

## **Regulatory Impact Statement**

### **Gas Industry Company Levy 2014/15**

#### **Agency Disclosure Statement**

- 1 This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.
- 2 It provides an analysis of the Gas Industry Company's (GIC) recommendation to the Minister of Energy and Resources to make levy regulations to recover up to \$3.951 million of its costs from gas industry participants for 2014/15. The Minister can accept or reject the recommendation, but must accept it if satisfied that the recommendation meets certain requirements in the Gas Act 1992 (the Act).
- 3 Options analysis is limited to the single work programme and associated budget consulted on by the GIC and then recommended to the Minister. The options are that the Minister can accept or reject the recommendation. Rejecting the recommendation would result in the GIC having to develop a new work programme and budget for consultation, and then making a new recommendation to the Minister.
- 4 The Ministry has assessed the options against the objective of ensuring that the GIC can meet its principle objective, and against the requirements in the Act. The requirements are that the levy rate or amount must be reasonable, industry participants must have been consulted with on it, and that the levy regulations must meet certain statutory requirements.
- 5 The preferred option is that the Minister accepts the recommendation, and that new levy regulations are then made for the 2014/15 financial year.

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## Status Quo and Problem Definition

- 6 The government has adopted a co-regulatory governance approach for New Zealand's gas industry that is set out in the Gas Act 1992 (the Act). This approach means that an industry body "co-regulates" the industry by having the power to recommend arrangements to the Minister of Energy and Resources (the Minister). Those arrangements include rules and regulations on gas wholesaling, processing, transmission, distribution, and retailing. The Gas Industry Company (GIC) has been the approved co-regulator of the gas industry since December 2004<sup>1</sup>.
- 7 The Act sets out the GIC's objectives when recommending rules and regulations to the Minister, the principal objective being to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner. The Act also provides that the Minister can set objectives and outcomes for the GIC in a Government Policy Statement (GPS), and there are a number currently set out in the "GPS on Gas Governance 2008"<sup>2</sup>.
- 8 Under the Act, the GIC must prepare a Statement of Intent (SOI) that sets out its own objectives for the following three years, and how they relate to the Government's outcomes and objectives. The SOI is a strategic document that sets out the GIC's operating environment and scope of its work programme. The current version covers the period from 1 July 2014 to 30 June 2016, and is aligned with the GIC's principle objective, and with the other government objectives set out in the GPS.
- 9 The GIC recovers most (approx. 70 percent) of the cost of implementing its work programme through a levy on gas industry participants, and the rest through fees and equity reserves set aside to meet the depreciation costs on industry assets. The Act provides for the GIC to make a recommendation to the Minister that regulations are made to set the levy rates and require gas industry participants to pay the levy.
- 10 The levy regulations can only apply to the financial year in which they are made<sup>3</sup>, so new levy regulations must be made every year. The 2013 levy regulations<sup>4</sup> allow the GIC to recover \$4.134 million for its costs in 2013/14 through a levy on gas retailers of \$5.90 per customer (a retail levy), and a levy of 1.63 cents per gigajoule of gas purchased on the wholesale market (a wholesale levy).
- 11 The GIC has made a recommendation to the Minister to make levy regulations to recover \$3.951 million for the 2014/15 financial year. The recommendation is to recover the costs through a retail levy of \$5.48 for each customer, and a wholesale levy of 1.30 cents per gigajoule of gas purchased<sup>5</sup>.
- 12 Without new levy regulations, the GIC will be unable to meet its principal objective under the Act, which is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner. It would also be unable to meet the government's other objectives set out in the Act and the GPS.

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<sup>1</sup> Through the making of the Gas (Approval of Industry Body) Order 2004 under the Act

<sup>2</sup> [www.med.govt.nz/sectors-industries/energy/pdf-docs-library/gas-market](http://www.med.govt.nz/sectors-industries/energy/pdf-docs-library/gas-market)

<sup>3</sup> Section 43ZZE (3) of the Act

<sup>4</sup> Gas (Levy of Industry Participants) Regulations 2013

<sup>5</sup> Both amounts are GST exclusive

- 13 The GIC has financial reserves to operate for about two months without levy revenue, and will continue to receive some revenue from market fees and equity reserves, but both are insufficient to deliver the 2014/15 work programme.

### **Objective**

- 14 The objectives are to ensure that the GIC can meet its principle objective under the Act, and that:
- a. the levy rate is reasonable, having regard to the GIC's SOI, annual report, and the objectives and outcomes in the GPS on Gas Governance 2008;
  - b. the GIC has consulted with industry participants on the levy rate or amount; and
  - c. the requirements of sections 43ZZB to 43ZZE of the Act (which prescribe the costs that may be funded from the levy and various legal aspects of making the regulations) are met.

### **Regulatory Impact Analysis**

- 15 The GIC needs to be able to deliver its work programme to meet its principal objective, the objectives and outcomes in the Government Policy Statement on Gas Governance 2008, and other government objectives under the Act. The GIC needs appropriate funding to deliver its work programme.
- 16 The Minister can accept or reject the GIC's levy recommendation, but must accept it if satisfied that the recommendation meets certain requirements in the Act. These two options are assessed against those requirements, and the overall objective of the GIC having appropriate funding for its work programme, in Table one below.
- 17 The first option is to reject the GIC recommendation, which would require it to re-consult on a new work programme and associated budget, and make a new recommendation for levy regulations for the 2014/15 financial year. The second option is to accept the recommendation and make levy regulations to allow the GIC to recover up to \$3.951 million in 2014/15.
- 18 The \$3.951 million will allow the GIC to implement the work programme set out in its SOI. The work programme includes activities to meet statutory requirements, such as the administration of existing gas governance regulations, but also the delivery of key projects to address Government and industry priorities. It contains the continuation of existing multi-year workstreams, but no significant new workstreams, which reflects the significant progress made over recent years in addressing the goals set for the GIC and industry in the Act and GPS. The work programme and SOI align with the Government's objectives and outcomes for the gas sector.

Table 1: Options assessment

	<b>Reject GIC's recommendation</b>	<b>Accept GIC's recommendation</b>
Allows appropriate funding for the GIC's work programme	? Unknown. Requires new work programme to be developed and consulted on. A funding delay will impact on multi-year projects as reserves only sufficient for seven to eight weeks operation	ü The levy regulations will recover the estimated \$3.951 million it will cost to implement the GIC's work programme
The levy rate is reasonable, having regard to the GIC's SOI, annual report, and the objectives and outcomes in the GPS on Gas Governance 2008 (section 43ZZD(2)(a) of the Act)	? Unknown. Requires GIC to develop and consult on a new work programme and levy rate	ü The levy rate is reasonable given the costs of implementing the work programme set out in the SOI that aligns with GPS objectives and outcomes. Industry participants were supportive of the rates, and reduction from 2013/14
The GIC has consulted with industry participants on the levy rate or amount (section 43ZZD(2)(b) of the Act)	ü Would have to re-consult on a new work programme and associated levy rate	ü Extensive consultation undertaken, including a forum and the release of a consultation paper
The following requirements must be met (section 43ZZD(2)(c) of the Act):  43ZZB – provides that GIC recommends to the Minister regulations to require industry participants to pay a levy  43ZZC – sets out the types of costs that may be met from the levy  43ZZD – provides that the Minister must accept the GIC recommendation if sections 43ZZD(2)(a), (b) and (c) are met  43ZZE – provides that regulations may be made on the recommendation of the Minister, and sets out regulation making powers	ü  43ZZB – met as GIC has made the recommendation  43ZZC – unknown as requires development of a new work programme and associated levy rate  43ZZD – not met as the levy recommendation is rejected for not meeting one or more of the requirements  43ZZE – not met as the Minister has declined to recommend making of regulations	ü  43ZZB – met as GIC has made the recommendation  43ZZC – met as all of the costs to be recovered may be met from the levy  43ZZD – met as the Minister is satisfied the requirements are met  43ZZE – met as the levy regulations are being made on the recommendation of the Minister and are within regulation making powers

- 19 The second option is the preferred option as it meets the objective and requirements. This option means that the levy would be recovered by a retail levy on gas retailers (based on customer numbers) and a wholesale levy on participants that purchase gas from gas producers (based on the amount of gas purchased).
- 20 Table two below sets out the estimated costs to be recovered under each levy, and the resulting rates, which are a retail levy of \$5.48 per customer<sup>6</sup>, and a wholesale levy of 1.30 cents per gigajoule purchased. This is an overall four percent reduction from 2013/14, when levy revenue of \$4.134 million was recovered with a retail levy of \$5.90 per customer and a wholesale levy of 1.63 cents per gigajoule purchased.

*Table 2: Levy funding requirements*

	2014/15 (\$)		
	Retail	Wholesale	Total
Direct costs	846,254	1,469,036	2,315,290
Indirect costs	743,203	1,008,544	1,771,748
<b>Sub-total</b>	<b>1,589,457</b>	<b>2,477,580</b>	<b>4,087,038</b>
Depreciation on industry assets	(136,219)		(136,219)
<b>Total levy funding requirement</b>	<b>1,453,238</b>	<b>2,477,580</b>	<b>3,950,818</b>
Basis of apportionment	per ICP	per GJ	
Number	265,000	190,000,000	
Levy unit	\$ per ICP	Cents per GJ	
<b>Levy rate</b>	<b>5.48</b>	<b>1.30</b>	
<b>Projected levy revenue</b>	<b>1,453,238</b>	<b>2,477,580</b>	<b>3,950,818</b>

- 21 The GIC allocates costs between wholesale and retail work streams by estimating the 'direct costs' that can be attributed to each, then apportioning the 'indirect costs' based on the relative proportion of activity in each work stream. Costs that are recovered through market fees are deducted from the relevant work area. Depreciation on industry assets is then taken into account, and the retail and wholesale levies are then set to recover the allocated costs in each area.
- 22 The method used by the GIC to calculate the levy rate is reasonable, and that the levy recommendation is consistent with the Auditor-General and Treasury's respective guidelines on public sector charging.

<sup>6</sup> Measured by the number of Installation Control Points (ICP), which are the physical point of connection of a consumer with the gas distribution network, and the point at which a gas retailer supplies gas to a consumer.

## ***Impacts of the Levy***

### *Government*

- 23 Adequate funding will enable the GIC to deliver its work programme and meet government's policy objectives for the gas sector as set out in the GPS on Gas Governance 2008 and in the Act. There will be no costs imposed on government because the levy will be paid by gas industry participants and collected by the GIC.

### *Gas suppliers*

- 24 Gas retailers and wholesalers will face costs of \$3.951 million for 2014/15 in paying the levy. This represents a four per cent decrease on 2013/14 costs of \$4.134 million. The administrative costs of paying this levy are assumed to be negligible compared to the levy itself. The GIC has established processes for managing any levy reserves which are supported by levy payers.
- 25 Assuming demand is relatively inelastic and/or there is an absence of readily available alternative energy supply options, retailers and wholesalers will be able to pass costs on to gas customers without distorting demand. The total levy amount of \$3.951 million represents less than 0.3 per cent of the total annual turnover of the gas industry which is around \$1.4 billion.

### *Gas consumers (residential)*

- 26 The expected impact and benefits of the GIC's work programmes on the gas market will flow through to end consumers. The size of the proposed levy is small in comparison with the value of a residential consumer's gas take. Assuming the full pass-through of these levies to end users, an average residential consumer consuming 25 gigajoules per year will pay a total levy of \$5.81 per year. This compares to an estimated annual gas bill for that consumer of \$850. The levy thus represents 0.68 per cent of the total gas bill for that consumer.

### *Gas consumers (commercial)*

- 27 Assuming the full pass-through of these levies to end users, an average commercial consumer of 1000 gigajoules per year will pay a total levy of \$18.48 per year. This compares to an estimated annual gas bill for that consumer of \$10,500. The levy thus represents 0.18 per cent of the total gas bill for that consumer.

### *Gas consumers (industrial)*

- 28 Assuming the full pass-through of these levies to end users, an average industrial consumer of 1 million gigajoules per year will pay a total levy of \$13,005.48 per year. This compares to an estimated annual gas bill for that consumer of \$7 million. The levy thus represents 0.19 per cent of the total gas bill for that consumer.

## **Consultation**

- 29 The GIC undertakes extensive consultation each year when developing its levy recommendation. The consultation process included end users who account for

approximately 75 per cent of gas consumption in New Zealand. The initial round of consultation took place at a “co-regulatory forum” organised by the GIC in November 2013. This forum provided industry participants with an opportunity to supply the GIC with feedback on priorities for the 2014/15 work programme.

- 30 The co-regulatory forum was followed by the release of a consultation document on the proposed levy regulations. Six submissions were received from industry participants and were generally supportive of the proposed work programme and the levy rates. Although consumers were part of the consultation process, none made a formal submission.
- 31 There was broad industry support for the decrease in the levy rate for 2014/15 relative to 2013/14. Submissions generally commented on specific aspects of the proposed work programme and relative work priorities, these comments have been considered by the GIC.
- 32 The Ministry consulted with The Treasury on this paper.

### **Conclusions and Recommendations**

- 33 The GIC, as the gas sector’s approved industry body, requires levy revenue of \$3.951 million to implement its work programme for 2014/15. This funding will enable it to meet the government’s policy objectives for the gas sector. The GIC has recommended a levy comprising two components – a wholesale levy and a retail levy. The wholesale levy is 1.30 cents per gigajoule of gas purchased from the wholesale market. The retail levy is \$5.48 per customer.
- 34 In assessing the options of either accepting or rejecting the GIC’s levy recommendation, accepting the recommendation is the preferred option as it meets the legislative requirements, and the overall objective of the GIC having appropriate funding for its work programme. It is recommended that regulations be made requiring industry participants to pay the recommended levy to GIC to fund its operations in 2014/15.

### **Implementation**

- 35 Levy payers will continue to use the same processes as in previous financial years to pay levies to the GIC. To ensure the amount of levy paid is correct, every industry participant who is liable to pay a wholesale gas levy for a month must supply to GIC a written return stating the total number of gigajoules of gas that the industry participant purchased during the previous month from:
  - a. all gas producers; and
  - b. those gas producers who have purchased the gas from other gas producers.
- 36 The retail levy is calculated by the GIC using ICP data from the gas registry which, for each ICP, shows which gas retailer is the responsible retailer for each customer, and the status of the ICP.
- 37 The levy regulations enable the GIC to require information from industry participants that purchase gas from gas producers for the purposes of calculating the levy.

- 38 The proposed levy amounts are GST exclusive and are to be paid in monthly instalments. This process is well known within the industry and will not impose any substantive additional compliance costs on levy payers.

**Monitoring, Evaluation and Review**

- 39 Monitoring of levy payments will be undertaken by the GIC. The proposed levy regulations will replace the existing levy regulations which end on 30 June 2014. As the gas levy regulations are only effective for 2014/15, no review is planned. The GIC's accounts are audited and tabled in the House annually.