

# Regulatory Impact Statement

## Gas Industry Company Levy 2016/17

### Agency Disclosure Statement

- 1 This Regulatory Impact Statement (RIS) 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 \$3.913 million of its costs from gas industry participants for 2016/17 (a one per cent reduction from the 2015/16 levy).
- 3 The Minister can accept or reject the GIC's recommendation, but must accept the recommendation if satisfied that the recommendation meets certain requirements in the Gas Act 1992 (the Act). These are that:
  - a. the levy rate must be 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.
- 4 If there are grounds to reject the GIC's levy recommendation, this would require the GIC to re-consult with stakeholders on a new work programme and associated budget, and then make a new recommendation to the Minister. For this reason, this RIS is limited to assessing two options; either accepting the levy rate proposed in the GIC's recommendation or rejecting the levy recommendation.
- 5 The Ministry has assessed the options against the objective of enabling the GIC to deliver on its principal objective, and against the requirements in the Act.

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## Status Quo and Problem Definition

- 1 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>.
- 2 The GIC recovers most (approximately 72 per cent) of the cost of implementing its work programme through a levy on gas industry participants. The rest is recovered through market fees<sup>2</sup> 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.
- 3 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. For the 2016/17 financial year the GIC has recommended the Minister make levy regulations to recover \$3.913 million.
- 4 Table 1 compares the current 2015 and proposed 2016 levy regulations. In particular it shows how the total levy funding requirement is collected through gas retailers via a retail levy (per ICP<sup>4</sup>) and on the wholesale market via a wholesale levy (per gigajoule). Note the proposed levy regulations represent a reduction of less than one per cent from the 2015/16 levy.

*Table 1: Levy funding requirements comparison*

	<b>2015/16 Levy Regulations<sup>5</sup></b>	<b>Proposed 2016/17 Levy Regulations</b>
Retail Levy rate	\$6.97 per ICP	\$6.92 per ICP
Wholesale Levy rate	1.12 cents per GJ	1.15 cents per GJ
Total Levy funding requirement <sup>6</sup>	\$3,916,821	\$3,913,060

## Objective

- 5 The objective of the proposal is to enable the GIC to deliver its principal objective, which is to ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner.
- 6 This objective must be achieved while considering the requirements of the Act. In particular, the levy rate must be reasonable, having regard to the GIC's SOI, annual report, and the objectives and outcomes in the GPS on Gas Governance 2008.

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

<sup>2</sup> Market fees are a contractually-agreed provision to recover actual expenses directly required to administer service provider arrangements and any other expected direct costs related to the monitoring of those arrangements. Current service providers include Jade Software Corporation, Energy Market Services and Core Group.

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

<sup>4</sup> Installation Control Points (ICP) 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.

<sup>5</sup> Gas (Levy of Industry Participants) Regulations 2015.

<sup>6</sup> Both amounts are GST exclusive.

## Regulatory Impact Analysis

- 7 Regulatory analysis identifies two options, which are assessed against certain requirements in the Act, and the overall objective of the GIC to have appropriate funding for its work programme.

### *Option 1: Accept the GIC's recommendation*

- 8 The first option is to accept the GIC's recommendation and make levy regulations to recover up to \$3.913 million in 2016/17. This levy will allow the GIC to deliver on its work programme.
- 9 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.

### *Option 2: Reject the GIC's recommendation*

- 10 The second option is to reject the GIC's recommendation. This would result in the GIC operating without levy revenue from 1 July 2016, relying on revenue from market fees and equity reserves. Both are insufficient to deliver its work programme as its financial reserves would run out in just over two months.
- 11 Rejection would also require the GIC to re-consult with stakeholders on a new work programme and associated budget, and make a new recommendation to the Minister. There is no case to reject the GIC's levy recommendation under the requirements in the Act.

### *Preferred Option: Accept the GIC's recommendation (Option 1)*

- 12 The preferred option is to accept the GIC's recommendation and make the necessary levy regulations. 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).
- 13 Table Two outlines the estimated costs to be recovered under each levy, and the resulting rates, which are an annual retail levy of \$6.92 per customer, and a wholesale levy of 1.15 cents per gigajoule purchased.
- 14 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 workstream. These costs allocated to the retail and wholesale workstreams are net of market fees.
- 15 The levy rate is reasonable because the work programme aligns with government objectives and outcomes for the gas sector, and the estimated total levy funding requirement is based on the cost of delivering that work programme. The levy recommendation is also consistent with the Auditor-General and Treasury's respective guidelines on public sector charging.

Table 2: Detailed 2016/17 levy funding requirements

	2016/17 (\$)		
	Retail	Wholesale	Total
Direct costs	1,125,903	1,247,446	2,373,349
Indirect costs	728,657	811,054	1,539,711
<b>Total levy funding requirement</b>	<b>1,836,000</b>	<b>2,058,500</b>	<b>3,913,060</b>
Basis of apportionment	per ICP	per GJ	
Number	268,000	179,000,000	
Levy unit	\$ per ICP	Cents per GJ	
<b>Levy rate</b>	<b>6.92</b>	<b>1.15</b>	
<b>Projected levy revenue</b>	<b>1,836,000</b>	<b>2,058,500</b>	<b>3,913,060</b>

- 16 The proposed work programme for 2016/17 largely continues existing multi-year workstreams, including 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.
- 17 The GIC's workstreams continue to be balanced between those funded by the retail levy and wholesale levy. The former includes continuing the D+1<sup>7</sup> pilot scheme which, if fully implemented, aims to provide gas retailers with more timely information about their customer's gas usage. The latter includes continuing the Gas Transmission Investment Programme (GTIP)<sup>8</sup>, which aims to ensure gas industry participants and new entrants are able to access transmission pipelines on reasonable terms and conditions.
- 18 Both workstreams outlined have potential efficiency and competition benefits, which reduce costs to consumers. It should however be noted that changing market conditions could significantly influence these workstreams. In particular, the conditional sales of New Zealand's two open access transmission systems, Vector and Maui, to a single buyer, Colonial First State.
- 19 Should the sale of the two open access transmission systems proceed, the GIC would reassess its workstreams, potentially deferring or stopping each as necessary. Under the GIC's current policy, funding would then be re-allocated to alternative workstreams, saved or returned to levy payers at year-end.
- 20 Given the GIC's workstreams remain largely unchanged, the minor changes to the estimate retail and wholesale levy are due to variance in the base assumptions. The increase in the number of ICP's from 265,000 to 268,000 has lowered the annual retail levy rate from \$6.97 to \$6.92. While the decrease in the annual gas consumption from 185 PJ to 179 PJ has raised the wholesale levy rate from 1.12 cents per GJ to 1.15 cents per GJ.

<sup>7</sup> D+1 is a process that sets rules for the fair, efficient and reliable allocation and reconciliation of downstream gas quantities. The term itself refers to a system of allocating gas usage to retailers a day after use.

<sup>8</sup> GTIP is an industry initiative established in 2011 to address transmission capacity issues in the wake of a 2009 announcement by Vector Limited that capacity on its North Pipeline supplying Auckland and Northland, was constrained, and that it was unable to sell any more reserved capacity to retailers.

*Costs imposed on gas industry participants*

- 21 Table 3 provides a summary of the estimated impact of the levy on gas industry participants.

*Table 3: Estimated impact of the 2016/17 levy on gas industry participants*

	<b>Proposed 2016/17 Levy Regulations</b>		
	<b>Residential consumers</b>	<b>Commercial consumers</b>	<b>Industrial consumers</b>
Typical annual usage	26 GJ	1000 GJ	50,000 GJ
Estimated annual gas bill <sup>9</sup>	\$959	\$15,150	\$352,000
Total annual levy	\$7.22	\$18.42	\$581.92
Per cent of total gas bill	0.75%	0.12%	0.17%

- 22 Note 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*

- 23 Gas retailers and wholesalers will face costs of \$3.913 million for 2016/17 in paying the levy. 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.
- 24 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 \$3.913 million represents less than 0.24 per cent of the total annual turnover of the gas industry, which is around \$1.6 billion.

*Gas consumers (residential)*

- 25 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 26 gigajoules of gas per year will pay a total levy of \$7.22 per year. This compares to an estimated annual gas bill for that consumer of \$959. The levy represents 0.75 per cent of the total gas bill for that consumer.

*Gas consumers (commercial)*

- 26 Assuming the full pass-through of these levies to end users, an average commercial consumer of 1,000 gigajoules per year will pay a total levy of \$18.42 per year. This

<sup>9</sup> All dollar amounts in the table are GST exclusive

compares to an estimated annual gas bill for that consumer of \$15,150. The levy represents 0.12 per cent of the total gas bill for that consumer.

*Gas consumers (industrial)*

- 27 Assuming the full pass-through of these levies to end users, an average industrial consumer of 50,000 gigajoules per year will pay a total levy of \$582 per year. This compares to an estimated annual gas bill for that consumer of \$352,000. The levy represents 0.17 per cent of the total gas bill for that consumer.

**Consultation**

- 28 The GIC undertakes extensive consultation each year when developing its levy recommendation as required by the Act. 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 2015. This forum provided industry participants with an opportunity to supply the GIC with feedback on priorities for the 2016/17 work programme.
- 29 The co-regulatory forum was followed by the release of a consultation document on the proposed work programme and levy rates. Seven 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.
- 30 There was broad industry support for the decrease in the levy rate for 2016/17. Submissions generally commented on specific aspects of the proposed work programme and relative work priorities, these comments have been considered by the GIC.
- 31 The Ministry consulted with The Treasury on this paper.

**Conclusions and Recommendations**

- 32 The GIC, as the gas sector’s approved industry body, requires levy revenue of \$3.913 million to implement its work programme for 2016/17. 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 1.15 cents per gigajoule of gas purchased from the wholesale market. The retail levy is \$6.92 per customer.
- 33 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 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 2016/17.

## **Implementation**

- 34 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.
- 35 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.
- 36 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.
- 37 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**

- 38 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 2016. As the gas levy regulations are only effective for 2016/17, no review is planned. The GIC's accounts are audited and tabled in the House annually.
- 39 More broadly, the Ministry will continue to oversee and monitor the activities of the GIC throughout the year. The Ministry meets bi-monthly with the GIC to discuss how projects and other work in the work programme is progressing and any real or potential issues facing the industry. The GIC also provide the Minister and Ministry with quarterly performance reports.