

Cost Recovery Impact Statement

Regulations to set the Gas Industry Company Levy 2019/20

Agency Disclosure Statement

This statement has been prepared by the Ministry of Business, Innovation and Employment (MBIE). It provides an analysis of options to set the rate of the gas industry levy, as provided for under section 43ZZE of the Gas Act 1992.

- 1 This statement provides an analysis of the Gas Industry Company's (GIC) annual recommendation to the Minister of Energy and Resources (the Minister) to make levy regulations to recover up to \$3.77 million of its costs from gas industry participants for financial year beginning 1 July 2019 (ie. 2019/20).
- 2 Section 43ZZE of the Gas Act 1992 (the Act) sets out the basis for the GIC's annual levy recommendation. The levy is principally used to fund the GIC's industry governance activities. Section 43ZZE(3) of the Act requires that the GIC submit a new levy recommendation to the Minister each year.
- 3 As the Act provides that the Minister can only accept or reject the GIC's recommendation, only these two options have been assessed. Further, the Minister must accept the recommendation if satisfied that the recommendation meets certain requirements in the Act. These requirements are:
 - a. the levy rate must be reasonable, having regard to the GIC's Statement of Intent (SOI), annual report, and the objectives and outcomes in the Government Policy Statement (GPS) on Gas Governance 2008
 - b. the GIC has consulted with industry participants on the levy rate or amount
 - 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 MBIE has assessed the two options and have found that the recommendation meets the requirements in the Act and the principle objective of the GIC so, therefore, should be accepted by the Minister.

Sarah Stevenson

Manager, Resource Markets Policy
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Executive summary

- 1 The Gas Act 1992 (the Act) sets out New Zealand’s co-regulatory governance approach to the gas industry with the Gas Industry Company (GIC) being the approved industry regulator since 2004. As set out in the Act, the GIC’s principal policy objective, to which it must give regard when making rules or recommending regulations, is ‘to ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner’.
- 2 To meet the costs of the GIC’s activities in working to achieve this objective, section 43ZZC of the Act provides for the GIC to make a recommendation to the Minister of Energy and Resources on the rate of a levy on industry participants. The activities which may be funded by the levy are set out in section 43ZZC of the Act.
- 3 The levy of gas industry participants has a wholesale component based on the energy quantities of gas, and a retail component that is apportioned based on Installation Control Point (ICP) market shares. For 2019/20, the GIC’s proposed levy rates will meet \$3.77 million of the GIC’s estimated costs. This is a 5.2 per cent decrease from 2018/19. The proposed levy rates are as follows:

Table one: Comparison of retail and wholesale levy rates 2018/19 and 2019/20

	2018/19 rate	2019/20 rate	Change
Retail Levy	\$6.18 per ICP	\$6.12 per ICP	0.97 per cent decrease
Wholesale Levy	1.2374 cents per gigajoule	1.1279 cents per gigajoule	8.85 per cent decrease

- 4 For 2019/20, the GIC estimates the number of ICP’s to grow, but the amount of gas purchased to decline. Coupled with moving to the implementation phase of the Gas Transmissions Access Code (GTAC), this has reduced the need for the GIC to increase the levy rates as levy funded work programme costs have decreased.
- 5 If a new levy is not approved by 1 July 2019, the GIC will be required to rely on revenue through market fees and equity reserve, both insufficient to deliver its work programme.
- 6 The costs imposed on end users are relatively small, approximately 0.67% of residential gas consumer’s annual gas bill. Large industry users, who consume the most gas, pay the bulk of the levy. No costs will be imposed on government as the levy will be paid by gas industry participants and collected by the GIC.
- 7 The Minister must accept the levy recommendation if she or he is satisfied that it meets certain requirements laid out in the Act. MBIE has found that the recommendation meets the requirements of the Act and the objectives of the industry so, therefore, should be accepted by the Minister.

Status quo

Governance of the New Zealand Gas Industry

- 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). Since 2004¹, the Gas Industry Company (GIC) has 'co-regulated' the gas sector by having the power to recommend arrangements to the Minister of Energy and Resources (the Minister).
- 2 The principal policy objective of the GIC is *'to ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner'*. In order for the GIC to meet the costs of its activities in working to achieve this objective, 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 Section 43ZZE(3) of the Act sets out that the levy regulations can only apply to the financial year in which they are made, so new levy regulations must be made every year. The levy, as set out in the Act, has been in place since 2005, and is well understood by industry participants. Only minor adjustments have been made over time.
- 4 The GIC's work programme priorities are set in consultation with industry, and are driven by industry's priorities. A levy applied to industry participants continues to be the most appropriate mechanism to best meet the GIC's costs in achieving the Government's objectives for the gas industry.
- 5 The levy is charged of all industry participants. In practice, the cost of the levy is passed on to consumers. For the 2019/20 year, the GIC expects there to be 285,000 gas consumers (up from 280,000 in 2018/19). Large industry users, who consume the most gas, pay the bulk of the levy.
- 6 The GIC recovers most (approximately 72 per cent) of the cost of its total work programme through a levy on gas industry participants. The other main sources of funding are market fees and an annual fee of \$2,000 (excl. GST) per GIC shareholder.

Levy rates

- 7 The Gas (Levy of Industry Participants) Regulations 2018 set the current rate of wholesale and retail levy rates as follows:
 - a. a retail levy rate is \$6.18 per Installation Control Point (ICP²)
 - b. a wholesale levy rate is 1.2374 cents per gigajoule.
- 8 The GIC estimated that these rates would enable the GIC to collect \$3.98 million for the 2018/19 year. The actual amount that will be collected depends on the accuracy of assumptions underpinning the retail and wholesale levy rates (discussed in the levy methodology section of this document). To counterbalance any levy overpayment, the GIC has a 'wash-up' process for refunding unspent levies to industry participants.

¹ Through the establishment of the Gas (Approval of Industry Body) Order 2004 under the Act.

² Installation Control Points (ICPs) 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.

Cost recovery principles and objectives

- 9 New regulations for the levy of gas industry participants are made each financial year. The levy is the principal mechanism for the GIC to meet the costs of its activities, with section 43ZZC of the Act setting out the activities that the levy can fund. The levy rates and a schedule of levy funded activities are publicly available on the GIC's website.³
- 10 The Act, the GPS on gas governance 2008, and the SOI establish a policy framework within which the GIC makes rules and recommends regulations. The levy is the key financial enabler for the GIC to deliver its principal policy objective as set out in the Act, which is 'to ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner.'
- 11 For the levy recommendation, it must be reasonable, having regard to the GIC's SOI, annual report, and the objectives and outcomes in the GPS. In addition, any levy recommendation made by the GIC must also be consistent with the Auditor-General and Treasury's respective guidelines on public sector charging. Alongside this policy framework, the GIC has developed principles that it uses when developing its annual levy recommendation, attached as Annex One.

The level of the proposed fee and its cost components (cost recovery model)

Proposed levy rates

- 12 The levy has two components:
 - a. A wholesale component based on the energy quantities of gas, underpinned by an estimate of the amount of gas (in gigajoules) that will be purchased in the following year.
 - b. A retail component that is apportioned based on ICP market shares, underpinned by an estimate of the number of active ICP's for the period of the levy.
- 13 For 2019/20, the GIC's proposed levy rates will meet \$3.77 million of the GIC's costs. This is a decrease of \$208,215 (or 5.2 per cent) from 2018/19. The proposed levy rates are set out in table three.
- 14 *Table two: Comparison of retail and wholesale levy rates 2018/19 and 2019/20*

Figures in table GST exclusive where applicable	2018/19 rate	2019/20 rate	Change
Retail Levy	\$6.18 per ICP	\$6.12 per ICP	0.97 per cent decrease
Wholesale Levy	1.2374 cents per gigajoule	1.1279 cents per gigajoule	8.85 per cent decrease

- 15 For 2019/20, the GIC estimates the number of ICP's to grow, but the amount of gas purchased to decline. Coupled with moving to the implementation phase of the Gas Transmissions Access Code (GTAC), this has reduced the need for the GIC to increase the levy rates as levy funded work programme costs have decreased.

³ <https://gasindustry.co.nz/work-programmes/levies/background/previous-levies/levy-fy2018-1-july-2017-to-30-june-2018/>

Table three: Levy funding requirements comparison

Figures in table GST exclusive where applicable	2017/18 Levy Regulations	2018/19 Levy Regulations	Proposed 2019/20 Levy Regulations
Retail Levy rate	\$6.18 per ICP	\$6.18 per ICP	\$6.12 per ICP
Wholesale Levy rate	1.236 cents per gigajoule	1.2374 cents per gigajoule	1.1279 cents per gigajoule
Total GIC Levy funding requirement	\$3,911,481	\$3,982,551	\$3,774,336

Levy methodology

- 16 The recommended levy rate is based on the estimated cost of the GIC's levy funded work programme for the next financial year. The GIC allocates costs between its 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. These costs allocated to the retail and wholesale work streams are net of market fees.
- 17 In years where the GIC's work programme primarily focusses on retail issues, the retail levy rate will increase while the wholesale levy will decrease, and vice versa. This is consistent with the GIC's cost allocation principles (particularly beneficiary pays principle) for the levy.

Assumptions underpinning levy model

- 18 There are two key assumptions underpinning the GIC's 2019/20 proposal:
 - a. The retail levy is estimated based on the number of active ICP's (estimated to be 285,000 for the 2019/20 levy regulations). If the number of active ICP's changes, then this will impact on the amount collected under the retail levy.
 - b. The wholesale levy is charged per gigajoule of gas purchased. The GIC's estimate for gas consumption is 180 petajoules. If the amount of gas decreases or increases, this will impact the amount recovered through the wholesale levy.
- 19 Any overpaid levies will be refunded to industry participants at the end of the financial year through a process the GIC calls a 'wash up.' At the end of the 2017/18 financial year, total refunds of \$397,583 were reimbursed to levy payers.

Primary cost driver – GIC's proposed 2019/20 work programme

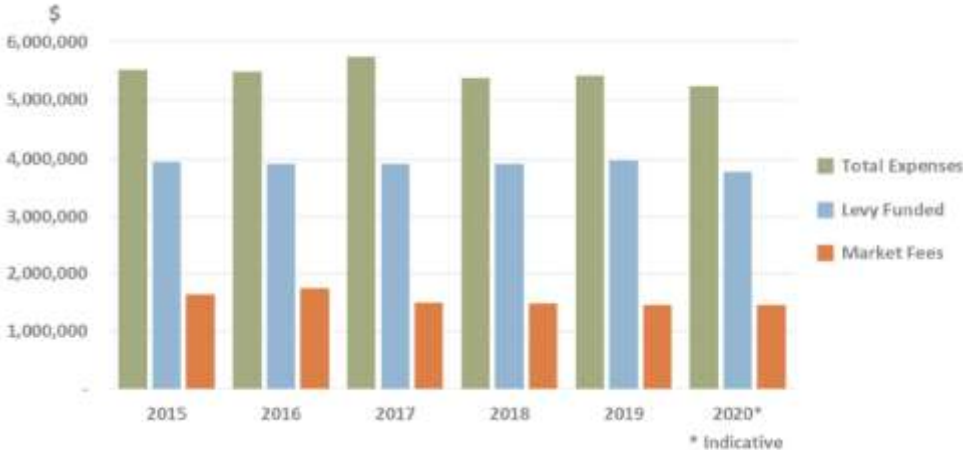
- 20 The proposed work programme for 2019/20 largely continues existing multi-year work streams, including activities to meet statutory requirements (such as the administration of existing gas governance regulations), but also the delivery of key projects to meet government and industry priorities.
- 21 The past three years have dedicated an intense amount of activity to the development of the Gas Transmission Access Code (GTAC), a single transmission access code. This work is expected to continue in 2019/20 with a focus on the implementation of the GTAC to replace the two separate access code arrangements. This task will remain a high-intensity work stream.

- 22 Accordingly, the move to a single code requires changes to other arrangements to address implementation and transition issues. The GIC intends to make refinements to the D+1 Pilot Scheme, begin the process of amending the Downstream Reconciliation Rules and update the Critical Contingency Management Regulations in alignment with the GTAC.
- 23 A work stream has also commenced to address concerns around the asymmetric access to information, particularly regarding upstream activities and outages. The GIC plans to analyse submissions made in an options paper by the end of FY2019 to identify whether an issue exists and if a non-regulated solution is feasible or if regulation is likely to be required.
- 24 The GIC reports how its levy costs and associated work streams are allocated against four strategic objectives. Annex Two provides an overview of how the levies are allocated against each of these GIC's strategic objectives.

Forecasted GIC revenue

- 25 Figure one shows the breakdown of the GIC's funding requirements since 2014/15. The GIC's total funding requirement has remained fairly stable over this time period. Levy funding requirements have remained close to \$4 million per annum, with a slightly lesser \$3.77 million being proposed for 2019/20.
- 26 When added to the Market Fees for year 2019/20 of \$1.458 million, the GIC's total work programme requirements for 2019/20 are expected to be \$5,232,336.
- 27 Between 2018/19 and 2019/20 levy funding requirements have decreased by 5.2 per cent. This is a substantial decrease considering the 1.82 per cent increase in levy funding requirements in 2018/19 compared with 2017/18.
- 28 Annex Three shows the allocation of the levy funding across indirect and direct costs. For 2019/20 the direct costs of the retail levy have increased creating a slightly higher retail levy funding compared with 2018/19. However, a decrease in all other costs results in an overall decrease of required levy funding for 2019/20.

Figure one: Breakdown of the GIC's levy funded and market fees requirements



Impact analysis

- 29 There are, across the industrial, commercial and residential sectors, over 285,000 gas consumers in New Zealand. The impact on all types of consumers by the proposed levy is small when compared to the total amount paid for gas. For example, assuming the levy is passed through to end users, residential gas consumers would each pay around \$6.40 per annum, or 0.67 per cent of their annual gas bill.

- 30 Due to the unique model of New Zealand’s regulatory regime for natural gas international comparisons on the cost of the GIC’s activities are not appropriate.
- 31 The largest consumers of the gas supply in New Zealand (e.g. Methanex New Zealand, Refinery New Zealand) have been consulted on the proposed levy rate and have raised no objections. In terms of residential gas consumers, whilst not direct beneficiaries of the GIC’s work programmes, the expected benefits of these programmes on the gas market will indirectly flow through to end consumers.
- 32 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. No costs will be imposed on government as the levy will be paid by gas industry participants and collected by the GIC.

Overview of costs imposed on industry participants

Table four: Estimated impact of the 2019/20 levy on gas industry participants⁴

Proposed 2019/20 Levy Regulations			
Figures in table GST exclusive where applicable	Typical Residential consumer	Typical Commercial consumer	Typical Industrial consumer
Annual gas usage	25 gigajoules	1000 gigajoules	50,000 gigajoules
Estimated annual gas bill	\$961	\$15,190	\$306,500
Estimated total annual levy	\$6.40	\$17.40	\$570.07
Estimated proportion total gas bill	0.67 per cent	0.11 per cent	0.19 per cent

⁴ There is no “typical” commercial or industrial customer and so these numbers are intended to be indicative only. To provide some indication of the impact on users, the paper assumes a typical annual gas usage of 25 GJ for residential consumers, 1,000 GJ for commercial consumers and 50,000 GJ for industrial consumers. It also assumes an average price of gas of \$38.46 per GJ for residential consumers, \$15.19 per GJ for commercial consumers and \$6.13 per GJ for industrial consumers.

Options analysis

- 33 Consistent with the Act providing that the Minister can only accept or reject the levy recommendation from the GIC, regulatory analysis identifies only these two options.

Option 1: Accept the GIC's recommendation

- 34 The first option is to accept the GIC's recommendation and make levy regulations to recover up to \$3.77 million in 2019/20. This levy will allow the GIC to deliver on its proposed work programme and will enable it to meet the government's policy objectives for the gas sector.
- 35 Without new levy regulations, the GIC will be unable to meet its principal objective under the Act, and the other objectives set out in the Act and the GPS.
- 36 We consider that the levy recommendation is also consistent with the Auditor-General and Treasury's respective guidelines on public sector charging, in addition to being consistent with the GIC's own principles used when determining the levy recommendation, as highlighted in Annex One.

Option 2: Reject the GIC's recommendation

- 37 The second option is to reject the GIC's recommendation. This would result in the GIC operating without levy revenue from 1 July 2019, 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 approximately two to three months.
- 38 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.
- 39 In our assessment, there are not any grounds to reject the GIC's 2019/20 levy recommendation as it has fulfilled its requirements under the Act.

Preferred option: Accept the GIC's recommendation

- 40 Option 1 is MBIE's preferred option as we consider the levy rate reasonable, 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.

Consultation

- 41 The GIC undertakes extensive consultation when developing its levy recommendation each year. The process includes consultation on all aspects of its work programme and the proposed levy rate and amount, consistent with the Act. The GIC engaged with interested stakeholders, including gas industry participants and major gas users.
- 42 The consultation process commenced at the annual Co-Regulatory Forum in November 2018. This forum provided industry participants with an opportunity to supply the GIC with feedback on the 2019/20 work programme, which was reportedly generally positive.
- 43 In December 2018, the GIC released its consultation paper in respect of the proposed strategy, work programme and levy rates. Six submissions were received from industry participants who were broadly supportive of the proposed work programme and levy. Although consumers were part of the consultation process, none made a formal submission.

- 44 Submitters either did not address the proposed levy rates in submissions, or were comfortable with them. Submissions generally commented on specific aspects of the proposed work programme, which were responded to and considered by the GIC.

Conclusions and recommendations

- 45 The GIC, as the gas sector's approved co-regulatory body, requires levy revenue of \$3.77 million to implement its work programme for 2019/20. The GIC has recommended a levy comprising two components – a wholesale levy and a retail levy. The wholesale levy is 1.1279 cents per gigajoule of gas purchased from the wholesale market. The retail levy is \$6.12 per customer (measured through ICP).
- 46 In assessing the options of either accepting or rejecting the GIC's levy recommendation, accepting the recommendation is the preferred option as it ensures the GIC having appropriate funding for its work programme and meeting its principle policy objective.
- 47 It is recommended that regulations be made requiring industry participants to pay the recommended levy to GIC to fund its operations in 2019/20.

Implementation plan

- 48 The proposed new levy regulations will replace the existing levy regulations, which end on 30 June 2019. If approved, the new levy rates will start on 1 July 2019.
- 49 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 and evaluation

- 50 Monitoring of wholesale levy payments will be undertaken by the GIC. 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.
- 51 If the proposal is approved, starting 1 July 2019, 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 each gas producer. Accordingly, gas producers will also provide the total number of gigajoules of gas sold to each industry participant. This allows verification that the levy is being paid correctly.
- 52 The GIC's accounts are audited and tabled in the House annually. The GIC's annual report also outlines achievements and progress for each work stream.
- 53 MBIE will continue to oversee and monitor the activities of the GIC throughout the year. MBIE meets bi-monthly with the GIC to discuss how projects and other work in the work programme are progressing and any real or potential issues facing the industry. The GIC also provide the Minister and MBIE with quarterly performance reports.

Review

- 54 There is a legislative requirement that the GIC make a new levy recommendation to the Minister of Energy and Resources for each financial year. For the 2019/20 financial year, both the wholesale and retail levy rate will be reviewed again and new regulations made. This is set out in section 43ZZE(3) of the Gas Act 1992.

Annexes

Annex One	Decision making principles for setting the methodology and rate of the levy
Annex Two	Comparison of levy requirements across strategic objectives 2018/19 and 2019/20
Annex Three	Comparison of direct and indirect costs of levy

Annex One: Decision making principles for setting the methodology and rate of the levy

	Levy Principle	Description
1	Economic Efficiency	<ul style="list-style-type: none"> The levy structure should promote efficient market behaviour (or at least not detract from it significantly).
2	Beneficiary / Causer pays	<ul style="list-style-type: none"> The costs of regulation development and implementation should be allocated in a way that reflects the cause of regulation (causer pays) and/or the incidence of the benefits from regulation.
3	Rationality	<ul style="list-style-type: none"> Where levies are to recover costs that are allocated to participant classes, there should be a relatively strong logical nexus between the participants on whom a levy is imposed and the costs being recovered through that levy.
4	Simplicity	<ul style="list-style-type: none"> The levy structure should not create undue transaction costs for the organisation which implements and administers it, nor for the participants who must pay it. The levy structure should only consist of as many individual levies as are necessary to recover the costs in an efficient manner, taking account of all the other principles applying. The levy structures should be transparent to industry participants.
5	Equity	<ul style="list-style-type: none"> Users in similar situations should pay similar amounts. Competitive neutrality should be preserved, so that within a class of participants the allocation of costs should not competitively advantage one participant over another.
6	Revenue Sufficiency	<ul style="list-style-type: none"> The levies, together with other sources of revenue such as penalty payments, need to be sufficient to recover the costs borne by the organisation collecting the levy. Levy setting must nevertheless be in accordance with section 43ZZC(3) of the Act, which says that the levy may be adjusted in any year to take account of under-recoveries and over-recoveries in previous years.

Source: Consultation on Gas Industry Co FY2018 Statement of Intent and Levy, Gas Industry Company⁵

⁵ <http://www.gasindustry.co.nz/dmsdocument/5448>

Annex Two: Comparison of levy requirements across strategic objectives 2018/19 and 2019/20

Figures in table GST exclusive where applicable	2018/19		2019/20	
	Wholesale	Retail	Wholesale	Retail
Strategic Objective One Promote efficient, competitive and confident gas markets.	\$0	\$751,438	\$0	\$758,361
Strategic Objective Two Facilitate efficient use of, and investment in, gas infrastructure.	\$1,357,072	\$0	\$1,222,002	\$0
Strategic Objective Three Deliver effectively on the GIC's accountabilities as the gas industry body.	\$803,387	\$902,272	\$723,426	\$910,584
Strategic Objective Four Develop and communicate the role of gas in meeting New Zealand's energy needs.	\$91,692	\$76,690	\$82,556	\$77,397
Total	\$3,982,551		\$3,774,336	

Annex Three: Comparison of direct and indirect costs of levy

Figures in table GST exclusive where applicable	2018/19			2019/20		
	Retail	Wholesale	Total	Retail	Wholesale	Total
Direct costs	\$1,104,807	1,411,232	\$2,516,039	\$1,149,392	\$1,323,229	\$2,472,621
Indirect costs	\$625,593	\$840,919	\$1,466,512	\$596,950	\$704,765	\$1,301,715
Total levy funding requirement	\$1,730,400	\$2,252,151	\$3,982,551	\$1,746,342	\$2,027,994	\$3,774,336
Basis of apportionment	per ICP	per GJ		per ICP	per GJ	
Number	280,000	182,000,000		285,000	180,000,000	
Levy rate	\$6.18/ICP	1.2374c/GJ		\$6.12/ICP	1.1279c/GJ	
Projected levy revenue	\$1,730,400	\$2,252,068	\$3,982,468	\$1,746,342	\$2,027,994	\$3,774,336