

# Attachment 4: Capital contributions framework

## Principles for treatment of past capital contributions

### 1. Recognition of past capital contributions

*The QCA's previous decision(s) regarding recognition of past capital contributions should be preserved.*

### 2. Derivation of corresponding pricing benefits

The QCA's current (2005) approach to the derivation of pricing benefits corresponding to past capital contributions should be continued.

- The QCA's current approach to the calculation of customer rebates (undertaken as part of the 2005 review) involves:
  - identification of the contributed asset
  - valuation of the contributed asset, based on a DORC approach and
  - calculation of the return on capital and return of capital components, as relevant.
- Where a contributed asset is shared amongst a group of water users, the corresponding customer rebate is apportioned between users based on contracted volumes.
- This approach should be continued for the purposes of determining any future pricing benefits corresponding to past capital contributions, except where the following circumstances apply:
  - the regulatory treatment of the contributed asset changes, i.e., if the QCA were to re-value, rather than roll-forward, the value of contributed assets at a future regulatory review, and/or
  - one or more users of a shared contributed asset elects to purchase less water from GAWB than initially agreed (i.e. reduce their water reservation).
- If either of these circumstances arise, GAWB may revise the quantum of future pricing benefits corresponding to past capital contributions, so that the amount rebated to customers better reflects these new circumstances.

### 3. Accommodating new customers

*To the extent that accommodating a new customer affects the original capital contributing customer, GAWB may elect to revise the pricing agreement in place with that customer, such that the rebate amount better reflects this change in circumstance.*

Specifically, where a new customer begins using a contributed asset, GAWB would consider each of the following options (or any combination of these options) ahead of determining the most appropriate response to the change in use of the contributed asset:

### Option 1

- GAWB may choose to refund the whole capital contribution amount, or any part thereof, to the original capital contributing customer.
- GAWB would *not* seek any capital contribution from the new customer(s).
- In deriving the refund amount, GAWB may consider any of the following matters:
  - the original capital contribution amount
  - the nature of the original capital contribution
  - the DORC value of the contributed asset at the time the change in use of the contributed asset occurs
  - the length of time that has lapsed between when the contributed asset was built (for the sole use of the original capital contributing party), and the asset being used by a new customer
  - how the original capital contributing party is impacted by the new customer using the contributed asset (if at all). This may involve considering:
    - the particular requirements of the new customer
    - the terms of the water supply agreement established with the new customer, including:
      - the contract duration, i.e. how long the new customer will use this asset
      - the volume of the contract (including relevant reservation clauses) and so on.

### Option 2

- GAWB would seek a capital contribution from the new customer(s).
- GAWB would use some or all of this contribution to refund the whole capital contribution amount, or any part thereof, to the original capital contributing customer.
- In deriving the refund amount, GAWB may consider any of the following matters:
  - the original capital contribution amount
  - the nature of the original capital contribution
  - the DORC value of the contributed asset at the time the change in use of the contributed asset occurs
  - the length of time that has lapsed between when the contributed asset was built (for the sole use of the original capital contributing party), and the asset being used by a new customer
  - how the original capital contributing party is impacted by the new customer using the contributed asset (if at all). This may involve considering:
    - the particular requirements of the new customer

- the terms of the water supply agreement established with the new customer, including:
  - the contract duration, i.e. how long the new customer will use this asset
  - the volume of the contract (including relevant reservation clauses) and so on.

### *Option 3*

- GAWB would elect not to return any amount to the original capital contributing customer.
- This option would only be pursued if it can be demonstrated that there was no detrimental impact to the agreed pricing benefit due to the original capital contributing customer.
- Irrespective of precisely how GAWB proceeds in this circumstance, GAWB will ensure that:
  - the value due to the original capital contributing party is preserved, with reference to the calculation methodology of the current pricing benefit; and
  - the rebate provided to a customer is no greater than the return on capital and, if appropriate, return of capital components of the price. This would be achieved by way of a lump sum payment to the original capital contributing customer consistent with Option 1.

## Principles for treatment of new capital contributions

### 1. Identification of the basis for the capital contribution

GAWB may seek a capital contribution from customers in order to manage the risks associated with construction of new significant infrastructure.

These risks include:

- changes in customer circumstances that would prevent GAWB recovering the full cost of the asset over its useful life, and
- the construction of customer specific infrastructure that may not be suitable for common customer requirements.

### 2. Identification and classification of the contributed asset(s)

*At the time a new capital contribution is made, contributed network assets must be identified by GAWB as one of the following:*

- a dedicated connection asset or
- an extension asset or
- a shared network asset.

The pricing agreement that is established between GAWB and the capital contributing customer(s) must explicitly state how the asset has been classified, using the following definitions:

- a dedicated connection asset – an asset that is installed for the purpose of connecting a customer to the shared network (or to an extension asset), is for the sole use of the connecting customer and is expected to remain for the sole use of that customer at all times over the life of the asset. This excludes all connecting assets installed upstream of a connection point ('connection point assets'),
- an extension asset – an asset that is installed to lengthen or otherwise extend the existing system to facilitate the connection – these assets may commence their lives as dedicated assets, i.e., in GAWB's case, linking a single customer to the relevant supply zone network, but later become shared as additional customers connect by means of that same spur line, and
- a shared network asset – an asset that constitutes part of the shared network. This includes all connection point assets.

The treatment of dedicated connection assets is addressed in Appendix A.

### 3. Establishing whether a pricing benefit is appropriate

*Where a new capital contribution is made, GAWB will determine whether a corresponding pricing benefit should apply and include an explicit statement in the pricing agreement to that effect.*

In determining whether a pricing benefit is appropriate, GAWB may consider:

- whether the contributed asset is recognised in the firm's regulated asset base and the supply charges derived by reference to that asset base

- the intent and actions of the contracting parties at the time (as implied by the contract in place), and
- the nature of the risk-sharing arrangements between the contracting parties.

#### 4. *Deriving the quantum of any pricing benefit amount*

*Where GAWB determines that a pricing benefit should apply, GAWB will include an explicit statement in the pricing agreement that sets out the quantum of that pricing benefit, and how it will be calculated over the life of the contributed asset.*

In deriving the quantum of any pricing benefit amount, GAWB may consider:

- the s36 pricing practices
- the intention of the contracting parties at the time the capital contribution is made
- how the pricing benefit will evolve over time as the asset depreciates
- whether the pricing benefit provides appropriate investment signals (where investment decisions are effectively being driven by customers)
- whether future changes in the circumstances surrounding the use of contributed assets are provided for, i.e., if a dedicated asset were to become part of the shared network or, one or more users of a shared contributed asset reduce their water reservations, and
- the consequences of any future change in the regulatory treatment of the contributed assets, i.e., the asset valuation methodology.

If either of the latter two circumstances arise, GAWB may revise the quantum of future pricing benefits corresponding to past capital contributions so that the amount rebated to customers better reflects these new circumstances.

#### 5. *Establishing arrangements for accommodating new customers*

*GAWB will include an explicit statement in the pricing agreement that sets out the arrangements that will apply in the event a contributed asset is subsequently used by other customers.*

This statement will include, as relevant:

- the circumstances in which access to that asset will be provided to other customers
- GAWB's approach to re-classifying the contributed asset, based on the asset definitions set out in this framework, and
- how GAWB intends to revise (if at all) the quantum of pricing benefit that will apply in the event the contributed asset is subsequently used by other customers.

This will necessarily involve GAWB setting out the arrangements for allocating the cost of the contributed asset amongst users. Specifically, where a new customer begins using a contributed asset, GAWB would consider each of the following options (or any combination of these options) ahead of determining the most appropriate response to the change in use of the contributed asset:

### Option 1

- GAWB may choose to refund the whole capital contribution amount, or any part thereof, to the original capital contributing customer.
- GAWB would *not* seek any capital contribution from the new customer(s).
- In deriving the refund amount, GAWB may consider any of the following matters:
  - the original capital contribution amount
  - the nature of the original capital contribution
  - the DORC value of the contributed asset at the time the change in use of the contributed asset occurs
  - the length of time that has lapsed between when the contributed asset was built (for the sole use of the original capital contributing party), and the asset being used by a new customer
  - how the original capital contributing party is impacted by the new customer using the contributed asset (if at all). This may involve considering:
    - the particular requirements of the new customer
    - the terms of the water supply agreement established with the new customer, including:
      - the contract duration, i.e. how long the new customer will use this asset
      - the volume of the contract (including relevant reservation clauses) and so on.

### Option 2

- GAWB would seek a capital contribution from the new customer(s).
- GAWB would use some or all of this contribution to refund the whole capital contribution amount, or any part thereof, to the original capital contributing customer.
- In deriving the refund amount, GAWB may consider any of the following matters:
  - the original capital contribution amount
  - the nature of the original capital contribution
  - the DORC value of the contributed asset at the time the change in use of the contributed asset occurs
  - the length of time that has lapsed between when the contributed asset was built (for the sole use of the original capital contributing party), and the asset being used by a new customer
  - how the original capital contributing party is impacted by the new customer using the contributed asset (if at all). This may involve considering:
    - the particular requirements of the new customer

- the terms of the water supply agreement established with the new customer, including:
  - the contract duration, i.e. how long the new customer will use this asset
  - the volume of the contract (including relevant reservation clauses) and so on.

### *Option 3*

- GAWB would elect not to return any amount to the original capital contributing customer.
- This option would only be pursued if it can be demonstrated that there was no detrimental impact to the agreed pricing benefit due to the original capital contributing customer.

Irrespective of precisely how GAWB proceeds in this circumstance, GAWB will ensure that:

- the value due to the original capital contributing party is preserved, with reference to the calculation methodology of the current pricing benefit; and
- the rebate provided to a customer is no greater than the return on capital and, if appropriate, return of capital components of the price. This would be achieved by way of a lump sum payment to the original capital contributing customer consistent with Option 1.

## Appendix A: Dedicated connection assets

Customers will fund, own and maintain responsibility for new dedicated connection assets. GAWB may negotiate an agreement with the customer to construct and/or maintain that asset on the customer's behalf. GAWB also needs to be able to ensure that the design, construction, operation and maintenance of that asset complies with all necessary specifications and standards.

- This policy applies to new dedicated connection assets only, that is, assets developed after 1 July 2020. The current pricing treatment of all existing dedicated connection assets (that is, assets installed prior to 1 July 2020) will remain unchanged.
- The definition of a 'dedicated connection asset' includes all assets that are constructed to connect a customer to the shared network (or to an extension asset), excluding all connecting assets installed upstream of a connection point ('connection point asset').

### Funding and ownership responsibility

- Unless otherwise agreed with GAWB, customers will bear responsibility for the development, construction, funding, commissioning, ownership, operation and maintenance of dedicated connection assets.
- GAWB will retain the right to develop, construct, fund, commission, own, operate and maintain a dedicated connection asset, including, for example, in the case of 'strategic' assets that could be subsequently used by other customers or where the investment is so small that its inclusion in prices is immaterial.
- GAWB will retain responsibility for the development, construction, funding, commissioning, ownership, operation and maintenance of all connection point assets, which will be included in the RAB for the relevant Pricing Zone.

### Development and construction of dedicated connection assets

- GAWB may enter into an agreement with the customer to design and construct a dedicated connection asset on behalf of that customer. The agreement will address arrangements for funding.
- GAWB may enter into an agreement with the customer for the ongoing operation and maintenance of the dedicated connection asset on behalf of that customer. This agreement will require the customer to meet the associated costs.
- If GAWB does not undertake the design and construction of a dedicated connection asset on behalf of the customer, before the customer will be permitted to connect the infrastructure at the connection point, GAWB must approve the design, construction and commissioning of the infrastructure and be satisfied that:
  - the infrastructure meets all technical specifications required by GAWB; and
  - the infrastructure has been constructed to a standard that is appropriate for the services required.
- To facilitate the above:
  - GAWB will provide the customer with the appropriate specifications and standards at the start of the process.

- If the dedicated connection asset fails to meet these specifications and standards, GAWB will work with the customer to determine how the issues can be rectified, noting that all rectification costs (including GAWB's costs) and risks will be borne by the customer.
- If GAWB does not undertake the ongoing operation and maintenance of a dedicated connection asset on behalf of the customer, before the customer will be permitted to connect the infrastructure at the connection point, GAWB must be satisfied that:
  - the customer will continue to maintain the asset in accordance with the technical specifications and to the required standard, and this extends to any necessary asset upgrades and renewals; and
  - the customer will comply with any directions given by GAWB including in the event of asset failure, an emergency or when issues arise such as water quality events.
- The responsibilities and obligations of GAWB and the customer in relation to dedicated connection assets will be documented. Where a Water Supply Contract is in place, this may be via a condition of GAWB's consent to the connection or an amendment to the contract. A new agreement may be required in other instances, for example, for new customers.