Teleconference on the AER's draft decision for Country Energy Gas Networks Wagga Wagga Natural Gas Distribution Network (1 July 2010 to 30 June 2015)

Location:	**By teleconference**
Date:	**Thursday, 19 November 2009 (3.30pm to 4.15pm)**
Forum Chair:	**Mike Buckley, General Manager Network Regulation North, Australian Energy Regulator**
Attendees:	**See appendix 1**

Summary of forum

A summary of the discussions from the forum is set out below.

1. AER presentation – *Mike Buckley, General Manager Network Regulation North, AER*

Slide 1: Overview of forum

Mike Buckley opened the forum and outlined that:

- today's teleconference is intended to provide interested parties with an overview of the AER's draft decision on Country Energy's proposed Wagga Wagga gas distribution network access arrangement
- this is the first time the AER has undertaken a public forum through a teleconference format. He further added that as there are many participants from a range of different areas this was the most convenient means to disseminate the draft decision to all interested parties
- the AER had earlier distributed a slide pack via email. This presentation is to follow the order of these slides
- the proposed structure of the presentation included time allotted at the beginning for questions which had been submitted to the AER prior to the teleconference. As no attendees had previously submitted questions, Mr Buckley proposed an unstructured approach to the presentation and welcomed participants to ask questions during the presentation

- alternatively questions can also be emailed to Sarah Curby that can be addressed during the teleconference.

Slide 2: Background

Country Energy Gas Networks owns, controls and operates the Wagga Wagga gas network. This network provides gas to over 18,000 residential and industrial customers.

Country Energy submitted its proposed revisions to its access arrangement to the AER on 1 July 2009. The AER is expected to make its final decision in early April.

This is the first time the AER has considered an access arrangement proposal for Country Energy. The current access arrangement was established under the Code and approved by the IPART. The previous access arrangement period was for four and a half years, this means that like on like comparisons for changes in operating and capital expenditures is not possible.

Since IPART approved the access arrangement the regulatory regime has changed. On 1 July 2008 the new National Gas Law (NGL) and National Gas Rules (NGR) came into operation. The NGL and NGR do not significantly impact how the AER assesses historic or forecast capital expenditure. The main change is the way total revenue is allocated to individual tariffs, and the move from a more direct cost of service tariff setting framework for distribution tariffs than prevailed under the Code.

The AER engaged consultants to provide expert advice on aspects of Country Energy's proposal. These included:

  - Wilson Cook – Capex
  - ACIL Tasman – Demand forecasts
  - Access Economics – future labour input costs

The AER performed its own assessment of the forecast operating expenditure.

The AER hosted a public forum on Country Energy's access arrangement in Wagga Wagga on 28 July 2009.The AER called for submissions on the proposal from interested parties, however it did not receive any in this case. The AER released its draft decision on 11 November 2009.

Slide 3: Overview

The draft decision includes 84 revisions – most of these are minor and procedural in nature. The number of revisions is not an indicator of the quality of the proposal.

Gas has been available in Wagga Wagga since the late 1880s. Manufactured gas was available until 1981 when supplies from the Cooper Basin became available. As an ageing network it will require considerable asset replacement and refurbishment capex to maintain the system into the future.

This presentation will focus on the key issues arising from the AER's review of the access arrangement proposal including:

- demand forecasts
- operating costs
- capital works
- proposed return on capital sought.

The impact of these elements of the proposal on residential tariffs translates to an initial increase of 27 per cent in 2010-11 and averages 9.4 per cent in each subsequent year of the access arrangement period.

Jason Cooke, Country Energy:

When you came up with the tariffs, did you calculate those using our cost of supply model?

Eamon McGinn, AER:

Tariffs were scaled down to maintain the same relative proportions of proposed revenue allocated to each tariff class to achieve the new lower total revenue approved.

Slide 4: Demand

Slide 4 sets out Country Energy's proposed and the AER's approved demand forecasts.

Country Energy submitted that the total volume or load on the network is forecast to increase over the access arrangement period but at a slower rate than in the previous access arrangement period.

Load growth will mainly be driven by volume customers with contract load (industrial customers) remaining flat. The expected load growth is given in the table shown on the slide.

The AER sought the advice of ACIL Tasman on the demand forecasts. ACIL advised that the slower load growth was driven by an assumption that 50 per cent of new dwelling would connect to the network. ACIL did not support this assumption it considers that the historic experience of 90 per cent new dwelling is reasonable. On this basis it assumes 315 new gas connections in the access arrangement period compared with 175 proposed by Country Energy.

The AER requires Country Energy to amend its total load forecasts. The AER's amendment will produce an annual load growth as shown in the slide.

Slide 5: Operating Expenditure

Country Energy proposes forecast total operating expenditure for the access arrangement period of $13 million ($2009–10) which represents an increase of 28 per cent in opex over the access arrangement period.

As can be seen from the slide, Country Energy is proposing a steady real increase in opex over the access arrangement period.

The AER identified the following opex issues:

1) the selection of the base year on which to build the opex forecast
2) the treatment of unaccounted for gas (UAG), and
3) self insurance.

The base year proposed was 2009-10 and relies on forecast data. Overall, the forecast for the 2009-10 year was significantly higher than actual expenditure for 2008-09. The AER normally prefers to rely on a year that consists of actual data only, and therefore the draft decision applies the 2008-09 actual expenditure as the base year.

Country Energy currently recovers the cost of its UAG as an additional charge on network charges. Consistent with other access arrangements the AER is requiring Country Energy to include UAG in its opex allowance. This will provide Country Energy with a greater incentive to manage UAG.

Based on the advice of consultants Wilson Cook, the AER has assumed that system UAG will decline as network upgrades progress which in turn will produce a lower expected UAG cost.

Country Energy proposed self insurance for certain business risks. The AER has assessed the proposal and determined that except for the general public liability risk event, Country Energy has not adequately specified the risk or provided for a self insurance premium arrived at on a reasonable basis.

The AER approved total operating expenditure of $12.4 million ($2009–10) for the Wagga Wagga network. This is a reduction of $0.64 million from the original proposal.

Slide 6: Capital Expenditure

Country Energy proposes $18 million of conforming capital expenditure. This expenditure profile is shown in the slide.

The main capital expenditure program relates to:

- asset replacement and refurbishment capital expenditure which is further broken down into refurbishment costs ($7.2 million) and meter replacement ($1.8 million)

- growth related capital expenditure (new customer connections).

The major component of the asset replacement and refurbishment capital expenditure relates to a program commenced in 2006–07 to address supply pressure problems and gas leaks caused by the aging assets of the network.

Revisions made to Country Energy's capex proposal resulted from amendments to cost escalators, depreciation, and adjustments for inflation. These were relatively small.

Network management costs taken out of the opening capital base as this was included in the operating expenditure, and recovered through tariffs, in the earlier access arrangement period.

The total capital expenditure approved by the AER for the access arrangement period is $17.7 million ($2009–10). This represents an increase in real terms of approximately 19 per cent of total capital expenditure for the earlier access arrangement period.

Slide 7: Weighted Average Cost of Capital

Country Energy proposes a nominal vanilla WACC of 10.84 per cent. For this draft decision, the AER has determined a nominal vanilla WACC of 10.16 per cent for Country Energy.

The approved WACC reflects the AER's required amendments to the WACC parameters as follows:

- equity beta from 1.1 to 0.8
- market risk premium from 7.0 per cent to 6.5 per cent
- debt risk premium from 4.70 per cent to 3.24 per cent.

The WACC was established on the basis of the nominal risk-free rate of 5.54 per cent, this will be updated to reflect the CGS rate in the agreed averaging period.

The cost of debt allowance is a major factor contributing to the higher allowed cost of capital. The debt margin has more than doubled in real terms compared with the earlier period jumping from 1 per cent to 4 per cent.

The approved WACC numbers stated by the AER are not final and will change in the final decision. These changes will have a consequential impact on total revenue in the final decision.

Slide 8: Tariffs

Country Energy proposes two tariff classes, contract and volume. This is consistent with the earlier access arrangement period. However, instead of their being 3 tariff zones there will be two zones with the merger of the central and fringe zone tariffs for contract transportation services.

The draft decision provides for an initial nominal increase in tariff for residential customers of 27.2 per cent with annual average increase over the five year period of 9.4 per cent.

Slide 9: Tariff Variations

There are two mechanisms by which tariffs can be varied. First the annual tariff variation formula and second through a cost pass through mechanism.

Country Energy proposes using a similar annual tariff variation mechanism to the earlier access arrangement period.

The AER requires Country Energy to include a side constraint to limit any increase to tariff in any one year to consumer price index (CPI) plus 10 per cent. This side constraint does not limit tariff variations for cost pass throughs.

Country Energy is also required to amend its proposed cost pass through mechanism to include a general pass through event. Administrative procedures for both tariff variation mechanisms also require amendment.

Country Energy updates the cost pass through mechanism for contemporaneous events such as retail project (e.g. STTM) and climate changes (e.g. CPRS). Country Energy also proposes notification and oversight processes, which the AER's draft decisions requires minor amendments.

Natalie Lindsay, Country Energy:

Does the side constraint apply for each year or only the last four years?

Gwenda Gleeson, AER:

The tariff variation mechanism only applies in the last four years; therefore the 27 per cent increase in tariffs for the first year ($P_{0)}$ is not affected by the side constraint.

Natalie Lindsay, Country Energy:

How does the side constraint work?

Gwenda Gleeson, AER:

The side constraint is intended to work on groups of charging parameters so, for example, for small tariff customers the fixed and variable charge could not increase by more than the side constraint.

Jason Cooke, Country Energy:

Was there any discussion around this requirement in the draft decision?

Gwenda Gleeson, AER:

Refer to page 109 of the draft decision.

Slide 10: Non-tariff terms & conditions

Country Energy has substantially revised its standard user agreement. As this forms part of the access arrangement the AER has reviewed it against the NGL. The AER is usually guided by submissions in relation to the non tariff terms and conditions but as no submissions were received it has considered the proposed standard user agreement against the NEL objective.

The AER requires the user agreement to be amended to remove the charge in order to take account of the inclusion of UAG costs in opex. The user agreement also needs to be amended to ensure that capacity trading arrangements are consistent with Gas Market Business Rules.

Country Energy proposed a trigger event regarding significant increases in demand and costs which the AER has accepted. The AER also requires Country Energy to include a trigger event to account for the change in the NGL/NGR for the introduction of the retail energy and gas connections framework.

Country Energy proposed that all extensions and expansions to the pipeline are automatically covered by the access arrangement. The AER requires Country Energy to amend its extension policy to allow the AER the discretion to determine whether or not extensions are allowed under the access arrangement. Specifically, in the access arrangement proposal, high pressure pipeline extensions will need to be notified to the AER so it can decide whether it will be covered by the access arrangement.

All expansions will be automatically treated as part of the covered pipeline and covered by the access arrangement.

Slide 11: Process – where to from here?

Country Energy will be given until 6 January to respond to the AER’s draft decision and its response will be published soon after that. There will be an opportunity for interested parties to comment on both the AER’s draft decision and Country Energy’s response. These submissions have a closing date of 12/02/2010.

The current plan is for the AER to make its final decision in early April.

2. Questions from interested parties

Jason Cooke, Country Energy:

Country Energy has concerns regarding the AER’s approach to extensions and expansions. Mr Cooke expressed that Country Energy looks at the economics of each extension/expansion and does not take extension and expansion decisions lightly. Mr Cooke also indicated that they have been through the same issue with IPART in the past. Mr Cooke also noted that while Country Energy may not have an extensive list of extensions and expansions as other networks; he noted that the proposed administrative arrangements seemed onerous and there was a short time frame to provide information.

Gwenda Gleeson, AER:

Stated that the AER had a view on this but would be willing to discuss with Country Energy how to meet both the AER's objectives and provide a practical solution for Country Energy regarding the information requirements.

Jeff Stein, Industry & Investment NSW:

Commented that from the industrial customers' point of view they are happy that industrial tariffs are declining over the access arrangement period.

3. Concluding comments

Mike Buckley advised Mr Cooke that the AER would arrange informal discussions about outstanding issues arising from the draft decision. Mr Buckley then expressed his appreciation to the attendees for their participation and closed the forum.

AUSTRALIAN ENERGY REGULATOR

Appendix 1: List of attendees

Name	Organisation
Cathy Wadell	Country Energy
Cliff Priest	Country Energy
Gary Williams	Country Energy
Glenn Balderston	Country Energy
Jason Cooke	Country Energy
Maree Richards	Country Energy
Natalie Lindsay	Country Energy
Peter Cunningham	Country Energy
Phil Coulton	Country Energy
Katharine Hole	Industry & Investment NSW
Jeff Stein	Industry & Investment NSW
Mike Buckley	AER
Ben Stonehouse	AER
Brett McCarthy	AER
Caleb Stewart	AER
Eamon McGinn	AER
Gwenda Gleeson	AER
John Bastick	AER
Kenny Yap	AER
Luke Griffin	AER
Matthew Le Cornu	AER
Sajjad Minhas	AER
Tracey Ji	AER
Trevor Johnston	AER