GasNet Limited

Pricing Methodology

Gas Distribution Network

Valid from 1 October 2012 to 30 September 2013

Pursuant to:
Gas Distribution Information Disclosure Determination 2012

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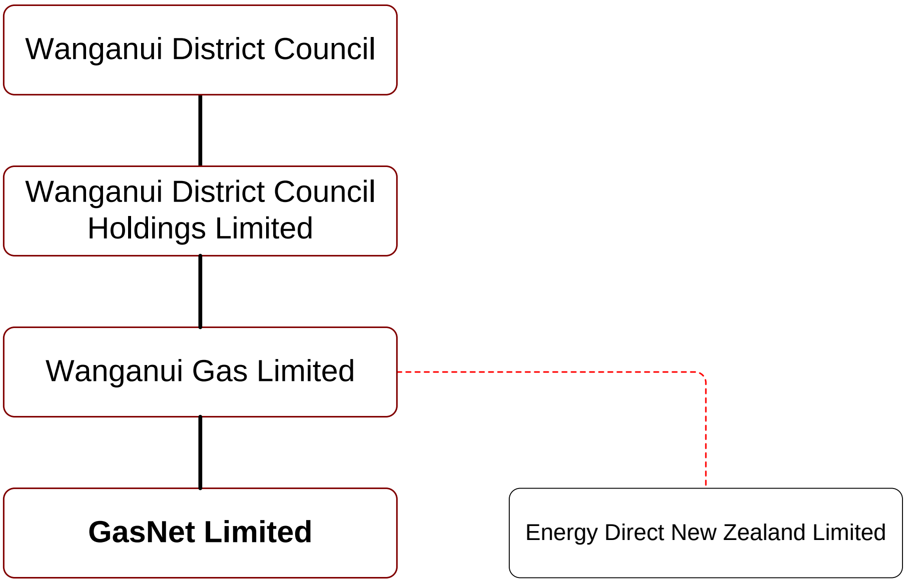
1.0 BACKGROUND

1.1 About GasNet

GasNet Limited is 100% owned by Wanganui Gas Limited which is itself owned by Wanganui District Council Holding Limited, the Wanganui District Council LATE (Local Authority Trading Enterprise).



GasNet Limited ("GasNet") commenced trading on 1 July 2008 after purchasing the network and metering business from Wanganui Gas Limited. Previously GasNet had been operating as an independent trading division of Wanganui Gas Limited and was responsible for managing the network and metering assets for the company.

Energy Direct NZ Limited (the energy retailer) commenced trading at the same time under identical arrangements. While GasNet Limited and Energy Direct NZ Limited remain 100% owned by Wanganui Gas Limited, they operate independently of each other, each having its own Board of Directors.

1.2 Regulatory Environment

Unlike most other gas distribution and electricity distribution businesses in New Zealand (GDB's & EDB's), GasNet has not been subject to any form of price or quality regulation such as that which it now faces under the Default Price-quality Path (DPP) regime and 2012 Information Disclosure Determination (IDD) under Part 4 of the Commerce Act 1986.

Whilst GasNet took an active participatory role throughout the development and consultation phase of the new regime lead by the Commerce Commission, the decision was made to wait until the required determinations and decisions had been published by the Commission before systems development and alignment with the new requirements would commence. Whilst this has resulted in a shorter time frame to implement the required change and comply with the new regime, the uncertainty that existed over the final form of the regulations provided justification that the decision to delay implementation had been the right one for GasNet.

2.0 PRICING METHODOLOGY

2.1 Revenue Requirements

GasNet has historically set prices based on an annual target revenue requirement which seeks the recovery of costs and an appropriate return on assets employed. Recent regulatory uncertainty over the value of our network assets has meant we have been unable to set prices based on this preferred approach, as we have been unable to accurately determine our capital costs (which includes depreciation and a return on assets employed). As an alternative, the revenue requirement for each successive pricing year during this regulatory development phase has been set based on the recovery of expected incremental cost increases relative to the previous year.

To provide context to this decision, our capital costs were previously derived using the most recent valuation of network assets. GasNet's gas distribution assets were last revalued on 30 June 2008 based on an Optimised Deprival Valuation (ODV) methodology. The valuation model employed was developed in the late 1990's and is based on the original manual extraction of pipeline asset types and quantities with incremental changes accommodated at each revaluation to add/remove assets.

This valuation model was upgraded the following year using new and more accurate data from the Geographic Information System (GIS), and a revaluation completed for 30 June 2009. The inclusion of this GIS based asset data was the main reason for a 7.8% increase on the previous year's valuation. Around the same time the Commerce Commission released its Input Methodologies Discussion Paper (19 June 2009) outlining its preliminary views on the regulation of GasNet, as well as other regulated electricity distribution and gas pipeline businesses. The resulting regulatory uncertainty created over GasNet's future revenue streams meant that the party engaged to peer review the 2009 revaluation was unable to support any change in value, either up or down. As a consequence the 2009 revaluation was not implemented and GasNet has been unable to revalue its network assets since 2008.

To facilitate the Commerce Commission's process to determine an initial DPP for gas distribution businesses, GasNet developed a new Regulatory Asset Base (RAB) valuation model compliant with the Commerce Act (Gas Distribution Services Input Methodologies) Determination 2010 (IMs). This valuation was based on the new GIS data and an Independent Engineer was engaged by GasNet to validate the changes. While GasNet could have used the RAB as a basis for setting its 2012 prices, it chose not to until the Commerce Commission had accepted the valuation. The RAB was accepted by the Commission, subject to minor amendments, in December 2012, after we had set 2012 prices.

The uncertainty created over the valuation of our network assets as a result of this regulatory change has meant that we have been unable to determine our capital costs, and therefore distribution prices, based on our preferred approach.

2.2 Consumer Groups

With the exception of the Large Sites which are individually priced, the Standard Sites are assigned a Load Group category based on the capacity requirements of each consumer connection. GasNet does not distinguish between the types consumers connected so does not provide pricing based on whether a consumer uses gas for residential, commercial or industrial purposes.

The existing Load Group structure is based on the capacity of the Gas Measurement System (GMS) installed at the consumer connection unless a specific capacity, known as the Maximum Hourly Quantity (MHQ), has been agreed between GasNet and the consumer's energy retailer.

We have developed these load groups to align our pricing with usage of network capacity, which is a key network cost driver.

Load Group	Criteria	Fixed Daily Charge	Variable Throughput Charge	Consumer Numbers
M6	Up to 6 m^3/hr	✓	✓	9,872
M12	> 6 and ≤ 12 m^3/hr	✓	✓	269
M23	> 12 and ≤ 23 m^3/hr	✓	✓	69
M33	> 23 and ≤ 33 m^3/hr	✓	✓	15
M43	> 33 and ≤ 43 m^3/hr	✓	✓	30
M85	> 43 and ≤ 85 m^3/hr	✓	✓	24
M142	> 85 and ≤ 142 m^3/hr	✓	✓	10
M200	> 142 and ≤ 200 m^3/hr	✓	✓	1
M450	> 200 and ≤ 450 m^3/hr	✓	✓	1
Large Sites	>10TJ p.a. and/or bypass risk	✓	×	12
CNG	CNG reseller	N/A	N/A	0
				10,303

2.3 Pricing Structure

The existing pricing structure is based on the following:

2.3.1 Total Recoverable Revenue (TRR)

The existing pricing methodology is based on the original determination of the Total Recoverable Revenue, or TRR, expressed mathematically as follows:

$$\text{Total Recoverable Revenue (TRR)} = \text{Return on Assets} + \text{Depreciation} + \text{Operating Costs} - \text{Capital Contributions}$$

2.3.2 Large Sites (Non-standard pricing and/or contracts)

GasNet has 12 non-standard consumers, which are referred to as Large Sites. These consumers account for 8% of the 2012 target revenue requirement and over 67% of annual throughput on the network.

Our criteria for deciding whether to enter into a non-standard contract are:

- annual throughput at the connection is greater than 10TJ; and/or
- there is a risk that the consumer may bypass the network to an alternative form of supply.

Individual pricing for Large Sites was originally based on each Large Site being allocated a share of the TRR referred to in 2.3.1 above, based on the value of the shared and dedicated assets used to transport the gas from the Sales Gate to the Large Site. The value of the assets was determined by either an apportionment of the original ODV of assets employed, or an assessment of the value of optimum dedicated assets required to meet the consumer's requirements where there is a threat of network bypass. Charges for Large Sites are on a fixed daily charge basis, i.e. there are no variable charges.

In the current pricing year the prices for the Large Sites have increased either by the movement in the Statistics NZ Producers Price Index (PPI SN8: Inputs – All markets excl. Health, Education and Administration), where the Large Site remains under a term contract with the relevant energy retailer, or by the standard increase of 2.5% referred to in 3.0 below.

With the exception of any contractually applicable annual price escalators (referred to above), GasNet's obligations and responsibilities associated with Large Sites as non-standard pricing/contracts, are identical to the standard prices.

2.3.3 Service Charges – Standard Sites

Service Charges (fixed daily charge) for Standard Sites were based on each Load Group being allocated a share of the TRR referred to in 2.3.1 above, calculated as the aggregate value of the service pipe assets for each Load Group. The value of the assets was determined by the original ODV valuation of the service assets identified within each Load Group. Based on the projected number of connections for the coming year, the revenue from Service Pipe Charges can be determined.

2.3.4 CNG Sites

Determination of the CNG Charge (fully variable) was originally made on the basis of market performance, demand projection, and the number of sites based on an average of the apportioned ODV assets employed by all CNG consumers. With the closure of the last remaining CNG outlet in Wanganui and the likelihood that it will not return, the CNG Charge is no longer applicable.

2.3.5 Supply Charge – Standard Sites

The balance of the annual revenue requirement is met through the fully variable Supply Charge, applicable to all Standard Sites, and determined by:

- calculating the revenue required by deducting the revenue attributed to the Large Sites and the Standard Sites Service Charges from the TRR referred to in 2.3.1 above;
- determination of the throughput projection for the Standard Sites;
- dividing the revenue required by the throughput projection.

3.0 2012/13 PRICING YEAR

3.1 Revenue Requirements

Based on an expected incremental increase in costs of $115,000 due predominantly to increases in regulatory compliance, network infrastructure insurance and personnel related operational costs, the annual revenue requirement over the 2012 Pricing Year increased by 2.5% to $4.65m.

As a result of this incremental cost approach, GasNet is unable to provide the components of cost that determined its target revenue in the current year under the existing pricing methodology.

3.2 Pricing Changes

In order to meet the revenue requirement, a 2.5% increase was applied across all charges for all Load Groups, effective 1 October 2012 as follows:

Network Charges (excl GST)	New Charges from 1 Oct-12		Charges to 30 Sep-12	
	Service Charge	Supply Charge	Service Charge	Supply Charge
	$/day	$/GJ	$/day	$/GJ
Standard Sites				
M6	$ 0.492	$ 6.396	$ 0.480	$ 6.240
M12	$ 0.359	$ 6.396	$ 0.350	$ 6.240
M23	$ 0.554	$ 6.396	$ 0.540	$ 6.240
M33	$ 0.769	$ 6.396	$ 0.750	$ 6.240
M43	$ 0.923	$ 6.396	$ 0.900	$ 6.240
M85	$ 1.107	$ 6.396	$ 1.080	$ 6.240
M142	$ 2.194	$ 6.396	$ 2.140	$ 6.240
M200	$ 2.696	$ 6.396	$ 2.630	$ 6.240
M300	$ 3.024	$ 6.396	$ 2.950	$ 6.240
M450	$ 3.454	$ 6.396	$ 3.370	$ 6.240
CNG Sites	N/A	$ 8.528	N/A	$ 8.320

3.3 Revenue Recovery by Load Group

The following table provides the breakdown of revenue by Load Group in addition to the consumer numbers and throughput for each.

2013 Pricing Year Forecast	Consumers Connected		Throughput		Revenue		
			(GJ)	%	Total		Increase
M6	9,872	95.82%	236,360	20.20%	$ 3,284,620	71%	$ 80,113
M12	269	2.61%	22,637	1.93%	$ 180,089	4%	$ 4,392
M23	69	0.67%	24,771	2.12%	$ 172,382	4%	$ 4,204
M33	15	0.15%	4,728	0.40%	$ 34,382	1%	$ 839
M43	30	0.29%	17,072	1.46%	$ 119,271	3%	$ 2,909
M85	24	0.23%	42,931	3.67%	$ 284,431	6%	$ 6,937
M142	10	0.10%	28,230	2.41%	$ 188,687	4%	$ 4,602
M200	1	0.01%	3,486	0.30%	$ 23,279	1%	$ 568
M450	1	0.01%	803	0.07%	$ 6,394	0%	$ 156
Large Sites	12	0.12%	788,945	67.43%	$ 358,796	8%	$ 8,751
	10,303	100%	1,169,963	100%	$ 4,652,331	100%	$ 113,471

3.4 Fixed and Variable Charge Apportionment

On aggregate the total revenue from fixed daily charges comprise 47.6% and the variable throughput charges 52.4% of the total annual revenue requirement.

4.0 PRICING METHODOLOGY REVIEW

4.1 Commencement of the Review

Consistent with the decision to wait until the required determinations and decisions had been published by the Commission before systems development and alignment with the new requirements would commence, it is planned to undertake a comprehensive review of the existing pricing methodology once the Commerce Commission has published its *Gas Distribution Services Default Price-Quality Path Determination* in February 2013, providing the necessary certainty to commence the review.

The purpose of the review is twofold: to ensure GasNet's pricing methodology satisfies the Commission's Pricing Principles (section 2.5.2 of the *Commerce Act (Gas Distribution Services Input Methodologies) Determination 2010*), and to develop a new model and pricing structure that is 'fit for purpose' and meets the needs of GasNet, its customers (the energy retailers) and consumers.

Whilst ultimately dependent on the outcome of the review, it is anticipated that there will be a consolidation in the number of Load Groups given that almost 96% of all consumers are within one group and the remaining 4% are across 8 other Load Groups. It is also anticipated that the current application of the same variable Supply Charge across all Load Groups will not provide the necessary outcome under a new cost allocation and recovery regime where over/under recovery could occur within Load Groups.

4.2 Timing of the Review

In order to meet the deadline to have a new pricing methodology in place by the start of the first pricing year under the new regime, GasNet needs to consult with its customers (the energy retailers), prior to implementation of the new methodology.

Accordingly it is expected to commence consultation in early June 2013 with the intention of finalising the methodology and prices by 1 August 2013, 2 months prior to implementation on 1 October 2013.

5.0 FIVE YEAR PRICING STRATEGY

GasNet's pricing strategy is to implement its new pricing methodology in year one as referred to in 4.0 above. Our strategy for the remaining four years will be dependent upon the outcome of the review and the decisions made in respect of the new pricing methodology.

6.0 COMPLIANCE WITH THE PRICING PRINCIPLES

GasNet is required under the IDD to describe the extent to which its pricing methodology is consistent with a set of gas distribution pricing principles. The table below summarises these pricing principles and how they are reflected in this pricing methodology.

Pricing Principle	Extent to which pricing methodology is consistent with pricing principles
(1) Prices are to signal the economic costs of service provision, by:	
(a) 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;	Incremental costs are the additional upfront and ongoing costs GasNet face in connecting a new consumer to the network. This typically includes costs associated with connection assets, ongoing operations and maintenance costs specific to that consumer, and network augmentation costs. GasNet's capital contributions policy requires a capital contribution from new consumers when the incremental capital costs associated with a new connection exceed the present value of expected future revenues. The combination of capital contributions and gas distribution prices therefore ensures that our prices are in excess of incremental capital costs. Operating and maintenance expenditure is recovered through distribution prices. Our supply charge, based on a fixed daily charge, ensures that we at least recover some of these incremental costs regardless of consumption. Supply charges also increase with the capacity size of the connection, which aligns pricing to incremental operating costs associated with various connection sizes. Stand alone costs are the full cost a consumer would face in being supplied from an alternative gas distribution system or alternative form of supply. For gas, stand alone cost is most likely to represent the full cost of converting from gas to electricity (a close substitute for gas), including the cost of replacing gas appliances. GasNet has set its prices and pricing structures mindful of the fact that consumers have alternative supply options. Our pricing, and indeed commercial business proposition, seeks to incentivise consumers connecting, and remaining connected, to distributed gas. Large consumers may also have options to bypass the distribution network for alternative networks, particularly where the consumer is close to a gas sales gate. GasNet offers non-standard pricing to a number of Large Sites with annual throughput of greater than 10TJ. These non-standard pricing arrangements reduce bypass risk by making it economic for these consumers to connect, and remain connected, to the network.

(b) having regard, to the extent practicable, to the level of available service capacity; and	GasNet sets its consumer groups to align with standard load group types based on typical connection sizes. This aligns pricing with various end-consumer usage profiles and with the capacity of their connection assets, a key network cost driver.
(c) signalling, to the extent practicable, the impact of additional usage on future investment costs.	GasNet's prices are based on a daily fixed supply charge and a consumption based tariffs (in GJs). The consumption tariff ensures consumers that use more are charged more. This basic principle is effective in signalling the impact of additional usage on future investment costs. Similarly, the supply charge applying to each load grouping increases relative to the standard capacity size of the connection. This signals that larger connections typically have higher consumption and peak demand and therefore create higher investment costs.
(2) 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.	GasNet's pricing is not based on willingness to pay or demand responsiveness considerations, but on load groupings based on typical connection sizes. We consider this most appropriately aligns with our investments in capacity, which is a key network cost driver.
(3) Provided that prices satisfy (1) above, prices should be responsive to the requirements and circumstances of stakeholders in order to:	
(a) discourage uneconomic bypass;	This principle allows for pricing and other incentives to discourage consumers bypassing GasNet's network to another supply alternative. GasNet seeks to discourage consumers bypassing the network by offering non-standard pricing to its Large Site consumers. This pricing recognises the alternative supply options these consumers have available to them.
(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.	This principle allows for negotiation over price in recognition of different levels of service or other arrangements of value to consumers. Price and quality trade-offs are primarily addressed under our capital contributions policy when scoping connection asset specifications. Our non-standard contracts for Large Sites also provide a forum to address price and quality of supply related matters.
(4) Development of prices is transparent, promotes price stability and certainty for consumers, and changes to prices have regard to the effect on consumers.	This methodology transparently sets out the approach we have adopted to determine prices for consumers connection to the network, and is publicly available via GasNet's website www.gasnet.co.nz. GasNet's pricing methodology has not materially changed for some time. However, we are in the process of reviewing this pricing methodology, as discussed above. In making decisions on our future pricing methodology we will be mindful of the effect any changes have on consumers. We will also fully consult with consumers and other affected parties on the key changes prior to making a decision.

Schedule 18: Certification for Disclosures at the Beginning of a Pricing Year

Clause 2.9.2

1. We, Matthew James Doyle and Harvey George Green, being directors of GasNet Limited certify that, having made all reasonable enquiry, to the best of our knowledge:

    a. the following attached information of GasNet Limited prepared for the purposes of clause 2.4.1 of the Gas Distribution Information Disclosure Determination 2012 in all material respects complies with that determination.

    b. The prospective financial or non-financial information included in the attached information has been forecast on a basis consistent with regulatory requirements or recognised industry standards.

Matthew James Doyle — Date: 15 / April / 2013

Harvey George Green — Date: 15/4/2013