



GUIDE TO GAS CAPITAL CONTRIBUTIONS



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1 INTRODUCTION

If your home or business connects, or wants to connect, to Powerco's gas distribution network, we may require you to contribute to some of the costs towards the design and installation of the gas assets. This payment is called a capital contribution or a customer contribution. This guide outlines when you may be required to contribute, the process that is followed and how the amount is calculated. If you need one of Powerco's gas pipelines to be moved, we may also ask you to contribute to the capital costs.

Powerco reviews its policy towards capital contributions annually and this guide is updated on the Powerco website (www.powerco.co.nz) after any changes are made.

If you have any questions about this guide or the process, please contact Powerco's Gas office on 0800 427970.

This guide also contains information required under section 2.4.6 of the Gas Distribution Information Disclosure Determination 2012. Amongst other things, this requires disclosure of Powerco's current policy for determining capital contributions and how the amounts payable for any capital contribution is determined.

2 DEFINITIONS

The following terms are used in this guide and their meaning is provided below.

The Gas Hub is Powerco's gas team and they promote the benefits of natural gas, while providing information to make it easier for people to connect to reticulated gas, via residential and commercial specialists.

Customer Initiated Work, often referred to as Customer Work, means work to construct new assets that will form part of Powerco's network (and be owned by Powerco) and/or work to upgrade, alter or relocate existing Powerco assets for any of the following reasons:

- a) the connection of a new customer to Powerco's network;
- b) the extension of Powerco's network into new subdivisions;
- c) the upgrade of Powerco's network to meet the gas capacity needs for the purposes of:
 - (a) or (b) above, or to meet the gas capacity needs of an existing customer where their load or capacity requirements have increased; and
- d) the moving, relocating, altering or removal of the existing Powerco network for an existing customer or a third party with an interest in the assets.

Customer Contribution is the amount of money a customer must contribute to the Customer Work to enable the work to precede. This is often termed a capital contribution.

Gas Measurement System (GMS) means a combined meter and regulator, which is used to record the quantity of gas being supplied to a customer as well as to reduce the network pressure being supplied to the customer's installation.

Incremental Upgrade Assets means the assets upstream of the Customer Work that would be required to meet the capacity or security requirements for the incremental new load.

New Revenue means additional revenue to Powerco as a result of a new customer connection and/or an upgrade to an existing customer's load resulting in new revenue.

Powerco Investment means the amount of money Powerco is prepared to invest into the Customer Work. This is calculated given the future forecast returns from the development.

3 WHY DOES POWERCO REQUIRE CONTRIBUTIONS FROM CUSTOMERS?

Powerco's gas network is constantly growing as new homes and businesses connect to the network and existing consumers require new assets as their gas demand increases. To be fair to our current gas consumers, who are not increasing their load, we sometimes require a contribution:

- when people need extensions or reinforcements to the gas network that will benefit them but not other users of the network; and
- when people want to connect to the network or increase their load and this requires new assets to be built.

The principal objective of the contribution is to create a price signal to incentivise consumers to assess the cost effectiveness of connecting to the network, or increasing their load versus alternative options that may be available to them. A secondary objective is to share costs reasonably equitably between customers that require new connections or additional capacity and existing customers that require no additional investment.

An alternative approach would be for Powerco to undertake the full investment and recover the additional costs from the consumer as part of regular gas charges over a period of time. However, this approach is not generally practicable for the following reasons:

- the assets built are likely to have a long life (e.g. over 40 years) and it is not reasonable to expect consumers to be locked into a contract for this length of time;
- in practice, charging arrangements need to be reasonably simple and consistently applicable to a large number of customers – it is not usually feasible to tailor charges to individual customers, unless they are very large; and
- how a new connection or new investment will be utilised in the future, and by how many parties, is not always known. In many cases it is not possible to make an accurate calculation of future cash-flows and the return on investment that should be recovered from an individual consumer.

4 WHAT IS THE PROCESS THAT WILL BE FOLLOWED?

If you need a new connection(s), increased capacity or want to move one of our assets, your first point of contact is likely to depend on the amount of gas you (will) consume or the size of the asset being moved. If you are a residential consumer or a small or medium business, your first point of contact should be your gas retailer or the Gas Hub.

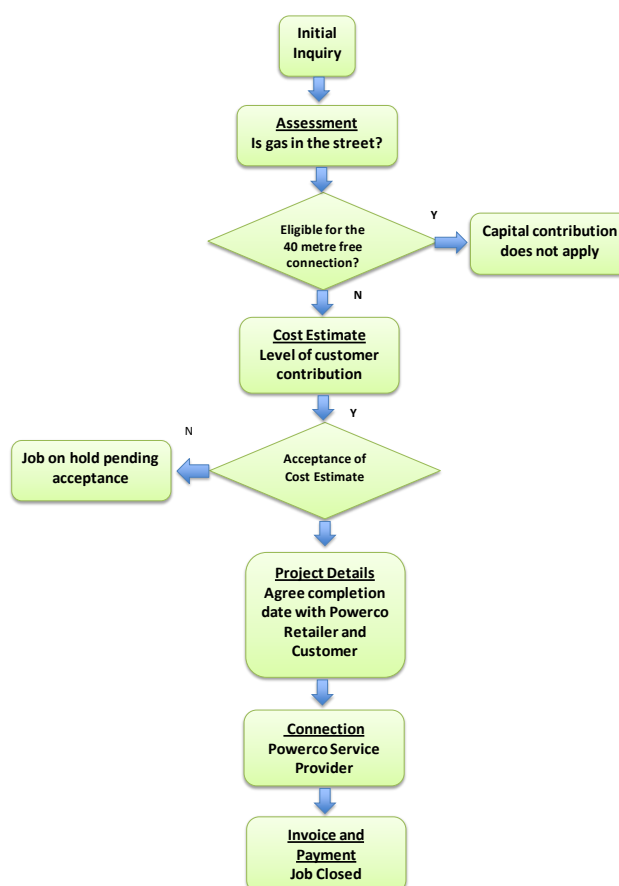
A list of gas retailers is available at <http://www.thegashub.co.nz/its-easy-to-connect/Energy-retailers/>. You may also want to visit the consumer website powerswitch.org.nz to find the best pricing plan for your circumstances.

If you are a larger commercial customer, or require major works, you can contact Powerco directly on 0800 427970, where a Powerco account manager will facilitate and manage the process for you.

4.1 A new residential connection

Households seeking a new gas connection can contact a gas retailer or the Gas Hub. The Gas Hub (www.gashub.co.nz) is a one-stop-shop to help make connecting to gas, finding a retailer and installing gas appliances as easy as possible.

Once you have made an initial inquiry, Powerco will assess your circumstances and provide an estimate of any capital contribution required. The process is described below.



4.2 A new commercial connection

If you are a small or medium business, or a new subdivision with five connections of less, you will follow the same process as residential connections.

If you are a large commercial customer, please contact Powerco on 0800 427970 and a specialist account manager will contact you to discuss your connection requirements. They manage the process for you to make the connection as simple as possible. The process may take longer than a residential connection and may require more investigation by Powerco of the impact of your gas demand on the network. This may require a technical study or design work.

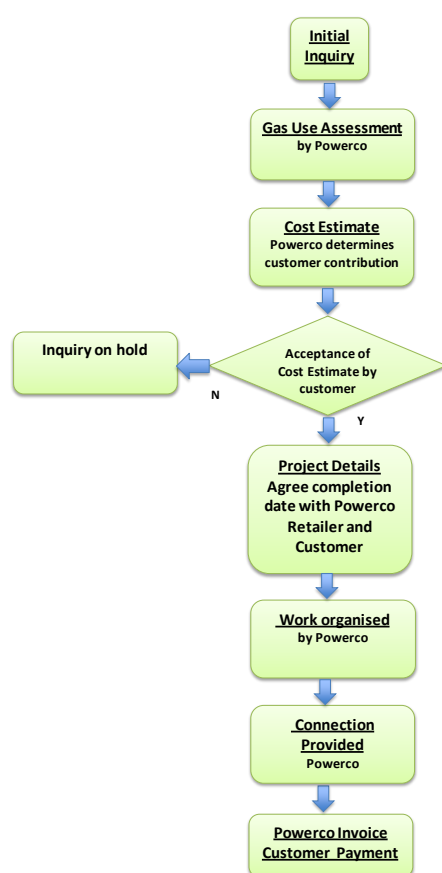
4.3 Extensions, reinforcements, moving of assets or reticulating subdivisions with more than 5 connections

If you are an existing commercial customer, you may already have an existing account manager at Powerco. If you require a major change to your capacity or need Powerco's assets to be moved, contact the account manager in the first instance.

If you are a residential consumer who requires Powerco's assets to be moved, please contact your gas retailer. They will liaise with Powerco on your behalf.

If you are developing a subdivision greater than 5 connections, your surveyor or engineering company may contact Powerco on your behalf. If not, then contact Powerco on 0800 42797.

This process is described below.



5 CAN I USE MY OWN CONTRACTOR?

In the interests of safety, only Powerco's approved personnel can undertake work upstream of the outlet of a gas metering system (GMS). This includes the capping of the riser valve. However, in certain circumstances retailers may arrange temporary isolation of a gas service by closing and tagging the service valve, including capping of the meter outlet if required, but this work must be undertaken by suitably qualified and appropriately certified gas fitters.

6 WILL I HAVE TO PAY A CONTRIBUTION & HOW WILL IT BE CALCULATED?

This section describes the circumstances when you may have to pay a contribution towards work associated with a gas connection. When you apply to connect to Powerco's network, require additional capacity, or request other changes to the network, Powerco will follow the principles below to determine if you need to pay a customer contribution. The application of the principles is discussed in the following sections.

6.1 Principles

1. The level of investment Powerco makes into any Customer Work will be commensurate to the level of return that Powerco will expect to receive as a result of the work, such that:
 - a) New Revenue received from the new customer or existing customer upgrade will provide for Powerco to receive an adequate commercial return on the Powerco Investment into the Customer Work including the Incremental Upgrade Assets after considering the:
 - i. marginal increase in operating and maintenance costs;
 - ii. marginal increase in overhead costs;
 - iii. potential and/or commitment to gas connection uptake (new subdivisions); and
 - iv. the risk of asset stranding.
 - b) The value of the deferment in renewal expenditure as a result of early replacement of existing assets involved in Customer Initiated Work will be determined and accounted for in the analysis.
 - c) The allocation of Incremental Upgrade Assets and cost components will be made using an avoidable cost allocation methodology.
2. New Revenue will only be accounted for once for the life of the Customer Work. Consequently, New Revenue for residential subdivisions will be assigned to the development of the reticulation for the subdivision. For commercial and industrial subdivisions, the New Revenue estimated to be derived from the development will be assigned to the development of the reticulation for the subdivision. If commercial/industrial load requirements subsequently exceed the capacity of the development, this will trigger a new Customer Work, with its own New Revenue attributable to that work.
3. The customer may be required to make a Customer Contribution to the cost of the Customer Work where the level of Powerco Investment does not cover the cost of the Customer Work and the Incremental Upgrade Assets. The Customer Contribution will not exceed the cost of the Customer Initiated Work.
4. Where the need for the Customer Work is shared among a number of customers, the Customer Contribution will be apportioned between those customers based on their projected annual consumption or load requirements.

6.2 Contributions for new residential connections

Powerco's *Gas Distribution Pricing Book* and *GMS Pricing Book* describe the fees Powerco charges for modifications and the charges for new connections. For new connections, the contribution we require depends on the length of the service pipe and associated fittings required to complete the connection; and the nature of the load being connected.

New residential customers who plan to install gas water heating and/or gas central heating will usually qualify for up to 40 metres of service pipe connection from the gas main to either the home or boundary, which ever is applicable¹. Occasionally, the connection may be particularly difficult and expensive to install and we may require a contribution to this cost from the customer. In some circumstances we may only be able to run a service pipe to a property's boundary.

If you do not intend to install gas water heating or gas central heating, please contact the Gas Hub who will discuss your needs. If you require more than 40 metres of service pipe to reach your house gas meter position (as deemed by the gas rules), Powerco will calculate the cost by the method below.

	Total Cost of Customer Work
Less:	Powerco Investment (up to 40 meters free)
=	Customer Contribution (for Customer Work)
Plus:	GST
=	<u>Total Quotation to Customer</u>

Example: A customer has moved into a new home without gas and wants to replace their electric cylinder with instant gas water heating. The consumer has checked www.gashub.co.nz and found there is a gas main in their area, they then contact The Gas Hub on 0508 427 482 to confirm that it is in their street and passing their property. In this example if the house is approximately 20 metres from the road and the consumer is using the gas supply for water heating they qualify for 40 metres of free service pipe. As only 20 metres of service pipe is required, no customer contribution is required.

For more details contact the Gas Hub team via 0508 427 482 or email info@thegashub.co.nz.

¹ Powerco's current Pricing Book Standard Connection offer is 10 metres of free connection, but, is currently extended to 40 metres subject to conditions.

6.3 Contributions for new commercial and industrial connections, extensions and reinforcements of existing connections and reticulating subdivisions of more than 5 connections

The charge for commercial and industrial connections is determined by Powerco using a more detailed methodology. This methodology is also applied if you are an existing customer and need an extension or reinforcement of the network due to an increase in your gas demand.

How Powerco will calculate your contribution is explained below:

1. **Information collection and completion of analysis of impact on network of the new connection:** A range of information needs to be collected in order for us to complete an analysis. This includes information such as the number of new connections needed, the type of gas meter that needs to be installed, the expected life of the assets being installed, the length of service pipe required, if the network will need to be reinforced or extended, the forecast annual consumption of the connection(s), if there will be any salvage value if equipment is reused, and the expected life of the connection (including a risk assessment of the business).
2. **Calculation of the total cost of the Customer Work:** Based on the information above, Powerco determines the new assets required and this is costed based on Powerco's competitively tendered service provision contract. The salvage value of any equipment removed is deducted from this cost.
3. **Powerco Investment:** The amount of money Powerco is prepared to invest into the Customer Work is calculated, based on the cost of customer work and the forecast revenue from the connection and the life of the project. The revenue generated by the new connection is based on a defined period of time, determined by criteria Powerco use to assess a new connection.
4. **Customer contribution level:** The customer contribution required is the amount of capital required to be deducted to ensure the Powerco Investment is greater than the total Cost of Customer Work.

	Total Cost of Customer Work
Less:	Powerco Investment
=	Customer Contribution (for Customer Work)
Plus:	GST
=	<u>Total Quotation to Customer</u>

If your contribution is calculated on a minimum term of connection or minimum annual gas consumption, this will be specified in your contract with Powerco. Powerco may pursue breaches of contract as per our standard commercial operating procedures.

7 WHAT IF I DISAGREE WITH THE LEVEL OF THE CONTRIBUTION?

If you have concerns or questions about the level of the contribution, please contact Powerco on 0800 427970. We will respond to your query with ten working days of receiving the request and provide an explanation about how the contribution was determined.

8 CONSISTENCY WITH COMMERCE COMMISSION PRICING PRINCIPLES

This section discusses the extent to which Powerco's approach to customer contributions is consistent with the Commerce Commission's pricing principles. This section should be read alongside Powerco's Gas Pricing Methodology, which has a wider discussion of Powerco's pricing approach.

The pricing principles are based on economic theory. Powerco considers that we balance a complex mix of factors when considering how the principles should be applied in practice. Our view is that current policy around the application of capital contributions is fully compliant with the pricing principles.

8.1 a) i) Prices are to signal the economic costs of service provision, by being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulation.

8.1.1 Incremental cost

The term "incremental cost" (IC) is defined as the cost of the next additional unit of production and "long run incremental cost" (LRIC) is defined as the cost of providing an additional unit, including, if necessary, the capital cost of increasing the capacity of the network to enable an additional network to be provided. The LRIC may be the present value of the cost of a future addition to the network.

There are two aspects of incremental cost that are relevant to a new connection or increase in capacity. First, there are the direct additional costs that result from the additional assets that are required to join the consumer to the network, or expand capacity. Powerco's approach to capital contributions ensures that this cost is fully covered by the consumer through the contribution they are required to make and their regular gas charge.

Second, there is the incremental cost imposed on the existing network by additional load. This is difficult to evaluate in a meaningful way as much of the time it is zero, meaning that the next unit of gas can be distributed to a customer within the existing capacity of the network.

Once in a while the IC will be a very large number, because the next unit of electricity to be distributed would require additional capacity to be installed. The additional income Powerco derives from the increased consumption may be too low to justify the cost of providing the additional capacity. Our policy is to require the customer who initiates the need for the additional work to pay a share of the cost in proportion to the amount of capacity they require.

8.1.2 Standalone Cost

Cross subsidisation exists when customers pay more for a service than the costs another firm would incur if it served those customers on a stand-alone basis. As Powerco's policy is that customers never pay more than the total costs of customer work, the contribution will always be below the stand alone cost.

8.1.3 Subsidy Free Zone

As contributions are above incremental cost and below stand alone cost, they will be in the subsidy free zone. Powerco's use of a cost of supply model also provides additional reassurance that this will be the case by allocating actual costs of supply to individual price categories. By regularly reviewing the costs of supply and revenue by price category Powerco ensures that our contribution requirements fall within the subsidy free zone.

8.2 a) ii) Prices are to signal the economic costs of service provision, by having regard, to the extent practicable, to the level of available service capacity.

8.3 a) iii) Prices are to signal the economic costs of service provision, by signalling, to the extent practicable, the impact of additional usage on future investment costs.

These two principles essentially reflect opposite sides of the same coin, both requiring that prices should look to the future and be based on long run marginal costs. In essence, prices should be low where future investment is low (and spare capacity exists); and prices should be high where capacity is constrained and investment is needed. The criteria that Powerco take into account when calculating contributions ensures this principle is met.

8.4 b) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable.

The level of capital contribution is likely to directly relate to the cost of the work, and therefore is unlikely to lead to the under recovery of allowed revenues. There is no shortfall that needs to be made up in a manner that has regard to consumers' demand responsiveness.

8.5 c) i) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of consumers in order to discourage uneconomic bypass.

The main risk of bypass of the distribution network is large consumers opting to use a bypass gas network or choosing an alternative energy source. Powerco's practice is to offer non standard pricing and individual account management to industrial and large commercial customers to address the risk of uneconomic bypass and to enable arrangements that are tailored to customers' needs. Powerco's approach to non-standard pricing includes taking into account customers' individual capacity and demand to ensure, to the extent practicable, that the price is cost reflective.

8.6 c) ii) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of consumers in order to allow for negotiation to better reflect the economic value of services and enable consumers to make price/quality trade-offs or non-standard arrangements for services.

For non-standard customers, Powerco is able to offer a service more tailored to their requirements, Powerco continues to consult with these customers through one-to-one liaison with key account managers, in accordance with the Parson Brinckerhoff Associates best practice recommendations.² This works well as large customers are usually familiar with the issues involved in price/quality trade-offs and strong relationships provide a firm foundation for discussing all aspects of quality and price.

8.7 d) Development of prices should be transparent, promote price stability and certainty for consumers, and changes to prices should have regard to the impact on consumers.

8.7.1 Transparency

This capital contributions guide is published on Powerco's website.

8.7.2 Price stability, certainty and impact on customers

The impact on customers of changes to the established allocation methodology is a central consideration in the pricing process. Powerco's capital contribution approach has not changed materially over the last five years; this has helped provide certainty and stability.

Powerco consults with retailers and other customers a number of times throughout the year to discuss all aspects of our pricing approach (including potential improvements). This provides a mechanism to enable customers to communicate any concerns they may have about the impact of prices on them. A description of this process is available on request from Powerco.

For non-standard customers, Powerco continues to consult with customers through one-to-one liaison with key account managers, which provides a channel for discussions of all aspects of quality and price.

² Refer "PBA –Commerce Commission AMP and Consumer Engagement Review, section 6.4.2.2".