

In Confidence

Office of the Minister Energy and Resources

Chair, Cabinet Economic Growth and Infrastructure Committee

Improving recovery of the gas levy

Proposal

- 1 This paper seeks your agreement to legislative changes that address underpayment of the gas levy. The proposal is to alter who has to pay the levy provided for under the Energy (Fuels, Levies, and References) Act 1989 (the Energy Fuels Act).

Executive Summary

- 2 The gas levy provided for under section 23 of the Energy Fuels Act was established to recover the costs incurred by the regulator for safety, monitoring and information provision activity in relation to the gas industry.
- 3 Ministry of Business, Innovation and Employment (the Ministry) data indicates that not all the gas that should be subject to the gas levy is having levy paid on it. This means a situation exists where a smaller base of firms is bearing the cost of the levy than the apparent intent of the Act, leading to unfair burden of the cost.
- 4 Underpayment on liable gas has arisen due to the increasing complexity of the industry since the legislation was drafted in 1989. Specifically, the issues contributing to underpayment include:
 - 4.1 ambiguity around who is liable for the levy, due to uncertainty about how liability applies to the current industry structure;
 - 4.2 uncertainty about where exclusions to the levy are to be applied; and
 - 4.3 data to the level where liability currently lies (individual wholesale sales), is not readily available or easily utilised for the Ministry to be able to verify levy returns.
- 5 The current drafting of the levy has a primary point of liability (“every person who sells gas to a gas retailer”), and, where that does not occur, a secondary point of liability (“every gas retailer”).
- 6 The proposal is to remove the first point of liability and place all liability at the second point. This will mitigate the issues that exist currently because of the complexity of the levy design and the wholesale gas market. Data at the retailer level is also readily available and more easily able to be utilised to verify levy returns.
- 7 Because it aligns the levy with part of the existing design, the proposal does not require complete modification to the current scheme.
- 8 The proposal will also remove the exclusion where, if less than 10,000 gigajoules is sold by a person or body in a quarter, that gas is exempt from the levy.

- 9 I intend to make this legislative change as part of the Energy Innovation (Electric Vehicles and Other Matters) Amendment Bill (the Energy Innovation Bill) which is currently being considered by the Commerce Committee.
- 10 The Energy Innovation Bill is making other changes to the gas levy that will exacerbate the current concern with the levy. (Specifically, the Bill is expanding the purpose of the gas levy to recover funding for activities undertaken by the Energy Efficiency & Conservation Authority EECA)). The base of firms that is currently bearing the cost of the levy will take on the entire additional burden, unfairly increasing the costs to them, if the levy imposition were clarified and paid by all liable firms, the costs would be shared more widely. Making the changes in tandem is preferable so that the current inequity is not exacerbated.

Background

- 11 The gas levy provided for under section 23 of the Energy Fuels Act was established to recover the costs incurred by the regulator for safety, monitoring and information provision activity in relation to the gas industry.
- 12 This work is undertaken by WorkSafe (and includes gas safety activities) and the Ministry (and includes monitoring of the industry and the dissemination of information, for example, the gas sections in MBIE's quarterly and annual energy publications).
- 13 The gas levy is payable on all piped gas sold quarterly. The levy does not apply to gas sold for use as a feedstock¹, or for the generation of electricity, or to liquefied petroleum gas, or where less than 10,000 gigajoules is sold by a person or body in a quarter.
- 14 Ministry data indicates that not all the gas that should be subject to the gas levy is having levy paid on it. The total amount of gas that should be subject to the levy is estimated to be approximately 80 petajoules per year². However, levy payers are currently only paying the levy on around 31 petajoules of gas per year. At present the gas levy is set at two cents for each complete gigajoule of piped gas sold³. In 2015, the Ministry received \$615,774 from the levy. They should be recovering closer to \$1.6 million.
- 15 The current design of the gas levy applies the levy to "every person or body who or which sells piped gas to a gas retailer". However, where gas has not been subject to a levy at this point, then liability falls to "every gas retailer who sells piped gas". In terms of the supply chain, the primary point of liability is the wholesale selling point, and where there is no wholesale transaction, then liability for the levy arises where the gas is being retailed. (See Figure 1 below.) This latter scenario would occur in situations where, for example, an industry participant who is also a producer or wholesaler sells the gas directly to an end user/consumer.

¹ Feedstock is gas that is transformed or converted into another product (such as methanol) rather than being burned for energy or heat purposes.

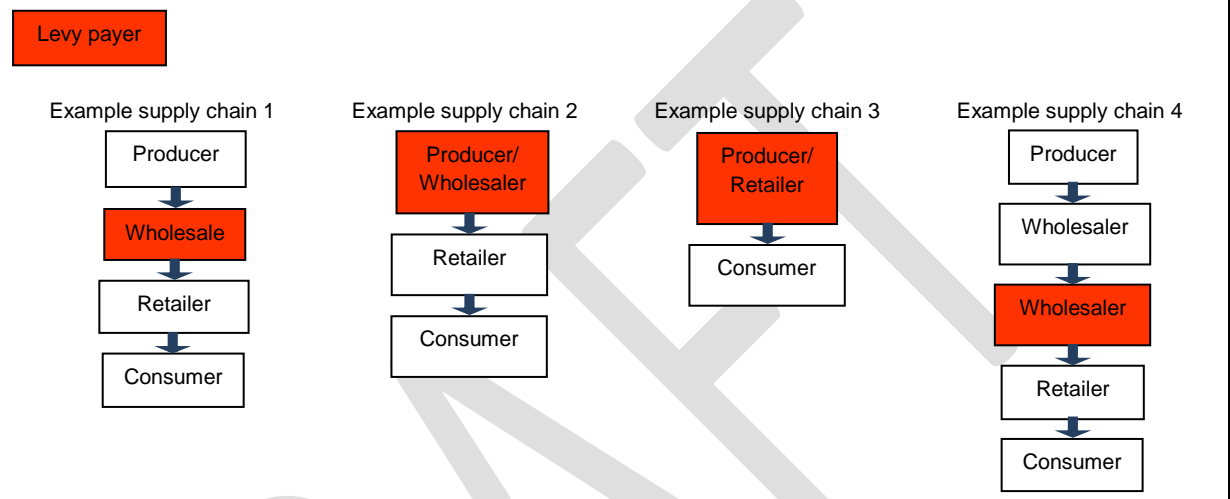
² This was the total amount of gas consumed in New Zealand for energy purposes other than electricity generation in 2015.

³ It is worth noting the levy is a very small cost to the payer; 2 cent per gigajoule is equivalent to 0.002 cents per kilowatt hour of electrical energy.

Figure 1: Current liability for paying the gas levy. The levy applies to “every person or body who or which sells piped gas to a gas retailer”. However, where gas has not been subject to a levy at this point, then liability falls to “every gas retailer who sells piped gas”.

The definition of an entity under the Gas Act 1992 is determined by the role it plays in the supply of gas. In different transactional arrangements the same entity may play different roles and therefore fall within different definitions. It is the role they play in the supply chain for any particular quantity of gas that determines their levy liability in respect of that gas.

The examples below show a variety of supply chains and how the definition of an entity changes depending on their role(s) in the supply chain. Current liability to pay the gas levy is indicated by red shading: In example 2 the producer is selling directly to a retailer, therefore in this transaction the producer is acting as (and is defined as) a wholesaler. In example 3 the producer is selling directly to the consumer meaning they become the retailer in this transaction.



- 16 I believe underpayment on liable gas has arisen due to the increasing complexity of the industry since the legislation was drafted in 1989. Specifically, the point at which the gas is sold to a retailer (the point of liability for the levy) may no longer be entirely clear because gas can be sold multiple times before it is finally retailed. A wholesaler may not know if the gas they are selling is then being on-sold again by a retailer/wholesaler to another retailer⁴.
- 17 This complexity in the supply chain also means current levy payers may not have sufficient information about the end-use of the gas they sell to be able to determine whether that gas can or cannot have an exemption applied (for example, whether the exemption for feedstock applies). Submitters in consultation on this issue reported needing to calculate deductions from payments to other industry participants, and the persistent risk of ‘double counting’ or failure to pass on costs.
- 18 The current drafting and design of the levy with both a primary and a secondary point of liability means there is ambiguity about who the legislation makes liable to pay the levy. The complexity means some parties liable to pay the levy on some sales of gas may not be aware of their obligation (for example producers who are selling gas to end users).
- 19 Finally, the Ministry cannot readily obtain data at the level of individual wholesale sales of gas. Nor would it be able to efficiently utilise this data due to the complexity and volume of sales. This means that under the current design the Ministry is unable to verify levy returns and determine who, or on what gas, payment is not being made.

⁴ For example, it would be almost impossible to accurately capture the transactions of market participants (usually wholesalers) trading on emsTradePoint, the wholesale trading platform for the gas market, as there is no visibility of the counter party to these trades, i.e. who sells gas to whom, and who is a retailer and who is a wholesaler.

- 20 In 2016, Cabinet agreed to expand the purpose of the gas levy, along with the Petroleum and Engine Fuels Monitoring Levy (PEFML) both levied under the Energy Fuels Act, as well as the electricity efficiency levy (levied under the Electricity Industry Act 2010). The purpose is to enable EECA to spread the recovery of its funding across these levies [EGI-16-MIN-0197 refers].
- 21 The changes to the levies are part of the Bill currently under consideration by the Commerce Committee.

Comment

- 22 In February I instructed officials to test with the industry the extent of the issues with the current levy design and to consider if an alternative option would mitigate these issues and improve the operation of the levy and the accuracy of its payment.

Consultation

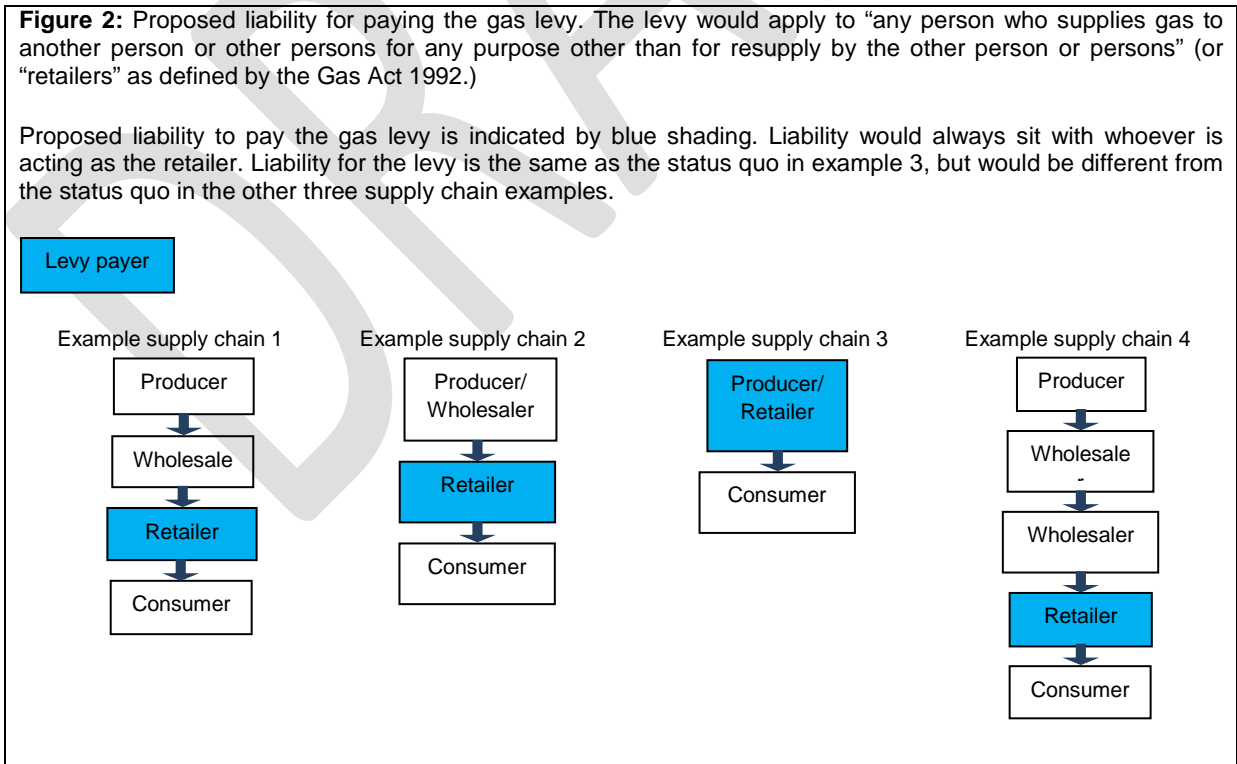
- 23 A consultation paper titled *Who should pay the gas levy? Consultation on which industry participants should pay the gas levy provided for under section 23 of the Energy (Fuels, Levies, and References) Act 1989* was released by the Ministry on 22 February and submissions closed on 6 March.
- 24 The paper set out where current liability for the levy sits, the problem of underpayment, and the issues believed to be causing the problem. It then analysed, against a set of criteria, a range of options for shifting liability for the levy up or down the supply chain, with sub-options that provided other changes to the design of the levy to help mitigate the issues.
- 25 Submitters were generally supportive of the proposal to improve the operation of the levy and the accuracy of levy payment. There was good support for the preferred option of moving liability of the levy from the wholesale selling of piped gas to where piped gas is sold by retailers.
- 26 Specifically this option was supported because:
- 26.1 it is easier for retailers to know if the person they sell the gas to is the end user (or is buying the gas for the purpose of resupply to other persons);
 - 26.2 as they sell directly to end users, retailers would more easily have access to information about what the end user will use the gas for (for example for energy or other purposes which are excluded from the levy);
 - 26.3 levy collection at the retail end of the market increases transparency without imposing real burden on retailers, i.e. most already pay other gas levies such as the Gas Industry Company retail levy.
 - 26.4 this option has a single point of liability which further increases clarity for levy payers as to whether they are the liable participant;

- 26.5 the Ministry has access to data which provides the information needed to verify levy payments (for example information from the Allocation Agent portal and the Gas Registry⁵, and other data from the production end of the supply chain); and
- 26.6 it aligns the levy entire with part of the existing design, therefore it does not require complete modification of the current scheme.
- 27 This option was seen as the best option to improve recovery of the levy because it overcomes the issues that are contributing to the problem.
- 28 Although part of the current obligations, some submitters did raise some concerns about using this approach at the 'upstream' end of the supply chain where, for example, producers sell directly to end users and are therefore acting as 'retailers' under the definitions in the Gas Act.
- 29 One concern expressed was that, in these situations, the producer/retailer may not always know how much gas was actually used by the end user, who may have on-sold the gas or used it for other non-energy purposes.
- 30 My view is that these participants are likely to have much better information than those wholesaling the gas, and, if levy payers place the onus on the consumers to provide evidence where they believe they meet the test for an exclusion, consumers will respond with the information.
- 31 Some submitters questioned why the levy is not just applied directly to the end user, and why the producer/retailer needs to be involved at all. To place liability for paying the levy with end users would significantly increase administrative complexity and cost at the residential and commercial end of the supply chain. Here the majority of submitters agreed that it makes sense for the retailer to pay the levy on behalf of end users.
- 32 Further, it would be difficult to provide a carve-out for where gas is sold by producers to large end users so that the liability would transfer to those large end users. Carve outs can lead to the type of complexity that creates the issues this paper is seeking to address. One of the objectives of the current proposal is to improve clarity about who is liable to pay the levy; to use a single point of liability (i.e: the definition of 'retailer' provided under the Gas Act) provides this clarity.
- 33 Several submitters indicated that their current contractual arrangements may already build the levy into the price agreed for the gas. Thus, changes to the responsible party will either need renegotiation of contracts, or shift costs of the levy from one party to the other without appropriate recourse.
- 34 I appreciate that some renegotiation of contracts may need to be undertaken. However, there are ways for firms to work around this such as carrying over the levy costs to the next contract.

⁵ The Allocation Agent (appointed under the Gas (Downstream Reconciliation) Rules 2008) calculates each retailer's share of deliveries from the shared distribution networks. The Gas Registry (provided for by The Gas (Switching Arrangements) Rules 2008) is a national database kept by the Gas Industry Company that contains information on every point of connection on natural gas distribution networks from which gas is supplied. That information, in conjunction with information published by the transmission owner, identifies consumption by large users and, in most instances, the identity of the retailer that provides supply.

Proposal

- 35 It is inequitable that a narrower base of firms (and consumers, who ultimately pay the levy, assuming it is passed on) bear the cost of the levy while other firms liable for the levy do not. This situation will be exacerbated when recovery of the proposed EECA levy begins; existing levy payers will take on the entire additional burden, unfairly increasing the costs to them⁶.
- 36 The issues creating the underpayment of the levy relate to information barriers caused by changes in market structure (mainly the blurring of distinctions between ‘wholesalers’ and ‘retailers’), which the legislation does not take account of. My view is that a change to the legislation is required.
- 37 I therefore propose that the Energy (Fuels, Levies, and References) Act 1989 be amended to place liability for the gas levy solely at the point in the supply chain where gas is being sold by a person or persons acting as a retailer (as defined under the Gas Act 1992).
- 38 My intention is that the current obligation on those industry participants selling gas to retailers is removed.
- 39 The effect will be to retain the obligation already on industry participants (such as those who identify primarily as producers or wholesalers) where, under the Gas Act definition, they are acting as the retailer for a particular transaction of gas.
- 40 However, it will now apply to all gas (because there will be no question that the levy will not have been collected at another point in the supply chain).



⁶ For example, if the expanded levy is recovered from only 31 petajoules of gas (the present level), then in order to raise the additional \$1.3 million for EECA in 2017/18, the levy rate will need to increase from the current two cents to six cents. However, if the levy recovery was spread across 80 petajoules (the full quantity that should be subject to the levy) then the levy will only need to increase to four cents per gigajoule.

- 41 I also intend to remove the exclusion where, if less than 10,000 gigajoules is sold by a person or body in a quarter, that gas is exempt from the levy. I believe it is fairer if every retailer is subject to same provisions.
- 42 These changes will increase clarity about who is liable to pay the levy, provide a simpler and more transparent system stating when it is to be collected, and allow the Ministry to verify levy returns. This should improve recovery of the levy and increase its fairness.
- 43 I do not intend to pursue retrospective recovery of the unpaid levy amounts. Retrospective recovery would be challenging given that the Ministry does not have all the information necessary to determine who should currently be paying the levy at the wholesale level.
- 44 There is an opportunity to make the change now through the Energy Innovation Bill (currently being considered by the Commerce Committee) where the other levy changes are being progressed. Making the changes in tandem reduces the risk that current levy payers are further inequitably burdened by the expanded levy.

Further measures to improve the accuracy of levy recovery

- 45 One issue raised in submissions on the Energy Innovation Bill was that if any measures were undertaken to improve the accuracy of levy recovery, would this mean the Ministry will be over-collecting the levy in the future. Although over collection is unlikely⁷ the Ministry proposes reviewing the recovery of the levy 12 months after any changes are made and will adjust the rate by regulations if change is required⁸.

Consultation

- 46 Targeted consultation with affected or potentially affected gas industry participants was undertaken. The consultation document was also released on the Ministry's website.
- 47 The following departments and organisations have been consulted on the contents of this paper; The Treasury and the Gas Industry Company⁹. The Department of Prime Minister and Cabinet has been informed.

Financial Implications

- 48 There are no financial implications for the Crown from the proposals.

Human Rights

- 49 There are no human rights issues associated with the proposals in this paper.

⁷ Current budget approved spend for the gas levy funding is a total of \$1.5 million. If, for example, the levy was being recovered on 80 petajoules of gas (the full amount of gas the Ministry believes should be subject to the levy), at the current rate of 2 cents per gigajoule the Ministry would recover approximately \$1.6 million, only slightly exceeding budget approved spend of the funding.

⁸ Changes are already proposed in the Energy Innovation Bill to allow for the rate of the levy to be adjusted in future to reflect approved spend. The Bill removes the rate of the levy from the primary legislation and places it in regulations so that the rate can be amended more easily to reflect approved spend of the funding.

⁹ The Gas Industry Company is the 'industry body' provided for under Part 4A of the Gas Act 1992 to co-regulate the gas industry.

Legislative Implications

- 50 The proposals will require legislative amendments. I plan to include them in the Energy Innovation (Electric Vehicles and Other Matters) Bill currently before the Commerce Committee. I seek your agreement for the changes in time for the Committee to consider them as part of its deliberations on the Bill. If there is not enough time to do this I will make the amendments through a Supplementary Order Paper at the appropriate time.
- 51 The proposed changes will amend the Energy (Fuels, Levies and References) Act and will bind the Crown.

Regulatory Impact Analysis

- 52 The policy initiatives proposed in this paper have been assessed by The Treasury as meeting an exemption from the Regulatory Impact Assessment requirements because they are technical revisions or consolidations that substantially re-enact current law to improve legislative clarity or navigability (including the clarification of existing legislative intent).

Publicity

- 53 I will proactively release this paper and make it available on the Ministry's website. If the amendments are incorporated in the Energy Innovation Bill I will release the paper once the Bill has been reported back to the House. The Ministry will inform and educate the industry about the amended requirements and their obligations in respect to them.

Recommendations

The Minister of Energy and Resources recommends that the Committee:

- 1 **note** that there is underpayment of the gas levy provided for under the Energy (Fuels, Levies, and References) Act 1989;
- 2 **note** that underpayment has arisen due to the increasing complexity of the industry since the legislation was drafted in 1989. Specifically, the issues contributing to underpayment include the current complex design, and lack of ready access to data at the level where liability currently lies to be able to efficiently verify levy returns;
- 3 **agree** to amend the Energy (Fuels, Levies, and References) Act 1989 to place liability for the gas levy solely where gas is sold by a gas retailer (as defined under the Gas Act 1992);
- 4 **note** that this will remove the current obligation on those industry participants selling gas to retailers, and will retain, but expand to all gas, the current part of the levy design that places the levy obligation on industry participants where they are acting as the retailer (under the Gas Act definition) for a particular transaction of gas;
- 5 **agree** to remove the exclusion where, if less than 10,000 gigajoules of gas is sold by a person or body in a quarter, that gas is exempt from the levy, and the person does not need to supply a return for that gas;
- 6 **note** that the purpose of the levy is being expanded by the Energy Innovation (Electric Vehicles and Other Matters) Bill to recover funding for EECA, resulting in an increase in

the levy, the cost of which is only met by some of those liable to pay it if change is not made;

- 7 **agree** to the changes proposed in this paper being considered by the Commerce Committee as part of their consideration of the Energy Innovation (Electric Vehicles and Other Matters) Bill currently before them. Or, if timing does not permit, for the amendments through a Supplementary Order Paper to that Bill;
- 8 **invite** the Minister of Energy and Resources to issue drafting instructions to the Parliamentary Counsel Office to implement the proposals outlined in the above paragraphs;
- 9 **authorise** the Minister of Energy and Resources to make decisions consistent with the policy decisions in this paper on any minor and technical issues that may arise in drafting, including any further minor changes that will improve the operation of the levy.

Authorised for lodgement

Hon Judith Collins

Minister of Energy and Resources