Policy for determining capital contributions on Vector's gas distribution network

From 1 May 2025

Pursuant to:
Gas Distribution Information Disclosure
(amendments relate to IM Review 2023)
Amendment Determination 2024

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1. Introduction

1.1 This document describes Vector's policy for determining capital contributions and meets the requirements of clause 2.4.6 of the Gas Distribution Information Disclosure (amendments relate to IM Review 2023) Amendment Determination 2024[1].

1.2 Vector provides gas distribution services to consumers via its gas distribution network covering the Auckland region. Vector recovers the cost of providing gas distribution services to existing consumers through gas distribution prices, including published standard prices and in a limited number of circumstances non-standard prices. Vector's distribution prices are set with reference to the Commerce Commission's Pricing Principles[2] (see Appendix A).

1.3 A key feature of gas distribution networks is that many of the assets used to supply consumers are highly interconnected, so many of the assets are used by many consumers. The way the network of assets has been built up over time is something that Vector now has limited ability to change, however Vector is able to determine present and future investment decisions in its gas distribution network.

1.4 Vector's distribution prices are designed, in line with Pricing Principles published by the Commerce Commission, to efficiently recover the cost of the existing gas distribution network and send efficient signals to users when new investments may be required.

1.5 Vector's distribution prices are set to recover the costs of owning and operating the gas distribution network as it currently exists. The most significant cost element reflected in Vector's distribution prices relates to physical gas distribution assets, for example the pipes, valves and pressure reducing stations. These assets are part way through their useful life, meaning their carrying value is only part of that of equivalent new assets. This means that Vector's distribution prices are lower than they would be if the assets were new or, in other words, the existing distribution prices may be insufficient to recover the full cost of a new investment in the network.

1.6 To send the right price signals to consumers and ensure new investments in the network are as efficient as possible, consumers should be charged for the full or proportionate cost of those assets (new and existing) they will be using. However, Vector's distribution prices are only sufficient to recover existing shared assets and their enhancement, so Vector uses capital contributions to recover the cost of new connections / sole use assets and the enhancement of existing connections / sole use assets (referred to in this policy as "the Services").

1.7 Vector directs its capital investment primarily at the enhancement and expansion of the shared assets that benefit all consumers. As Vector's capital resources are limited it must prioritise its expenditure. Consequently, investing in assets that are for the connection or sole use of a new or existing consumer would result in existing consumers helping to fund these connection and sole use assets. Vector therefore requires applicants to fund connection and sole use assets directly via capital contributions.

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[1] https://comcom.govt.nz/__data/assets/pdf_file/0028/363376/Gas-Distribution-Information-Disclosure-amendments-related-to-IM-Review-2023-Amendment-Determination-2024-red-lined-version-27-November-2024.pdf

[2] The Pricing Principles are specified in clause 2.5.2 of the Gas Distribution Services Input Methodologies Determination 2012 (Consolidated April 2024)

1.8 Furthermore, there is significant uncertainty over the future operating environment for gas distribution businesses in New Zealand. This uncertainty is influenced by New Zealand's targets for net-zero carbon emissions by 2050, combined with a shortage of upstream gas supply. Recently, declining gas volumes have been observed, along with a slowdown in new connections and consumers disconnecting from the network. Therefore, it is important that the costs of the Services are recovered upfront from those who trigger the costs to be incurred. This approach reduces asset stranding risk and ensures that remaining consumers are not burdened with higher costs as the number of consumers decreases over time.

1.9 Capital contributions typically take the form of an upfront one-off payment with respect to the Services.

1.10 The Input Methodologies require that capital contributions received are netted off the value of the commissioned assets added to the Regulatory Asset Base (RAB). This means that assets resulting from the Services only contribute to future revenue requirements to the extent they have not already been paid for via a capital contribution. This ensures that no cross subsidy is provided from existing consumers to the applicant for the Services.

1.11 This document sets out Vector's policy for determining such capital contributions.

2. Objectives of the capital contribution policy

2.1 Vector's capital contribution policy has been developed with the following objectives:

(a) The Services should not make existing consumers worse off either now or in the future.

(b) Ideally, the addition of a new connection should benefit existing consumers as the new connection should contribute towards shared costs and assets via distribution prices.

(c) The Services' costs should be determined using a "but for" or avoidable cost approach that identifies the costs attributable to the Services.

(d) Capital contributions should incentivise improved utilisation of the gas distribution network and not incentivise inefficient construction (for example: over-sized network assets).

2.2 Vector considers that the capital contribution policy and its implementation as detailed in this document achieves these objectives for the following reasons:

(e) Objective (a) is achieved as existing consumers do not subsidise or contribute to the Services except to the extent that existing consumers derive a benefit from those additional assets.

(a) Objective (b) is achieved as new connections contribute to and benefit from the overall existing and future shared assets through Vector's distribution pricing, including the ongoing maintenance and enhancement of Vector's interconnected distribution system. This is of benefit to all consumers, both present and future.

(b) Objective (c) is achieved as Vector assesses and recovers the Services' costs directly from the party receiving the services; "but for" the services no investment would be required by Vector. From Vector's perspective the investment is avoidable.

(c) Objective (d) is achieved as Vector only provides the Services as agreed with and required by the applicant. Vector's capital investment is in assets for the shared use of all consumers. Vector seeks to invest appropriately through time to ensure a reliable and resilient network is provided to existing consumers and is accessible to new connections and consumers.

3. Circumstances for requiring a capital contribution

3.1 Vector requires the party requiring the Services to pay a capital contribution when those Services are required. The capital contribution would include the Services' costs and in some instances other costs that would be avoidable from Vector's perspective, but for the applicant's requirements.

4. Methodology for determining the amount of a capital contribution

4.1 Vector has developed its capital contribution policy to meet the objectives outlined in section 2. Vector has achieved this by:

(a) Adopting an approach so that the Services' costs are 100 percent recovered by the capital contribution. This avoids cross subsidies from existing consumers to the applicant for the Services and allows existing and new connections access to the shared network assets on an equivalent basis;

(b) Developing approaches to identify the Services' costs and including these costs in the determination of capital contributions; and

(c) Ensuring the Services' applicants have financial incentives (through capital contributions) to assess carefully the technical requirements of the Services relevant to them so that efficiently sized assets are provided.

5. Determining cost

5.1 Avoidable or incremental costs are the costs that would be incurred by Vector from augmenting the gas distribution network which Vector would not otherwise face 'but for' the requirements of the applicant for the Services. Avoidable cost may relate to:

(a) Assets for use only by the Services' applicant and the associated costs; and

(b) Wider system assets used by the Services' applicant as well as other consumers and the associated costs (shared costs).

5.2 Avoidable cost may include but are not limited to the following:

(a) Design and certification costs;

(b) Any costs for conducting a tender process for the applicant;

(c) The costs of procuring materials and services, building, constructing and commissioning assets;

(d) Any legal or administrative costs, including procuring appropriate easements, statutory consents and negotiating suitable contractual arrangements;

(e) Augmentation of existing assets to provide what is required by the applicant;

(f) The cost relating to changes in the timing of planned shared gas distribution network investment in order to provide what is required by the applicant; and

(g) The incremental cost of the consumption of existing capacity, capital expenditure necessary for growth over the long term and the effect of additional usage on future investment costs.

5.3 Where the avoidable cost relates to shared costs, Vector determines the avoidable cost with reference (but not limited) to:

(a) Changes in the timing of capital expenditure compared with Vector's Asset Management Plan3 on a 'but for' basis; and/or

(b) The applicant's allocated share of the actual capital expenditure in shared costs required to provide the Services; and/or

(c) The applicant's allocated share of upstream augmentation.

6. Extent of consumer connection, sole use cost and non-consumer related augmentation

6.1 Vector may elect to augment the gas distribution network to a greater extent than required by the applicant of the Services. This may arise due to the economies of scale of installing new gas distribution network infrastructure.

6.2 Subject to 6.4 the Services' costs will only include those costs necessary to provide the gas distribution services requested by the applicant at the least cost and technically acceptable standard (as determined by Vector). The capital contribution required to be paid by the applicant does not include the costs referred to in 6.1.

6.3 If the applicant requests assets of a higher standard or more costly nature than Vector considers necessary, then the avoidable cost may include the greater costs (if any) that may result.

6.4 Where an applicant's requirements fall between the capacity of two standard size network elements capable of meeting such requirements and Vector installs the larger of the two, this does not constitute Vector electing to perform the work to a higher standard or capacity.

[3] Vector's Asset Management Plan is available at https://www.vector.co.nz/about-us/regulatory/disclosures-gas/gas-asset-management

7. Capital contributions for projects by other infrastructure owners

7.1 Vector may apply different methodologies for determining capital contributions for projects involving other infrastructure owners such as territorial authorities or government-owned entities which are covered by other legislation and regulations that would dictate how the capital contribution is determined. This reflects the potential for cost reductions which arise due to coordination of works by the different infrastructure owners.

8. Adherence to pricing principles

8.1 Vector's capital contribution policy is consistent with the Pricing Principles published by the Commerce Commission in the Input Methodologies. These are included in Appendix A.

8.2 Charging an applicant costs equal to the avoidable costs should ensure that any capital contribution falls within the subsidy free range (equal to or greater than incremental costs, and less than or equal to standalone costs). To the extent avoidable cost is greater than stand alone cost then Vector may negotiate with the applicant to mitigate against uneconomic bypass.

8.3 Vector's distribution prices recover the costs of the existing gas distribution network and a portion of investment and enhancement of shared assets that are to the benefit of all consumers. Vector's capital contribution policy means that capital contributions recover avoidable costs. These two mechanisms combined ensure that allowed revenues are fully recovered. As a consequence, Vector has not considered revenue under-recoveries in this contribution policy.

9. Use of independent contractors

9.1 In some circumstances the applicant may undertake some of the work that would otherwise be covered by the capital contribution. Vector may allow the applicant to undertake the preparatory work using appropriately trained and qualified personnel familiar with Vector's standards and requirements prior to Vector installing new gas distribution infrastructure. Preparatory work includes, by way of example, trenching and / or civil work, reinstatement and laying of duct. Depending on the circumstances Vector may also allow the applicant to install the new gas distribution infrastructure.

9.2 If the applicant performs some of the Services work, then the costs associated with this work will be excluded from the costs used to determine the capital contribution. They will also be excluded from the RAB and hence the determination of distribution prices.

10. Definitions

Applicant means any person who applies for the Services and may include a consumer.

Augmentation means the expansion, upgrade, increase, addition to, removal, relocation or enhancement of any part of the gas distribution network which would not otherwise be required but for works required to meet the applicant's requirements. Augmentation may include the allocation of extant spare capacity (i.e. prior augmentation) to a new connection service.

Avoidable cost means the costs determined in accordance with section 5.

Capital contribution means money or the monetary value of other consideration to be charged to or received from an applicant for the purposes of Vector providing the Services, and is separate from any ongoing revenue from distribution prices.

Capital contribution policy means the document that outlines the policy or methodology for determining capital contributions. Vector's current and previous capital contribution policies are available at https://www.vector.co.nz/about-us/regulatory/disclosures-gas/capital-contributions.

Connection and sole use assets mean assets connected to the network for use by only one connecting consumer in order to receive gas distribution services.

Consumer means any person who is supplied, or who applies to be supplied, with gas, as defined in the Gas Act 1992.

Distribution prices means Vector's standard published prices and non-standard prices for the provision of gas distribution services.

Enhancement means the same as augmentation.

Gas distribution network means the Vector owned works that are used or intended to be used by Vector to provide gas distribution services.

Gas distribution services means the provision of gas distribution services as defined in the Commerce Act (Gas Distribution Services Input Methodologies Determination 2012 (consolidated 23 April 2024)).

Input Methodologies means the Gas Distribution Services Input Methodologies Determination 2012 (consolidated 23 April 2024) [4].

RAB means Vector's regulatory asset base, in respect of the gas distribution network.

Shared assets mean a network asset used by more than one consumer in order to receive gas distribution services.

Shared costs mean the costs associated with shared assets.

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[4] https://comcom.govt.nz/__data/assets/pdf_file/0028/59716/Gas-Distribution-Services-Input-Methodologies-Determination-2012-consolidated-as-of-23-April-2024.pdf

The Services mean:

- a new connection;
- a new sole use asset;
- an enhancement to an existing connection; and/or
- an enhancement to an existing sole use asset.

This includes any combination of the above and, for the avoidance of doubt, applies in both the singular and plural.

The Services' costs mean the costs associated with providing the Services.

Vector means Vector Limited and its related companies (as defined in the Companies Act 1993).

Appendix A Pricing principles

(1) Prices are to signal the economic costs of service provision, by-
  (a) 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;
  (b) 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.

(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.

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

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