangements would need to be documented in the levy regulations;
3. the complexity of nominations data means that pipeline billing information would need to be disaggregated which would require significant work;
4. breaking out the volumes from gas production stations would be unnecessarily complex and costly; and
5. because First Gas buys gas for its own use, it raises issues of conflict (or perceived conflict) of interest.

Gas Industry Co had already noted the existence of the first two concerns in the Options Paper but accepts that it may have under-estimated the extent of changes to contracts that might be required as a result of altering the allocation of payment of the wholesale levy. On items 3 and 4 Gas Industry Co had acknowledged that some set-up work would be required but had assumed that, once this was done, it would be an automated process into the future. Gas Industry Co does not believe that item 5 is of any concern given the current arrangements for the pipeline mean that the data on gas for own-use is transparent either through the Open Access Transmission Information System (OATIS) or the Balancing Gas Information Exchange (BGIX) data.

Next steps

Gas Industry Co will need to have further discussions with parties to determine the feasibility of obtaining information regarding receipts into the transmission system such as nominations from receipt points as those are highly correlated with sales by gas producers. This is a refinement of Option 3.

Gas Industry Co also intends to look further at Option 1 as it might be possible to use that option in conjunction with information from the Ministry of Business, Innovation and Employment (MBIE) for verification purposes.

Discussions to date have caused us to think that a hybrid of Options 1 and 3 might be feasible. The hybrid option would require:

1. where gas sales occur at a Maui pipeline receipt point, the pipeline owner would provide the nominations data for the receipt point that identifies volumes acquired by each shipper who trades at that point;[1] and
2. in all other cases, including sales transported via private pipelines, gas producers would be required to provide a monthly schedule of those sales by customer (whilst there may be instances where the producer is conflicted, the increased data on the gas market provided under the hybrid option should enable Gas Industry Co to more readily identify issues).

The hybrid has the advantage that for a significant percentage of sales the information required, i.e. nominations data, is held by the pipeline operator and that data originates from the gas purchasers. For non-Maui receipts there would be an additional burden on gas producers, but a lesser burden than would apply under Option 1. In addition, the hybrid appears to make no

[1] Receipt point nominations typically indicate a transaction between a gas producer and one of its customers. We understand that, as a general rule, gas is not traded between purchasers and other shippers at Maui receipt points.

change to the current incidence of the wholesale levy, i.e. the parties who are liable to pay the wholesale levy currently would be the same parties that would be liable to pay the levy under the hybrid option.

Gas Industry Co will work towards a decision as between Option 1, Option 3, or the hybrid and that will be incorporated in the Consultation Paper for the FY2018 levy and work programme, to be published in December 2016. As part of that consultation we shall seek final feedback on the preferred option.

2. Summary of feedback from submitters

emsTradepoint supports the information and conclusions found in Gas Industry Co's consultation paper. Its only request is that the system for collection of the wholesale levy takes into account its market rules (specifically 15.4;16/14;16.17) when determining the administrative burden (or any other cost) of each of the options.

First Gas believes that Options 2 and 4 are too expensive and complex. It believes Option 3 is sub-optimal. Option 1 is the best of the four but it thinks that charging levies to producers directly would be the simplest solution. First Gas believes this option would avoid need to make consequential changes to the Critical Contingency Management Regulations (CCM Regulations). Its own 'option' would be to charge wholesale levy to producers directly, based on their respective, aggregate primary sales volumes of gas allowing payment of levy at the source of production. Those volumes could be checked against MBIE statistics. First Gas believes that this offers greater cost savings compared to the status quo and would not require consequential changes to the CCM Regulations.

Genesis supports the intention of the paper to increase transparency and strengthen verification in the wholesale levy collection process and believes it will improve both Gas Industry Co's and participants' confidence in it as well as reducing likelihood of future errors and associated costs to rectify. However, Genesis prefers Option 1 as it provides a more straightforward solution to the issue. Gas Industry Co's preferred option (3) may lead to significant changes in cost allocation due to the chain of commercial contracts in place.

Major Gas Users Group (MGUG) agrees with Gas Industry Co's questions and believes that the analysis looks reasonable. MGUG would expect the TSP to be well-aligned with the requirement for accuracy. MGUG supports Option 3 as it seems the most practical and lowest cost.

Methanex's preferred approach is to retain the self-assessment regime with Option 1, in combination with a lighter-handed version of Option 2 even if this option requires changes to the Gas Act to provide for audit rights. It believes this could be effected in time for the FY2018 levy year. Methanex does not find the current approach onerous and would particularly like Gas Industry Co to test its assumption that retention of the self-assessment regime in combination with Option 1 and Option 2 (separately or together) is not a lower cost or a more practicable solution to the underlying assurance issue.

Nova supports Gas Industry Co's initiative. Under current arrangements errors can creep into participants' processes and there is no simple way for Gas Industry Co to check this. Nova prefers Option 3. Nova favours the option of using transmission data as the primary source of information, although it notes it will still need to compile information on gas supplied through private pipelines in Taranaki.

Vector prefers Option 1 on the basis that it would not require wash-ups, is low-cost, and would provide data accuracy as volume data from producers relates directly to the wholesale process. Vector considers it unlikely there would be significant changes as a result of using Option 1, thereby resulting in minimal disruption to existing processes. It does not support Option 3 as it could raise issues of conflict, increase costs, excludes private pipelines, and cuts across existing gas supply agreements which could result in unnecessary disputes.

3. Gas Industry Co's analysis

Gas Industry Co was surprised at the degree of difficulty that First Gas cited in respect of generating a subset of transmission billing information to use for creating wholesale levy invoices. Under the current Maui Pipeline Operating Code (MPOC), customers of the gas producers signal their intention to purchase gas by making nominations at the receipt welded point(s) of their supplier(s). Those nominations (once approved) are the volumes that the customer is deemed to have purchased from the gas producer(s). Gas Industry Co also understands that it is most unusual for gas to change hands between shippers at receipt welded points, as the welded party would not confirm nominations for a shipper with which it did not have a contract. That being the case, nominations (which underpin transmission billing volumes) would provide that information that Gas Industry Co requires to create wholesale levy invoices. We shall explore this further with First Gas.

Gas Industry Co was also surprised at the suggestion in one submission that Option 3 required wash-ups. That is a misunderstanding of the position. Wash-ups occur as a result of the process of successive approximation that is embodied in the Downstream Reconciliation Rules (DR Rules). As allocations are revised for consumption periods, the differences are washed through transmission invoices such that volumes of gas effectively change hands. Those transactions do not, of themselves, affect levy payments. Rather, those transactions cause gas purchasers to revise their present-day purchases up or down depending on how the wash-ups are affecting each of them. This means that the MPOC nominations that would be used under Option 3 would automatically account for the effects of wash-ups. This is no different from the status quo (or Option 1) where purchases rise and fall as a result of wash-ups triggered by the DR Rules.

One submitter suggested that Option 3 suffered from the fact that the TSP is a purchaser of gas for its own use (for both balancing and compressor fuel) and, therefore, has a conflict (or perceived conflict) in providing gas sales information to Gas Industry Co. Gas Industry Co does not agree: balancing gas is procured using the emsTradepoint market and prices on that market are all 'levy paid'. Similarly, while fuel gas for compressors is not a pass-through cost and, therefore, the TSP may strive to minimise those costs, the volumes (and, therefore, costs) are very small. Given the above, Gas Industry Co does not agree that the TSP has a conflict (either real or perceived).

A number of submitters raised the issue of Option 3 potentially changing the incidence of the wholesale levy and a consequential need to change some gas sales agreements. Gas Industry Co acknowledged this possibility in the Options Paper but we may have under-estimated the effort required to make any changes.

As noted in section 1, the misgivings expressed by a number of submitters in respect of Option 3 means that Gas Industry Co will re-evaluate both Option 1 and Option 3. Option 1 does have the great advantage that it continues the status quo with regard to which parties are liable to pay the wholesale levy. The key question is whether we can identify a cure for the risk inherent in Option 1 where the gas producer supplying the information is conflicted due to being associated with the levy payer. It is possible that a further option, essentially a hybrid, may offer an acceptable solution. The hybrid option would require that:

1. where gas sales occur at a Maui receipt point, the pipeline owner would provide the nominations data for that receipt point that identifies volumes acquired by each shipper on a day; and
2. in all other cases, including sales transported via private pipelines, gas producers would be required to provide a monthly schedule of those sales by customer.

To the extent that the hybrid option is still reliant on returns from gas producers that are vertically integrated with gas shippers it is likely that Gas Industry Co will need to undertake further analysis of gas production data provided by MBIE. Unlike the status quo, that analysis will be made much easier by the extent of the data that Gas Industry Co will receive from gas producers and the Maui pipeline operator.

The challenge is now to frame-up drafting for the levy regulations that is as simple as possible while being unambiguous. Over the balance of this month, Gas Industry Co will be working with selected industry participants to refine that drafting.

4. Submissions: Parties responding and summaries of answers to questions

4.1 Parties who responded

The following parties provided submissions on the Options Paper and their names have been assigned colours in the list below so as to identify them in the table that follows.

emsTradepoint

First Gas

Genesis

Methanex

MGUG

Nova

Vector

4.2 Table of questions and summarised responses

The submissions are published on Gas Industry Co's website at this page: http://www.gasindustry.co.nz/work-programmes/levies/developing/wholesale-levy-assurance-options-paper-september-2016/ (a link to the Options Paper is on the same page).

For convenience we have summarised submitters' answers to the questions in the table below.

Q1: Do you agree that the current arrangements do not provide adequate assurance that wholesale levy payers are meeting their respective obligations and that changes need to be made to provide adequate assurance that wholesale levy returns and payments are accurate?	
Response	**Submitters**
Yes, based on information GIC have provided in the consultation paper	emsTradepoint
Assume GIC's initiative prompted by unpaid levy issue. While it may have been a surprise, the shortfall was eventually discovered. Seeking verification of returns is a reasonable activity for GIC but may be considered a relatively small problem in the overall scheme of things. While FG do not propose any solution be subject to a cost/benefit analysis, they do suggest that the chosen solution should be simple to implement and not materially increase recurring costs.	First Gas
Yes	Genesis
Yes	MGUG
Consider current arrangement to be most cost-efficient model and not systematically flawed. Methanex supports GIC gaining access to additional information from gas producers (as defined in Gas Act) and/or pipeline owners in order to verify payments together with discretionary right to audit where there are concerns. This is best way to resolve assurance issue.	Methanex
Yes. There are insufficient checks and balances in the existing processes that help identify possible errors in returns.	Nova
Yes	Vector

Q2: Do you consider that there are any other efficient, low-cost options to address the shortcomings of the current methodology in the Levy Regulations? If so, please provide the alternative (s) together with your assessment compared with the four options presented.	
Response	**Submitters**
emsTradepoint have not considered any other options.	emsTradepoint
Propose new option '0': charge wholesale levy to producers directly, based on aggregate primary sales volumes of gas which would allow payment of levy at source of production and eliminate all need to further break down information on who purchased, how, where. These volumes could be checked against MBIC stats. Would provide greatest cost savings compared to status quo. Would also alleviate need to make changes to CCM Regulations but might be convenient to make CCM fees directly payable by producers as well. Wouldn't change economic value of gas being purchased but would simplify allocation/collection of fees.	First Gas
No	Genesis
Not aware of any	MGUG
Do not have any other options to propose	Methanex
No response	Nova
Yes. Believe Option 1 provides better alternative solution compared to other options because under this option: • Volume data from producers relates directly to wholesale process ensuring accuracy. Data already available and likely to be lowest-cost data that can be accessed. Also could consider collecting this data quarterly. • Would not require wash-ups, making it a simple low-cost option. • Significant changes to payments made by wholesale levy payers under current arrangements are unlikely, minimising disruption to existing processes and facilitating smooth transition to new arrangements.	Vector

Q3: Do you agree with the analysis of each of the four options? If not, please provide your reasons.	
Response	**Submitters**
Agree with analysis of options however, emsTradepoint Market Rules contain a number of rules (eg 15.4, 16.14, 16.17) that apply to, or are affected by, industry body levies (which includes wholesale levy). Important that any analysis that considers costs of possible options also takes into account effect on relevant emsTradepoint market rules and therefore their effect on emsTradepoint and their participants	emsTradepoint
Options 2/4 are too expensive and complex. Option 2 costs considerably outweigh the benefits. Option 4 seems needlessly complex as imposing levies on every retailer and every directly connected transmission/distribution customer increases number of parties needing to pay. Wash-ups would only change allocations of levies to individual participants but not the aggregate amount of levies payable to GIC. Option 4 would also require GIC to impose/collect information from participants connected to private pipelines. This could introduce additional cost/complexity to implement any reliable arrangements.	First Gas
Yes	Genesis
Analysis looks reasonable	MGUG
• Option 1 would enable GIC to readily verify returns without making changes to underlying self-assessment model or require shifting responsibility for paying levy from 'first purchaser' to Shipper (which could have significant flow-on consequents. Do not consider this will be more work for GIC or levy payers than if GIC were to embark on calculating/issuing invoices based on transmission billing and addressing complications arising with Option 3. • Option 2 - surprised GIC do not have stronger audit rights and, if a change to Gas Act was required believe it is overdue. Believe these changes could be made in time for FY2018 or shortly thereafter but audit provision should be discretionary and used by exception in order to investigate concerns rather than mandatory periodic audits on all participants. • Option 3 – presents a number of challenges needing thorough investigation. It may interfere with existing contractual arrangements allocating levy between Seller/Buyer with amendments required to existing gas contracts. Potential issue where Shipper is only that and not beneficial consumer of gas but cannot pass on costs to party who is. ○ Believe that extensive changes (and more than for Options 1/2) will be required to Levy Regulations to support this option. Could add regulatory hazard to industry participants.	Methanex

Q3: Do you agree with the analysis of each of the four options? If not, please provide your reasons.	
- This option (and option 1) will incur similar additional costs. As status quo is not onerous, option 3 will incur additional effort to comply. Shippers would also need to invest further resources into checking GIC invoices, undertaking their own investigations and cost-recovery positions where necessary to ensure they are paying what they should be as 'first purchaser' and on-passing costs where they aren't. - Private pipelines not addressed in this option. Arrangements on these pipelines vary widely. Depending on where charges are billed, the gas supplier or producers will need to approached for information, which means there is no fundamental difference between providing this information with status quo. • Option 4 – is possibly a more appropriate mechanism for recovering wholesale levy than either option 3 or status quo but that it would be far more complicated to operate (particularly with GIC undertaking assessment and invoicing). Would also require more substantial changes to Ley Regulations than other options. Is rational approach from perspective of direct connect consumer, but issue of wash-ups on DR volumes is a particular problem for this option.	
Mostly, but the following observations are made: • Under Option 1, the point of measurement needs to be clearly defined as producers may sell gas in a raw state (prior to LPG/gas liquids are extracted). Nova presume intent is that levy based on quantities of AS/NZS saleable gas post processing rather than inclusive of those other components. • While Option 2 cannot provide an immediate solution, it seems appropriate to provide GIC with powers to audit participants' returns on a selective basis even if it follows through on another option.	Nova

Q3: Do you agree with the analysis of each of the four options? If not, please provide your reasons.	
No for following reasons: • Option 1 best alternative as explained above. • Option 2 not feasible at present. Requirement for industry participant's determination of volumes to be audited also imposes significant additional costs on relevant parties. • Option 3 has a number of shortcomings – further explained in Q4 below. • Option 4 is administratively complex as it requires successive reconciliations and wash-ups. It also widens the pool of levy payer with new parties to this process and this has associated cost implications.	Vector

Q4: Do you agree with the analysis that option 3 addresses the problem at low cost and provides an appropriate set of checks and balances?	
Response	**Submitters**
Agree, subject to same caveat as Q3.	emsTradepoint
Consider this option to be sub-optimal. While FG is willing to work with GIC on this option if selected they believe GIC has underestimated the difficulties, complexities and disadvantages. They do not recommend it as follows; • GIC will still need to implement arrangements to levy users of private pipelines as the concept of 'shipper' may not apply to them. • GIC will not be able to use aggregate billing volumes for each shipper because those volumes will include a multitude of receipt/delivery point combinations including displaced gas nominations and ones to/from emsTradepoint Trading Hub under MPOC resulting in billing volumes needing to be reviewed on line-item basis. • GIC will need to consider whether/how to impose levies on shipper mismatch – under MPOC/VTC – and on cash-outs or trades of operational imbalance for Welded Parties under MPOC. • First Gas believes they will have issues regarding information disclosure under Section 24.4 of MPOC, placing them in an awkward position. • FG assume GIC only intends to impose levies on transmission volumes from gas production stations otherwise VTC Shippers would in many cases pay a levy twice. Breaking out those levies by Shipper is unnecessarily complex and costly.	First Gas
While Genesis broadly support use of transmission billing volumes to reconcile against levy returns, it believes there may be an issue as to how commercial contracts will align with proposed method. Title could change between parties at a Maui receipt or delivery point or not. Genesis believe there is potential for a significant change in cost allocation using this method.	Genesis
Analysis looks reasonable but MGUG would expect the TSP to be well aligned with the requirement for accuracy. MGUG support this option as it seems the most practical and lowest cost one.	MGUG
• Support retention of self-assessment regime complemented by introduction of Options 1/2, provided that in respect of option 2, audit right used on a discretionary/exceptional basis where data collected does not tally with returns (this approach analogous to IRD tax collection methods).	Methanex

Q4: Do you agree with the analysis that option 3 addresses the problem at low cost and provides an appropriate set of checks and balances?	
• Not fundamentally opposed to Option 3 but consider GIC has under-estimated associated costs/complexity involved. GIC will need to separately assess liability on private pipelines, avoiding double counting of volumes; have a disputes process; and ensure that same participants liable under current regime, are liable under Option 3. If GIC proceeds with this option it would need considerable consultation process to ensure all issues are addressed and appropriately concerned. • If choosing this options, Methanex recommend that GIC investigates further into costs/potential issues that may result from what they consider to be a substantial change in way levy is collected and an increase in complexity of process.	
Nova favours this option. As it is closely aligned with a gas producer, it is conscious of the additional obligations created in terms of reconciling details of gas supplied through exclusive pipeline arrangements versus quantities shipped through the open access pipelines (i.e. some gas may come directly from private pipelines while other may be exported into an open access pipelines). It is important to avoid double counting as well as missing volumes. Therefore it may also be appropriate to require customers directly supplied by private pipelines to confirm the quantities supplied to them by each gas wholesaler from time to time. This would provide further check that data supplied by gas wholesaler was correct.	Nova
No for reasons as follows: • TSP not independent. As it buys gas for its own use, this raises issues of conflict (or perceived conflict) of interest. • While overall w/s levy amount would not change, the proportion paid by each party to other parties could significantly change. • Option excludes gas sold and transported on private pipelines. • Would require wash-ups as transmission billing volumes are impacted by DR volumes. • 'Cuts across' existing gas supply arrangements. Vector's experience shows that most parties provide an energy price inclusive of w/s levy when wholesaling gas. This creates potential risk of levy costs being double counted requiring either addition transactions to remove this risk or changes to gas supply agreements resulting in unnecessary disputes.	Vector

Q5: Do you agree that it would be desirable to amend regulations 18 and 20 of the CCM Regulations to align with any changed levy regulations?	
Response	**Submitters**
Yes	emsTradepoint
FG suggest option 1 as being optimal in terms of cost/ease. Do not understand relevance of statement that GIC would need to analyse data/verify returns as they believe GIC would have to do this regardless of who provides them. Using data from gas producers directly allows simple collection of data at source and eliminates need to break out data by shippers and add arrangements to collect data for use of private pipelines. As a benefit to this option, it would avoid the need to make consequential changes to the CCM Regulations.	First Gas
Yes	Genesis
Yes	MGUG
Section 17 of CCM Regs, while somewhat inconsistent with S5 of Levy Regulations, is more concise definition of party liable for paying wholesale levy. There is a need for consistency so, regardless of option chosen, CCM Regs would need to change by either amending S17(3) or amending Levy Regs to align this definition.	Methanex
Yes, this is necessary. Clause 20(3) of the CCM Regulations should remain. Clause 18 should include a requirement that sufficient details of data used to determine each market participant's fee should be provided to the participant in order that they can reconcile the volumes against their own records.	Nova
As Vector believe Option 1 is best option, amending the CCM Regulations is unnecessary. The need to amend the CCM Regulations under options 3/4 reflects additional amount of work required under these options.	Vector

Q6: do you agree that such an amendment to regulations 18 and 20 would be minor and technical?	
Response	**Submitters**
Yes	emsTradepoint
Not directly addressed	First Gas
Genesis would need to see the proposed amendments to these regulations prior to providing a comment	Genesis
No comment made	MGUG
Cannot respond directly to this question as GIC have not elaborated on specific changes proposed but fully support amendments being made to CCM Regulations as to the above alignment.	Methanex
Amendment of Regulation 18 will require specific disclosure of gas volumes supplied through direct connection arrangements. While Nova concurs with GIC's objectives, it feels this is a higher level of transparency than previously provided. Commercially sensitive details should be aggregated so that individual participant's data is not disclosed.	Nova
Agree but, again, using Option 1 would render this unnecessary	Vector

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'.