

Capital contribution policy

Gas distribution business



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Introduction

Firstgas operates over 2,500 kilometres of gas transmission pipelines (including the Maui pipeline), and more than 5,000 kilometres of gas distribution pipelines across the North Island. Our business continues to play a vital role in supporting industrial, commercial, and residential needs across the North Island.

Firstgas' distribution business services more than 67,000 customers with natural gas. Our networks cover Whangarei, Waikato, Bay of Plenty, the Central Plateau, Gisborne and Kapiti. We are focused on distributing gas across our networks to meet the diverse needs of our customers, be it industrial processes, commercial businesses, or residential customers using gas for their space heating, water heating and cooking needs. We are focused on providing energy choice for consumers, while operating within the regulated price-quality framework set by the Commerce Commission.

Firstgas is part of Clarus which based in Taranaki and one of New Zealand's largest energy groups with businesses that touch many aspects of the energy supply chain including Rockgas, Firstgas and Flexgas.

Purpose of the capital contribution policy

Firstgas is committed to the utilisation of existing assets and providing energy choice for consumers. Our capital contribution policy ensures a fair balance of the costs and benefits between new and existing consumers as the network changes over time.

This document contains information required under section 2.4.6 of the *Gas Distribution Information Disclosure Determination 2012*.¹ This involves disclosing Firstgas' policy for determining capital contributions, and how the capital contribution amount is calculated.

The Commerce Commission's *Input Methodologies*² require that capital contributions received are netted off the value of new assets added to our Regulated Asset Base. This means that new assets only contribute to future revenue requirements to the extent that they have not already been paid for via capital contributions.

The Firstgas distribution capital contributions policy will continually be reviewed in line with changing market and regulatory conditions, with updates available online at [firstgas.co.nz/about-us/regulatory/distribution/](https://www.firstgas.co.nz/about-us/regulatory/distribution/).

Further information

For further information please visit our website www.firstgas.co.nz or contact:

Distribution Commercial Manager

First Gas Limited · 0800 FIRST GAS (0800 347 784) · connections@firstgas.co.nz

¹ Gas distribution information disclosure determine 2012, consolidated as at 3 April 2018, Commerce Commission.

² Gas distribution services input methodologies determination 2012, consolidated as at 3 April 2018, Commerce Commission.

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1. Definitions

Customer work (or works)	The time, materials and resources that go into establishing new network assets, altering or upgrading the existing network or relocating existing Firstgas assets in response to any of the following requests: • The connection of a new customer to the Firstgas network • The extension of Firstgas' network into new subdivisions • The upgrading of Firstgas' network to meet the capacity needs due to new connections, or to meet the gas capacity needs of an existing customer where increased load or capacity is required and/or • Disconnections, relocations, upgrades or alterations of existing Firstgas network for a customer or third party with an interest in the assets.
Capital contribution	The upfront payment required from the customer so that the customer work can be carried out.
Incremental cost	The cost to Firstgas that is incurred because of the customer work. This cost is used in the calculation of a customer's capital contribution.
Incremental revenue	The revenue that Firstgas earns because of the customer work. This revenue is used in the calculation of a customer's capital contribution.

2. When we require a capital contribution

Firstgas require a capital contribution when the cost of connecting a new consumer or undertaking customer-initiated works exceeds the incremental benefit that extension brings to the network. This ensures prices remain subsidy-free and aligned with Commerce Commission pricing principles, with new customers contributing fairly to the cost of customer work. By applying capital contributions in this way, we maintain equity between existing and new consumers, support prudent investment decisions, and help ensure that network development continues to deliver long-term value for all customers.

Firstgas principles

When calculating capital contributions we adhere to the following principles:

- 1) Existing customers should not be made economically worse off (either immediately or in the future) because of the customer work and should benefit overall from new customers sharing existing assets
- 2) The customer's total contribution towards incremental costs includes both the incremental revenue that will result from the customer work and any capital contribution
- 3) The customer requesting the works should contribute a representative amount towards any part of the customer work which will also be of benefit to other customers
- 4) Where the need for the customer works is shared amongst several customers, the capital contribution will be apportioned between these customers based on their projected annual consumption, load requirements, service costs and any other special requirements
- 5) Variations to the cost of customer work should be passed on to the customer where the cause of the variation was within the customer's control
- 6) Firstgas does not pay customers to connect to the network.

3. The contribution calculation process

All connections to our network are assessed using a standard capital contribution formula, shown below.

Equation 1: Capital contribution formula

$$CC = IC - IR \quad \text{as long as } CC \geq MIN$$

where:

- CC is the **capital contribution** (in dollars) where $MIN \leq CC$;
- IC is the **incremental cost** arising from the customer works and determined in accordance with section 4;
- IR is the **incremental revenue** which would result from the customer works;
- MIN is the **minimum capital** contribution determined in accordance with Section 6;

The key components of this formula are explained further below.

4. Determining incremental cost

To determine incremental cost, Firstgas completes an engineering design study to assess the optimal network solution to supply the customer³. When conducting this study, we use best practice industry design principles and select the most efficient network elements available.

Incremental cost includes, but is not limited to, the sum of all:

- 1) Design and compliance/certification costs
- 2) Construction and installation of all network components
- 3) Commissioning and reinstatement costs
- 4) Easements and other property rights
- 5) Estimated ongoing operation and maintenance costs of the new assets and
- 6) Modifications, upgrades, reconfigurations or realignments of existing assets.

Incremental cost can be broken into two broad categories:

- 1) **Direct Assets:** Assets for the sole benefit of the customer and
- 2) **Indirect Assets:** Assets used by multiple customers, either arising from or requiring modification because of the customer's request.

All costs associated with direct assets are applied in their entirety to the customer's capital contribution calculation.

For indirect assets, Firstgas assesses any changes to the timing of expenditure to that in our Asset Management Plan (found [here](#)) due to the request and what additional benefits the expenditure will provide to existing and future customers. A proportional amount of the expenditure on indirect assets is then applied to the incremental costs of the customer's request.

5. Determining Incremental Revenue

Incremental revenue arises from customer works for the following reasons:

- Increased gas consumption
- Increased number of connections or customers

Establishing the value of this revenue requires reasonable assumptions about the number of new customers, their likely gas appliances, usage patterns, timing and the network tariffs that will apply. We will gladly review any detail or information that a customer can offer which may help us to ensure that these assumptions are as accurate as possible. We note however that these assumptions are at Firstgas' sole discretion.

For new residential connections and subdivisions, we have proven assumptions that we will apply where more specific detail is not otherwise available.

For larger commercial and industrial connections, information about the customer's gas appliances, their design capacities and usage patterns is particularly important.

Using the best available information, the above assumptions are combined with projected network tariffs to produce expected annual revenues.

The expected annual revenues are then valued over a reasonable timeframe, which may be the length of a contract, the duration of a known project, a historical average or other estimate of the timeframe over which the customer works will continue to generate incremental revenue.

6. Minimum capital contributions

Minimum capital contributions are used to ensure a fair balance of the costs and benefits of customer work between new and existing consumers. They also incentivise users to design their connection in the most efficient way and encourage greater connection rates in new network areas. The table below outlines the minimum and maximum contributions payable:

Table 1: Capital contribution range: New Connections

Application type	Minimum capital contribution	Maximum capital contribution	Criteria: Further detail in the Appendices
Residential connection: Trench provided	\$1,500 incl GST	\$1,500 incl GST	- Standard connection criteria apply - Trench is compliant and ready on time. - Minimum gas appliances installed. - Max. connection length 20m.
Residential connection: Full construction ≤ 20m	\$2,200 incl GST	\$2,200 incl GST	- Standard connection criteria apply - Minimum gas appliances installed - Max. connection length 20m.
Residential connection: Full construction > 20m	\$2,200 + \$107 per meter incl GST	\$2,200 + \$107 per meter incl GST	- Standard connection criteria apply - Minimum gas appliances installed "Per meter" rate for each meter of connection length after 20m up to 40m.
Residential connection: Non-standard	60% of incremental cost	100% of incremental cost	Subject to individual contribution assessment
Commercial connection	60% of incremental cost	100% of incremental cost	Subject to individual contribution assessment
Industrial connection	60% of incremental cost	100% of incremental cost	- Subject to individual contribution assessment - Non-standard network tariffs may apply

Table 2: Capital contribution range: Other customer works

Application type	Minimum capital contribution	Maximum capital contribution	Criteria: Further detail in the Appendices
Subdivision reticulation	60% of incremental cost of mains extension	100% of incremental cost of mains extension	Subject to individual contribution assessment
Asset relocations	60% of incremental cost	100% of incremental cost	Subject to individual contribution assessment
Capacity upgrades	10% of incremental cost	100% of incremental cost	Subject to individual contribution assessment

7. Elective works

Firstgas only seek a contribution from the customer to cover the incremental costs that arise from the customer works.

When completing the customer works, Firstgas may also elect to modify the network by a greater extent than required to purely service the customer's request.

This is because bringing elective works forward and performing them at the same time as customer works can often achieve significant cost efficiencies that benefit all network users. Elective works are at Firstgas' sole discretion and may include but are not limited to:

- 1) Strategic need to increase the capacity of the network
- 2) Network reinforcement and asset renewal requirements
- 3) Standardisation of equipment
- 4) Realignment of network assets
- 5) Changes to delivery pressure in response to changes in demand.

Firstgas will not seek to recover the costs of elective work from the customer where that work was not required to meet the customer's supply requirements. We consider elective work to be part of our ongoing management of the network and that it should be covered through our general network expenditure.

This exclusion does not apply when a customer requests that we install a larger network asset, or non-standard solution to serve their future requirements. In this case, the full expenditure would relate to the customer's request and would be included in the incremental cost calculation.

8. Saving costs: Dig your own trench

In many circumstances customers can undertake some of the work that would otherwise be included in the incremental costs. For example, this may include providing trenches or other civil work, reinstating areas disturbed during the installation process or the laying of ducts.

If a customer performs the agreed work on a compliant and on-time basis, then the costs of that work will be excluded from the capital contribution calculation.

We encourage customers to provide suitable trenches for use by Firstgas and its contractors, but only where they can do so safely and **have first checked with the beforeUdig service**.

9. Quotes and Variations

For all customer works, Firstgas do not pass on cost overruns unless they have been caused by the customer. This means that customers can proceed with confidence on the quote they receive, knowing that what they have been quoted is what they will need to pay.

There are however some scenarios where Firstgas will seek recovery of additional costs from the customer. These are outlined in the agreement that customers receive as a part of their application, but for example recoverable costs (variations) may arise from:

- A customer's trench being non-compliant or not available for use by Firstgas on time
- Rework resulting from damage to Firstgas assets caused by a customer or their contractors
- Relaying or relocating pipe because the finished ground level is lowered by a customer or their contractors
- Changes to the agreed scope of works including for example changes to pipe lengths, gas demand, meter or pipe locations, depths, types or number of connections

10. Consistency with the Commerce Commission pricing principles

This section details how Firstgas' capital contributions policy is consistent with the Commerce Commission's pricing principles, as per clause 2.5.2 of the Gas Distribution Services Input Methodologies Determination, part 1 subpart 5. For ease of reference, the IM principles have been quoted in italics below. For a greater understanding of how Firstgas has developed our pricing approach to be compliant with these principles, please also see our Pricing Methodology.

Definition of Pricing in the context of the IM principles

Firstgas considers the definition of 'Price' as it relates to the pricing principles to refer to both our network tariffs and capital contributions. When assessing consistency with the pricing principles Firstgas therefore considers the combined effect of tariffs and capital contributions on consumers. This is consistent with 3.3.1(4) of the Input Methodologies Determination and is reflected in the methodology used to calculate capital contributions given above.

Principle and Firstgas response

2.5.2 1) (a) *Prices are to signal the economic costs of service provision, by being subsidy free, that is, 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*

The capital contribution calculation and associated minimum capital contributions ensure that prices are always greater than or equal to incremental costs. The practical effect of this approach is that new customers added to our networks contribute towards shared network costs and growth which makes all consumers better off.

(b) *Prices are to signal the economic costs of service provision, by having regard, to the extent practicable, to the level of available service capacity; and*

(c) *signalling, to the extent practicable, the effect of additional usage on future investment costs.*

Firstgas takes impact on future expenditure (either change in scope or timing) into account when calculating the Incremental Cost to ensure this principle is met.

For residential and small commercial connections, where the peak demand is low, no modelling is conducted in most cases as small organic growth is an underlying feature of utility networks and is managed through the asset management planning process. For larger loads, and substantial subdivisions, the impact on peak demand is assessed and reinforcement considerations are included in the calculation of incremental costs when required.

2.5.2 2) *Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall is made up by prices being set in a manner that has regard to consumers' demand responsiveness, to the extent practicable.*

The capital contribution methodology described in this document ensures that new customers make an appropriate contribution towards shared network costs while reflecting their willingness to pay for network services over time.

2.5.2 3) (a) *Provided that prices satisfy 2.5.2 (1) above, prices are responsive to the requirements and circumstances of consumers in order to discourage uneconomic bypass*

We acknowledge that new customers have choices when considering energy solutions and we assess our policies against these alternative solutions. One category of bypass risk is for large customers who may opt to use a bypass gas network or choose an alternative energy source. Firstgas' practice is to offer non-standard pricing and individual account management to industrial and large commercial customers to address any risk of uneconomic bypass and to enable arrangements that are tailored to customers' needs. Firstgas' approach to non-standard pricing includes considering customers' individual capacity and demand to ensure that the agreed price is cost reflective.

- (b) *Provided that prices satisfy 2.5.2 (1) above, prices are responsive to the requirements and circumstances of consumers in order to allow negotiation to better reflect the economic value of services and enable consumers to make price/quality trade-offs or non-standard arrangements for services.*

Firstgas offers a non-standard pricing arrangement which allows for negotiation on prices by large customers.

- 2.5.2 4) *Development of prices is transparent, promotes price stability and certainty for consumers, and changes to prices have regard to the effect on consumers.*

Firstgas consults with retailers and key stakeholders when adjusting prices. We continue to make improvements to our pricing methodologies, documentation and public disclosures in the interest of keeping these disclosures understandable for consumers and to reduce complexity. When considering changes to our capital contribution policy, we consider it important to avoid significant step-changes in any minimum contribution or calculation assumption to avoid disruptions to market confidence.

Appendix 1: Developer contributions

Firstgas sees the new home market as a significant contributor to economies of scale on our networks. Working closely with the development community creates opportunities to reduce capital expenditure via open trench construction methodology while also securing commitment to connections and thereby reducing commercial risk and improving network efficiency.

When assessing the capital contribution applicable to the developer from any new subdivision investment, we consider:

- Project capital costs
- Expected uptake rates, including phasing over years
- Average usage per connection
- Construction methodology, particularly pipe placement and surface cover types
- Whether laterals and open trench or ducting are available, and the viability of using these in the final install
- Average connection cost and
- Target revenue per residential connection.

To ensure that we do not recover two capital contributions for the same connection, connection costs are excluded from the capital contribution calculation as it applies to the developer

Appendix 2: Residential new connections

Many factors can influence the cost of connecting a new customer to our network. We have created our capital contribution policy in a way that means standard rates can be applied to most new connections. Some connections will provide more unique challenges or third-party costs that are outside of our control and these costs will be included in an individual contribution assessment.

Standard Connection Criteria

New residential customers will often qualify for a 'standard' connection. The following criteria apply to all standard connection types:

- Customers must be installing either gas water heating and/or gas central heating
- There must be an existing polyethylene (PE) gas main within a maximum distance from the meter location (see below)
- None of the non-standard connection criteria are applicable (see next section)

The above criteria apply to all standard connections, together with the additional individual criteria as follows:

1. Trench provided

- The distance from the gas main to the meter location is equal to or less than 20m
- The trench provided meets the technical criteria provided by Firstgas
- The trench is ready on time as scheduled with Firstgas

2. Full construction ≤20m

If the customer chooses not to provide a trench, or if a trench is not suitable, Firstgas can use other techniques to 'thrust' or 'drill' the connection between the gas main and the gas meter, which minimises the digging that is required. These connections are known as 'full construction' and are considered standard where the following applies:

- The distance from the gas main to the meter location is equal to or less than 20m
- There are no substantial underground barriers or other complications that would impede the drilling or thrusting technique
- The connection is on a Firstgas Distribution network in the Bay of Plenty, Waikato, Gisborne, Kapiti Coast or Taupo regions

Please note: Due to the nature of underground rock formations in Whangarei and the difficulties experienced with drilling and thrusting there, Firstgas is not able to offer the full construction option as standard in this region.

2. Full construction >20m

Firstgas can complete some standard full construction connections where they are longer than 20m but less than 40m, where the following applies:

- The distance from the gas main to the meter location is more than 20m but less than 40m
- There are no substantial underground barriers or other complications that would impede the drilling or thrusting technique
- The connection is on a Firstgas Distribution network in the Bay of Plenty, Waikato, Gisborne, Kapiti Coast or Taupo regions

Non-standard connection criteria

Not all homes are mains-fronted by gas and some works may require additional resources, techniques or have other complications meaning that the connection is non-standard and the capital contribution needs to be individually assessed. We may assess a connection request as non-standard because we need to:

- Connect to or modify a gas main that is made of steel
- Run a gas service under a road or provide traffic management
- Extend the gas main so that it is in front of the property
- Reinstate specialty areas or hard surfaces (including concrete)
- Drill through difficult ground conditions
- Follow complex pathways with multiple turns or significant changes in ground level
- Complete a connection that is longer than 40m from gas main to gas meter

In some rare instances a gas connection may simply be infeasible because of location, access, safety or technical reasons and we can discuss alternative solutions with you.

Low users

For customers not opting to install either gas hot water or gas central heating (or an equivalent load), the incremental revenue may be minimal and customers should expect that the capital contribution required will closely reflect the incremental costs.

If you are not looking to install gas water heating or gas central heating, please contact us to discuss your requirements. There are other energy options and we aim to get the right solution for you. We can be contacted at firstgas.co.nz, connections@firstgas.co.nz or on 0800 NEW GAS (0800 639 427).

Appendix 3: Relocations, disconnections and upgrades

Please note that customers should discuss these requirements with their **gas retailer** directly, as most capital contributions for **upgrades, disconnections** and **relocations** will be made to the customer by their energy retailer.

1. Disconnections

A set contribution applies for standard PE disconnections, however the complexity of some disconnections, including steel disconnections requires that we assess each instance individually. Non-standard disconnections are those that have unique site characteristics such as significant traffic management or methodology requirements.

- Polyethylene (PE) pipe disconnections are \$500 + GST
- Non-standard and/or steel pipe disconnections are priced on application.

2. Relocations

We pass on a minimum of 60% of the incremental costs for relocations through the capital contribution process. Contributions will be calculated based on the incremental revenue associated with relocation work.

3. Upgrades

When considering significant new natural gas appliances, please speak to your retailer first. Sometimes this additional load will mean either your gas service, meter, or both will need to be resized. If your service needs to be upgraded to allow for a larger gas load, we will model the cost of the work against the additional revenue, using the contribution calculation detailed in this policy.

If you have a current gas connection and want any network action done – relocation, reconnection, upgrade or disconnection – talk to your energy retailer and they will facilitate this process for you. If you do not know who your gas retailer is, please contact us and we will be happy to help.

Questions and concerns around the contribution amount

For all questions and concerns, get in touch with on 0800 FIRST GAS (0800 347 784), email connections@firstgas.co.nz, or visit <http://firstgas.co.nz/about-us/regulatory/distribution>. If you are already a gas user, you can also talk to your gas retailer.