

# Recommendation on Gas (Levy of Participants) Regulations 2014

**Date issued: March 2014**







## **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'.

# Executive summary

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This paper recommends that the Minister of Energy and Resources proposes the annual regulations for the necessary levy funding to support the key elements of Gas Industry Co's work programme to the end of financial year 2015 (30 June 2015).

Gas Industry Co was established in 2004 to perform the role of the 'industry body' as set out in Part 4A of the Gas Act 1992 (Act). In consultation with the industry, it develops an annual Statement of Intent<sup>1</sup>, which includes an annual work programme, an indication of further activity in following years, and associated levy funding requirements.

Along with governance objectives set out in the Act, Gas Industry Co must have regard to the objectives and outcomes in the April 2008 Government Policy Statement on Gas Governance (GPS).

Each financial year, the Company must consult with stakeholders on the costs for the work programme described in the Statement of Intent, which are funded through a levy and fees imposed on the industry. This paper sets out the key elements of Gas Industry Co's Statement of Intent and the associated levy funding required for the year ended 30 June 2015 (FY2015).

In performing its statutory role, the Company has developed a Corporate Strategy goal to *optimise the contribution of gas to New Zealand* and its purpose is to *provide leadership for the Gas Industry and the New Zealand Gas Story*. The following strategic objectives also form part of the Corporate Strategy and have then been used to frame the proposed FY2015 work programme set out in this Statement of Proposal:

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

The work programme proposed in this paper includes meeting statutory requirements, such as the administration of existing gas governance regulations, and also seeks to address Government and industry priorities through the completion of deliverables of key projects. It continues existing multi-year workstreams and proposes no significant new workstreams. This reflects the significant progress made over recent years in addressing the goals set for Gas Industry Co and the industry in the Act and the GPS.

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<sup>1</sup> The Statement of Intent was formerly called the 'strategic plan'. An amendment to the Gas Act in December 2012 changed the title of this document but not its content, which covers Gas Industry Co's proposed scope of operations.

While Gas Industry Co is a privately held company whose shareholders are industry participants, it operates as a not-for-profit organisation and undertakes the performance of a public function. As such, the Company's activities are to a large extent 'stakeholder driven' and thus submissions and feedback from stakeholders were sought on its proposed work programme<sup>2</sup>.

The industry has been fully consulted on the FY2015 work programme and associated costs. Gas Industry Co received feedback on draft proposals at the Co-regulatory Forum held at Gas Industry Co's offices on 28 November 2013; published a formal Statement of Proposal; and considered submissions on that; resulting in the work programme and associated levy recommendations set out in this paper being endorsed by the Gas Industry Co Board of Directors. In summary, the proposals:

- involve a high level of continuity in terms of progressing or finalising multi-year workstreams; and
- attracted a high level of industry agreement or acceptance.

With the competing demands of a finite budget and the 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, firstly, statutory and policy requirements; secondly, maintaining momentum on existing and committed projects; and thirdly, attending to new work that is seen as a priority by the Company and stakeholders. The Company has reviewed its work programme accordingly and, following consultation with stakeholders, considers that all proposed workstreams meet a priority need for the gas industry<sup>3</sup>.

We are pleased to report that we expect the FY2015 work programme can be achieved at a lower cost than required for this current FY2014 year.

The estimated FY2015 Work Programme Costs of \$5.6m are less than the corresponding budgeted costs for FY2014 (\$5.9m). Work Programme Costs are met by a combination of market fees, raised under specific gas governance regulations, and by the levy recommended in this paper. The estimated levy component of those costs of \$4.052m is also less than FY2014 (\$4,134m).

Gas Industry Co believes that recovering the levy through a retail and a wholesale component as in previous years (and in the same proportions) remains appropriate.

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<sup>2</sup> The Government is a key stakeholder. In particular, it sets the legislative and policy framework, particularly through Part 4A of the Gas Act and the GPS, but does not formally submit on Gas Industry Co proposals. However, the Company maintains a close working relationship with the Minister and officials to ensure policy is developed in line with Government objectives.

<sup>3</sup> It should be noted, however, that any unforeseen priority/urgent issues arising during the year may require a reduced focus on, or even deferral of, planned workstreams.

## **Recommendation**

Accordingly, Gas Industry Co recommends that the Minister propose the making of regulations to enable the collection of a FY2015 Levy on Gas Industry Participants of \$4,052,100.

The proposed levy rates for FY2015 are:

- a retail levy of \$5.73 per ICP (down from \$5.90 in the current year), and
- a wholesale levy rate of 1.33 cents per GJ of gas (currently 1.63 cents per GJ).

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# 1

## Strategic Direction and Work Programme

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### 1.1 Introduction

The Government and the gas industry have implemented a unique co-regulatory model in which a specially established 'industry body' develops and maintains governance arrangements for consumers and other participants 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 1992 (Act). In consultation with the industry, it develops an annual Statement of Intent<sup>4</sup>, which includes an annual work programme and associated levy funding requirements for the next financial year, and provides an indication of further activity through the following two years.

#### 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, Government 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<sup>5</sup> 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:

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<sup>4</sup> The Statement of Intent was formerly called the 'strategic plan'. An amendment to the Gas Act in December 2012 changed the title of this document but not its content, which covers Gas Industry Co's proposed scope of operations.

<sup>5</sup> 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<sup>6</sup>.

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 GPS 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 FY2015.

### **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 reflects the 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.

#### **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

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<sup>6</sup> [http://gasindustry.co.nz/sites/default/files/publications/Government\\_Policy\\_Statement\\_on\\_Gas\\_Governance\\_-\\_April\\_2008.pdf](http://gasindustry.co.nz/sites/default/files/publications/Government_Policy_Statement_on_Gas_Governance_-_April_2008.pdf)

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:**

- Promote 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 FY2015 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 FY2015, and an indication of further activity in FY2016 and FY2017, will be published before the start of the next financial year (1 July 2014) as the Company's Statement of Intent<sup>7</sup>.

### **Annual Work Programme**

Each year the Company develops an indicative work programme and determines the expected cost of that work; consults on that work programme and the associated levy funding requirements to meet the costs; and then makes a recommendation to the Minister for regulations requiring industry participants<sup>8</sup> 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 other than those recovered through market fees.

Consistent with our statutory role and our Company Strategy, we anticipate a "consolidation" year for FY2015, focussing on our core market governance role under existing rules/regulations and continuing our key multi-year programmes. In particular, FY2015 sees a continuation of the Company's work on transmission issues. Our substantive work on implementing changes to the Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations) and the Gas Governance (Compliance) Regulations 2008 (Compliance Regulations) should be largely complete<sup>9</sup>. Substantial mid-level work will continue in relation to gas allocation/reconciliation, gas quality, and gas balancing.

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

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<sup>7</sup> A draft Statement of Intent has been forwarded to the Minister together with this Recommendation.

<sup>8</sup> Industry participants are defined in the Gas Act as including gas retailers, distributors, producers, pipeline or meter owners, wholesalers, and major upstream gas consumers.

<sup>9</sup> The majority of costs for administering governance arrangements (such as service providers and consultants) are met through market fees. However, the costs for Gas Industry Co staff time and internal resources are met through levy funding.

momentum on existing and committed projects, and attending to new work that is seen as a priority by stakeholders and the Company.<sup>10</sup>

### **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 Statement of Intent, 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 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.

### **Other ongoing/committed workstreams**

There are a number of other significant workstreams that Gas Industry Co has previously committed to and have been developed in response to stakeholder concerns and/or Ministerial requests. For instance, major end users and other industry stakeholders requested a focused project be led by Gas Industry Co to address the transmission capacity issues, particularly in respect of the North Pipeline owned and operated by Vector. The GTIP kicked off in FY2012 and will be substantially advanced in this current year, but more work is needed through and beyond FY2015.

Other examples include:

- a second phase review of the Downstream Reconciliation process to consider improved allocation methodologies (including D+1);
- finalising the transition activities required to implement amendments to the CCM Regulations; and

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<sup>10</sup> It should be noted, however, that any unforeseen priority/urgent issues arising during the year may require a reduced focus on, or even deferral of, planned workstreams.

- continuing to research and examine options for addressing transmission capacity allocation and pricing, as per the recommendation of the PEA.

In order to ensure meaningful progress is made with such projects it is essential to programme them into the budget as a means of establishing or maintaining some momentum.

## **1.5 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 4.1 below). The annual fee is set by the Board and is currently \$5,000 per shareholder. There are eleven (11) shareholders at the date of this recommendation.
- 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.

## **1.6 FY2015 Work Programme Costs**

A list of the FY2015 workstreams and associated costs is set out below, together with a comparison to FY2014. Further detail of workstreams, with descriptions of relevant deliverables, can be found in the Statement of Intent FY2015-17 (which has been provided separately to this document).

Total expenditure for the FY2015 work programme described in the draft Statement of Intent is estimated at \$5,628,320. The work programme budget is based on all activities to be undertaken by the industry body in FY2015<sup>11</sup>. Some of these activities will be funded through market fees charged pursuant to specific gas governance regulations or rules (estimated to be \$1,440,000 in FY2015), but the majority of Gas Industry Co's funding comes from the levy (\$4,052,100).

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<sup>11</sup> Work Programme Costs also include the non-cash amortisation expense for the industry assets (gas registry and downstream reconciliation system). This expense is met from pre-funded reserves and does not affect the levy funding requirement, but it must be tracked as an expense each year for accounting purposes.

	<b>FY2015 (to 30/06/15) Work Programme Costs</b>	<b>FY2014 (to 30/06/14) Work Programme Costs</b>
Critical Contingency Management	500,000	483,000
Critical Contingency Management Review	(Part of 'Rule Changes')	(Part of 'Rule Changes')
Gas Processing	0	0
Compliance	18,000	18,000
Infrastructure Access	40,000	80,000
- <i>Balancing</i>		
- <i>Gas Quality</i>		
- <i>Interconnection</i>		
- <i>Industry Facilitation</i>		
GTIP	350,000	430,000
Statutory Accountability	12,000	12,000
Gas Story	22,500	22,500
Information Gathering	-	5,000
Strategic Issues	30,000	--
<b>Total Wholesale Costs</b>	<b>972,500</b>	<b>1,050,500</b>
Switching	300,000	292,025
Reconciliation	550,000	750,000
Compliance	72,000	72,000
Distribution Contracts	7,500	30,000
Rule Changes	150,000	100,000
Consumer Issues	7,500	20,000
Insolvent Retailers	0	20,000
Bridge Commitments	10,000	10,000
Statutory Accountability	12,000	12,000
Information Gathering		5,000
NZ Gas Story	22,500	22,500
Strategic Issues	30,000	--
<b>Total Retail Costs</b>	<b>1,161,500</b>	<b>1,333,525</b>
Board	262,460	262,460
Corporate Consultancy	130,000	130,000

Salaries	2,233,354	2,199,142
Organisational Support	732,284	773,372
- System amortisation	136,222	392,153
<b>Total Other Costs</b>	<b>3,494,320</b>	<b>3,757,127</b>
<b>Total Expenses</b>	<b>5,628,320</b>	<b>6,141,152</b>

#### Notes to Work Programme Costs FY2014 and FY2015:

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 'NZ 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.
3. The system amortisation expense is pre-funded and is off-set at the end of the year from an equity reserve provisioned for this purpose. The expense must be accounted for in the total costs, but it does not influence the overall levy funding requirement.

# 2

## Work Programme Costs and Levy

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### 2.1 Maximising value

#### Cost-efficiencies

As with all public and levy-raising entities, Gas Industry Co aims to deliver value in both its operational workstreams and in the provision of organisational support services to the Company as a whole. There is a specific focus on delivering efficiency and value for money. In particular, the Company implemented a programme in FY2013 to review organisational support costs, and appropriate mechanisms for ensuring that procurement decisions are managed effectively. The benefits of this review translated into savings reflected in the FY2014 budget and these will be maintained in the FY2015 budget.

As well, we have considered carefully how each line item in the work programme should be budgeted. A review of past years' budgets has shown that some items – such as the Maui Pipeline Operating Code/ Vector Transmission Code (MPOC/VTC) change request reviews – are allocated funding on the prospect of work needing to be undertaken, but that work may not always arise. We have determined that it is more efficient to group certain line items and allocate an amount of funding that is less than the sum of what has previously been allocated separately, thus achieving a modest saving in these areas<sup>12</sup>.

Cost-effectiveness is a key element in planning our work programme. For example, regarding the scope of the GTIP, we have planned and resourced to address specific issues within the next financial year that will ultimately move the market forward, rather than jumping directly to design and development of a new market system.

While satisfied that each workstream is justifiably included in the work programme, Gas Industry Co will continue to assess the value of each workstream within the financial year. Should the need or priority for a given workstream decrease, resources originally earmarked for that work can be re-allocated or the funding saved and included in the return to levy payers of any surplus at year-end.

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<sup>12</sup> Of course, there is now a risk that each line item may be fully active in a given year, leading to a budget deficit, but we expect to be able to manage this risk through re-prioritisation of other work.

## Delivering value for money

The Government has advised to Gas Industry Co that, as an entity funded by a levy on industry, the Company is expected to provide 'value for money' and 'reduc[e] business and household costs'<sup>13</sup>. The message delivered to the Company set out three objectives:

- **Clear priorities** – focusing on things that matter, including providing high quality, cost effective and customer-focused frontline services.
- **High quality services** – ensuring that services are modern, responsive, business like, and provide good value for money.
- **Reducing waste** – ensuring that administration is as efficient, streamlined, and as well organised as it can be.

Gas Industry Co's work programme has been designed to address those issues of most pressing concern to stakeholders, and the principal Gas Act objective for the Company is focused on the safe, efficient, and reliable delivery of gas to end-users. The Gas Industry Co team comprises experienced and professional people who are committed to operating a fit-for-purpose, best-practice organisation. Furthermore, the Company receives guidance from a Board with lengthy public and private sector experience, and includes industry representatives to cement the link between industry and Government.

The Company's operations are supported by an administrative team that consistently seeks to provide high quality support in the most cost-effective way possible. The Company's overhead costs have reduced significantly in the last three years.

## Workstream benefits

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.

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.

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<sup>13</sup> Letter to Gas Industry Co from Minister Parata dated 21 November 2011.

## 2.2 Levy Calculation

The industry was fully consulted regarding the FY2015 work programme and associated costs. Gas Industry Co received feedback on draft proposals at the Co-regulatory Forum held at Gas Industry Co's offices on 28 November; published a formal Statement of Proposal; and considered submissions on that paper. As a result, the draft Statement of Intent and the associated levy recommendation set out in this paper have been endorsed by the Gas Industry Co Board of Directors.

In summary, the proposals:

- involve a high level of continuity in terms of progressing or finalising multi-year workstreams; and
- attracted a high level of industry agreement or acceptance.

Total Work Programme costs for the current financial year are expected to be below, but close to, the budgeted \$5,995,684.

While addressing a similar work programme to the current year, the total cost of operation for FY2015 is forecast to reduce to a level of \$5,628,320. The amount required to be funded from the levy on participants is \$4,052,100 (allocated against two workstream categories: 'wholesale' and 'retail'). This is a decrease of \$81874 (1.97%) from the FY2014 levy requirement of \$4,133,974.

The levy funding requirement (\$4.05m) is the difference between the total cost of the work programme (\$5.6m) and those costs met by 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.

The following allocation methodology is used to calculate the levy rates:

- 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 recent information from the Switching Registry, the Company will assume an ICP count of 265,000 for the purposes of calculating the retail component of the levy (\$5.73/ICP).
- Wholesale levies will be collected at a rate of 1.33c/GJ based on an assumption of 190,000,000GJ (190PJ) 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 the industry as to its own expected levels of gas volumes in FY2015. In prior years, we have had to consider signalled downward changes in gas-fired power generation against some increased industrial usage. That said, periods of dry, warm weather – such as the first three months of 2013 – can lead to increased gas-fired power generation (low hydro lake levels).

Gas Industry Co's policy is to set an estimate of gas volumes to ensure it mitigates the risk of insufficient revenue collection, and bearing in mind the Company's policy of generally refunding any surpluses to levy payers. Gas volumes flowing through the market have been significantly increasing over the past couple of years as Methanex has rebuilt its operations to include both trains at Motonui and the production facility at Waitara. As such, Gas Industry Co proposed figure of 190PJ for gas volumes in FY2015 (up from the estimate of 160PJ for FY2014) for consultation with industry. Submissions did not differ from this estimate, and it is now included in this Recommendation.

Based on the above methodology, the FY2015 levy funding requirement is:

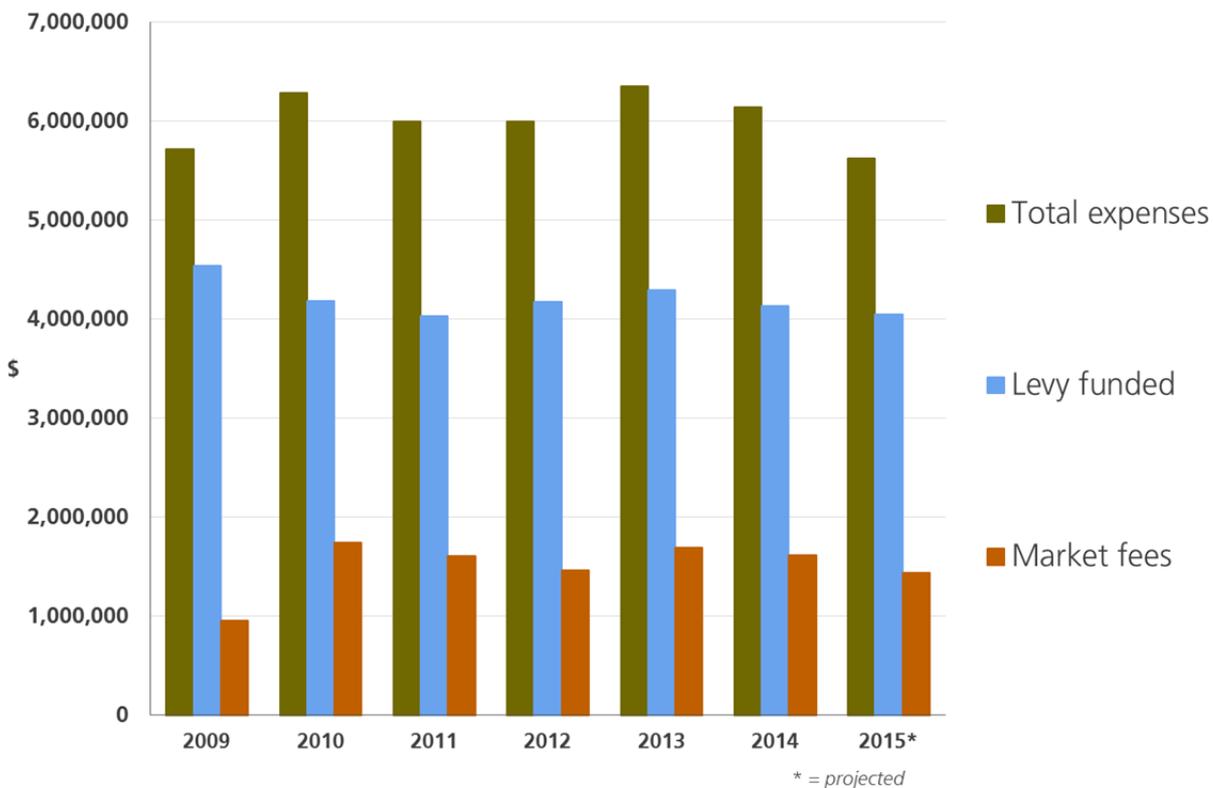
	FY2015		
	Retail	Wholesale	Total
Direct Costs	839,300	1,456,990	2,296,290
<i>Proportion of Direct Costs to Total Costs</i>	<i>36.6%</i>	<i>63.4%</i>	
Indirect Costs	815,027	1,077,003	1,892,030
<b>Work Programme Costs not met by market fees</b>	<b>1,654,326</b>	<b>2,533,994</b>	<b>4,188,320</b>
Less Amortisation on Industry Assets (met from equity reserves)	(136,219)	-	(136,219)
	<b>(136,219)</b>	<b>-</b>	<b>(136,219)</b>
<b>Total Levy Funding Requirement</b>	<b>1,518,107</b>	<b>2,533,994</b>	<b>4,052,100</b>
Basis of apportionment	<i>per ICP</i>	<i>per GJ</i>	
Number	265,000	190,000,000	
Levy Unit	<i>\$/ICP</i>	<i>c/GJ</i>	
<b>Levy Rate</b>	<b>\$5.73</b>	<b>1.33</b>	
<b>Projected Levy Revenue</b>	<b>1,518,107</b>	<b>2,533,994</b>	<b>4,052,100</b>

## 2.3 Conclusion

Gas Industry Co accordingly recommends to the Minister that the proposed levy is appropriate, having regard to all factors, particularly the Company’s Statement of Intent, Annual Report, indicative work programme, the GPS objectives and outcomes, submissions from industry participants, and past expenditure.

The following chart shows actual Work Programme Costs for FY2009-13, forecast Costs for FY2014 and estimated Costs for FY2015. The light green and brown bars show the proportion of Costs met by the levy (light green) and market fees (brown). Costs have remained within a narrow range (around the \$6m mark), even taking into account the increased activity over the past two years to cover key priority projects sought by all stakeholders. These are expected to be lower in FY2015 and the Company will aim to continue this downward trend over the next few years.

**Chart 1: Historical and projected work programme**



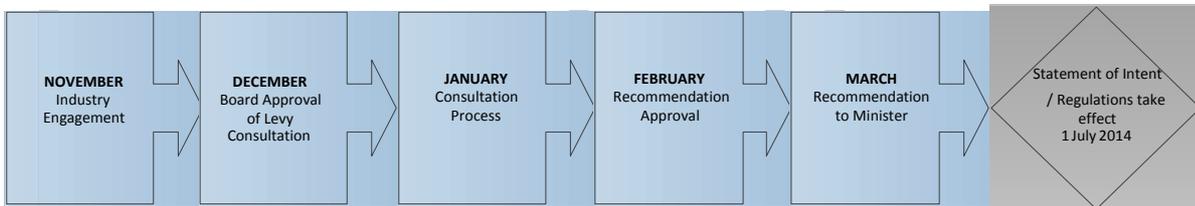
# 3

## 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 FY2015 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.

The consultation process commenced early, with a Co-regulatory Forum in November at which industry participants and other stakeholders receive an indicative briefing on the proposed work programme for the next financial year. Often, MBIE officials are also in attendance. This meeting was aimed at learning about the work priorities held by industry participants, 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 programme.

The Board has also issued a standing invitation to the Minister of Energy to talk with Directors at their November meeting about issues relevant to the industry and the development of the work programme and levy proposal for the next financial year.

In December 2013, Gas Industry Co released a Statement of Proposal on the FY2015 Strategy, Work Programme, and Levy. This paper:

- set out Gas Industry Co's strategic direction and the rationale for that mission;
- described the work that Gas Industry Co would undertake in FY2015 and the estimated costs;
- outlined the calculation of the levy funding requirement for FY2015; and
- proposed the levy for FY2015.

The Statement of Proposal indicated a Work Programme Cost (WPC) of \$5,628,320 (a decrease from the previous year's figure of \$6,141,152 and a Levy Funding Requirement (LFR) of \$4,052,100 (compared with the FY2014 figure of \$4,133,974). 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 7 February 2014.

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, Contact Energy, Major Gas Users Group, Powerco, and Vector. Participants were invited to express interest in a further workshop to discuss the proposed levy at the end of January 2014, but there was insufficient demand for this to take place.

Submitters on the consultation paper strongly supported the work programme and budget, with several congratulating Gas Industry Co on achieving a decrease in the levy funding requirement. This was in line with views expressed by industry participants who attended the 28 November 2013 Co-regulatory Forum.

A summary of all of the issues raised in the FY2015 levy consultation submissions is set out in the Submissions Analysis Summary, which is available from the Gas Industry Co website.

### **3.2 Conclusion on consultation**

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

# 4

## Other Information

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### 4.1 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. Gas Industry Co has determined that it should refund overpaid levies as soon as the annual accounts have been received by shareholders at the Annual Meeting. This is also consistent with the treatment of over-recoveries collected under the various Market Fee arrangements. This policy encourages a predictable and stable levy by removing from the levy calculations any variability resulting from a fluctuating level of reserves.

The first such refund, at the end of FY2010, was made to levy payers in November 2011, amounting to approximately \$1.5 million. 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 (GTIP) and other unfunded workstreams (CCM Regulations review). As some of this fund was required to meet those costs, the remainder of this reserve amount – around \$286,000 – was returned to levy payers in December 2012. The reserve at the end of FY2013 was approximately \$509K, which was returned to levy payers in December 2013.

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 associated with these assets, which is met from the amortisation reserve. 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.

## 4.2 Minimal impact on consumers

The levy is paid directly to Gas Industry Co by industry participants; however, it is recognised that consumers ultimately bear that impost through delivered gas prices that are set in a competitive market – one that is not only competitive within the gas sector but also against other fuel options – thereby limiting the ability of retailers to ‘pass on’ the levy. References in this paper to ‘levy payers’ are to those industry participants that directly pay the levy to Gas Industry Co.

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	\$5.73	\$5.73	\$5.73
Annual Wholesale Levy	\$0.33	\$13.30	\$13,300
<b>Total Annual Levies</b>	<b>\$6.06</b>	<b>\$19.03</b>	<b>\$16,305.73</b>
% of annual Gas Bill	0.71%	0.18%	0.23%

# 5 Recommendation

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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 2014 to 30 June 2015 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 \$5.73 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 rate of 1.33c/GJ based on gas purchases made directly from gas producers during the previous month.