

## **Regulatory Impact Statement**

### **GAS INDUSTRY Co. 2012/2013 LEVY**

#### **AGENCY DISCLOSURE STATEMENT**

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

Under section 43ZZD(2) of the Gas Act 1992 the Minister must accept a recommendation for a levy from Gas Industry Company if the Minister is satisfied that the recommendation meets the requirements of that section.

The Ministry has reviewed the recommendation and is satisfied that it meets the requirements of the Gas Act 1992. The Ministry therefore recommends that the Minister accepts the levy recommendation.

There are no other feasible options for funding Gas Industry Company available without altering the Gas Act 1992. Accordingly no other options have been developed in this analysis.

The Ministry of Economic Development considers that the disclosure of information is adequate, and the level of analysis is appropriate given the likely impacts of the proposal.



 Gareth Wilson, Manager, Energy Markets Group

## **STATUS QUO AND PROBLEM DEFINITION**

### *Status quo*

The Government through the Gas Act 1992 (the Act) has adopted a co-regulatory governance approach for New Zealand's gas industry. The central component of the co-regulatory approach is an industry body that has standing to recommend arrangements to the Minister of Energy and Resources, including rules and regulations in the areas of gas wholesaling, processing, transmission, distribution, and retailing. The Gas Industry Company (GIC) was approved as the industry body by Order in Council on 22 December 2002.

GIC covers its operating costs through a levy on gas industry participants. Section 43ZZB of the Act provides for GIC to make a recommendation to the Minister that regulations be made that require gas industry participants to pay this levy to GIC. In accordance with section 43ZZE(3) these levy regulations only apply to the financial year in which they are made, therefore new levy regulations must be passed annually.

The current 2011/12 levy regulations allowed GIC to recover \$3,962 million, which is divided between a retail levy of \$5.76 per installation control point, and a wholesale levy of 1.66 cents per gigajoule.

### *Problem Definition*

GIC requires \$4.299 million to fund its operational costs for 2012/13 and has recommended to government a levy in two components – a wholesale levy and a retail levy. GIC has recommended a retail levy of \$6.23 for each connected installation control point to be collected from retail customers. The recommended wholesale levy is 1.74 cents per gigajoule on all gas purchased from producers by the buyers of that gas. The proposed levy amounts are GST exclusive.

As the levy must be set annually, if no action is taken, GIC will have no levy revenue and therefore insufficient funding to implement its work programme for 2012/13. GIC will be incapable of delivering its work programme to meet the Government's policy expectations, as it is tasked to do under the Act. The status quo, therefore, is not a feasible option.

## **OBJECTIVES**

The objectives of the regulations are to:

1. allow appropriate funding for GIC's work programme, enabling it to meet the Government's policy expectations for the gas sector, which is to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner; and
2. ensure that the Minister can be satisfied that the Act's conditions for setting the levy have been met:

- the levy rate or amount is reasonable, having regard to GIC’s strategic plan, annual report and any Government Policy Statement objectives and outcomes;
- GIC has consulted with industry participants on the levy rate or amount; and
- The requirements in section 43ZZB to section 43ZZE of the Act are met, which prescribe the costs that may be funded from the levy and various legal aspects of the making of regulations.

## **REGULATORY IMPACT ANALYSIS**

The Ministry’s view is that GIC’s levy recommendation meets the requirements of section 43ZZD(2) of the Act, therefore, alternative options for funding GIC for 2012/13 are not available under the present regulatory setting. Accordingly alternative options are not developed in this analysis.

The Ministry has assessed GIC’s recommendation against the three requirements of section 43ZZD(2) of the ACT.

*The levy rate or amount is reasonable, having regard to GIC’s strategic plan, annual report and any Government Policy Statement objectives and outcomes*

GIC’s levy calculation method allocates direct costs to wholesale and retail work streams. The indirect costs are then apportioned on the basis of the direct costs of each work stream. Costs recovered through market fees are deducted from the relevant areas of activity – wholesale or retail. After accounting for amortisation on industry assets, the retail and wholesale levies are then set to recover the allocated costs in each area.

The total retail cost is divided by the total number of installation control points (ICPs), resulting in a “per ICP” retail levy. An installation control point is the physical point of connection of a consumer with the gas distribution network. It is the point at which a gas retailer supplies gas to a consumer.

The total wholesale cost is divided by an estimate of the volume of gas sold, resulting in a “cents per gigajoule” wholesale levy.

The table below shows the levy calculation for 2012/13 based on this methodology. The resulting retail levy is \$6.23 per installation control point per year while the resulting wholesale levy is 1.74 cents/gigajoule. This compares with 2011/12 when GIC required levy revenue of \$3.962 million, comprised of a retail levy of \$5.76 per installation control point per year and a wholesale levy of 1.66 cents/gigajoule. All the proposed levy amounts are GST exclusive.

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.

Levy funding requirement	2012/13		
	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
<b>Total work programme costs</b>	<b>1,972,129</b>	<b>2,691,253</b>	<b>4,663,382</b>
Amortisation on industry assets	(363,804)		(363,804)
<b>Total levy funding requirement</b>	<b>1,608,325</b>	<b>2,691,253</b>	<b>4,299,578</b>
Basis of apportionment	Per ICP	Per GJ	
Number	258,000	155,000,000	
Levy unit	\$ per ICP	Cents per GJ	
<b>Levy rate</b>	<b>\$6.23</b>	<b>1.74</b>	
<b>Projected levy revenue</b>	<b>1,608,325</b>	<b>2,691,253</b>	<b>4,299,578</b>

The Ministry is satisfied that GIC's estimates costs are commensurate with the work programme contained in its strategic plan. The Ministry is satisfied that the strategic plan is sufficiently aligned with GPS objectives and outcomes. The Ministry is also satisfied that the method used by GIC to calculate the levy rate is reasonable.

*The requirements of section 43ZZB to section 43ZZE of the Act are met*

Sections 43ZZB to 43ZZE prescribe the costs that may be met from the levy and various legal requirements that the levy regulations must be satisfied. The Ministry is satisfied that all of the costs that GIC has proposed to cover with the levy are in line with the requirements of sections 43ZZC, and that regulations that GIC has proposed meet the legal requirements of sections 43ZZB to 43ZZE.

*Satisfied that requirements are met*

The Ministry is satisfied that the requirements of section 43ZZD(2) of the Act are met with respect to GIC's levy recommendation. Accordingly, the Ministry recommends that the Minister accept GIC recommendation on its annual levy.

The proposed levy amounts are GST exclusive and are to be paid in monthly instalments.

The regulations will enable GIC to require information from industry participants that purchase gas from gas producers for the purposes of calculating the levy. In cases where an industry participant fails to pay any amount of the levy by the due date, the participant is liable to pay an additional levy of 10 per cent of the amount that was

unpaid on that date. These are the same generic provisions that have applied in past years.

## **Impacts of the Levy**

### *Government*

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

### *Gas suppliers*

Gas retailers and wholesalers will face costs of \$4.299 million for 2012/13 in paying the levy. This represents an 8.5 per cent increase on 2011/12 costs. The administrative costs of paying this levy are assumed to be negligible compared to the levy itself.

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 \$4.299 million represents less than 0.4 per cent of the total annual turnover of the gas industry which is around \$1 billion.

### *Gas consumers (residential)*

The size of the proposed levy is small in comparison with the value of a residential consumers' gas take. Assuming the full pass-through of these levies to end users, an average residential consumer consuming 25 gigajoules per annum will pay a total levy of \$6.67 per annum. This compares to an estimated annual gas bill for that consumer of \$850. The levy thus represents 0.78 per cent of the total gas bill for that consumer<sup>1</sup>.

There is a small risk that there will be enquiries and complaints from consumers about the levy, both to gas retailers and to the Minister.

### *Gas consumers (commercial)*

Assuming the full pass-through of these levies to end users, an average commercial consumer of 1000 gigajoules per annum will pay a total levy of \$23.63 per annum. This compares to an estimated annual gas bill for that consumer of \$10,500. The levy thus represents 0.23 per cent of the total gas bill for that consumer.

---

<sup>1</sup> Refer paragraph 9 of cabinet paper for discussion of cost allocation to market segments.

### *Gas consumers (industrial)*

Assuming the full pass-through of these levies to end users, an average industrial consumer of 1 million gigajoules per annum will pay a total levy of \$17,400 per annum. This compares to an estimated annual gas bill for that consumer of \$7 million. The levy thus represents 0.25 per cent of the total gas bill for that consumer.

## **CONSULTATION**

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 GIC on 18 November 2011. This forum provided industry participants with an opportunity to supply GIC with feedback on priorities for the 2012/13 work programme.

The co-regulatory forum was followed by GIC’s release on 21 December 2011 of a consultation document on the proposed levy regulations. Submissions were received by 2 February 2011 and were generally supportive of GIC’s proposed work programme and the levy rate. Although consumers were part of the consultation process, none made a formal submission.

There was broad industry support for the increase in the levy rate for 2012/13 relative to 2011/12. Submissions were generally supportive of GIC’s proposed work programme and levy, with four of the five submissions indicating that the proposed level of funding is appropriate. The remaining submission stated that it believes GIC should focus on a smaller number of high priorities, but noted that its proposed budget increase is relatively modest.

## **CONCLUSIONS AND RECOMMENDATIONS**

GIC, as the gas sector’s approved industry body, requires annual levy revenue of \$4.299 million to fund its operating costs for 2012/13. This funding will enable it to pursue the Government’s policy objectives for the gas sector. GIC has recommended a levy comprising two components – a wholesale levy and a retail levy. The wholesale levy is 1.74 cents/gigajoule paid on all gas purchased from producers by the buyers of that gas. The retail levy is \$6.23 per installation control point per annum.

GIC’s levy recommendation meets the requirements of section 43ZZD(2) of the Act, therefore, alternative options for funding GIC for 2012/13 are not available under the present regulatory setting. It is therefore recommended that regulations be made requiring industry participants to pay the recommended levy to GIC to fund its operations in 2012/13.

## **IMPLEMENTATION**

Levy payers will continue using similar processes as in previous financial years to pay levies to GIC. Both the retail levy and the wholesale levy are paid monthly. 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:

1. all gas producers; and
2. those gas producers, as described in regulation 5(3), who have purchased the gas from other gas producers.

The retail levy is calculated by GIC using ICP data from the registry which, for each ICP, shows which gas retailer is the responsible retailer, and the ICP status.

An industry participant who fails to pay any amount of any levy under the regulations on or before the date on which it falls due is liable to pay an additional levy of 10 per cent.

This process is well embedded with industry participants and will not impose any substantive additional compliance costs on levy payers.

### **MONITORING, EVALUATION AND REVIEW**

Monitoring of levy payments will be undertaken by GIC. The proposed levy regulations do not overlap with existing regulations. They replace the existing levy regulations which will end on 30 June 2012. As the gas levy regulation is only effective for 2012/13, no review of the regulation is planned.