



Draft decision – public version

**Country Energy Wagga Wagga Natural Gas  
Distribution Network**

**Access arrangement proposal**

**1 July 2010 – 30 June 2015**

November 2009

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## Request for submissions

This document sets out the Australian Energy Regulator's (AER) draft decision for Country Energy Gas Pty Ltd (Country Energy) Wagga Wagga access arrangement proposal for the period 1 July 2010 to 30 June 2015.

The draft decision requires Country Energy to revise its access arrangement proposal. Country Energy may submit a revised access arrangement revision proposal responding to the AER's draft decision by 6 January 2010.

The AER has scheduled a public forum on its draft decision for Thursday, 19 November 2009. At the forum the AER will outline the reasons for its draft decision and provide an opportunity for interested parties to provide comment or questions. Forum details are available at [www.aer.gov.au](http://www.aer.gov.au)

Interested parties are invited to make written submissions on issues regarding the draft decision including its consultants' reports to the AER by 12 February 2010. The AER will consider all information it receives in the access arrangement review process, including submissions on the draft decision, in accordance with its access arrangement guideline (AAG) and the ACCC–AER information policy: the collection, use and disclosure of information (ACCC–AER Information Policy)<sup>1</sup>. These documents are available at [www.aer.gov.au](http://www.aer.gov.au).

Submissions can be sent electronically to [nswactgas@er.gov.au](mailto:nswactgas@er.gov.au).

Alternatively, submissions can be mailed to:

Mike Buckley  
General Manager  
Network Regulation North Branch  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601.

The AER prefers that all submissions be publicly made to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to submit this information as outlined in the access arrangement guideline.

All non-confidential submissions will be placed on the AER's website.

Copies of Country Energy's access arrangement proposal, consultancy reports and submissions from interested parties are available on the AER's website.

Inquiries about this draft decision or how to make submissions can be made by email to [nswactgas@er.gov.au](mailto:nswactgas@er.gov.au) or by telephone on (02) 6243 1233.

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<sup>1</sup> ACCC and AER, *ACCC–AER information policy: collection, use and disclosure of information*, 23 October 2008.

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## Draft decision

The AER does not propose to approve Country Energy's access arrangement proposal as it is not satisfied that it meets the requirements specified in the NGR.<sup>2</sup> The draft decision sets out the detailed reasons for this decision.<sup>3</sup>

For the AER to approve the access arrangement proposal this decision outlines the amendments (or nature of amendments)<sup>4</sup> required to be made to the access arrangement proposal<sup>5</sup> or access arrangement information.<sup>6</sup>

Provisions of the access arrangement proposal that do not require amendment are consistent with the national gas objective.<sup>7</sup>

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<sup>2</sup> NGR, r. 41 and r. 100.

<sup>3</sup> NGR, r. 59(4).

<sup>4</sup> NGR, r. 43(3) and r. 59(2).

<sup>5</sup> Country Energy, *Access arrangement for the Wagga Wagga natural gas distribution network*, 1 July 2009 (access arrangement proposal).

<sup>6</sup> Country Energy, *Access arrangement information for the Wagga Wagga natural gas distribution network*, 1 July 2009 (access arrangement information).

<sup>7</sup> NGR, r. 100.

# Amendments

Before the proposed access arrangement proposal can be accepted, Country Energy must make the following amendments<sup>8</sup>:

## Pipeline Services

**Amendment 2.1:** amend section 15 in the access arrangement proposal to include the following:

**Services** means services which are pipeline services within the meaning of section 2 of the *NGL*.

**Amendment 2.2:** delete the definition of ‘Retail Market Procedure’ in section 15 in the access arrangement proposal and replace it with the following:

**Retail Market Procedures** means the retail market procedures made by the AEMO from time to time under section 91M of the *NGL*.

**Amendment 2.3:** amend the end of sections 4.3.1, 4.3.2, and 11.2.2 in the access arrangement proposal to include the following:

If contestability in the gas industry is introduced in New South Wales which permits the provision of gas meter reading services or on-site data and communication equipment in Wagga Wagga by a person other than *Country Energy Gas* then *Customers, Users* and *Prospective Users* are permitted to acquire such services and equipment from that person. *Customers, Users* and *Prospective Users* which acquire such services and equipment from a person other than *Country Energy Gas* will not be charged a fee by *Country Energy Gas* for such services and equipment whether or not the fee is aggregated into another fee or *Charge*, or a *Reference Tariff*.

**Amendment 2.4:** amend the end of section 11.2.1 in the access arrangement proposal to include the following:

If contestability in the gas industry is introduced in New South Wales which permits the provision of gas meter reading services or on-site data and communication equipment in Wagga Wagga by a person other than *Country Energy Gas* then *Customers, Users* and *Prospective Users* are permitted to acquire such services and equipment from that person. *Customers, Users* and *Prospective Users* which acquire such services and equipment from a person other than *Country Energy Gas* will not be charged the *Monthly Metering Charge* or any other fee by *Country Energy Gas* for such services and equipment whether or not the charge or fee is aggregated into another fee or *Charge*, or a *Reference Tariff*.

**Amendment 2.5:** amend the access arrangement proposal to:

- delete the heading for section 4.1 and replace it with the following:

### 4.1 Pipeline services to be offered

- delete the heading for section 4.3 and replace it with the following:

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<sup>8</sup> All references to clauses, sections, chapters refer to those in the access arrangement proposal and access arrangement information unless indicated otherwise.



#### **4.3 Reference Services**

- delete the definition of ‘Reference Services’ in section 15 and replace it with the following:

**Reference Services** means the *Contract Transportation Service, Volume Transportation Service* and *Additional Services*.

**Amendment 2.6:** amend the access arrangement information to:

- delete the heading for section 3.2 and replace it with the following:

#### **3.1.3 Additional Services**

- delete the words ‘and *Additional Services*’ from section 8.2.2 .

**Amendment 2.7:** delete appendix 2 of the access arrangement proposal and replace it with appendix D of the draft decision.

**Amendment 2.8:** amend the access arrangement proposal to:

- delete the heading for section 4.3.4 and replace it with the following:

#### **4.4 Non-Reference Services—Negotiated Services**

- renumber the existing sections 4.4 and 4.5 (including their subsections).

**Amendment 2.9:** amend the access arrangement information to:

- delete the heading for section 3.3 and replace it with the following:

#### **3.2 Non-Reference Services—Negotiated Services**

- delete the heading for section 3.4 replace it with the following:

#### **3.3 Service Standards and Quality**

## Capital Base

**Amendment 3.1:** delete Table 3 in the access arrangement information and replace it with the following:

**Table 3.7: Actual vs regulatory allowances for total capital expenditure for the previous Access Arrangement (\$'000, nominal)**

	Jan to June 2006	2006-07	2007-08	2008-09	2009-10	Total
Actual/Estimated expenditure	1727	2191	3816	3594	4225	15 554
Less network management costs						1 400
Total						14 154

**Amendment 3.2:** delete Table 11 in the access arrangement information and replace it with the following:

**Table 3.8: Regulatory depreciation in the previous Access Arrangement (\$'000, nominal)**

	Jan-June	2006-07	2007-08	2008-09	2009-10
Total	564	1226	1332	1474	1588

**Amendment 3.3:** delete Table 13 in the access arrangement information and replace it with the following:

**Table 3.9: CPI indexation of capital base (%)**

	Jan to June 2006	2006-07	2007-08	2008-09	2009-10
Total	1.33	3.54	2.33	4.35	1.82

**Amendment 3.4:** delete Table 12 in the access arrangement information and replace it with the following:

**Table 3.10: Calculation of the capital base as at 30 June 2010 (\$'000, nominal)**

	Jan-June 2006	2006-07	2007-08	2008-09	2009-10
Opening capital base	44 515	46 280	48 921	52 590	57 079
Capital expenditure	1727	2191	3816	3594	4225
Less network management costs					1400

Depreciation	564	1226	1332	1474	1588
Disposals	0	0	0	0	0
Adjustment for inflation (indexation)	602	1676	1186	2368	1466
Less difference between actual and forecast capital expenditure (Jan–June 06)					25
Less adjustment					13
Closing capital base	46 280	48 921	52 590	57 079	59 743

**Amendment 3.5:** delete Tables 14, 15, 16 and 17 in the access arrangement information and replace them with the following:

**Table 3.11: Forecast conforming capital expenditure for the access arrangement (\$'000 real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Asset replacement and refurbishment	1984	1681	1835	1894	8819	8843
Growth related	1690	2150	1827	1470	1737	8874
Total	3674	3834	3661	3364	3163	17693

**Table 3.12 Forecast mains refurbishment expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Refurbishment cost	1588	1452	1624	1508	924

**Table 3.13: Forecast meter replacement expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Meter replacement cost	399	230	211	387	502

**Table 3.14: Forecast new connection expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Small customers	521	522	523	526	528

Medium/large customers	15	15	15	15	15
Expansion mains:	214	215	216	217	217
Network reinforcement	944	1404	1079	716	980
Total	1694	2155	1832	1473	1741

**Amendment 3.6:** delete Table 19 in the access arrangement information and replace it with the following:

**Table 3.15: Forecast depreciation for the access arrangement (\$'000, nominal)**

	Total economic life	Average Remain. life	WDV 30/6/10	2010–11	2011–12	2012–13	2013–14	2014–15
System assets	52.6	33.4	59544	2084	2231	2379	2533	2695
Non-system assets	5	1	199	204	0	0	0	0
Total				2288	2231	2379	2533	2695

**Amendment 3.7:** delete Table 20 in the access arrangement information and replace it with the following:

**Table 3.16: Forecast capital base as at 30 June for each year of the access arrangement (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening capital base	59 743	62 830	66 314	69 649	72 671
Forecast capital expenditure	3911	4176	4089	3848	3706
Forecast depreciation	2288	2231	2379	2533	2695
Disposals	0	0	0	0	0
Adjustment for inflation (Indexation)	1464	1539	1625	1706	1780
Closing capital base	62 830	66 314	69 649	72 671	75 462

**Amendment 3.8:** delete section 12 of the access arrangement proposal and replace it with the following:

*Country Energy Gas* proposes to use the allowed forecast depreciation in this *Access Arrangement* to determine the opening *Capital Base* for the *Access Arrangement* commencing on 1 July 2015.

**Amendment 3.9:** delete sections 14.1(a) to (d) in the access arrangement proposal.

## Rate of Return

**Amendment 5.1:** delete the rate of return in chapter 6 in the access arrangement information and replace it with the following:

**Table 5.1: WACC parameters**

Parameter	AER's draft decision
Nominal risk-free rate (%)	5.54 <sup>a</sup>
Inflation (%)	2.45 <sup>b</sup>
Real risk-free rate (%)	3.02 <sup>a</sup>
Equity beta	0.8
Market risk premium (%)	6.5
Debt risk premium (%)	4.24 <sup>a</sup>
Debt to total assets (gearing) (%)	60
<b>Nominal vanilla WACC (%)</b>	<b>10.16<sup>a</sup></b>
Gamma (utilisation of imputation credits)	0.65

Source: AER analysis.

a: These figures are current to 23 October 2009, but should be considered indicative only. They will be updated for the final decision (in accordance with the averaging period set out in confidential appendix A).

b: This figure will be updated for the final decision using the latest data from the RBA statement of monetary policy.

## Taxation

**Amendment 6.1:** delete the taxation standard life of 80 years for high pressure mains in the PTRM and replace it with 50 years.

## Operating Expenditure

### **Amendment 7.1:**

- delete Table 23 in the access arrangement information and replace it with the following table
- make any and all consequential amendments necessary to take account of and reflect the

table below.

**Table 7.5: Country Energy’s forecast operating expenditure (\$’000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
<b>Controllable costs</b>						
Network operations and maintenance	1259	1279	1302	1328	1356	6524
Marketing	111	111	111	112	113	557
Direct gas network management	322	327	333	340	347	1670
Corporate allocation	193	196	199	203	208	999
Sub total	1885	1914	1946	1983	2023	9750
<b>Non-controllable costs</b>						
Self insurance	1	1	1	1	1	4
Debt raising costs	36	37	38	39	40	192
Unaccounted for gas	549	523	494	469	444	2 480
Sub total	586	561	534	509	485	2 676
<b>Total operating expenditure</b>	<b>2 471</b>	<b>2 475</b>	<b>2 480</b>	<b>2 493</b>	<b>2 508</b>	<b>12 426</b>

**Amendment 7.2:** delete section 5.3.3 in the access arrangement proposal including the table and replace it with the following:

An allowance for the cost of unaccounted for gas has been included in Country Energy’s operating expenditure.

**Amendment 7.3:** delete section 8.1.4 in the access arrangement information and replace it with the following:

An allowance for the cost of unaccounted for gas has been included in Country Energy’s operating expenditure.

**Amendment 7.4:** delete the text in brackets in section 5.2.1 (d) of the access arrangement proposal that states ‘including an amount for *unaccounted for gas*’.

## **Total Revenue**

**Amendment 8.1:** delete Tables 28 and 29 in the access arrangement information and replace them with the following:

**Table 8.3 – Forecast total revenue requirements for the Access Arrangement (\$m, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	5.9	6.2	6.6	6.9	7.2
Depreciation	0.8	0.7	0.8	0.8	0.9
Operating and maintenance	2.5	2.6	2.7	2.7	2.8
Corporate income tax	0.2	0.2	0.2	0.2	0.2
Total	9.5	9.7	10.2	10.7	11.2

**Table 8.4 – Real price adjustments for the Access Arrangement (%)**

	2010–11	2011–12	2012–13	2013–14	2014–15
X factor tariff revenue <sup>a</sup>	-16.6	-2.5	-2.5	-2.5	-2.5

(a) Negative values for X indicate real price increases under the CPI-X formula.

## Demand Forecasts

**Amendment 9.1:** delete Table 8 in the access arrangement information and replace it with the following:

**Table 9.4: Country Energy’s forecast demand and customer numbers for the access arrangement period (units as stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
<b>Volume Load Forecasts</b>					
Volume customers (no.)	18 869	19 159	19 449	19 739	20 029
Total volume load (GJ)	915 353	927 642	937 948	949 132	960 241
<b>Contract Load Forecasts</b>					
Contract Customer (no.)	15	15	15	15	15
Bomen Load Zone (GJ)	496 372	496 193	496 013	495 834	495 655
Central / Fringe zone load (GJ.)	184 972	184 802	184 632	184 461	184 291
Total contract load (GJ)	681 344	680 995	680 645	680 295	679 946
<b>Total load</b>	1 596 697	1 608 637	1 618 593	1 629 427	1 640 187
<b>Contract MDQ</b>					
Bomen zone MDQ (GJ)	3099	3099	3099	3099	3099
Central/Fringe zone MDQ (GJ)	1084	1084	1084	1084	1084

## Reference Tariffs

**Amendment 10.1:** delete section 13.6 in the access arrangement proposal and section 8.2.4 in the access arrangement information.

## Tariff Variation Mechanism

**Amendment 11.1:** amend section 8.2.2.1 in the access arrangement information to include the following:

$$\frac{\sum_{j=1}^m P_{ij}^t * Q_{ij}^{t-2}}{\sum_{j=1}^m P_{ij}^{t-1} * Q_{ij}^{t-2}} \leq 1.1 + \% \Delta CPI$$

For all tariff i where i = 1, ..., n

Where the tariff class has up to 'j' components where j = 1, ..., m

Note: this side constraint formula applies to CPI changes only (and not cost pass throughs).

### Amendment 11.2:

- delete the first sentence of clause 13.1 of the access arrangement proposal and replace it with the following:

The manner in which the *Reference Tariff* for the *Contract Transportation Service* and the *Volume Transportation Service* will change annually on 1 July 2011 and 1 July in each *Year* thereafter throughout this *Access Arrangement* is set out in section 8 of the *Access Arrangement Information*.

- delete the first sentence of clause 8.2.2 in the access arrangement information and replace it with the following:

This clause sets out the manner in which *Reference Tariffs* (including *Monthly Metering Charges*) and *Additional Services* will change on 1 July 2011 and 1 July each *Year* thereafter throughout the *Access Arrangement Period*.

### Amendment 11.3:

- delete section 8.2.2.1 in the access arrangement information and replace it with the following:

As occurred in the previous *Access Arrangement*, *Reference Tariffs* (excluding *Monthly Metering Charges*) will change on 1 July each year (starting from 1 July 2011) in accordance with the following formula:



$$(1 + CPI_{t-1}) * (1 - X_t) > \left( \frac{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t Q_{ij}^{t-2}}{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^{t-1} Q_{ij}^{t-2}} \right)$$

where:

$P_{ij}^t$  is the proposed price for component j of tariff I in the coming year

$P_{ij}^{t-1}$  is the price currently being charged for component j of tariff i

$Q_{ij}^{t-2}$  is the *Quantity* of component j of tariff I sold in the previous year

$X_t$  is the real change in average prices from year t-1 to year t, as set out in section 7.2 above

'Change in the CPI' for a Year t-1 means the average of the CPI for the four quarters to the December quarter immediately preceding Year t-1 divided by the average of the CPI for the four quarters to the December quarter immediately preceding Year t-2, as set out on page 45 of this *Access Arrangement*.

Year t is defined in the *Access Arrangement* as the financial year ending 30 June each Year of the access arrangement period. For example t = 2011 means the period 1 July 2010 to 30 June 2011.

- delete the definition of 'Change in the CPI' in section 15 in the access arrangement proposal and replace it with the following:

'Change in the CPI' for a Year t-1 means the average of the CPI for the four quarters to the December quarter immediately preceding Year t-1 divided by the average of the CPI for the four quarters to the December quarter immediately preceding year t-2.

**Amendment 11.4:** amend the access arrangement proposal to include a new subsection in section 13 for a rounding convention for the tariff variation formula mechanism.

**Amendment 11.5:** amend section 13.5 in the access arrangement proposal to include a new paragraph (h):

if it appears that the past tariff variations contain a material error or deficiency because of a clerical mistake, accidental slip or omission, miscalculation or misdescription the *Regulator* may change subsequent tariffs to account for these past issues.

**Amendment 11.6:** amend section 13.5 in the access arrangement proposal to include a new subsection 13.5 g(3):

a statement must be provided to support the *Gas Quantity* inputs in the tariff variation formula. The statement must be independently audited or verified and the *Quantity* input must reflect the most recent annual quantities available at the time of tariff variation assessment. The actual annual *Quantity* should be provided as four quarters of *Gas Quantity* data reconciling to an annual total *Quantity* of *Gas*.

**Amendment 11.7:** amend the end of subsection 13.5(f)(2) in the access arrangement proposal to include the following:

which is supported by relevant workings

**Amendment 11.8:**

- amend section 13.4 in the access arrangement proposal to include the following:

General pass through event: any other *Pass Through Event* whose costs is not already included in building block revenue or reimbursed by a third party. These events will be assessed at the time of application for consistency with the relevant NGR criteria.

- amend section 8.2.3 in the access arrangement information to include a new bullet point:
  - General pass through event

**Amendment 11.9:** delete section 13.4.1 in the access arrangement proposal and replace it with the following:

(a) Material impact for a *Pass Through Event* is one per cent of the approved total revenue in 2009–10 dollars in the *Year* the cost is incurred for each event except each Tax Change event in 13.4.1(b).

(b) Material impact for a Tax Change event is commensurate with the administrative costs of the service provider, user and the *Regulator* in making and reviewing a notification.

**Amendment 11.10:** delete section 13.4.3(g) in the access arrangement proposal and replace it with the following:

In assessing pass through application, the Relevant *Regulator* must take into account the following:

- the costs to be passed through are for the delivery of *Pipeline* services
- the costs to be passed through are building block components of total revenue
- the costs to be passed through meet the relevant NGR criteria for determining the building block for total revenue for *Reference Services*
- the costs to be passed through have not been funded by other means including self insurance, external insurance or paid for or compensated by another third party, and
- any other factors the Relevant *Regulator* considers are relevant and consistent with the NGL and NGR.

**Amendment 11.11:** correct the following typographical and drafting errors in the access arrangement proposal:

- in section 13.4.2(b): delete 13.4.1(a) and replace it with 13.4.2(a)
- in section 13.4.3(a): delete 13.4.1 and replace it with 13.4.2 and delete 13.4.4 and replace it with 13.4.5
- in section 13.4.3(b): delete 13.4.1 and replace it with 13.4.2

- in section 13.4.3(c): delete 13.4.2(b) and replace it with 13.4.3(b)
- in section 13.4.3(d): delete 13.4.2(b) and replace it with 13.4.3(b)
- in section 13.4.3(f): delete 13.4.2(e) and replace it with 13.4.3(e)
- in section 13.4.5: delete 13.4.2(b), (c) or (f) and replace it with 13.4.3(b), (c) or (f).

**Amendment 11.12:** amend section to 13.4.2(b) in the access arrangement proposal to include two new clauses:

- using a verification statement by an officer of the service provider that the financial impact of the *Pass Through Event* in an application under clause 13.4.2(a) is net of any third party including insurer payment or reimbursement in connection with the event. The verification statement will also provide information about the financial impact of the event less any reimbursement or payment made by a third party in connection with the event to verify the financial impact of the event in an application under clause 13.4.2(a).
- an application under clause 13.4.2(a) for a Tax Change event must be supported by information about the financial impact of taxation change event from the relevant taxation or regulatory authority. An application for a *Pass Through Event* other than a Tax Change event must be supported by relevant information to justify the financial impact of the events with reference to the relevant capital and/or operating expenditure criteria.

**Amendment 11.13:** delete section 13.4.3(c) in the access arrangement proposal and replace it with the following:

The *Regulator* must give notice to *Country Energy Gas* under section 13.4.3(b) within 30 *Business Days* of receiving an application from *Country Energy Gas*. This period may be extended for the time taken by the *Regulator* to obtain information from *Country Energy Gas*, obtain expert advice or consult about the *Pass Through Event*. The AER must assess a pass through application within 90 *Business Days* including any extension of decision making time. Excluding the extension of decision making time, on the 31st *Business Day* the *Regulator* is deemed to have notified *Country Energy Gas* that the proposed amendments to *Reference Tariffs* are to apply as specified in the application.

**Amendment 11.14:** delete section 13.4.3(e) in the access arrangement proposal and replace it with the following:

*Country Energy Gas* must notify the *Regulator* of a *Pass Through Event* within 3 months of the occurrence of that event.

**Amendment 11.15:** amend the access arrangement proposal to:

- delete section 13.5(a) and replace it with the following:
  - (a) This Notification and Approval process applies to notifications for annual changes in *Reference Tariffs* under section 13.3 and includes the financial impact of *Pass Through Event* approvals made under section 13.4.3(b) following a notification under section 13.4.2. When *Country Energy Gas* proposes to vary tariffs it is required to provide the *Regulator* with 50 *Business Days* notice prior to the effective date of the variation.

- delete section 13.5(d) and replace it with the following:

- (d) The decision making time under section 13.5(c) of the *Access Arrangement* does not include time where the *Regulator* has requested information from *Country Energy Gas* related to the Notification of Annual Changes in *Reference Tariffs* under section 13.3.

**Amendment 11.16:** amend the first sentence of section 13.4 in the access arrangement proposal and replace it with the following:

*Reference Tariffs* may be varied if there is a material impact on the cost to *Country Energy Gas* of providing *Reference Services* as a result of one *Pass Through Event* listed below (*Pass Through Events*), where the costs were not incorporated in the determination of *Reference Tariff* incorporated in this *Access Arrangement* or, if there has been a previous review of the *Reference Tariffs*, at that review.

## Non-tariff Components

**Amendment 12.1:** amend the terms and conditions in appendix 1 in the access arrangement proposal to include the following:

In the *Terms and Conditions* of this *Agreement*, where a word or phrase is capitalised and italicised the term has the meaning set out in the NGL and NGR, unless the word or phrase is defined in the glossary in section 15 of the *Access Arrangement* in which case the word or phrase has the meaning given to that word or phrase in the glossary.

**Amendment 12.2:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- delete the heading ‘**Unaccounted for Gas**’ which appears immediately above clause 3.22.
- delete clauses 3.22 and 3.23.

**Amendment 12.3:** amend clause 12.12 of the terms and conditions in appendix 1 in the access arrangement proposal to include the following words after the word ‘control’:

unless that liability results from *Country Energy Gas*’ negligence

**Amendment 12.4:** delete clause 6.14 in the terms and conditions in appendix 1 in the access arrangement proposal and replace it with the following:

Invoices will be in a format determined by *Country Energy Gas*. *Country Energy Gas* will ensure that its invoices will include, without limitation, the following information:

- (a) **(gas received):** the quantity of *Gas* deemed to be received from the *User* at the *Receipt Points* in the billing period;
- (b) **(gas delivered):** the quantity of *Gas* delivered to the *User* at each *Delivery Point* in the billing period;
- (c) **(monthly capacity charge):** the *Monthly Capacity Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Contract*

*Transportation Service* is provided, as well as the *MDQ* for that *Delivery Point*;

- (d) **(monthly metering charge):** the *Monthly Metering Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Contract Transportation Service* is provided;
- (e) **(volumetric charge):** the *Volumetric Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Volume Transportation Service* is provided;
- (f) **(monthly fixed charge):** the *Monthly Fixed Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Volume Transportation Service* is provided;
- (g) **(Additional Services charges):** the number of each *Additional Service* provided during the billing period and the total charge for the billing period for each *Additional Service*;
- (h) **(other amounts):** any other charge payable by the *User* in respect of the billing period;
- (i) **(other information):** sufficient information as is reasonable to allow the *User*:
  - (i) to assess the accuracy of the *Charges* specified in each invoice; and
  - (ii) to comply with its obligations under the *Regulatory Instruments* in relation to the provision to the *Customer* of information concerning such *Charges*.

**Amendment 12.5:** include the words ‘and paid’ after the word ‘rendered’ in clause 6.23 of the terms and conditions in appendix 1 in the access arrangement proposal.

**Amendment 12.6:** delete the definition of ‘Charges’ in section 15 in the access arrangement proposal and replace it with the following:

**Charges** means the charges payable by the *User* to *Country Energy Gas* under clause 6 of the *Terms and Conditions* and includes:

- (a) the amount determined from the application of the *Reference Tariffs* in respect of the *Reference Services* provided to the *User* in respect of its *Customers* or such other amount as agreed in writing; and
- (b) *Additional Charges*.

**Amendment 12.7:** include the following words after the word ‘includes’ in clause 8.20 of the terms and conditions in appendix 1 in the access arrangement proposal:

the reasonable disbursements incurred by the *First Party*, including

**Amendment 12.8:** amend section 9 of the terms and conditions in appendix 1 in the access arrangement proposal so the section applies to all parties to the agreement.

**Amendment 12.9:** delete the definition of the term ‘Force Majeure Event’ in section 15 in the access arrangement proposal and replace it with the following:

**Force Majeure Event** means an event or circumstance beyond the reasonable control of a party, as the case may be, which results in or causes a failure by such party in the performance of any obligations imposed on it by the *Agreement* notwithstanding the

exercise by such party of reasonable care and will include but will not be limited to acts of God, sabotage, acts of war, blockades, insurrections, riots, epidemics, floods, storms, fires, washouts, explosions, breakage of or accident to machines or lines of pipe, freezing of wells or delivery facilities, well blowouts, craterings, the necessity for making repairs to or reconditioning wells, machinery, equipment or pipelines (not resulting from the fault or negligence of the relevant party), arrests and restraints of rulers and peoples, civil disturbances and the order of any court or government authority.

**Amendment 12.10:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- include a new clause 10.6:

**Country Energy to indemnify the User**

10.6 *Country Energy Gas* shall indemnify the *User* against *Claims* arising from, or incurred by the *User* as a consequence of, any action taken by the *User* under this clause 10 to enforce the *Country Energy Gas*' rights at the request of *Country Energy Gas*, except to the extent that the *Claim* arises from the negligent or reckless act or omission of the *User* or from any breach or non-observance by the *User* of the *Agreement* or the *Regulatory Instruments*.

- include a new clause 10.7:

**Limitation of the User's obligations**

10.7 Nothing in this clause is intended to affect or impose on the *User* any of *Country Energy Gas*' rights or obligations under the *Regulatory Instruments*.

**Amendment 12.11:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- include a new clause 12.2A after clause 12.2:

12.2A *Country Energy Gas*' liability will not be limited in this way if:

- (a) the *User* establishes that such a limitation is not fair or reasonable in the circumstances; or
- (b) the condition or warranty is implied under section 69 of the *Trade Practices Act 1974* (Cth).

- include at the start of before clause 12.13: 'Subject to clauses 12.2 to 12.2A,'.

**Amendment 12.12:** amend clause 5.6.2 in the access arrangement proposal to include after the first paragraph:

In the case of a guarantee, it must be in the form of the *Required Bank Guarantee*.

**Amendment 12.13:** delete the definition of 'Required Bank Guarantee Amount' in section 15 in the access arrangement proposal and replace it with a definition of the term 'Required Bank Guarantee' where by the term 'Required Bank Guarantee' should be defined as the pro forma bank guarantee set out in the appropriate appendix in the access arrangement proposal.

**Amendment 12.14:** delete clause 1.11 of the terms and conditions in appendix 1 in the access

arrangement proposal and replace it with:

1.11 The *Access Arrangement* prevails to the extent of any inconsistency between the *Terms and Conditions* and the *Access Arrangement*.

**Amendment 12.15:** amend the end of the first sentence at section 5.1(g) in the access arrangement proposal to include:

‘and approved by the Regulator in accordance with r. 66 and r. 67 of the NGR’

**Amendment 12.16:** amend the beginning of clause 18.3 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Subject to clause 18.4

**Amendment 12.17:** amend the beginning of clause 18.4 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Amendments to the *Agreement* can only be approved by the *Regulator*.

**Amendment 12.18:** amend the beginning of clause 18.13 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Subject to clauses 18.3 and 18.4

**Amendment 12.19:** delete section 4.5.1 in the access arrangement proposal and replace it with the following:

The *User* must enter into agreements with its *Customers* which are in accordance with the provisions of Schedule 2 of the *Terms and Conditions* and Schedule 1 of the Gas Supply (Natural Gas Retail Competition) Regulation 2001.

**Amendment 12.20:** delete paragraph (c) in section 5.1 in the access arrangement proposal and replace it with the following:

(c) the *Retail Market Procedures*

**Amendment 12.21:** delete the term ‘*Service Agreement*’ in section 5.7.1 in the access arrangement proposal and replace it with ‘service agreement’.

**Amendment 12.22:** delete the headings in section 8 in the access arrangement proposal and section 9.2 in the access arrangement information and replace them with ‘Contract Carriage Pipeline’.

**Amendment 12.23:** delete the definition of ‘Contracted Capacity’ in section 15 in the access arrangement proposal following:

**Contracted Capacity** means, in respect of a *User*, the part of the *Capacity* which has been reserved by that *User* pursuant to an agreement entered into with *Country Energy Gas*.

**Amendment 12.24:** correct the following typographical and drafting errors in the terms and conditions in appendix 1 in the access arrangement proposal:

- there are two clauses 3.11. The second clause 3.11 should be numbered 3.12 and

the remaining clauses should be renumbered.

- in clause 3.18: delete clause 3.15 and replace it with clause 3.17(c)
- delete the words ‘and the Asset Removal Policy’ from clause 5.17
- in clause 8.6: delete clause 8.7(a) and replace it with clause 8.5
- delete the word ‘If’ from the second line of clause 11.13 and delete the words ‘under the *Regulatory Instruments*, then *Country Energy Gas* may terminate the *Agreement* by notice to the *User*, effective from the date specified in the notice’ from the end of the clause.
- in clause 13.15(a): delete clause 14.5(b) and replace it with clause 13.12
- the content of clause 14.1 is a heading for the two clauses which follow it. Therefore, it should not be numbered as a clause and, instead, should be made into a heading.
- in clause 14.6: delete clauses 5.5 and 5.6 and replace them with clause 5.9
- delete the word ‘or’ from the end of clause 15.2(d)
- delete the words ‘Conditions on disclosure’ in clause 16.1(h) and replace them with ‘Information Exchange’
- italicise and capitalise the first letter of, the word ‘producer’ in clause 16.2.

**Amendment 12.25:** amend end of section 5.4.1 in the access arrangement proposal to include the following:

In the event that load shedding is required, *Country Energy Gas* will advise any *User* what load shedding priority category the *User* falls into at the *User*’s request.

**Amendment 12.26:** amend section 11.2.4(d) in the access arrangement proposal to:

- delete the words ‘duration of the *Agreement*’ and replace them with ‘remaining duration of the *Agreement*’
- include the following words at the end of the last sentence of the section: ‘or, in the case of the fifth unauthorised *Overrun* in that *Year*, the month in which the fifth unauthorised *Overrun* occurred’.

**Amendment 12.27:** amend section 9 in the access arrangement proposal to include at the end of the first sentence:

To the extent that the NGR does not apply (because *Country Energy Gas* is registered as a participant in a gas market and the rules or procedures of the gas market deal with capacity trading), the capacity trading requirements in this *Access Arrangement* are subject to the Gas Retail Market Business Rules to Support Retail Competition in Gas for the NSW and ACT gas retail market (or, if these rules are no longer applicable, any other rules or procedures which govern the gas market in which *Country Energy Gas* is a registered participant) in force from time to time



**Amendment 12.28:** amend the end of section 9.3 in the access arrangement proposal to include:

in accordance with the capacity trading requirements

**Amendment 12.29:** amend the definition of *Capacity Transfer* in section 15 in the access arrangement proposal to italicise and capitalise the first letter of, the word ‘agreement’.

**Amendment 12.30:** delete the text in section 7.1.1 in the access arrangement proposal and replace it with the following:

**7.1.1.1 High pressure pipeline extensions**

- (a) If *Country Energy Gas* proposes a high pressure pipeline extension of the *Covered Pipeline* it must apply to the *Regulator* in writing to decide whether the proposed extension will be taken to form part of the *Covered Pipeline* and will be covered by this *Access Arrangement*. The application must describe the extension and set out why the extension is necessary.
- (b) The application must be made before the proposed high pressure pipeline extension comes into service.
- (c) After considering the application, and undertaking such consultation as the *Regulator* considers appropriate, the *Regulator* will inform *Country Energy Gas* of its decision.
- (d) The decision may be made on such reasonable conditions determined by the *Regulator* and will have the operation specified in the decision.

**7.1.1.2 Low and medium pressure pipeline extensions**

Any low or medium pressure pipeline extension of the *Capacity* of the *Network* will be treated as part of the *Network* and accordingly will be the subject of coverage under this *Access Arrangement*. No later than 20 *Business Days* following the expiration of each *Year*, *Country Energy* must notify the *Regulator* of all low and medium pressure pipeline extensions of the *Capacity of the Network* (including all extensions commenced, in progress and completed) during that *Year*. The notice must describe each extension and set out why the extension was necessary.

**Amendment 12.31:** amend the end of section 7.1.2 in the access arrangement proposal to include:

No later than 20 *Business Days* following the expiration of each *Year*, *Country Energy* must notify the *Regulator* of all expansions of the *Capacity* of the *Network* (including all expansions commenced, in progress and completed) during that *Year*. The notice must describe each expansion and set out why the expansion was necessary.

**Amendment 12.32:** delete section 7.2(c) in the access arrangement proposal and replace it with the following:

*Country Energy* will notify the *Regulator* of any proposed *Surcharge* to be levied on users of incremental services and designed to recover non-conforming capital expenditure or a specified portion of non-conforming capital expenditure (non-conforming capital expenditure which is recovered by means of a *Surcharge* will not be rolled into the capital base).

**Amendment 12.33:** delete section 7.2(d) in the access arrangement proposal and replace it

with the following:

Despite sections 7.2 (a) and (b), but subject to the NGR, *Country Energy Gas* and a *Prospective User* or *Users* or a third party may agree that the *Prospective User* or *Users* or a third party will contribute to the funding of an extension or expansion.

**Amendment 12.34:** delete the word ‘Where’ at the beginning of sections 7.3.2 and 7.3.3 in the access arrangement proposal and replace it with the following:

Subject to the NGR, where

**Amendment 12.35:** delete the last sentence of section 9.4.2 in the access arrangement proposal and replace it with the following:

The efficient costs incurred as a result of a change of *Delivery Point* will be charged to the *User*.

**Amendment 12.36:** delete the last sentence of section 9.5.1 in the access arrangement proposal and replace it with the following:

*Country Energy Gas* may refuse its consent or make the granting of consent subject to conditions where this is commercially and technically reasonable including where *Country Energy Gas* would not, after the change, receive at least the same amount of revenue it would have received before the change.

**Amendment 12.37:** delete section 10.3 in the access arrangement proposal and replace it with the following:

### 10.3 Trigger events

#### 10.3.1 Increases in demand or capital expenditure

If one of the following trigger events occurs:

- (a) a new or existing service is sought by a significant part of the market such that a non-temporary increase in actual throughput is in excess of 15 per cent of the demand forecast for the *Year* as provided in the *Access Arrangement Information*; or
- (b) an extension, expansion or interconnection occurs such that capital expenditure incurred for that extension, expansion or interconnection for a *Year* is in excess of 5 per cent of the forecast capital base for that *Year*,

the *Revisions Submission Date* stated in section 10.2 of the *Access Arrangement* will advance and require *Country Energy Gas* to submit an access arrangement revision proposal to the *Regulator* within six calendar months of the occurrence of the trigger event, but in any case before the *Revisions Submission Date*. *Country Energy Gas* must notify the *Regulator* of the occurrence of a trigger event as soon as it is practically possible and, in any event, no later than five *Business Days* following the occurrence of the trigger event. The notice must contain a description of the event, specify when it occurred and state the level: (i) for the purpose of (a) above, of the non-temporary increase in actual throughput; and (ii) for the purpose of (b) above, of the capital expenditure incurred for that extension, expansion or interconnection. An event which is a *Pass Through Event* cannot be a trigger event for the purposes of section 10.3(b).

**Amendment 12.38:** amend section 10.3 in the access arrangement proposal to include the

following new section 10.3.2:

- 10.3.2 Amendments to the NGL and NGR
- 10.3.2.1 The *Revisions Submission Date* stated in section 10.2 of this *Access Arrangement* will advance on the occurrence of a *NGL or NGR Trigger Event* described in clause 10.3.2.2.
- 10.3.2.2 For the purposes of clause 10.3.2.1, a “*NGL or NGR Trigger Event*” occurs if:
  - (a) there is an amendment to the *NGL* or *NGR*; and
  - (b) the *Regulator* provides *Country Energy Gas* with a notice stating that the amendment described in clause 10.3.2.2(a) affects this *Access Arrangement*.
- 10.3.2.3 The new *Revisions Submission Date* will be the date which is the earlier of six calendar months from the date of the notice provided by the *Regulator* under clause 10.3.2.2 and the original *Revisions Submission Date* stated in section 10.2 of this *Access Arrangement*.

## Shortened forms

access arrangement information	Country Energy gas Pty Ltd, Access arrangement information for the Wagga Wagga natural gas distribution network, 1 July 2009
access arrangement period	1 July 2010 to 30 June 2015
access arrangement proposal	Country Energy gas Pty Ltd, Access arrangement for the Wagga Wagga natural gas distribution network, 1 July 2009
AER	Australian Energy Regulator
Code	National Third Party Access Code for Natural Gas Pipeline Systems
Country Energy	Country Energy Gas Pty Ltd
CPI	consumer price index
earlier access arrangement	access arrangement for 1 July 2005 to 30 June 2010 inclusive
earlier access arrangement period	1 July 2005 to 30 June 2010 inclusive
IPART	The Independent Pricing and Regulatory Tribunal
NGL	National Gas Law
NGR	National Gas Rules

# Summary

## Introduction

The AER is responsible for the economic regulation of covered natural gas distribution pipelines in all states and territories (except WA). The AER's functions and powers are set out in the National Gas Law (NGL) and the National Gas Rules<sup>9</sup> (NGR). The NGL and NGR came into effect on 1 July 2008. Prior to this, the National Third Party Access Code for Natural Gas Pipeline Systems (Code) provided the relevant regulatory framework for gas distribution pipelines. Country Energy's Wagga Wagga distribution pipeline is currently subject to an access arrangement approved by the Independent Pricing and Regulatory Tribunal (IPART) under the Code. The AER's draft decision on Country Energy's access arrangement revision proposal (access arrangement proposal) for Country Energy for the period 1 July 2010 to 30 June 2015 (access arrangement period) is one of the first to be made by the AER under the new law. The AER relies on the transitional access arrangement provisions set out in schedule 1 of the NGR. These are designed to facilitate the transition of previous access arrangements from the Code to the NGR.

On 1 July 2009, Country Energy submitted its access arrangement proposal to the AER. The AER published Country Energy's access arrangement proposal on 22 July 2009. Interested parties were invited to make submissions on the proposal and no submissions were received. Country Energy presented its access arrangement proposal at a public forum held in Wagga Wagga on 28 July 2009.

The AER engaged the following consultants to assist in its consideration of the access arrangement proposal:

- Wilson Cook to review the proposed capital expenditure
- ACIL Tasman to review the proposed demand forecasts
- Access Economics to advise on the proposed labour cost escalators.

The draft decision should be read in conjunction with the consultants' reports, which are available on the AER's website.

## Regulatory requirements

### National Gas Law

The NGL sets out the functions and powers of the AER, including its role as the economic regulator of covered natural gas distribution pipelines. The NGL states that when performing or exercising a regulatory function or power, the AER must do so in a manner that will or is likely to contribute to the achievement of the national gas

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<sup>9</sup> The AER uses the version of the NGR that is in effect at the date the regulatory proposal is lodged. For the purposes of the draft decision, the relevant version of the NGR came into effect on 1 July 2009.

objective.<sup>10</sup> The AER is also required to take into account the revenue and pricing principles when exercising its discretion in approving or making those parts of an access arrangement relating to a reference tariff.

## **National Gas Rules**

The NGR sets out the provisions the AER must apply in exercising its regulatory functions and powers when making the access arrangement draft decision. This involves using a building block approach to determine total revenue for pipeline services, tariff setting for reference services and approving other terms and conditions of access for the pipeline.

## **Pipeline services**

Country Energy proposes to offer pipeline services, comprising reference services and services which are not reference services. The services are largely the same as those offered in the earlier access arrangement period.

However, the AER notes that there is ambiguity in Country Energy's access arrangement proposal and access arrangement information regarding the classification of additional services and requires additional services are treated as reference services.

## **Total revenue (building block components)**

### **Capital Base**

#### **Opening capital base**

Country Energy proposes an opening capital base of \$61.2 million for the access arrangement period. Country Energy's estimation of the proposed opening capital base is summarised in Table 1.

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<sup>10</sup> NGL, s. 28.

**Table 1: Country Energy's opening capital base (\$'000, nominal)**

	January– June 2006	2006–07	2007–08	2008–09	2009–10
<b>Country Energy's proposed opening capital base</b>					
Opening capital base	44 515	46 280	48 922	52 606	57 108
Capital expenditure	1727	2191	3816	3594	4225
Depreciation	564	1225	1318	1460	1555
Adjustment for inflation	602	1676	1186	2368	1466
Difference between actual and forecast capital expenditure (January–June 2006)					– 25
Return on difference					– 13
Closing capital base	46 280	48 922	52 606	57 108	61 205
<b>AER's conclusion opening capital base</b>					
Opening capital base	44 515	46 280	48 921	52 590	57 079
Capital expenditure	1727	2191	3816	3594	4225
Less network management costs					1400
Depreciation	564	1226	1332	1474	1588
Disposals	0	0	0	0	0
Adjustment for inflation (indexation)	602	1676	1186	2368	1466
Less difference between actual and forecast capital expenditure (Jan–June 06)					25
Less adjustment					13
Closing capital base	46 280	48 921	52 590	57 079	59 743

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 23.

Country Energy's proposed total capital expenditure of \$15.6 million for the earlier access arrangement period is substantially higher than the \$8.1 million approved by the IPART. Included in Country Energy's proposed capital expenditure for the earlier access arrangement period are \$1.4 million of network management costs.

The AER approves an opening capital base of \$59.7 million by:

- removing Country Energy's proposed network management costs of \$1.4 million
- amending depreciation in the earlier access arrangement period for discrepancies
- adjusting the forecast inflation rate for 2009–2010 based on the most recent Reserve Bank of Australia (RBA) forecasts.

### Projected capital base

Country Energy proposes a projected capital base of \$77.3 million, which is summarised in Table 2.

**Table 2: Country Energy's projected capital base and the AER conclusion on projected capital base (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
<b>Country Energy proposed projected capital base</b>					
Opening capital base	61 205	64 330	67 903	71 332	74 428
Forecast capital expenditure	3976	4268	4187	3927	3771
Forecast depreciation	2367	2286	2439	2596	2762
Adjustment for inflation	1515	1592	1681	1765	1842
Closing capital base	64 330	67 903	71 332	74 428	77 278
<b>AER conclusion projected capital base</b>					
Opening capital base	59 743	62 830	66 314	69 649	72 671
Forecast capital expenditure	3911	4176	4089	3848	3706
Forecast depreciation	2288	2231	2379	2533	2695
Disposals	0	0	0	0	0
Adjustment for inflation (Indexation)	1464	1539	1625	1706	1780
Closing capital base	62 830	66 314	69 649	72 671	75 462

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 28.

### Projected capital base

The AER approves a projected capital base of \$75.5 million, by:

- adjusting down the opening capital base as outlined above



- amending the cost escalators used to determine input costs for capital expenditure for more up to date forecasts or double counting of inflation
- using more up-to-date RBA inflation forecasts.

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

## Depreciation

The AER approves Country Energy's proposed straight line depreciation method to estimate depreciation and considers that the proposed reclassification of assets and the depreciation schedule meet the requirements of the NGR.

## Rate of return methodology

Country Energy proposes the use of a nominal vanilla WACC of 10.84 per cent<sup>11</sup>. The AER requires Country Energy to reduce the nominal vanilla WACC to 10.16 per cent based on the amendments required to the nominal risk-free rate, equity beta, market risk premium and debt risk premium. The risk-free rate is determined on the basis of an averaging period which will be updated closer to the final decision date. Table 3 outlines the proposed and approved WACC parameter values.

**Table 3: WACC parameters**

Parameter	Country Energy's proposal	AER's draft decision
Nominal risk-free rate (%)	4.94	5.54 <sup>a</sup>
Inflation (%)	2.47	2.45 <sup>b</sup>
Real risk-free rate (%)	2.41	3.02 <sup>a</sup>
Equity beta	1.1	0.8
Market risk premium (%)	7.0	6.5
Debt risk premium (%)	4.70	3.24 <sup>a</sup>
Debt to total assets (gearing) (%)	60	60
<b>Nominal vanilla WACC (%)</b>	<b>10.84</b>	<b>10.16<sup>a</sup></b>
Gamma (utilisation of imputation credits)	0.30	0.65

Source: AER analysis and Country Energy, *Access arrangement information*, 1 July 2009, pp. 30, 35.

a: These figures have been updated with data current to 23 October 2009, but should be considered indicative only. They will be updated for the final

<sup>11</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29. Although not specified by Country Energy, the formula applied is the standard Sharpe–Lintner CAPM.

decision (in accordance with the averaging period set out in confidential appendix A).

- b: This figure will be updated for the final decision using the latest data from the RBA statement of monetary policy.

## **Taxation**

Country Energy proposes using a post-taxation framework to estimate total revenue. Using actual taxation asset values as at 30 June 2008 which are rolled forward to establish an opening taxation asset base at 30 June 2010. Country Energy proposes estimating taxation depreciation on a straight line basis using the effective lives published by the Australian Taxation Office (ATO).

The AER approves Country Energy's proposed approach to estimating the cost of corporate income taxation, but requires Country Energy to change the taxation standard life of high pressure mains from 80 years as proposed to 50 years.<sup>12</sup>

## **Operating expenditure**

Country Energy proposes forecast total operating expenditure for the access arrangement period of \$13.0 million (\$2009–10) or an increase of 28.0 per cent in the average annual expected operating expenditure.

The AER requires Country Energy to reduce Country Energy's proposed total operating expenditure by \$0.6 million (\$2009–10) or 4.3 per cent to a total operating expenditure of \$12.4 million (\$2009–10). This represents an increase in real terms of approximately 25 per cent over the earlier access arrangement period, after adjusting for the earlier period being only 4.5 years duration. The adjustments include:

- an additional \$2.5 million (\$2009–10) for unaccounted for gas (UAG) which was not included in Country Energy's proposed operating expenditure
- a change in the referable base year to 2008–09
- reductions in proposed self insurance operating expenditure.

Table 4 sets out Country Energy's proposed forecast operating expenditure and the AER's draft decision forecast operating expenditure.

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<sup>12</sup> Australian Taxation Office, *Taxation Ruling Income tax: effective life of depreciating assets*, 2002, viewed 20 July 2009, p. 32.  
<<http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR200018%2FNAT%2FATO%2F00001&filename=pdf/pbr/tr2000-018c4.pdf&PiT=20020626000001>>.

**Table 4: AER’s conclusion on Country Energy’s forecast operating expenditure (\$’000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
<b>Country Energy proposed operating expenditure</b>						
Controllable costs	2346	2398	2445	2483	2524	12 196
Non controllable costs <sup>a</sup>	157	158	158	159	160	792
Total operating expenditure <sup>b</sup>	2503	2556	2603	2642	2684	12 988
<b>AER draft decision operating expenditure</b>						
Controllable costs	1885	1914	1946	1983	2023	9750
Non controllable costs	586	561	534	509	485	2676
Total operating expenditure <sup>b</sup>	2471	2475	2480	2493	2508	12426

Source: Country Energy, *Access arrangement information*, 1 July 2009, p.32, AER’s draft decision on Operating expenditure, chapter 7.

a: Country Energy does not separate operating expenditure into controllable and non controllable costs.

b: Totals may not add up due to rounding.

### Total revenue

Country Energy’s proposed total revenue requirement for each year of the access arrangement period and X factors are set out in table 5.

**Table 5: Country Energy’s proposed annual revenue requirements and X factors (\$’000, nominal unless otherwise stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	6635	6973	7361	7732	8068
Return of capital	852	694	758	831	921
Operating expenditure	2565	2684	2801	2913	3032
Benchmark tax liability	526	502	543	584	624
Total costs	10 578	10 853	11 463	12 060	12 645
X factor <sup>a</sup> (%)	–33.6	–2.5	–2.5	–2.5	–2.5

Source: Country Energy, *Access arrangement information*, June 2009, p. 37.

a: Negative values for X indicate real price increases under the CPI–X formula.

The AER has estimated Country Energy’s total revenue over the access arrangement period to be \$48.2 million (\$2009–10), compared to \$57.6 million proposed by Country Energy based on its assessment of building block total revenue components

against the relevant NGR criteria for the building block components. The approved forecasts and relevant X factors are summarised in table 6.

**Table 6: AER’s conclusion on Country Energy’s annual revenue requirements and X factors (\$’000, nominal unless otherwise stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	6.1	6.4	6.7	7.1	7.4
Depreciation	0.8	0.7	0.8	0.8	0.9
Operating and maintenance	2.5	2.6	2.7	2.7	2.8
Corporate income tax	0.2	0.2	0.2	0.2	0.2
Total	9.6	9.8	10.3	10.8	11.3
X factor tariff revenue <sup>a</sup> (%)	-16.6	-2.5	-2.5	-2.5	-2.5
Revenue smoothing path	9.2	9.8	10.4	11.0	11.7

na: Not applicable.

a: Negative values for X indicate real price increases under the CPI-X formula.

## Tariffs

### Demand forecasts

Country Energy’s demand forecasts for the access arrangement period are outlined in Table 7. These demand forecasts support Country Energy’s proposed capital expenditure and operating expenditure forecasts.

**Table 7: Country Energy’s proposal–forecast demand and customer numbers for the access arrangement period (units as stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Volume Customers (no.)	18 449	18 599	18 749	18 899	19 049
Volume load (GJ)	895 278	900 925	904 682	909 326	913 929
Contract Customers (no.)	15	15	15	15	15
Contract load (GJ)	681 344	680 995	680 645	680 295	679 946
Total load (GJ)	1 576 622	1 581 920	1 585 327	1 589 621	1 593 875

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 20.

The AER does not consider that all of the assumptions underlying Country Energy’s demand forecasts for volume customers are adequately supported and it does not approve Country Energy’s demand forecasts. The required amendments to Country Energy’s demand forecasts are summarised in Table 8.

**Table 8: AER’s draft decision demand forecasts and customer numbers for the access arrangement period (units as stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Volume Customers (no.)	18 869	19 159	19 449	19 739	20 029
Total volume load (GJ)	915 353	927 642	937 948	949 432	960 241
Total load (GJ)	1 596 697	1 608 637	1 618 593	1 629 427	1 640 187

### Reference tariffs

Country Energy proposes two tariff classes, contract and volume, similar to the earlier access arrangement period except for the merger of the central and fringe zone tariffs for contract transportation services. Country Energy submits that tariffs meet the requirements for determining distribution tariffs and also proposes the inclusion of an arrangement to add or delete reference tariffs or the components of tariffs during the access arrangement period.

The AER does not approve certain aspects of Country Energy’s proposal including the procedure for adding or deleting of reference tariffs during the access arrangement period and the proposed monthly metering charges for contract customers that join the network after 1 July 2010.

Tariffs for residential users are expected to increase by 27 per cent in 2010–11, and then by 9.4 per cent on average each subsequent year of the access arrangement period in nominal terms. Commercial and industrial tariffs will fall by 12.8 per cent and 9.5 per cent respectively in 2010–11 and are estimated to fall by around 2.4 per cent and 1.4 per cent in each subsequent year of the access arrangement period in nominal terms. The tariff reductions for most contract or high volume users over the access arrangement period are even larger than for commercial and industrial users. These estimated tariffs do not take into account the impact of cost pass throughs.

### Tariff variation mechanism

Country Energy proposes using a similar annual tariff variation mechanism to the earlier access arrangement period but updates the cost pass through mechanism for contemporaneous events such as retail project and climate changes. Country Energy also proposes notification and oversight processes.

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. In addition Country Energy needs 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.

## **Other provisions of an access arrangement**

### **Terms and conditions**

Country Energy proposes new terms and conditions for users seeking access to its Wagga Wagga gas distribution network as outlined in its new Standard User Agreement.

The AER has proposed a number of amendments to the Standard User Agreement.

### **Capacity trading requirements**

Country Energy has proposed a number of changes to the trading policy from its earlier access arrangement for the transitioning from the Code to the NGL and NGR.

The AER requires the proposed capacity trading conditions are amended so that liability for the charges and other amounts following the transfer are consistent with the requirements of the NGR.

### **Extension and expansion requirements**

Country Energy has proposed a number of changes to its policy for extensions to, and expansions of the capacity of the pipeline to transition from the Code to the NGL and NGR. It proposes that all extensions made during the access arrangement period be covered by the access arrangement.

The AER considers that whether a particular extension should be covered under the access arrangement will depend on whether the extension relates to a high pressure pipeline or a medium or low pressure pipeline, and the AER has proposed amendments to reflect this requirement. The AER accepts that expansions of pipeline capacity should be covered by default by the access arrangement.

### **Acceleration of review submission date triggers**

Country Energy proposes trigger events when a new service has been sought by a significant part of the market or a significant extension, expansion or interconnection occurs.

The AER requires Country Energy to amend the proposed trigger events to changes to actual demand and large increases in capital expenditure related to an extension, expansion or interconnection during the access arrangement period.

### **Changing receipt and delivery points**

Country Energy proposes that users may change receipt and delivery points with prior written consent, which the AER approves subject to some minor amendments to the terms and conditions for changing receipt and delivery points.

### **Review dates**

Country Energy proposes and the AER approves a review submission date of 1 July 2014 and a revision commencement date of 1 July 2015.

# 1 Introduction

## 1.1 Background

Country Energy was established following the merger of Great Southern Energy, Advance Energy and NorthPower.<sup>13</sup> Country Energy is owned by the NSW government.<sup>14</sup>

### 1.1.1 Regulatory requirements

The AER is responsible for the economic regulation of covered natural gas distribution pipelines in all states and territories (except WA). The AER's functions and powers are set out in the NGL and the NGR.

Country Energy's access arrangement for the earlier access arrangement period is a transitional access arrangement in accordance with schedule 1 of the NGR. This means the transitional arrangements set out in schedule 1 of the NGR apply to the review of Country Energy's access arrangement proposal for the access arrangement period.

#### 1.1.1.1 National Gas Law

The NGL states that when performing or exercising an economic regulatory function or power, the AER must do so in a manner that will or is likely to contribute to the achievement of the national gas objective. The national gas objective is:

... to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.<sup>15</sup>

The AER must take into account the revenue and pricing principles when exercising its discretion in approving or making those parts of an access arrangement relating to a reference tariff. The AER may also take the revenue and pricing principles into consideration in its performance or exercise of any other economic regulatory function or power where it considers this appropriate.<sup>16</sup>

#### 1.1.1.2 National Gas Rules

The NGR sets out the provisions the AER must apply in exercising its regulatory functions and powers when making the draft decision on Country Energy's access arrangement proposal.

#### 1.1.1.3 National Energy Customer Framework

The Ministerial Council on Energy Standing Committee of Officials released the First Exposure Draft of the National Energy Customer Framework (NECF) on 30 April

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<sup>13</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 5.

<sup>14</sup> Country Energy, *Annual Report 2007–2008*, p. 4.

<sup>15</sup> NGL, s. 23.

<sup>16</sup> NGL, s. 28. The revenue and pricing principles are set out in NGL, s. 24.

2009.<sup>17</sup> The details of the final framework, the timing of the new regulatory framework and transitional provisions that may apply are not yet finalised and it is uncertain what impact, if any, the new framework might have on access arrangements. Rule 65 of the NGR allows for variations of applicable access arrangements and is available to service providers if changes to the access arrangement are required following the introduction of the NECF.

### **1.1.2 Pipeline description**

Country Energy's Wagga Wagga gas distribution network has around 680 km of pipeline, delivers approximately 1.6 PJ of gas annually and supplies gas to over 18 300 customers located primarily in the districts of Wagga Wagga and its surrounding areas.<sup>18</sup>

Gas is sourced from the Cooper Basin and supplied by a lateral pipeline of the Moomba–Sydney Pipeline. Gas is also sourced from the New South Wales–Victoria interconnection pipeline that runs from Wagga Wagga to Wodonga.<sup>19</sup>

Country Energy's distribution network is classified as a covered distribution pipeline.<sup>20</sup>

## **1.2 Review process**

The AER has reviewed Country Energy's access arrangement proposal and access arrangement information in accordance with the NGL and NGR.

- Country Energy submitted its access arrangement proposal and access arrangement information to the AER on 1 July 2009.
- The access arrangement proposal and access arrangement information were published on the AER's website on 22 July 2009 and submissions were sought from interested parties.
- The request for submissions on Country Energy's access arrangement proposal and access arrangement information closed on 11 September 2009.
- The AER engaged consultants Wilson Cook to review Country Energy's proposed capital expenditure (including a review of past capital expenditure) and operating expenditures.
- The AER engaged consultants ACIL Tasman to review Country Energy's proposed demand forecasts.

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<sup>17</sup> Ministerial Council on Energy Standing Committee of Officials, *First Exposure Draft of the National Energy Customer Framework*, viewed 10 September 2009, <[http://www.ret.gov.au/Documents/mce/\\_documents/Energy%20Market%20Reform/NECF%20Package-First%20Exposure%20Draft.pdf](http://www.ret.gov.au/Documents/mce/_documents/Energy%20Market%20Reform/NECF%20Package-First%20Exposure%20Draft.pdf)>.

<sup>18</sup> Country Energy, *Access arrangement information*, June 2009, pp. 5, 19.

<sup>19</sup> Pipeline Publications, *Map of major Australian Gas pipelines*, viewed 15 October 2009, <[http://pipeliner.com.au/pipeline\\_map\\_of\\_australia](http://pipeliner.com.au/pipeline_map_of_australia)>.

<sup>20</sup> AEMC, *List of Natural Pipelines – description and classifications*, viewed 15 October 2009, <<http://www.aemc.gov.au/Gas/Scheme-Register/Pipeline-list-summary.html>>.



- The AER engaged Access Economics to review Country Energy's proposed labour cost escalators.

Based on the advice provided by the AER's consultants and submissions received from interested parties the AER has prepared this draft decision.

The AER has scheduled a forum on its draft decision for Country Energy on 19 November 2009. This forum will be used by the AER to explain its draft decision to interested parties and consider comments from interested parties.

Country Energy may submit a revised access arrangement proposal and access arrangement information to the AER by 6 January 2010.<sup>21</sup>

Interested parties are invited to make written submissions on issues regarding the draft decision and the consultants' reports to the AER by 12 February 2010. The AER expects to release the final decision in early April 2010.

### **1.3 Structure of draft decision**

The AER's consideration of Country Energy's access arrangement proposal and accompanying access arrangement information are set out as follows:

- Introductory chapters outline the introduction and pipeline services.
- Part A outlines the key components of the total revenue building blocks including the capital base, depreciation, the rate of return, taxation, operating expenditure and total revenue.
- Part B outlines the demand forecasts, reference tariffs and tariff variation mechanisms.
- Part C outlines the non-tariff components of the access arrangement proposal.

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<sup>21</sup> NGR, r. 60 and 43(3).

## 2 Pipeline services

### 2.1 Introduction

This chapter considers the pipeline services set out in Country Energy's access arrangement proposal.

### 2.2 Regulatory requirements

Rule 48(1) of the NGR provides that a full access arrangement must specify certain information for pipeline services, including reference services. Pipeline services include haulage services, interconnection services and ancillary services.<sup>22</sup> Reference services are defined as pipeline services that are likely to be sought by a significant part of the market.<sup>23</sup> Relevantly, an access arrangement must:

- identify the pipeline to which the access arrangement relates and a website at which a description of the pipeline can be inspected<sup>24</sup>
- describe the pipeline services the service provider proposes to offer to provide by means of the pipeline,<sup>25</sup> and
- specify the reference services.<sup>26</sup>

In addition, r. 101(1) of the NGR provides that a full access arrangement must specify all reference services.<sup>27</sup>

Rule 109(1) of the NGR provides that a scheme pipeline service provider<sup>28</sup> must not make it a condition of the provision of a particular service to a prospective user that the prospective user accept another non-gratuitous service from the service provider, unless the bundling of services is reasonably necessary.<sup>29</sup>

### 2.3 Country Energy's proposal

Country Energy proposes to offer pipeline services, comprising reference services and services which are not a reference service (i.e. negotiated services). The services are largely the same as those offered in the earlier access arrangement period.<sup>30</sup>

Country Energy's reference services are transportation services and additional services.

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<sup>22</sup> NGL, s. 2.

<sup>23</sup> NGR, r. 101(2).

<sup>24</sup> NGR, r. 48(1)(a).

<sup>25</sup> NGR, r. 48(1)(b).

<sup>26</sup> NGR, r. 48(1)(c).

<sup>27</sup> NGR, r. 101(1).

<sup>28</sup> Rule 3 of the NGR defines a 'scheme pipeline service provider' as 'a service provider for a scheme pipeline'. Section 2 of the NGL provides that 'scheme pipeline' 'means— (a) a covered pipeline; or (b) an international pipeline to which a price regulation exemption applies'.

<sup>29</sup> NGR, r. 109(1).

<sup>30</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 16 and 18.

### 2.3.1 Transportation services

Country Energy's transportation services are a contract transportation service and a volume transportation service.<sup>31</sup>

Both reference services involve:

- transporting gas through Country Energy's network from a receipt point to a delivery point
- installing, maintaining, repairing and reading (daily for contract customers and at least quarterly for volume customers) metering facilities at the delivery point
- providing data in accordance with the retail market procedures,<sup>32</sup> and
- connecting customers who are not connected to Country Energy's network by a pipe from the network to the nearest point on the customer's property.<sup>33</sup>

The contract transportation service is available to customers with an (anticipated) annual consumption of 10 TJ or more at a single delivery point.<sup>34</sup> The volume transportation service is available to customers with an annual consumption of less than 10 TJ at a single delivery point.<sup>35</sup>

### 2.3.2 Additional services

Country Energy's additional services are a residential meter testing service, special meter reading service, reconnection service, disconnection service, business disconnection/reconnection service, after hours reconnection service and deactivation service.<sup>36</sup>

## 2.4 AER's analysis and considerations

The AER is satisfied that Country Energy identifies the pipeline the subject of the proposal (including a reference to a website at which a description of the pipeline can be inspected)<sup>37</sup> and provides a description of its network in section 2 of its access arrangement proposal.<sup>38</sup>

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<sup>31</sup> Country Energy, *Access arrangement proposal* and Country Energy, *Access arrangement information*, 1 July 2009, pp. 16–18.

<sup>32</sup> The retail market procedures are made by the AEMO under s. 91M of the NGL and are called the *Retail Market Procedures (NSW and ACT)*, version 1, effective 1 July 2009.

<sup>33</sup> Country Energy submits that this will be consistent with its extensions and expansions policy set out in section 7 of the access arrangement and that it satisfies the new capital expenditure criteria set out in r. 79 of the NGR. See Country Energy, *Access arrangement proposal*, 1 July 2009, section 4.3.1, p. 9.

<sup>34</sup> If the annual consumption of a contract transportation service customer does not amount to 10 TJ or more in two consecutive years, they may be reclassified as volume customers at the end of this period. See Country Energy, *Access arrangement proposal*, 1 July 2009, section 4.3.1, p. 9.

<sup>35</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 4.3.1, p. 9.

<sup>36</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section. 4.1, p. 8.

<sup>37</sup> NGR, r. 48(1)(a).

<sup>38</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 6.

Further, the AER notes that section 4 of Country Energy's access arrangement proposal sets out a description of the services to be offered.

The AER notes that in sections 5.7.1 and 9.4.1(a) of the access arrangement proposal the term 'Services' is used but is not defined in the section 15 glossary of the proposal. The AER considers that the term should be defined as pipeline services.

#### *Conclusion*

The AER does not propose to approve Country Energy's description of pipeline services as it does not comply with r. 48(1)(b) of the NGR and requires Country Energy to make the following amendment:

**Amendment 2.1:** amend section 15 in the access arrangement proposal to include the following:

**Services** means services which are pipeline services within the meaning of section 2 of the *NGL*.

## **2.4.1 Reference services**

### **2.4.1.1 Transportation services**

The term 'Reference Services' is defined in the access arrangement proposal as the contract transportation service and the volume transportation service.<sup>39</sup>

Country Energy submits that the two transportation reference services in the access arrangement proposal have not changed since the original access arrangement approved in 1999.<sup>40</sup> The AER notes that Country Energy has changed the description of the contract transportation service to account for the service being provided when the pipeline is extended to a customer's property.<sup>41</sup> The AER notes that in the earlier access arrangement a similar description was used for volume transportation services but it was limited to extensions of up to 50 metres of pipeline to a customer's property.<sup>42</sup> This limitation has been removed in the access arrangement proposal.<sup>43</sup> The AER considers that the changes to the description of the contract transportation service and volume transportation service are acceptable.

The AER is not aware of any change in circumstances, or any other reason, that would result in these services not being likely to be sought by a significant part of the

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<sup>39</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 51.

<sup>40</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 8.

<sup>41</sup> The additional component provides as follows:

'in the case of a Customer who is not connected to the *Network*, the provision of a pipe from the *Network* to the nearest point on the *Customer's* property, where the provision of such pipe is consistent with Extensions/Expansions Policy sets out in section 7 and satisfies the new capital expenditure criteria of NGR 79.'

See Country Energy, *Access arrangement proposal*, 1 July 2009, p. 10.

<sup>42</sup> Country Energy, *Access arrangement for the Wagga Wagga natural gas distribution network*, 1 January 2006, p. 5.

<sup>43</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 10.

market such that they would no longer be reference services,<sup>44</sup> consistent with Country Energy's submission.<sup>45</sup>

The term 'Retail Market Procedures' used in Country Energy's description of transportation services in the access arrangement proposal<sup>46</sup> is defined as 'the *Retail Gas Market (NSW and ACT) Procedures* for the NSW and ACT retail gas market made and amended in accordance with the NGR'.<sup>47</sup> The AER notes that the retail market procedures are made by the AEMO under the NGL and not the NGR,<sup>48</sup> and that the procedures are called the *Retail Market Procedures (NSW and ACT)*.<sup>49</sup> The AER considers that the definition of the term 'Retail Market Procedures' should be amended to reflect this.

#### *Prohibition of bundling of services*

The AER notes that Country Energy does not have a separate meter data service under which customers are charged for meter readings which are part of the normal billing cycle. Instead, Country Energy has included the normal reading of metering facilities as part of the contract transportation service and volume transportation service. The AER considers that since Country Energy does not intend to offer a separate non-gratuitous meter data service, the inclusion of the normal meter reading as part of the transportation services does not require assessment of the reasonableness of any bundling of services for the purposes of r. 109(1) of the NGR. However, the AER considers that if contestability in the gas industry is introduced in New South Wales which permits the provision of gas meter reading services or on-site data and communication equipment in Wagga Wagga by a person other than Country Energy then Country Energy must permit its existing and new customers to acquire such services and equipment from that person. Country Energy's customers which acquire such services and equipment from a person other than Country Energy must not be charged a fee by Country Energy for such services and equipment whether or not the fee is aggregated into another fee or charge, or a reference tariff.

#### *Conclusion*

The AER does not propose to approve Country Energy's description of pipeline services and specification of reference services as it does not comply with r. 48(1)(b) and (c) of the NGR and requires Country Energy to make the following amendment:

**Amendment 2.2:** delete the definition of 'Retail Market Procedure' in section 15 in the access arrangement proposal and replace it with the following:

**Retail Market Procedures** means the retail market procedures made by the AEMO from time to time under section 91M of the *NGL*.

**Amendment 2.3:** amend the end of sections 4.3.1, 4.3.2, and 11.2.2 in the access arrangement proposal to include the following:

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<sup>44</sup> Rule 101(2) of the NGR defines a 'reference service' as a pipeline service that is likely to be sought by a significant part of the market.

<sup>45</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 8.

<sup>46</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 9–10.

<sup>47</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 52.

<sup>48</sup> NGL, s. 91M.

<sup>49</sup> AEMO, *Retail market procedures (NSW and ACT)*, version 1, effective 1 July 2009.

If contestability in the gas industry is introduced in New South Wales which permits the provision of gas meter reading services or on-site data and communication equipment in Wagga Wagga by a person other than *Country Energy Gas* then *Customers, Users* and *Prospective Users* are permitted to acquire such services and equipment from that person. *Customers, Users* and *Prospective Users* which acquire such services and equipment from a person other than *Country Energy Gas* will not be charged a fee by *Country Energy Gas* for such services and equipment whether or not the fee is aggregated into another fee or *Charge*, or a *Reference Tariff*.

**Amendment 2.4:** amend the end of section 11.2.1 in the access arrangement proposal to include the following:

If contestability in the gas industry is introduced in New South Wales which permits the provision of gas meter reading services or on-site data and communication equipment in Wagga Wagga by a person other than *Country Energy Gas* then *Customers, Users* and *Prospective Users* are permitted to acquire such services and equipment from that person. *Customers, Users* and *Prospective Users* which acquire such services and equipment from a person other than *Country Energy Gas* will not be charged the *Monthly Metering Charge* or any other fee by *Country Energy Gas* for such services and equipment whether or not the charge or fee is aggregated into another fee or *Charge*, or a *Reference Tariff*.

#### 2.4.1.2 Additional services

Country Energy's access arrangement proposal and access arrangement information are ambiguous regarding the classification of additional services.

All of the proposed additional services (other than the additional service described as the deactivation service) were offered in the earlier access arrangement period.<sup>50</sup> The deactivation service is proposed as a new additional service for the access arrangement period.<sup>51</sup>

While Country Energy states that the additional services defined in the access arrangement proposal are not reference services, it implies that currently the additional services are sought by a significant part of the market,<sup>52</sup> which would make these services reference services.<sup>53</sup>

The NGR definition does not specify a timeframe for when services are likely to be sought by a significant part of the market. As the additional services are likely to be sought by a significant part of the market at some point in time the AER considers that additional services are reference services.

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<sup>50</sup> Country Energy, *Access arrangement*, 1 January 2006, pp. 5–6.

<sup>51</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 18. The proposed deactivation service is described as the act of removing a meter from a distribution supply point and associated pipe work from the distribution system. See Country Energy, *Access arrangement proposal*, 1 January 2006, p. 11.

<sup>52</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 8 and Country Energy, *Access arrangement information*, 1 July 2009, p. 16.

<sup>53</sup> NGR, r. 101(2).

The AER considers that a number of changes need to be made to the access arrangement proposal and the access arrangement information to reflect that the additional services are reclassified as reference services. One key amendment is that reference tariffs for additional services need to be consistent with r. 94 of the NGR and specified in the access arrangement.<sup>54</sup>

The AER notes that Country Energy proposes to amend the description for each of the additional services from the earlier access arrangement. In particular, Country Energy proposes the following amendments:

- the residential meter testing service will apply to the metering facilities of any person that uses gas at a delivery point. In the earlier access arrangement, it only applied to residential customers, and
- the reconnection service, disconnection service, business disconnection or reconnection service and after hours reconnection service will apply to meters with a capacity less than or equal to 10 cubic metres per hour. In the earlier access arrangement the services only applied to meters with a capacity less than or equal to 6 cubic metres per hour.

The AER considers that the proposed amendments to the description for each of the additional services from the earlier access arrangement are acceptable.

#### *Conclusion*

The AER does not propose to approve Country Energy's description of pipeline services and specification of reference services as it does not comply with r. 48(1)(b) and (c) of the NGR and requires Country Energy to make the following amendments:

**Amendment 2.5:** amend the access arrangement proposal to:

- delete the heading for section 4.1 and replace it with the following:  
**4.1 Pipeline services to be offered**
- delete the heading for section 4.3 and replace it with the following:  
**4.3 Reference Services**
- delete the definition of 'Reference Services' in section 15 and replace it with the following:

**Reference Services** means the *Contract Transportation Service, Volume Transportation Service and Additional Services*.

**Amendment 2.6:** amend the access arrangement information to:

- delete the heading for section 3.2 and replace it with the following:

**3.1.3 Additional Services**

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<sup>54</sup> NGR, r. 48(1)(d)(i).

- delete the words ‘and *Additional Services*’ from section 8.2.2.

#### 2.4.1.3 Reference tariffs and charges—access arrangement proposal appendix 2

The AER considers that appendix 2 of the access arrangement proposal needs to be amended to more accurately reflect how reference tariffs will be determined under the access arrangement and to reflect that additional services are reference services.<sup>55</sup>

##### *Conclusion*

The AER does not propose to approve Country Energy’s description of pipeline services and specification of reference services as it does not comply with r. 48(1)(b) and (c) of the NGR and requires Country Energy to make the following amendment:

**Amendment 2.7:** delete appendix 2 of the access arrangement proposal and replace it with appendix D of the draft decision.

#### 2.4.2 Non-reference services—negotiated services

The AER notes that Country Energy’s access arrangement proposal includes negotiated services<sup>56</sup> which are non-reference services.

Country Energy proposes to make some amendments to the examples of negotiated services in the earlier access arrangement. Country Energy has deleted the examples regarding the delivery of natural gas<sup>57</sup> and replaces them with delivery of natural gas to a proposed delivery point which requires assets to be constructed that do not meet the requirements of r. 79 of the NGR which is concerned with conforming capital expenditure.<sup>58</sup> The AER is not aware of any reasons why the amendments to the examples should not be made.

As there is no information to suggest from the earlier access arrangement period that the negotiated services are likely to be sought by a significant part of the market in the access arrangement period, the AER considers that these services are non-reference services.

The AER considers that a number of consequential changes need to be made to the access arrangement proposal and the access arrangement information to reflect that negotiated services are not reference services.

##### *Conclusion*

The AER does not propose to approve Country Energy’s description of pipeline services as it does not comply with r. 48(1)(b) of the NGR and requires Country Energy to make the following amendments:

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<sup>55</sup> Section 11.4.1 of the draft decision provides for the deletion of the proposed tariffs for the period 2011 to 2015 and replaces them with revised tariffs for the 2010–2011 year. Section 10.4.6 of the draft decision provides that customers who become contract customers after 1 July 2010 will be subject to the same monthly metering charges as existing contract customers.

<sup>56</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 11.

<sup>57</sup> Country Energy, *Access arrangement*, 1 January 2006, section 2.3.4(a) and (b), p. 6.

<sup>58</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 11.



**Amendment 2.8:** amend the access arrangement proposal to:

- delete the heading for section 4.3.4 and replace it with the following:
  - 4.4 Non-Reference Services—Negotiated Services**
- renumber the existing sections 4.4 and 4.5 (including their subsections).

**Amendment 2.9:** amend the access arrangement information to:

- delete the heading for section 3.3 and replace it with the following:
  - 3.2 Non-Reference Services—Negotiated Services**
- delete the heading for section 3.4 replace it with the following:
  - 3.3 Service Standards and Quality**

**Part A—Total revenue (building block components)**

## **3 Capital base**

### **3.1 Introduction**

This chapter sets out the AER's consideration and analysis of the capital base that Country Energy proposes for the access arrangement period. This chapter includes a consideration of the opening capital base, which forms the initial value of the projected capital base.

The projected capital base is an input the return on the projected capital base and depreciation. This chapter considers:

- the opening capital base including the past capital expenditure proposed by Country Energy for the earlier access arrangement period, and
- the projected capital base, including forecast capital expenditure that Country Energy proposes for the access arrangement period. This is assessed against the requirements of the NGR.

The AER's consideration of Country Energy's depreciation schedule is set out in chapter 4 of the draft decision.

### **3.2 Regulatory requirements**

#### **3.2.1 Opening capital base**

Clause 3(2) of schedule 1 of the NGR provides that an agreement by the relevant regulator under section 8.21 of the Code that actual or forecast new facilities investment meets or will meet the requirements of section 8.16(a) of the Code will be taken to be:

- in the case of actual expenditure - a decision by the AER under r. 79 of the NGR to the effect that the capital expenditure conforms with the new capital expenditure criteria, and
- in the case of forecast capital expenditure – a determination by the AER under r. 80 of the NGR that, if the capital expenditure is made in accordance with the conditions of the agreement, it will meet the new capital expenditure criteria.

Rules 72(1)(a)(i) and (b) of the NGR provide that the access arrangement information for a full access arrangement proposal must include:

- capital expenditure (by asset class) over the earlier access arrangement period , and
- how the capital base is arrived at, and a demonstration of how the capital base increased or diminished over the previous access arrangement period.

Rule 77(2) of the NGR provides that if an access arrangement period follows immediately on the conclusion of a previous access arrangement period, the opening capital base for the later access arrangement period is to be:

- (a) the opening capital base as at the commencement of the earlier access arrangement period (adjusted for any difference between estimated and actual capital expenditure included in that opening capital base);

plus:

- (b) conforming capital expenditure made, or to be made, during the earlier access arrangement period;

plus:

- (c) any amounts to be added to the capital base under rule 82, 84 or 86;

less:

- (d) depreciation over the earlier access arrangement period (to be calculated in accordance with any relevant provisions of the access arrangement governing the calculation of depreciation for the purpose of establishing the opening capital base); and

*Note:*

*See rule 90.*

- (e) redundant assets identified during the course of the earlier access arrangement period; and
- (f) the value of pipeline assets disposed of during the earlier access arrangement period.

### **3.2.2 Projected capital base**

Rule 72(1)(c) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the projected capital base over the access arrangement, including:

- (i) a forecast of conforming capital expenditure for the period and the basis for the forecast; and
- (ii) a forecast of depreciation for the period including a demonstration of how the forecast is derived on the basis of the proposed depreciation method

Rule 78 of the NGR provides that the projected capital base for a particular period is:

- (a) the opening capital base;

plus:

- (b) forecast conforming capital expenditure for the period;

less:

- (c) forecast depreciation for the period; and
- (d) the forecast value of pipeline assets to be disposed of in the course of the period.

Rule 79(1) of the NGR provides that conforming capital expenditure is capital expenditure that conforms with the following:

- The capital expenditure must be such that it would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services.
- The capital expenditure must be justifiable on a ground stated in r. 79(2) of the NGR.

Grounds in r. 79(2)(c) of the NGR for justifying capital expenditure are:

- (i) to maintain and improve the safety of services; or
- (ii) to maintain the integrity of services; or
- (iii) to comply with a regulatory obligation or requirement; or
- (iv) to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred (as distinct from projected demand that is dependent on an expansion of pipeline capacity)

### **3.2.3 Opening capital base for the next access arrangement period**

Rule 90(1) of the NGR provides that a full access arrangement must contain provisions governing the calculation of depreciation for establishing the opening capital base for the next access arrangement period after the one to which the access arrangement currently relates. Rule 90(2) of the NGR provides that the provisions must resolve whether depreciation of the capital base is to be based on forecast or actual capital expenditure.

### **3.2.4 Capital redundancy**

Rule 85 of the NGR details particulars of capital redundancy. Clause 3(13) of schedule 1 of the NGR provides that a mechanism approved in a transitional access arrangement, will be taken to be a corresponding mechanism under rule 85 of the NGR.

Rule 72(1)(f) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the key performance indicators to be used by the service provider to support expenditure to be incurred over the access arrangement period.

## **3.3 Country Energy's proposal**

### **3.3.1 Opening capital base**

Country Energy proposes an opening capital base of \$61 million, which includes capital expenditure of approximately \$15.6 million for the earlier access arrangement period. It also includes depreciation of \$6.1 million for the earlier access arrangement period.

Table 3.1 shows Country Energy's calculation of the proposed opening capital base. The opening capital base for 2010–11 is the closing balance for 2009–10.

**Table 3.1: Country Energy's opening capital base (\$'000, nominal)**

	January– June 2006	2006–07	2007–08	2008–09	2009–10
Opening capital base	44 515	46 280	48 922	52 606	57 108
Capital expenditure	1727	2191	3816	3594	4225
Depreciation	564	1225	1318	1460	1555
Adjustment for inflation	602	1676	1186	2368	1466
Difference between actual and forecast capital expenditure (January-June 2006)					– 25
Return on difference					– 13
Closing capital base	46 280	48 922	52 606	57 108	61 205

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 23.

Country Energy does not propose to make any additions to its capital base from capital contributions by users during the earlier access arrangement period.<sup>59</sup>

Country Energy submits that it does not maintain a speculative capital expenditure account and therefore does not propose any additions to the opening capital base for speculative capital expenditure.<sup>60</sup>

Country Energy submits that it is not aware of any material assets that have become redundant. Therefore, Country Energy does not propose to deduct or remove any redundant assets in establishing the opening capital base.<sup>61</sup>

### 3.3.1.1 Capital expenditure

Country Energy's capital expenditure for the earlier access arrangement period is substantially higher than the \$8.1 million approved by the IPART. A comparison of Country Energy's actual and estimated capital expenditure for the earlier access arrangement is shown in Table 3.2.

<sup>59</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 22–23.

<sup>60</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 22.

<sup>61</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 22.

**Table 3.2: Forecast and actual capital expenditure for the earlier access arrangement period (\$'000, nominal)**

	January– June 2006	2006–07	2007–08	2008–09	2009–10	Total
Forecast (IPART approved)	827	1603	1692	1909	2089	8120
Actual/estimated	1727	2191	3816	3594	4225	15 554
Difference	900	588	2124	1685	2136	7434

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 8.

Country Energy submits that capital expenditure was higher than forecast in the earlier access arrangement period due to:

- higher than expected growth (64 per cent more than forecast) in new customer connections that account for \$1.9 million of additional capital expenditure
- an upgrade of the low–medium pressure to medium–high pressure pipelines due to long term demand growth at a cost of \$1.5 million
- an upgrade of the Bomen receipt point required due to an upgrade of the transmission pipeline at a cost of \$1.5 million, and
- gas network management costs being reclassified as capital expenditure from operating expenditure. This resulted in additional capital expenditure of \$1.4 million.<sup>62</sup>

### 3.3.1.2 Adjustment of the capital base for inflation

Country Energy proposes to index its capital base for the earlier access arrangement period using the weighted average consumer price index (CPI) of eight capital cities as published by the Australian Bureau of Statistics (ABS). For the period of 1 January 2006 to 30 June 2006 Country Energy proposes to use the half year CPI to June 2006. For other years in the earlier access arrangement period, Country Energy proposes to use the full financial year (July to June) CPI.<sup>63</sup> For 2009–10 Country Energy uses a rate of 2.47 per cent as approved by the AER for Country Energy’s electricity distribution determination.<sup>64</sup>

### 3.3.2 Projected capital base

Country Energy proposes a projected capital base of \$77.3 million, which incorporates forecast capital expenditure of \$20.1 million and depreciation of \$12.5 million for the access arrangement period. Country Energy’s proposed projected capital base is outlined in Table 3.3.

<sup>62</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 7–8.

<sup>63</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 23.

<sup>64</sup> AER, *Final Decision: NSW distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 236.

**Table 3.3: Country Energy's projected capital base (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening capital base	61 205	64 330	67 903	71 332	74 428
Forecast capital expenditure	3976	4268	4187	3927	3771
Forecast depreciation	2367	2286	2439	2596	2762
Adjustment for inflation	1515	1592	1681	1765	1842
Closing capital base	64 330	67 903	71 332	74 428	77 278

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 28.

Country Energy neither expects any assets to become redundant nor to dispose of any material assets during the access arrangement period.<sup>65</sup>

### 3.3.2.1 Forecast capital expenditure

Country Energy proposes \$18 million (\$2009–10) of conforming capital expenditure. This comprises mains refurbishment costs, meter replacement costs and growth related capital expenditure as outlined in Table 3.4.

**Table 3.4: Country Energy's proposed capital expenditure for the access arrangement period (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Mains refurbishment	1612	1481	1659	1535	938	7225
Meter replacement	404	234	215	393	508	1754
Growth related	1715	2193	1866	1496	1763	9033
Total	3731	3908	3741	3424	3208	18 012

Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 25–26.

Country Energy submits that the proposed mains refurbishment capital expenditure relates to a long term pressure upgrade program. The relevant areas are being converted from low (<7 kPa) and low–medium (20–40 kPa) to medium–high pressure (80–250 kPa). Country Energy states that this is required due to significant load growth and supply pressures falling to critically low levels during periods of high demand.<sup>66</sup>

Country Energy has a meter replacement policy of 15 years. Country Energy submits that its meter replacement capital expenditure is designed to comply with the Gas Supply (Gas Meters) Regulation 2002.<sup>67</sup> Country Energy completed an audit of domestic meter installation dates during the first quarter of the 2007–08 financial

<sup>65</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 26.

<sup>66</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 24–25.

<sup>67</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 25.



year. The audit outcome has been used to establish the capital expenditure program for meter replacement. This program commenced in November 2007 and will continue into the access arrangement period.

Country Energy submits that the growth related capital expenditure relates to the pressure upgrade program discussed above and that it accounts for new customer connections. The growth related capital expenditure is based on a forecast of 150 new customers per year.<sup>68</sup>

### **3.3.2.2 Adjustment of the capital base for inflation**

Country Energy proposes to index the capital base by an inflation rate of 2.47 per cent during the access arrangement period.<sup>69</sup> This inflation rate was approved by the AER in Country Energy's electricity distribution determination.<sup>70</sup>

### **3.3.3 Opening capital base for the next access arrangement period**

Country Energy proposes using the depreciation approved by the AER to determine the opening capital base for the access arrangement period commencing on 1 July 2015.<sup>71</sup>

### **3.3.4 Capital redundancy policy**

Country Energy does not propose a capital redundancy policy for the access arrangement period.<sup>72</sup>

## **3.4 Consultant's report**

The AER engaged Wilson Cook, engineering and management consultants, to review Country Energy's proposed capital expenditure. This included a review of the capital expenditure for the earlier access arrangement as well as Country Energy's forecast capital expenditure for the access arrangement period.

The report prepared by Wilson Cook<sup>73</sup> notes that in the earlier access arrangement period capital expenditure was significantly above that determined by IPART<sup>74</sup>. Country Energy provided several reasons for the increase which were considered in the Wilson Cook Report. The Wilson Cook Report considers:

- the additional expenditure of \$1.5 million on the cast iron and steel pipe refurbishment programme is prudent given the age of the network, the widespread occurrence of leaks from old pipes and the condition of the network. While the Wilson Cook Report is unable to comment on the efficiency of the expenditure

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<sup>68</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 26.

<sup>69</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>70</sup> AER, *Final Decision: NSW distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 236.

<sup>71</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 35.

<sup>72</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 43.

<sup>73</sup> Wilson Cook, *Review of expenditure of ACT & NSW GAS DNSPs: Country Energy's Wagga Wagga network*, 29 October 2009 (Wilson Cook Report, 29 October 2009), p. 1.

<sup>74</sup> IPART, *Final Decision: Revised access arrangement for Country Energy gas network*, November 2005, Table 7.12, p. 57.

because a breakdown of the costs is not available, it considers that the amount appears reasonable

- the rebuilding of the Bomen receipt point and replacement of the pipeline on the Murrumbidgee rail bridge were unavoidable. While a breakdown of the costs is not available, the Wilson Cook Report considers that the capital expenditure is reasonable
- the additional capital expenditure arising from growth and consequential new connections, and the implied average cost per connection of \$3 600, are within the range of possible costs using the costs components reported by SKM for mains, services and meters, and
- the meter replacement programme is considered justified to comply with compliance regulations and reasonable in approach, noting that around 75 per cent of the work has been contracted out competitively.<sup>75</sup>

The Wilson Cook Report was not required to make an assessment of the \$1.4 million reclassification of network management costs as capital expenditure.<sup>76</sup>

With respect to Country Energy's forecast capital expenditure for the access arrangement period the Wilson Cook Report considers:

- the forecast expenditure on replacement and rehabilitation of the mains is reasonable due to the aging network and increased forecast demand
- the Koorinal mains upgrade project and the Lake Albert pressure increase project appear to be appropriate
- the planned expenditure on meter replacement is necessary and reasonable
- capital expenditure on customer connections, extension of mains and network reinforcement is justified by demand growth, and
- SKM's methodology and findings in relation to unit rates for pipe laying and other routine work could be relied on without the need for Wilson Cook to recalculate or reassess them.<sup>77</sup>

The Wilson Cook Report considers that overall Country Energy's capital expenditure over the final three years of the earlier access arrangement period and its forecast capital expenditure for the access arrangement period is reasonable.<sup>78</sup>

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<sup>75</sup> Wilson Cook Report, 29 October 2009, pp. 4–6.

<sup>76</sup> Wilson Cook Report, 29 October 2009, pp. 5–6

<sup>77</sup> Wilson Cook Report, 29 October 2009, pp. 6–9.

<sup>78</sup> Wilson Cook Report, 29 October 2009, p. 6.

## 3.5 AER's analysis and considerations

### 3.5.1 Opening capital base

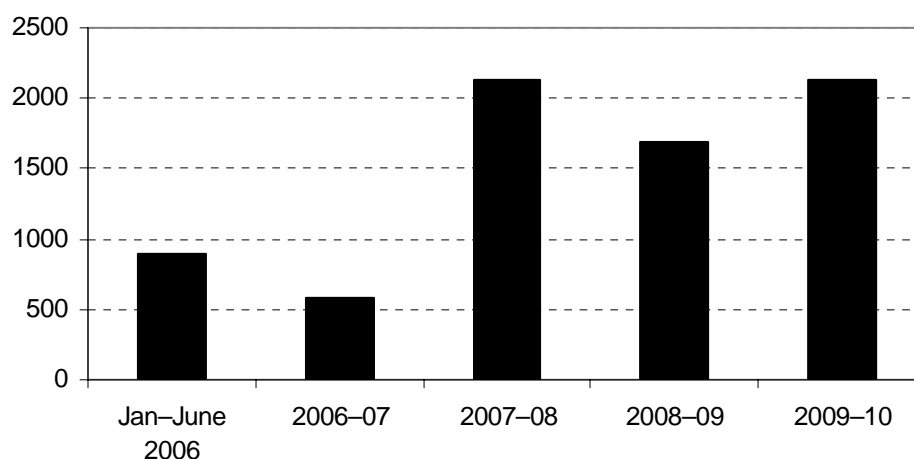
#### 3.5.1.1 Capital expenditure

The AER is required to undertake an ex-post assessment of capital expenditure in the earlier access arrangement period that Country Energy proposes to add to the opening capital base.<sup>79</sup>

Clause 3(2) of schedule 1 of the NGR provides that if the IPART had agreed under s. 8.21 of the Code that actual or forecast new facilities investment<sup>80</sup> in the earlier access arrangement met the requirements of s. 8.16(a) of the Code the AER will be bound by that agreement. The AER is not aware of any such agreement and Country Energy has not submitted that this clause should apply to its access arrangement proposal. Accordingly, the AER's consideration of Country Energy's proposed capital expenditure in the earlier access arrangement period is made under r. 79 of the NGR.

The total capital expenditure of \$15.6 million proposed by Country Energy to be added to the opening capital base is significantly higher than the forecast \$8.1 million which was approved by the IPART for the earlier access arrangement period.<sup>81</sup> As shown in Figure 3.1, most of the difference between forecast and actual (or estimated) capital expenditure (about 80 per cent) occurs in the last three years of the earlier access arrangement period.

**Figure 3.1: Difference between actual and forecast capital expenditure (\$'000, nominal)**



Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 8.

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<sup>79</sup> NGR, r. 77(2)(b).

<sup>80</sup> The Code used the term 'new facilities investment', whereas the NGR refers to 'capital expenditure'.

<sup>81</sup> IPART, *Final Decision: Revised access arrangement for Country Energy gas network*, November 2005, Table 7.12, p. 57.

The difference between forecast and actual or estimated capital expenditure can largely be attributed to unscheduled projects. These projects were not included in forecast capital expenditure pre-approved by the IPART at the commencement of the earlier access arrangement period.

The Wilson Cook Report concludes that the capital expenditure made or planned for the last three years of the earlier access arrangement period is reasonable (with the exception of the proposed \$1.4 million for reclassification of network management costs, which it did not assess).<sup>82</sup>

While Country Energy has provided details of the various capital expenditure projects in the earlier access arrangement period, it has not demonstrated that they comply with the requirements of r. 79 of the NGR. Nevertheless, in light of the assessment in the Wilson Cook Report<sup>83</sup> and the information provided by Country Energy, with the exception of the proposed \$1.4 million for reclassification of network management costs, the AER considers this capital expenditure meets the criteria requirements of r. 79 of the NGR.

Therefore, the AER considers this represents capital expenditure that would be invested by a prudent service provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of providing services.<sup>84</sup> The capital expenditure was incurred as a result of events essentially outside of Country Energy's control and which the AER considers were necessary to maintain the safety or integrity of services, comply with a regulatory obligation or requirement, or to maintain the service provider's capacity to meet levels of demand for services existing the time the capital expenditure was incurred.<sup>85</sup>

Country Energy proposes to add to the opening capital base \$1.4 million for gas network management costs.<sup>86</sup> This amount was previously included as forecast operating expenditure for the earlier access arrangement period.<sup>87</sup> As it has already been recovered through tariffs in the earlier access arrangement period, its inclusion in the opening capital base would result in double counting. As a result, the AER requires the \$1.4 million for gas network management costs to be removed from the opening capital base, as this amount would exceed that which would be invested by a prudent service provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of providing services as required by r. 79(1) of the NGR. Therefore, Country Energy must make amendment 3.1 below.

### **3.5.1.2 Depreciation**

There are two considerations relevant for depreciation in the earlier access arrangement period:

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<sup>82</sup> Wilson Cook Report, 29 October 2009, p. 6.

<sup>83</sup> Wilson Cook Report, 29 October 2009, pp. 4–6.

<sup>84</sup> NGR, r. 79(1).

<sup>85</sup> NGR, r. 79(2).

<sup>86</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 8.

<sup>87</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 8.

- any adjustments for differences between actual and forecast capital expenditure before the earlier access arrangement period,<sup>88</sup> and
- adjustments to the capital base for depreciation in the earlier access arrangement period.<sup>89</sup>

***Adjustments for capital expenditure before the earlier access arrangement period***

The AER is satisfied that Country Energy has adjusted the opening capital base at the commencement of the earlier access arrangement period for the difference between actual and forecast capital expenditure included in that opening capital base.<sup>90</sup>

***Depreciation in the earlier access arrangement period***

Country Energy proposes to use forecast rather than actual capital expenditure to calculate depreciation to establish the opening capital base.<sup>91</sup> The AER considers that this approach enables best forecasts or estimates to be arrived at on a reasonable basis consistent with r. 74(2) of the NGR and is also consistent with the approach outlined in the AER’s Access arrangement guideline (AAG).<sup>92</sup>

There is a discrepancy, however, in the way Country Energy calculates depreciation to determine the opening capital base for the access arrangement period. The depreciation schedule approved by the IPART used forecast inflation rates rather than actual rates of inflation.<sup>93</sup> Therefore, the IPART forecast inflation rates should be used to deflate the depreciation schedule to nominal dollars. However, Country Energy has used actual inflation rates. This discrepancy is shown at Table 3.5. As a result of this error, Country Energy’s proposed depreciation in the earlier access arrangement does not accord with the relevant provisions of the access arrangement governing the calculation of depreciation to establish the opening capital base and is therefore inconsistent with r. 77(2)(d) of the NGR. Therefore, Country Energy is required to make amendment 3.2 set out below.

**Table 3.5: Deflated depreciation schedules – Country Energy and IPART (\$’000, nominal)**

	2005–06	2006–07	2007–08	2008–09	2009–10
Depreciation – Country Energy	564	1225	1318	1460	1555
Depreciation – deflated by IPART rates	564	1226	1332	1474	1588

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 22 and from AER calculations.

<sup>88</sup> NGR, r. 77(2)(a).

<sup>89</sup> NGR, r. 77(2)(d).

<sup>90</sup> NGR, r. 77(2)(a).

<sup>91</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 23.

<sup>92</sup> AER, *Access arrangement guideline*, March 2009, pp. 61–62.

<sup>93</sup> IPART, *Final Decision: Revised access arrangement for Country Energy gas network*, November 2005, p. 41.

### **3.5.1.3 Adjustment of the capital base for inflation**

The AER considers that Country Energy's methodology for indexing its capital base to account for the effects of inflation during the earlier access arrangement period is appropriate up to 2008–2009. However, the AER considers that the rate of inflation proposed by Country Energy for 2009–2010 of 2.47 per cent, as approved by the AER for Country Energy's electricity distribution determination,<sup>94</sup> is now out-of-date and does not represent the best forecast or estimate possible in the circumstances.<sup>95</sup> For 2009–2010 the AER applies an inflation rate of 1.82 per cent, which is a hybrid of the CPI for the first six months of the calendar year 2009 and the RBA's inflation forecast for the last six months of the calendar year 2009.

The AER considers that this approach enables best forecasts or estimates to be arrived at on a reasonable basis.<sup>96</sup> Country Energy is required to amend the access arrangement proposal as outlined in amendment 3.3.

### **3.5.1.4 Conclusions on opening capital base**

The AER has considered Country Energy's proposed opening capital base. The AER does not consider that Country Energy's proposed opening capital base is consistent r. 74(2) of the NGR as it does not provide a best estimate that is arrived at on a reasonable basis or with r. 77(2). Therefore, Country Energy must make amendment 3.4 set out below.

## **3.5.2 Projected capital base**

### **3.5.2.1 Forecast capital expenditure**

Country Energy's forecast capital expenditure for the access arrangement period is \$18.0 million.<sup>97</sup> Country Energy's forecast annual capital expenditure is compared with actual and estimated yearly capital expenditure in Figure 3.2.

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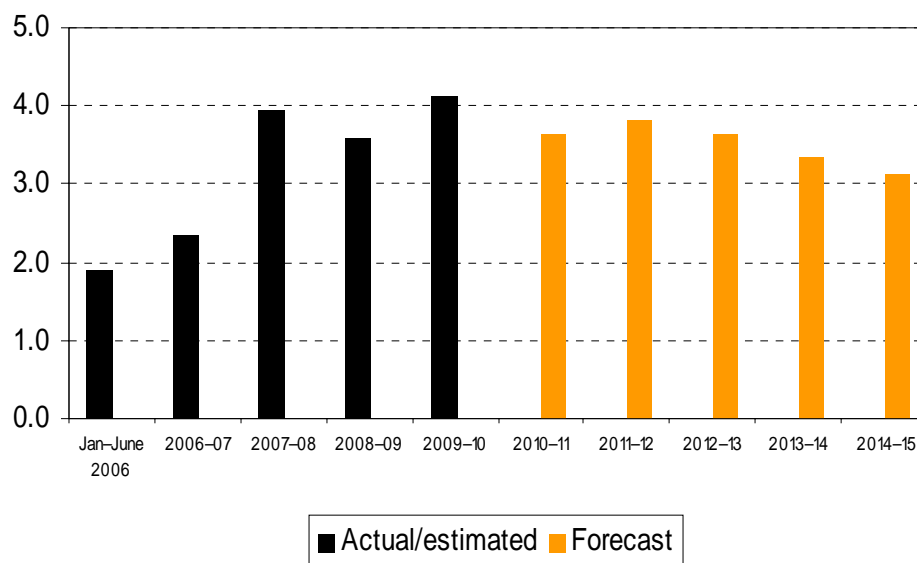
<sup>94</sup> AER, *Final Decision: NSW distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 237.

<sup>95</sup> NGR, r. 74(2)(b).

<sup>96</sup> NGR, r. 74(2).

<sup>97</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 24.

**Figure 3.2: Actual and forecast capital expenditure (\$m, real, 2009–10)**



Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 8, 14.

In view of the profile of the forecast capital expenditure for the access arrangement period, the AER was concerned that forecast capital expenditure has been projected on the basis of capital expenditure in the later years of the early access arrangement period. However, Country Energy has clarified that is not the case, because each project expected to be undertaken in the access arrangement period has been individually costed.

The forecast \$18.0 million capital expenditure is split approximately equally between asset replacement and refurbishment capital expenditure and growth related capital expenditure.<sup>98</sup>

### 3.5.2.2 Access replacement and refurbishment capital expenditure.

The \$9.0 million proposed as asset replacement and refurbishment capital expenditure is further broken down into refurbishment costs (\$7.2 million) and meter replacement (\$1.8 million).<sup>99</sup>

The main component of the refurbishment capital expenditure relates to a long term pressure upgrade to address supply pressure problems and gas leaks associated with aging assets.<sup>100</sup>

Country Energy submits that this capital expenditure is necessary to maintain the safety and integrity of services and meets the requirements of r. 79(2)(c)(i) and r. 79(2)(c)(ii) of the NGR.<sup>101</sup> Country Energy submits that meter replacement capital

<sup>98</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 24.

<sup>99</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 24.

<sup>100</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 24.

<sup>101</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 24.

expenditure is required to comply with the *Gas Supply (Gas Meters) Regulation 2002* and therefore satisfies r. 79(2)(c)(iii) of the NGR.<sup>102</sup>

### 3.5.2.3 Growth related capital expenditure

Growth related capital expenditure includes expenditure on new connections and new mains. Country Energy submits that the capital expenditure is necessary to maintain its capacity to meet forecast growth in demand and therefore satisfies r. 79(2)(c)(iv) of the NGR.<sup>103</sup>

The Wilson Cook Report examines the items that comprise each of these categories and concludes that Country Energy's proposed capital expenditure for the access arrangement period is reasonable but has not considered the cost of materials or cost of labour escalators in its review.<sup>104</sup>

## Summary

In light of the information provided by Country Energy, the AER's own analysis and the assessment in the Wilson Cook Report, the AER considers:

- Country Energy's proposed refurbishment capital expenditure is necessary to address supply pressure problems resulting from leaks caused by the aging assets of the Country Energy's gas network
- the meter replacement program is appropriate in order to comply with *Gas Supply (Gas Meters) Regulation 2002*, and
- growth related capital expenditure is necessary to cater for new gas connections.

### *Cost escalators*

The AER does not agree with all of the cost escalators that Country Energy applies. The AER's consideration of this aspect of the proposed capital expenditure is outlined below.

That said, Country Energy proposes to apply a number of real input cost escalators over the access arrangement period as a basis for determining its forecast capital expenditure.<sup>105</sup> This involves the disaggregation of the proposed capital expenditure into specific inputs (for example, labour and materials) which are priced in terms of a base year. These base year costs are increased or decreased using forecast changes in the real price of those inputs.

Country Energy's proposal is based on a recent Econtech report,<sup>106</sup> its own data and a report by the Competition Economists Group (CEG) (the CEG Cost Escalator

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<sup>102</sup> Country Energy, *Access arrangement information*, 1 July 2009, p 24–25.

<sup>103</sup> Country Energy, *Access arrangement information*, 1 July 2009, p 24–26.

<sup>104</sup> Wilson Cook Report, 29 October 2009, pp. 3, 9.

<sup>105</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009.

<sup>106</sup> Econtech, *Updated labour cost growth forecasts*, 25 March 2009.



Report).<sup>107</sup> The input costs which Country Energy proposes to escalate are enterprise bargaining agreement (EBA) labour, general labour, crude oil and polyethylene.

#### *Labour*

One key input into the capital expenditure forecasts is labour. The real cost escalation rates for both EBA and general labour are based on forecasts contained in a recent Econtech report.<sup>108</sup> The AER considers that this methodology for forecasting increases in labour costs is appropriate. However, given recent changes in the macroeconomic outlook, the AER has commissioned a report from Access Economics to produce more up-to-date forecasts for both general labour and electricity, gas and water (EGW) sector labour on a state-by-state basis. Consistent with r. 74(2) of the NGR, the AER considers that the most up-to-date forecast provides the best estimate possible in the circumstances.

#### *Crude oil*

Country Energy also submits crude oil as a key input into its proposed capital expenditure forecasts.<sup>109</sup> Country Energy has used crude oil futures prices from the New York Mercantile Exchange (NYMEX),<sup>110</sup> which are available over the access arrangement period until 2017. This methodology is consistent with AER's final decision for Country Energy's electricity distribution.<sup>111</sup> However, the AER does not consider that crude oil is a relevant input in a gas distribution context. This is because crude oil is used as a coolant and insulator in electricity transformers, which is not a relevant component of Country Energy's proposed capital expenditure forecasts. Further, Country Energy has not outlined why crude oil is a relevant input cost for the proposed capital expenditure for the Wagga Wagga gas distribution network.

#### *Polyethylene*

Polyethylene is also a key input into Country Energy's proposed capital expenditure forecasts. This is because polyethylene pipes are used by Country Energy in its pipeline replacement program.<sup>112</sup>

In order to forecast the real cost escalators for polyethylene over the access arrangement period, Country Energy proposes a two stage process. First, Country Energy seeks to demonstrate a historical relationship between crude oil prices and thermoplastic resin (which includes polyethylene) prices using an econometric model. This historical relationship is then used to create a forecast price index for

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<sup>107</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009.

<sup>108</sup> Econtech, *Updated labour cost growth forecasts*, 25 March 2009.

<sup>109</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, p. 17.

<sup>110</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, p. 17.

<sup>111</sup> AER, *Final decision New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, pp. 478–507.

<sup>112</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, p. 17.

thermoplastic resin.<sup>113</sup> Forecasting over the access arrangement period is possible as crude oil futures prices are available from NYMEX until 2017.<sup>114</sup>

The AER considers that the econometric model proposed by Country Energy appears to out perform other models considered by Country Energy's consultants.<sup>115</sup> The AER does not consider, however, that this ensures that the forecast price index is the best possible forecast available in the circumstances, as set out in r. 74(2)(b) of the NGR.

The AER has considered the construction of the forecast price index. There are two stages involved in the construction of the forecast price for polyethylene. The first stage is the demonstration of a historical relationship between thermoplastic resin and crude oil prices. This stage also involves the quantification of the historical relationship and is done using an econometric model. The second stage uses the historical relationship to construct a forecast price index, which involves inputting forecast crude oil price changes into the econometric model to develop forecast polyethylene price changes.

The AER notes that the first stage, the estimation of the historical relationship between crude oil prices and thermoplastic resin prices, is done using price indexes from the Bureau of Labour Statistics.<sup>116</sup> These price indexes show changes in nominal prices paid by producers for these commodities. However, when forecasting the price index for polyethylene the forecast crude oil price index is based on the change in real oil prices denominated in Australian dollars.

The AER does not consider this approach to be appropriate as the estimated relationship between crude oil prices and thermoplastic resin prices includes the effects of inflation, as the relationship is based on nominal prices. The AER considers that this approach may lead to double counting of inflation as the forecast real price is inflated in the post tax revenue model (PTRM). Further, the AER does not consider it appropriate to change data series, from a nominal price index based on US dollars to a real price index based on Australian dollars, between the estimation of the econometric model and its application to develop a forecast price index.

As there is the potential for double counting of inflation, the AER does not consider the method proposed by Country Energy for forecasting a price index for polyethylene represents the best forecast or estimate possible in the circumstances in accordance with r. 74(2).

#### *Summary of cost escalators*

The AER considers that the real cost escalators proposed by Country Energy are not arrived at on a reasonable basis and do not represent the best forecasts possible in the circumstances in accordance with r. 74(2) of the NGR.

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<sup>113</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, pp. 17–18.

<sup>114</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, p. 17.

<sup>115</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, pp. 17–18.

<sup>116</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts: A report for Country Energy*, June 2009, p. 18.

To forecast its capital expenditure, Country Energy must apply the real cost escalators shown in table 3.6, which take into consideration recent changes in the macroeconomic outlook, the nature of Country Energy’s capital expenditure program and the performance of the proposed forecasting methodologies. Therefore, Country Energy is required to amend its forecast capital expenditure for the real cost escalators as amended in Table 3.6 set out below.

**Table 3.6: AER's draft decision on real cost escalators for capital expenditure (%)**

	2010–11	2011–12	2012–13	2013–14	2014–15
EBA labour	0.1	0.5	0.9	1.5	1.7
General labour	1.2	1.4	1.4	1.9	2.0
Crude oil	n/a	n/a	n/a	n/a	n/a
Polyethylene	0	0	0	0	0

n/a: Not applicable.

#### ***Conclusion on capital expenditure***

In light of the analysis above concerning cost escalators, the AER considers that Country Energy’s forecast capital expenditure does not comply with r. 79. That is, it does not represent capital expenditure that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services. Further, the AER considers that Country Energy’s forecast capital expenditure does not represent the best forecast or estimate possible in the circumstances.<sup>117</sup> Therefore, Country Energy must make amendment 3.5 set out below.

#### **3.5.2.4 Capital contributions**

Country Energy does not include capital contributions in the capital base.<sup>118</sup> As a result the AER notes that it is appropriate that Country Energy does not include a mechanism to prevent Country Energy from benefiting through increased revenue because of a user’s contribution to the capital base.<sup>119</sup>

#### **3.5.2.5 Depreciation**

The AER requires Country Energy to amend its forecast depreciation as a consequence of the required amendment to Country Energy’s forecast capital expenditure and adjustment to the capital base for inflation outlined above. Therefore, Country Energy must amend its forecast depreciation as outlined in amendment 3.6 below.

<sup>117</sup> NGR, r. 74(2).

<sup>118</sup> NGR, r. 82(3) and Country Energy, *Access arrangement information*, 1 July 2009, p. 23.

<sup>119</sup> NGR, r. 82.

### **3.5.2.6 Forecast disposals**

Country Energy states that no disposals or redundancies are proposed for the access arrangement period.<sup>120</sup> Therefore, the AER considers that Country Energy is not proposing to reduce the projected capital base for disposals in the access arrangement period as required by r. 78(d) of the NGR.

Further, the AER notes that the NGR contains no provision for forecasting redundant assets, only disposals.<sup>121</sup> If assets do become redundant during the course of an access arrangement period they are removed from the capital base at the commencement of the subsequent access arrangement period as required by r. 77(2)(e) of the NGR.

### **3.5.2.7 Adjustment to the capital base for inflation**

The AER agrees with approach taken by Country Energy to forecast inflation.<sup>122</sup> That approach is to apply a 10-year inflation forecast calculated as a geometric average of the latest RBA short-term forecasts for two years and the mid-point of the RBA's target inflation range for the remaining eight years. The AER considers, however, that Country Energy's forecast inflation rate is now out-of-date and no longer represents the best forecast or estimate possible in the circumstances as required by r. 74(2) of the NGR.<sup>123</sup> Instead the AER applies a forecast rate of inflation of 2.45 per cent. The AER's full consideration of the appropriate inflation rate is contained in chapter 5 of the draft decision.

Therefore Country Energy must amend its adjustment to the capital base for forecast inflation by making amendment 3.7 as outlined above.

### **3.5.2.8 Summary of the projected capital base**

The AER has considered Country Energy's proposed projected capital base. Given the amendments required to Country Energy's proposed capital expenditure, depreciation schedules and indexation of the capital base for the access arrangement period, the AER considers that Country Energy's projected capital base does not comply with r. 74(2) and r. 78 of the NGR. Therefore, Country Energy must make amendment 3.7 set out below.

## **3.5.3 Opening capital base for the next access arrangement period**

Country Energy's access arrangement proposal does not resolve whether depreciation in the capital base is to be based on forecast or actual capital expenditure for the access arrangement period commencing 1 July 2015.<sup>124</sup> Country Energy has confirmed that it will use approved forecast capital expenditure to calculate depreciation.<sup>125</sup> However, in order to comply with r. 90(2) of the NGR, Country Energy should state this explicitly in the access arrangement. Therefore, Country Energy must make amendment 3.8 set out 3.9 below.

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<sup>120</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 23, 26.

<sup>121</sup> NGR, r. 78(d).

<sup>122</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>123</sup> NGR, r. 74(2)(b).

<sup>124</sup> NGR, r. 90(2).

<sup>125</sup> Country Energy email to AER, 7 August 2009, Attachment: *24 July 09 – AER to Country – proposal follow-up questions – 070809.doc* (confidential), p. 4 .

### **3.5.4 Capital redundancy policy**

Country Energy's access arrangement for the earlier access arrangement period includes a redundancy policy. However, Country Energy does not propose to include a capital redundancy policy in the access arrangement period. The AER accepts Country Energy's proposal. The AER notes that for the purposes of r. 77(2)(e) of the NGR any assets that become redundant during the access arrangement period will be removed from the opening capital base for the access arrangement period commencing on 1 July 2015.

Although Country Energy does not propose a capital redundancy policy for the access arrangement period, its access arrangement revision proposal includes provisions purporting to provide the AER with discretion to remove redundant assets from the capital base under certain circumstances. Consistent with Country Energy's proposal not to include a capital redundancy policy for the access arrangement period, the AER requires an amendment to remove those provisions from the access arrangement. Therefore, Country Energy must make amendment 3.9 set out below.

## **3.6 Conclusions**

### *Opening capital base*

The AER does not propose to approve the proposed opening capital base for the access arrangement period as it does not comply with r. 77(2) of the NGR and requires Country Energy to make amendments 3.1, 3.2, 3.3 and 3.4 set out below.

### *Projected capital base*

The AER does not propose to approve the proposed projected capital base for the access arrangement period as it does not comply with r. 78 of the NGR and requires Country Energy to make amendments 3.5, 3.6 and 3.7 set out below.

### *Opening capital base for the next access arrangement period*

The AER does not propose to approve the proposed calculation of depreciation for establishing the opening capital base for the access arrangement period commencing 1 July 2015 as it does not comply with r. 90 of the NGR and requires Country Energy to make amendment 3.8 set out below.

### *Capital redundancy*

The AER proposes to approve the proposal not to include a mechanism to remove redundant assets from the capital base for the access arrangement and requires Country Energy to make amendment 3.9 set out below.

## **3.7 Amendments required to the access arrangement proposal**

Before the revised access arrangement proposal can be approved, Country Energy must make the following amendments:

**Amendment 3.1:** delete Table 3 in the access arrangement information and replace it with the following:

**Table 3.7: Actual vs regulatory allowances for total capital expenditure for the previous Access Arrangement (\$'000, nominal)**

	Jan to June 2006	2006-07	2007-08	2008-09	2009-10	Total
Actual/Estimated expenditure	1727	2191	3816	3594	4225	15 554
Less network management costs						1 400
Total						14 154

**Amendment 3.2:** delete Table 11 in the access arrangement information and replace it with the following:

**Table 3.8: Regulatory depreciation in the previous Access Arrangement (\$'000, nominal)**

	Jan-June	2006-07	2007-08	2008-09	2009-10
Total	564	1226	1332	1474	1588

**Amendment 3.3:** delete Table 13 in the access arrangement information and replace it with the following:

**Table 3.9: CPI indexation of capital base (%)**

	Jan to June 2006	2006-07	2007-08	2008-09	2009-10
Total	1.33	3.54	2.33	4.35	1.82

**Amendment 3.4:** delete Table 12 in the access arrangement information and replace it with the following:

**Table 3.10: Calculation of the capital base as at 30 June 2010 (\$'000, nominal)**

	Jan-June 2006	2006-07	2007-08	2008-09	2009-10
Opening capital base	44 515	46 280	48 921	52 590	57 079
Capital expenditure	1727	2191	3816	3594	4225
Less network management costs					1400
Depreciation	564	1226	1332	1474	1588
Disposals	0	0	0	0	0

Adjustment for inflation (indexation)	602	1676	1186	2368	1466
Less difference between actual and forecast capital expenditure (Jan–June 06)					25
Less adjustment					13
Closing capital base	46 280	48 921	52 590	57 079	59 743

**Amendment 3.5:** delete Tables 14, 15, 16 and 17 in the access arrangement information and replace them with the following:

**Table 3.11: Forecast conforming capital expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Asset replacement and refurbishment	1984	1681	1835	1894	8819	8843
Growth related	1690	2150	1827	1470	1737	8874
Total	3674	3834	3661	3364	3163	17693

**Table 3.12 Forecast mains refurbishment expenditure for the access arrangement (\$'000, real 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Refurbishment cost	1588	1452	1624	1508	924

**Table 3.13: Forecast meter replacement expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Meter replacement cost	399	230	211	387	502

**Table 3.14: Forecast new connection expenditure for the access arrangement (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Small customers	521	522	523	526	528
Medium/large customers	15	15	15	15	15

Expansion mains:	214	215	216	217	217
Network reinforcement	944	1404	1079	716	980
Total	1694	2155	1832	1473	1741

**Amendment 3.6:** delete Table 19 in the access arrangement information and replace it with the following:

**Table 3.15: Forecast depreciation for the access arrangement (\$'000, nominal)**

	Total economic life	Average Remain. life	WDV 30/6/10	2010–11	2011–12	2012–13	2013–14	2014–15
System assets	52.6	33.4	59544	2084	2231	2379	2533	2695
Non-system assets	5	1	199	204	0	0	0	0
Total				2288	2231	2379	2533	2695

**Amendment 3.7:** delete Table 20 in the access arrangement information and replace it with the following:

**Table 3.16: Forecast capital base as at 30 June for each year of the access arrangement (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening capital base	59 743	62 830	66 314	69 649	72 671
Forecast capital expenditure	3911	4176	4089	3848	3706
Forecast depreciation	2288	2231	2379	2533	2695
Disposals	0	0	0	0	0
Adjustment for inflation (Indexation)	1464	1539	1625	1706	1780
Closing capital base	62 830	66 314	69 649	72 671	75 462

**Amendment 3.8:** delete section 12 of the access arrangement proposal and replace it with the following:

*Country Energy Gas proposes to use the allowed forecast depreciation in this Access Arrangement to determine the opening Capital Base for the Access Arrangement commencing on 1 July 2015.*

**Amendment 3.9:** delete sections 14.1(a) to (d) in the access arrangement proposal.



## 4 Depreciation

### 4.1 Introduction

This chapter sets out Country Energy's submissions and the AER's consideration of Country Energy's proposed depreciation schedules and asset lives.

Depreciation over the earlier access arrangement period is one of the determinants of the opening capital base. Depreciation over this access arrangement period is reflected in total revenue in two ways. First, it is a component of the projected capital base, and second, there is a separate depreciation building block.

### 4.2 Regulatory requirements

Rule 88(1) of the NGR provides that the depreciation schedule sets out the basis on which the pipeline assets constituting the capital base are to be depreciated for the purpose of determining a reference tariff. Rule 88(2) of the NGR provides that the depreciation schedule may consist of a number of separate schedules, each relating to a particular asset or class of assets.

Rule 89(1) of the NGR provides that the depreciation schedule should be designed:

- (a) so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services; and
- (b) so that each asset or group of assets is depreciated over the economic life of that asset or group of assets; and
- (c) so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets; and
- (d) so that (subject to the rules about capital redundancy), an asset is depreciated only once (i.e. that the amount by which the asset is depreciated over its economic life does not exceed the value of the asset at the time of its inclusion in the capital base (adjusted, if the accounting method approved by the AER permits, for inflation)); and
- (e) so as to allow for the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.

Rule 89(2) of the NGR provides that compliance with r. 89(1)(a) may involve deferral of a substantial proportion of the depreciation, particularly where:

- (a) the present market for pipeline services is relatively immature; and
- (b) the reference tariffs have been calculated on the assumption of significant market growth; and
- (c) the pipeline has been designed and constructed so as to accommodate future growth in demand.

Clause 5(1)(d) of schedule 1 of the NGR provides that in deciding whether to approve an access arrangement revision proposal for a transitional access arrangement, or in

making its own proposal for revision of a transitional access arrangement under r. 63 or r. 64 of the NGR, the AER must take into account the depreciation schedule for the transitional access arrangement under section 8.32 of the Code.

### 4.3 Country Energy's proposal

Country Energy proposes estimating depreciation using a straight line depreciation method for the access arrangement period.<sup>126</sup> The IPART approved this methodology for the earlier access arrangement period.<sup>127</sup>

Country Energy proposes changing its asset classes from the earlier access arrangement period. This change is intended to allow easier management of the assets by pressure zones and has no effect on the total value of the depreciation amount.<sup>128</sup>

Country Energy submits that the depreciation schedule used to establish the opening capital base is the depreciation approved by the IPART in the earlier access arrangement period and that it has adjusted this approved amount by actual CPI.<sup>129</sup> This means Country Energy is using forecast rather than actual capital expenditure to roll forward the capital base. Table 4.1 sets out the actual and forecast depreciation in the earlier access arrangement period.

**Table 4.1: Depreciation for the earlier access arrangement period (\$'000, nominal)**

	2005–06	2006–07	2007–08	2008–09	2009–10
Total	1128 <sup>a,c</sup>	1225 <sup>a</sup>	1318 <sup>a</sup>	1460 <sup>b</sup>	1555 <sup>b</sup>

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 22.

a: Actual.

b: Forecast.

c: Value has been multiplied by two to account for depreciation reported for the half year from January 2006 to June 2006.

Table 4.2 sets out Country Energy's forecast depreciation for the access arrangement period. Country Energy proposes to adjust depreciation in the earlier access arrangement for actual CPI.<sup>130</sup>

**Table 4.2: Forecast depreciation for the access arrangement period (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Total	2367	2286	2439	2596	2762

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 28.

Table 4.3 sets out the economic asset lives and remaining lives as at 30 June 2010.

<sup>126</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 27.

<sup>127</sup> IPART, *Draft decision: Revised Access Arrangement for Country Energy Gas Network*, August 2005, p. 50.

<sup>128</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 27.

<sup>129</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 22.

<sup>130</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 22.

**Table 4.3: Economic asset lives and remaining lives as at 30 June 2010 (years)**

Asset Category	Economic Life	Remaining Life
High Pressure	80	59
Medium–High Pressure	50	35
Medium–Low Pressure	50	25
Low Pressure	50	31
Services	50	30
Meters & Regulators	15	8
District Regulators	40	18
Gate Stations	50	45
SCADA & Telemetry	20	12
Non System Assets	5	1

Source: Country Energy, *Access arrangement information*, 1 Jul 2009, p. 27.

Country Energy submits that each category of assets is depreciated once over their economic life. In addition, Country Energy submits that the depreciation schedule allows reference tariffs to vary over time in a way that promotes efficient market growth.<sup>131</sup>

## 4.4 AER’s analysis and considerations

The AER’s analysis and considerations in this chapter outlines the AER’s assessment against the depreciation rules in division 6 of the NGR. This assessment does not include an analysis of the value of the depreciation under r. 76 and r. 78 of the NGR which is considered in chapter 3 of the draft decision.

### 4.4.1 Depreciation schedule

Rule 88 of the NGR outlines the function of the depreciation schedule and states that it may consist of one or more schedules for a particular asset or class of assets.

The AER considers that Country Energy’s depreciation schedule sets out the basis on which the pipeline assets constituting the capital base are depreciated for the purpose of determining a reference tariff.<sup>132</sup>

The AER notes that as required under r. 88(2) of the NGR, the depreciation schedule consists of separate schedules for the classes of assets which relate to the asset categories described at Table 4.3 of this chapter.

<sup>131</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 27.

<sup>132</sup> NGR, r. 88(1).

For the reasons given above, the AER considers that the depreciation schedule satisfies the requirements of r. 88 of the NGR.

As the AER's assessment of Country Energy's proposed depreciation allowance for the earlier access arrangement period and the access arrangement period is contained in chapter 3 of the draft decision, the depreciation schedules are reproduced here for information purposes. The depreciation allowance approved by the AER for the earlier access arrangement period is shown in Table 4.4 and for the access arrangement period in Table 4.5.

**Table 4.4: AER's draft decision depreciation for the earlier access arrangement period (\$'000, nominal)**

	Jan–June 2006	2006–07	2007–08	2008–09	2009–10
Depreciation	564	1226	1332	1474	1588

**Table 4.5: AER's draft decision on forecast depreciation for the access arrangement period (\$'000, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Depreciation	2288	2231	2379	2532	2694

#### 4.4.2 Depreciation criteria

Rule 89(1) of the NGR outlines the matters relevant to how a depreciation schedule is to be designed. Country Energy proposes to depreciate its assets on a straight line basis over their remaining economic lives.

Country Energy has reclassified its assets from physical classes (by type of pipe) to asset classes (by pressure). Country Energy submits that this reflects a business decision that may assist Country Energy better account for its assets and which is consistent with industry practice.<sup>133</sup> The AER has reviewed and considered the impact of this change in its reclassification of assets. The AER considers that reclassification of assets meets the requirement of r. 89(1)(c) of the NGR. The reclassification of assets is considered in relation to the effect on the written down value and the impact on asset lives.

If the written down value of the capital base is the same before and after the asset reclassification, this demonstrates that the asset values have not changed and that assets are only depreciated once. This also means that the amount by which an asset is depreciated over its economic life does not exceed the value of the asset at the time it is first included in the capital base. As the total written down value is equivalent between the two asset classifications, the depreciation amount over the life of the

<sup>133</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 27.

assets will not exceed the value of the assets at the time they are first included in the capital base.<sup>134</sup>

Further, given that the reclassification of assets has an impact on the remaining lives of the assets, to determine whether the proposed depreciation schedule reflects the age of the assets under the previous classification, the AER compares the total average remaining life of the capital base at the start of the access arrangement period for the new asset classification (33.3 years) with the total average remaining life of the capital base at the start the earlier access arrangement period (39.6 years).<sup>135</sup>

Therefore, the AER considers that the remaining asset lives under the new classification are consistent with the remaining asset lives for the earlier access arrangement period.

The AER has considered the depreciation schedule proposed by Country Energy and taken into account clause (5)(1)(d) of schedule 1 of the NGR.

The AER considers that the proposed depreciation schedule is consistent with the r. 89 of the NGR criteria for the following reasons:

- the straight line method of depreciation is appropriate when demand is forecast to grow relatively constantly over the access arrangement period.<sup>136</sup> This is consistent with r. 89(1)(a) of the NGR which requires reference tariffs to vary over time in a way that promotes efficient growth in the market for reference services<sup>137</sup>
- the design of the depreciation schedule shows that each asset is depreciated over the economic life of the gas distribution assets<sup>138</sup>
- the design of the depreciation schedule allows for adjustments reflecting changes in the expected economic life of those assets<sup>139</sup>
- the design of the depreciation schedule shows that each asset is depreciated only once, and<sup>140</sup>
- the design of the depreciation schedule ensures a positive value for depreciation adding to the positive components of the building block revenue ensuring positive

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<sup>134</sup> NGR, r. 89(1)(d).

<sup>135</sup> Information regarding the asset lives for the access arrangement period was sourced from Country Energy, *Access arrangement information*, 1 July 2010, p. 27 and for the earlier access arrangement period from Country Energy, *Access arrangement information*, 1 January 2006, p. 15.

<sup>136</sup> Despite some variation in actual volume demand, the longer term trend displays constant and linear growth characteristics consistent with the conclusion drawn above. This is based on analysis of longer term trends of the Country Energy demand profile including 19 years of demand data (forecast and actual) sourced from Country Energy, *Access arrangement information*, 1 July 2009, appendix A (confidential): Infrastructure and Regulation Services, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, pp. 25, 47.

<sup>137</sup> NGR, r. 89(1)(a).

<sup>138</sup> NGR, r. 89(1)(b).

<sup>139</sup> NGR, r. 89(1)(c).

<sup>140</sup> NGR, r. 89(1)(d).

cash flows in the form of revenue. This allows Country Energy reasonable cash flow to be able it to meet financing, non-capital and other costs.<sup>141</sup>

Rule 89(2) of the NGR refers to the deferral of depreciation. However, in this instance the AER does not consider this rule relevant because the present market for pipeline services is relatively mature and there is no assumption of significant market growth relating to the calculation of reference tariffs.

#### **4.4.2.1 Summary**

The AER considers that:

- Country Energy sets out the basis on which the pipeline assets constituting the capital base are depreciated for the purpose of determining reference tariffs and the depreciation schedule consists of separate schedules for the classes of assets. This is consistent with the requirements of r. 88 of the NGR.
- Country Energy's depreciation schedule, including the proposed asset reclassification, reflects the requirements of the depreciation criteria. This is consistent with the requirements of r. 89 of the NGR.

## **4.5 Conclusion**

Subject to amendments to Country Energy's depreciation for total revenue as required by amendment 3.6 of the draft decision, the AER proposes to approve Country Energy's depreciation schedule for the access arrangement period as it complies with r. 88 and r. 89 of the NGR.

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<sup>141</sup> NGR, r. 89(1)(e).

## 5 Rate of return

### 5.1 Introduction

This chapter sets out the AER's estimate of an efficient (market-based) benchmark rate of return on capital for Country Energy over the access arrangement period. The key issues considered include the selection of an approach to calculate the rate of return on capital including the estimation of relevant parameters, such as the risk-free rate, inflation forecast, equity beta, market risk premium, debt risk premium, gearing and gamma.

The AER's consideration of the corporate taxation allowance is not set out in this chapter because it is not compensated for through the weighted average cost of capital (WACC) and is considered in chapter 6 of this decision.

### 5.2 Regulatory requirements

Rule 72(1)(g) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the proposed rate of return, the assumptions on which the rate of return is calculated and a demonstration of how it is calculated.

Rule 87(1) of the NGR provides that the rate of return on capital is to be commensurate with prevailing conditions in the market for funds and the risks involved in providing reference services. Rule 87(2) of the NGR provides that in determining a rate of return on capital:

- (a) it will be assumed that the service provider:
  - (i) meets benchmark levels of efficiency; and
  - (ii) uses a financing structure that meets benchmark standards as to gearing and other financial parameters for a going concern and reflects in other respects best practice; and
- (b) a well accepted approach that incorporates the cost of equity and debt, such as the Weighted Average Cost of Capital, is to be used; and a well accepted financial model, such as the Capital Asset Pricing Model, is to be used.

### 5.3 Summary of Country Energy's proposal

Country Energy proposes a nominal vanilla WACC approach to determine the rate of return on the projected capital base.<sup>142</sup> Country Energy proposes the capital asset pricing model (CAPM) to establish the return on equity.<sup>143</sup>

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<sup>142</sup> Following the nomenclature of N. Hathaway, *Imputation WACCs: Descriptions and numerical valuation comparison*, November 2004, viewed 21 July 2009, <[http://www.capitalresearch.com.au/downloads/WACC\\_descript.pdf](http://www.capitalresearch.com.au/downloads/WACC_descript.pdf)>.

<sup>143</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29. Although not specified by Country Energy, the formula applied is the standard Sharpe–Lintner CAPM.

The proposed nominal vanilla WACC is 10.84 per cent. The parameters underlying this estimation of the WACC are presented in Table 5.1.

**Table 5.1: Country Energy's proposed WACC parameters**

Parameter	Country Energy's proposal
Nominal risk-free rate (%)	4.94
Inflation (%)	2.47
Real risk-free rate (%)	2.41
Equity beta	1.1
Market risk premium (%)	7.0
Debt risk premium (%)	4.70
Debt to total assets (gearing) (%)	60
<b>Nominal vanilla WACC (%)</b>	<b>10.84</b>
Gamma (utilisation of imputation credits) <sup>a</sup>	0.30

Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 30, 35.

a: Gamma does not directly enter the nominal vanilla WACC equation, since in this post-taxation framework all adjustments for taxation are made in cash flows. However, it is listed here because gamma is intrinsically linked to the MRP and therefore the WACC.

## 5.4 Risk-free rate

The risk-free rate measures the return an investor would expect from an asset with zero volatility and zero default risk. The yield on long term Commonwealth Government Securities (CGS) is often used as a proxy for the risk-free rate because the risk of government default on interest and debt repayments is considered to be low.<sup>144</sup>

In the CAPM framework, all information used for deriving the rate of return should be as current as possible in order to achieve an unbiased forward looking rate and a rate of return that is commensurate with prevailing conditions in the market for funds. While it may be theoretically correct to use the on the day rate as it represents the latest available information, this can expose the service provider to daily volatility. For this reason, an averaging method is used to minimise volatility in observed bond yields.<sup>145</sup>

<sup>144</sup> AER, *Final decision: Electricity transmission and distribution network service providers: Review of the weighted average cost of capital (WACC) parameters*, 1 May 2009, pp. 136–140.(AER, *Final decision: WACC Review*, 1 May 2009).

<sup>145</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 128–174.



#### 5.4.1 Country Energy's proposal

Country Energy proposes the annualised yield on CGS with a maturity of 10 years as a proxy for the risk-free rate.<sup>146</sup> Country Energy proposes a nominal risk-free rate of 4.94 per cent observed over a 15-day averaging period ending on 20 May 2009.<sup>147</sup> Country Energy labels its methodology as 'on a moving average basis using the indicative mid rates published by the Reserve Bank of Australia'. Therefore the AER considers that all other aspects of the sampling process are consistent with prior AER decisions, including interpolation between the two nearest dated bonds to determine a 10-year yield. Country Energy does not propose a specific procedure for updating the value for the risk-free rate closer to the time of the final decision.

#### 5.4.2 AER's analysis and considerations

The risk-free rate is a market wide parameter that will not vary between different types of businesses.

The AER accepts that the risk-free rate should be estimated using the yield on 10-year CGS. The AER considers that a 10-year term assumption is consistent with the findings of the review of WACC parameters for electricity transmission and distribution network service providers (the WACC review).<sup>148</sup>

The AER also considers that the risk-free rate should be estimated using a 10–40 business day averaging period. As discussed in the WACC review, the AER considers that a 10–40 business day averaging period represents the optimal length of time to balance the trade-off between 'volatility driven error' and 'old information driven error.'<sup>149</sup> Therefore, the AER accepts the length of the averaging period (15 days) proposed by Country Energy.<sup>150</sup>

In practice, and as stated in the WACC review, the AER determines a risk-free rate that is observed as close as practically possible to the date of the final decision.<sup>151</sup> This approach is consistent with accepted finance theory, in order to determine an unbiased best estimate that reflects prevailing market conditions.<sup>152</sup> Country Energy has not proposed an averaging period that is close to the final decision date. Therefore, the AER has decided on a date for the averaging period which it will use to update the risk-free rate for the final decision.<sup>153</sup>

The AER also notes that in most cases, there will not be any CGS that expire exactly 10 years from the sampling date for the risk-free rate. The AER therefore uses straight line interpolation between the two adjacent CGS to determine a proxy value.

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<sup>146</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>147</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>148</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 171–174.

<sup>149</sup> AER, *Final Decision: WACC review*, 1 May 2009, p. 170.

<sup>150</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>151</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. xiii, 170–174.

<sup>152</sup> AER, *Final decision: Australian Capital Territory distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 96, (AER, *Final decision: ACT distribution determination*, April 2009).

<sup>153</sup> The AER's consideration of this date is set out in confidential appendix A.

For the draft decision, the AER determines the risk-free rate using the average of the observed yields for CGS during 15 business days from 2 October to 23 October 2009 to calculate an indicative WACC. The result is a nominal risk-free rate of 5.54 per cent. Therefore, the AER requires Country Energy to amend its access arrangement information as set out in amendment 5.1.

The AER will update the risk-free rate and use the 15 business day averaging period closer to the final decision date that has been stated in confidential appendix A.

## 5.5 Inflation forecast

The expected inflation rate is not an explicit parameter within the WACC calculation. However, it is used in the PTRM to forecast nominal total revenue and to index the capital base. It is an implicit component of the nominal risk-free rate, with implications for the return on both equity and debt.

### 5.5.1 Country Energy's proposal

Country Energy proposes an inflation rate of 2.47 per cent, a value consistent with its electricity distribution determination.<sup>154</sup>

### 5.5.2 AER's analysis and considerations

The AER notes that the inflation forecast in Country Energy's electricity distribution determination was determined using the AER's methodology (based on RBA data), which was previously used in the absence of a credible market-based approach.<sup>155</sup>

In previous decisions, the AER outlined that a method likely to result in the best estimate arrived at on a reasonable basis<sup>156</sup> of inflation over a 10-year period is to apply the RBA's short-term inflation forecasts extending out for two years and the mid-point of the RBA's target inflation band beyond that period (i.e. 2.5 per cent) for the remaining eight years.<sup>157</sup> An implied 10-year inflation forecast is derived by averaging these individual forecasts. The AER considers that this approach remains appropriate and provides the best estimate of expected inflation arrived at on a reasonable basis.<sup>158</sup>

The RBA's statement on monetary policy examines a wide variety of objective data influencing inflation in both the domestic and international financial markets to develop its inflation forecast. The forecast is produced on a regular basis and is publicly available, including supporting analysis and reasoning. Use of the RBA's statement on monetary policy report provides consistency and transparency in the AER methodology for deriving an inflation forecast.

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<sup>154</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>155</sup> AER, *Final decision: NSW distribution determination*, April 2009, pp. 233–236.

<sup>156</sup> NGR, r. 74(2).

<sup>157</sup> AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, pp. 233–237 (AER, *Final decision: NSW distribution determination*, April 2009).

<sup>158</sup> For a full explanation of the AER's methodology, see AER, *Final decision: NSW distribution determination*, April 2009, p. 236; AER, *Final decision: ACT distribution determination*, April 2009, p. 105.

While Country Energy’s proposal refers to the AER’s electricity distribution determination and appears to accept the method used for forecasting inflation, the AER notes it considered in that determination that inflation forecasts can change in line with market sensitive data.<sup>159</sup> Regulatory practice in Australia has been to update these forecast values at the time of making a decision.<sup>160</sup> The AER does not consider that an inflation forecast from a previous decision can be applied to a later decision without consideration of the prevailing market conditions for each decision. The AER will therefore update its estimate of inflation based on the latest RBA forecasts as close as practical to the date of the final determination.

The AER considers that the best estimate arrived at on a reasonable basis<sup>161</sup> most reliable 10-year inflation forecast is a geometric average of the RBA short-term forecasts (currently extending out two years) and the mid-point of the RBA’s target inflation range for the remaining years in the 10-year period.<sup>162</sup> Based on this approach and using the latest RBA forecasts, an inflation forecast of 2.45 per cent per annum produces the best estimate for a 10-year period for this draft decision.<sup>163</sup>

Table 5.2 shows the calculation of the inflation forecast for the access arrangement period using RBA data.

**Table 5.2: AER's conclusion on inflation forecast (%)**

	June 2011	June 2012	June 2013	June 2014	June 2015	June 2016	June 2017	June 2018	June 2019	June 2020	Geometric Average
Forecast inflation	2.00	2.50a	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.45

Source: RBA, Statement on monetary policy, 7 August 09, p. 75.

a: The RBA has not yet released a forecast for the year ending June 2012. This forecast will be available and adopted by the AER (including any updated forecasts) at the time of the final decision. The mid-point of its target inflation band has been assumed for the purposes of this draft decision.

The AER also notes that the inflation forecast used in the AER’s 2009 transmission determination for Transend is currently the subject of a merits review by the Tribunal.<sup>164</sup> The AER’s final decision for Country Energy will take account of the Tribunal’s consideration of issues relating to the inflation forecast. Therefore the AER requires Country Energy to amend its access arrangement information as outlines in amendment 5.1.

<sup>159</sup> AER, *Final decision: NSW distribution determination*, April 2009, p. 233–236.

<sup>160</sup> AER, *Final decision: ACT distribution determination*, April 2009, pp. 105–107; AER, *Final decision: NSW distribution determination*, April 2009, pp. 233–237.

<sup>161</sup> NGR, r. 74(2).

<sup>162</sup> The current RBA forecasts are available at [www.rba.gov.au](http://www.rba.gov.au). The current target inflation band is between 2 and 3 per cent per annum; see Treasurer and the Governor of the Reserve Bank of Australia, Joint statement on the conduct of monetary policy, 6 December 2007; viewed 26 June 2009, <[http://www.rba.gov.au/MonetaryPolicy/statement\\_conduct\\_mp\\_4\\_06122007.html](http://www.rba.gov.au/MonetaryPolicy/statement_conduct_mp_4_06122007.html)>.

<sup>163</sup> The AER notes that this will be updated to incorporate the latest available data from the RBA at the time of the final decision.

<sup>164</sup> Australian Competition Tribunal, *Application by Transend*, ACompT 5/2009.

## 5.6 Equity beta

The equity beta measures the standardised correlation between the returns on an individual risky asset or business with that of the overall market. It represents the ‘riskiness’ of the business’ returns compared with that of the market. Risk results from the possibility that returns will differ from expected returns—the greater the uncertainty around the returns of a business, the greater its level of risk.

### 5.6.1 Country Energy’s proposal

Country Energy proposes an equity beta of 1.1. Country Energy submits a report by the Competition Economists Group (CEG) that provides two reasons for a gas business, equity beta equal to or above the market average (1.0), and two reasons for a gas business equity beta above the electricity business equity beta determined in the WACC review (0.8).<sup>165</sup>

### 5.6.2 AER’s analysis and considerations

The AER has considered Country Energy’s proposal, including the contents of the CEG report, and the details of its assessment are included in appendix B. In summary, the AER considers that:

- the WACC review statements that gas businesses may have a higher business risk than electricity did not sufficiently distinguish between exposure to systematic risk and exposure to business specific risk.<sup>166</sup> The AER did not intend to imply that business specific risk should be compensated for in the equity beta. Further, the difference in systematic risk exposure between gas and electricity is likely to be insignificant, particularly for business with regulated businesses such as Country Energy. As outlined in the WACC review, empirical evidence suggests an equity beta of between 0.4 and 0.7 for both gas and electricity businesses.<sup>167</sup> Setting a value for the equity beta slightly higher than the empirical estimates provides return to cover any uncertainty for volume risk
- the extent to which business volatility (shown as volatility in cash flow, customer numbers and revenue) represents business specific risk rather than exposure to systematic risk is not conclusively proven. The business volatility presented by Country Energy provides no persuasive evidence of exposure to systematic risk that would require compensation through the equity beta
- even though the Sharpe–Lintner CAPM has limitations it still remains a well accepted model that explains the risk–return relationship. Recent academic research continues to support the Sharpe–Lintner CAPM as the best available

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<sup>165</sup> CEG, *The market risk premium and relative risk for ActewAGL: A report for ActewAGL*, June 2009 (CEG, MRP and relative risk for ActewAGL, June 2009); CEG, *The market risk premium and relative risk for Country Energy: A report for Country Energy*, June 2009 (CEG, MRP and relative risk for Country Energy, June 2009). The AER notes the minor differentiation between the two reports when presenting business specific cash flow volatility arguments.

<sup>166</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 170–108, 257–258.

<sup>167</sup> AER, *Final decision: WACC review*, 1 May 2009, pp.239–334, 343.

predictor of returns from a capital asset, and it is particularly accurate under the circumstances applying to the benchmark efficient business,<sup>168</sup> and

- comparing two dividend growth model (DGM) projections to infer the equity risk premium for the equity beta is not a well accepted approach. The AER observes that DGM projections are highly variable in response to small changes in inputs. Further, several of the assumptions underlying these inputs are contentious, including the assumptions, that analyst forecasts are current, that market expectations can be used as a proxy for analyst expectations, and that markets are always perfectly priced. Deriving an equity beta by comparing two DGM projections amplifies the uncertainty inherent in any DGM projection, such that limited weight can be given to this empirical analysis.

Based on this information, an equity beta of between 0.4 and 0.7 ensures that the service provider has the opportunity to recover at least its efficient costs incurred in providing reference services and meeting regulatory requirements.<sup>169</sup> However, for reasons of regulatory certainty and adopting a conservative approach, the AER concludes that the value of 0.8 is the best estimate arrived at on a reasonable basis<sup>170</sup> of the equity beta. The AER considers that a value of 1.1 does not provide the best estimate of the equity beta, given prevailing market conditions.<sup>171</sup> The AER requires Country Energy to amend its equity beta to 0.8 in the access arrangement information as outlined in amendment 5.1.

## 5.7 Market risk premium

The market risk premium (MRP) is the expected return over the risk-free rate that investors require in order to invest in a well diversified portfolio of risky assets. The MRP represents the risk premium investors who invest in such a portfolio can expect to earn for bearing only non-diversifiable (i.e. systematic) risk. The MRP is common to all assets in the economy and is not specific to an individual asset or business.

The MRP is scaled up or down by the equity beta (of a particular asset or business) to reflect the risk premium—over and above the risk-free rate—equity holders would require to hold that particular risky asset or business as part of the investor's diversified portfolio.

### 5.7.1 Country Energy's proposal

Country Energy proposes an MRP of 7 per cent. Country Energy submits a report by CEG to support this estimate of the MRP.<sup>172</sup> The CEG report provides a number of forward looking MRP estimates using a DGM approach. Based on a gamma estimate

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<sup>168</sup> For a full discussion of this point, see appendix B. The source paper is Z. Da, R. Guo and R. Jagannathan, 'CAPM for estimating the cost of equity capital: Interpreting the empirical evidence', *NBER Working Paper*, April 2009, pp. 9–16, 27–29.

<sup>169</sup> NGL, s. 24(2).

<sup>170</sup> NGR, r. 74(2).

<sup>171</sup> NGR, r. 74(2)(b) and r. 87(1).

<sup>172</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29. Country Energy states that the CEG report demonstrates that the MRP lies within the range 6.6 to 11.2 per cent. However, the AER could not find reference to this specific range within the CEG report (for any gamma).

of 0.65, the CEG report estimates that the MRP is in the range of 8.3 to 16.7 per cent.<sup>173</sup>

### 5.7.2 AER's analysis and considerations

The MRP is a market wide parameter and it is not specific to any business or industry. Therefore, the AER considers that the estimation of the MRP for this determination should be consistent with the MRP estimated for electricity distribution in the WACC review.<sup>174</sup> Further, the AER considers that the MRP should be estimated based on a 10-year term assumption, consistent with the estimation of the risk-free rate. This is necessary for internal consistency within the WACC estimate.<sup>175</sup>

A detailed analysis of Country Energy's proposal (including the contents of the CEG report) is included in appendix B, which builds on previous considerations made in the WACC review.<sup>176</sup> In summary, this analysis outlines:

- the improvement in global financial conditions, including a reduction in market volatility
- the high variability of DGM based estimates of MRP, and
- the appropriate use of historical estimates of MRP.

The CEG report includes several statements from key economic institutions on the tumultuous nature of capital markets as a result of the global financial crisis (GFC).<sup>177</sup> The AER observes more recent statements from several of these institutions indicating that recovery has commenced, although the AER considers there is still need for caution.<sup>178</sup>

In particular, the CEG report presents data on the implied volatility of the equity index as evidence of the heightened risk in the market (and therefore the need for a higher MRP).<sup>179</sup> The AER considers that updated data on the ASX 200 index call options shows that volatility is returning to the levels experienced before the GFC.<sup>180</sup>

The CEG report presents a range of estimates for the MRP, all based on the same set of inputs to a DGM except for different assumptions regarding the length of time before market conditions return to pre-GFC levels (if at all).<sup>181</sup> The DGM does not differ substantially from the previous model submitted in the CEG report to the WACC review.

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<sup>173</sup> CEG, *MRP and relative risk for Country Energy*, June 2009, pp. 18–19.

<sup>174</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 175–238.

<sup>175</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 187. For practical reasons the MRP is estimated as a whole:  $MRP = \text{expected return on the market portfolio} - \text{risk-free rate}$ .

<sup>176</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 175–238.

<sup>177</sup> CEG, *MRP and relative risk for Country Energy*, June 2009, paragraphs 2–8, pp. 2–4.

<sup>178</sup> These statements are included in appendix B.

<sup>179</sup> CEG, *MRP and relative risk for Country Energy*, June 2009, p. 7.

<sup>180</sup> AER analysis of Bloomberg; data is graphed at figure B.1 in appendix B.

<sup>181</sup> CEG, *MRP and relative risk for Country Energy*, June 2009, pp. 18–19.

The AER notes, as stated in the WACC review, that cash flow based measures of the MRP (such as the DGM) are subject to a number of limitations:<sup>182</sup>

- They provide highly variable forward looking estimates of the MRP.
- They are sensitive to small changes in assumptions.
- There is a relative lack of sources of these estimates.

Small corrections to the DGM analysis in the CEG report produce an estimate of MRP between 6 per cent and 7.8 per cent. This is a marked reduction from an MRP between 8.3 per cent and 16.7 per cent outlined in the CEG report.<sup>183</sup>

As stated in the WACC review, the AER has previously observed MRP estimates derived using cash flow based measures substantially below the historical average, but has consistently maintained an MRP of 6 per cent in the interests of regulatory certainty and stability.<sup>184</sup> The AER considers that this approach balances the need to take account of prevailing market conditions and the need to provide regulatory certainty.

The AER further notes, as stated in the WACC review, that DGM based estimates provide measures of the MRP at a specific point in time, and as such are not necessarily consistent with the 10-year term assumption for the MRP.<sup>185</sup>

Consistent with the WACC review, the AER considers that due to these issues estimates of the MRP using a DGM approach are limited to being a useful cross-check for more reliable estimates of the MRP derived using other methods.

The AER considers that prior to the onset of the GFC, an estimate of 6 per cent for the forward looking long term MRP was the best estimate.<sup>186</sup> However, following the onset of the GFC, the AER notes the changed market conditions indicate an increase in the MRP, although it does not consider there is sufficient evidence to determine if this is a temporary or permanent change. The AER considers that in either case, given the uncertainty in the future outlook and consistent with its findings in the WACC review, an MRP of 6.5 per cent is appropriate for the purpose of a forward looking estimate commensurate with prevailing market conditions.

The AER considers that an MRP of 6.5 per cent provides the best estimate arrived at on a reasonable basis<sup>187</sup> of the MRP in the prevailing market conditions and required Country Energy to amend its access arrangement information as outlined in amendment 5.1.<sup>188</sup>

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<sup>182</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 219–220. See also AER, *Electricity transmission and distribution network service providers: Review of the weighted average cost of capital (WACC) parameters: Explanatory statement*, p. 250.

<sup>183</sup> CEG, *MRP and relative risk for Country Energy*, June 2009, p. 18.

<sup>184</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 237.

<sup>185</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 219.

<sup>186</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 175–238.

<sup>187</sup> NGR, r. 74(2).

<sup>188</sup> NGR, r. 74(2) and r. 87(1).

## 5.8 Debt risk premium

The debt risk premium (or debt margin) is added to the nominal risk-free rate to calculate the expected return on debt, which is an input for calculating the WACC. The debt risk premium is the margin above the risk-free rate that investors in a benchmark efficient service provider are likely to demand as a result of issuing debt to fund the business operations.

### 5.8.1 Country Energy's proposal

Country Energy proposes that the debt risk premium be set by taking the average of Bloomberg and CBASpectrum fair value estimates (for debt with a ten year maturity and a credit rating of BBB+) less the risk-free rate, measured over the same averaging period as the risk-free rate.<sup>189</sup> Country Energy proposes an indicative debt risk premium of 4.7 per cent that it estimated over the 15 business days ending on 20 May 2009 which is intended to be updated closer to the date of the final decision. Country Energy submits a report from CEG that compares the debt risk premium estimates from CBASpectrum and Bloomberg (known as 'fair value estimates').<sup>190</sup>

### 5.8.2 AER's analysis and considerations

The AER notes that much of the content of the CEG report is not new and has been considered in previous AER decisions.<sup>191</sup> The reasons provided in the CEG report for Country Energy are discussed and analysed in appendix B. In summary, the AER considers that:

- given that both Bloomberg and CBASpectrum generate their fair value estimates using proprietary methods, it is inappropriate to speculate on the relative merits of their internal methodology. Neither Country Energy or its consultants, nor the AER possess an in depth knowledge of how either Bloomberg or CBASpectrum calculate their fair value estimates, and no weight can be given to assertions regarding the selection of input data or mathematical formulation of the yield functions as contained in the CEG report submitted by Country Energy<sup>192</sup>
- evaluation of the output from each method against real world observations of yields (over a period) for a sample of actual bonds that reflect an efficient benchmark is the only impartial means of determining which method produces the best estimates. Consequently, comparing the CBASpectrum and Bloomberg fair value estimates (including the average of both estimates) to observed yields of actual BBB+ rated bonds is the approach given weight by the AER when determining which data service provides a better estimate for the purposes of determining an efficient benchmark cost of debt. The AER updates its previous analysis (of April 2009) using data for the averaging period and finds that on this occasion CBASpectrum's fair value estimates are more closely aligned to the

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<sup>189</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>190</sup> CEG, *Estimating the cost of 10 year BBB+ debt: A report for Country Energy*, June 2009.

<sup>191</sup> AER, *Final decision: NSW distribution determination*, April 2009, pp. 224–232; AER, *Final decision: ACT distribution determination*, April 2009, pp. 97–105; see also AER, *Victorian advanced metering infrastructure review: 2009–11 AMI budget and charges applications: Draft determination*, July 2009, pp. 119–123.

<sup>192</sup> CEG, *The cost of debt for Country Energy*, June 2009, pp. 14–16.



observed yields than Bloomberg's fair value estimates, and therefore provide the best estimate arrived at on a reasonable basis<sup>193</sup> possible in the circumstances, and

- there are problems with using the April 2009 Tabcorp floating rate note issue as the benchmark for comparing Bloomberg fair value estimates and CBASpectrum fair value estimates. Although a recent debt issue, it does not closely match the desired benchmark debt characteristics and is only a single data point.

The AER notes that except for the selection of a different benchmark data source, Country Energy adopts the AER's methodology for estimating the debt risk premium.<sup>194</sup> This includes adopting a debt risk premium averaging period that matches the risk-free rate and that the benchmark business issues 10-year Australian corporate bonds with a BBB+ credit rating.<sup>195</sup>

The AER considers that in the prevailing market conditions the best estimate arrived at on a reasonable basis<sup>196</sup> of the debt risk premium is found by using the CBASpectrum BBB+ fair value estimate. For the purposes of the draft decision, the debt risk premium was calculated by averaging over the 15 business days between 2 October and 23 October 2009 (to match the risk-free rate).<sup>197</sup> The resulting debt risk premium is 4.24 per cent. Adding this debt risk premium to the risk-free rate of 5.54 per cent provides a return on debt of 9.78 per cent. Therefore the AER requires Country Energy to amend its access arrangement information as outlined in amendment 5.1

The appropriateness of using Bloomberg or CBASpectrum (or an average of both) fair yield estimates to derive the debt risk premium in the AER's 2009 electricity determinations for NSW, ACT and Tasmanian network service providers is currently the subject of a merits review by the Tribunal.<sup>198</sup> The AER's final decision for Country Energy will take account of the Tribunal's consideration of issues relating to the debt risk premium.

For the final decision, the AER will update the debt risk premium based on the same averaging period as the risk-free rate.

## 5.9 Gearing ratio

The gearing ratio is defined as the ratio of the value of debt to total capital (i.e. debt and equity), and is used to weight the costs of debt and equity when formulating the WACC. A business' gearing ratio, also referred to as its capital structure, will have a significant bearing on the expected required return on debt and the expected required return on equity.

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<sup>193</sup> NGR, r. 74(2).

<sup>194</sup> AER, *Final decision: NSW distribution determination*, April 2009, pp. 224–232; AER, *Final Decision: ACT distribution determination*, April 2009, pp. 97–105.

<sup>195</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 345–392.

<sup>196</sup> NGR, r. 74(2).

<sup>197</sup> The AER will update the debt risk premium based on this methodology at the time of its final decision. It will have regard to r. 74(2) and r. 87(1) of the NGR.

<sup>198</sup> Australian Competition Tribunal, *Application by Energy Australia, TransGrid, Integral Energy, Transend and Country Energy*, ACompT 2/2009, 3/2009, 4/2009, 5/2009, 6/2009.

### 5.9.1 Country Energy's proposal

Country Energy proposes a proportion of debt to total assets of 60 per cent for the access arrangement period.<sup>199</sup>

### 5.9.2 AER's analysis and considerations

In theory, the optimal debt to equity ratio is the point at which business value is maximized, where the marginal costs of debt just offset the marginal benefits.<sup>200</sup>

However, while an optimal capital structure theoretically exists, the actual optimal value of debt and equity for any given business is dynamic and dependent on a number of business specific factors.

For the purposes of determining the gearing ratio of a benchmark efficient service provider, the AER considers that in the long-run businesses will trend towards an efficient gearing ratio.

The gearing ratio of a benchmark efficient service provider may be used:

- to re-lever asset betas for the purposes of analysing the level of systematic risk across businesses, and
- as a factor in determining a credit rating for deriving the debt risk premium.<sup>201</sup>

The AER considers, based on evidence from the WACC review, that gearing of 60 per cent for the benchmark efficient electricity business is supported by the most recent available and reliable empirical evidence. In the WACC review, the AER included gas businesses as close (but not perfect) comparators to the benchmark electricity business. The AER considers that this reasoning also holds in reverse—that is, electricity businesses are close (but not perfect) comparators for the benchmark efficient gas business.<sup>202</sup> Further, the majority of businesses in the WACC review sample were involved in gas networks.<sup>203</sup> The AER considers that the best estimate arrived at on a reasonable basis of the gearing level<sup>204</sup> for the benchmark efficient gas business is 60 per cent. This generates a forward looking rate of return that is commensurate with prevailing conditions in the market for funds.<sup>205</sup>

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<sup>199</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 29.

<sup>200</sup> M. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, American Economic Review, Vol.76, No.2, 1986, pp. 323–329.

<sup>201</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 111–127.

<sup>202</sup> These reasons are detailed further in appendix B, in the context of equity beta (section B.2.2) and credit rating (section B.4.2). See also AER, *Final decision: WACC review*, 1 May 2009, pp. 104–110.

<sup>203</sup> For the Bloomberg gearing ratio analysis, five out of six businesses were involved in gas networks; for the Standard and Poor's gearing analysis, nine out of eighteen businesses were involved in gas networks. AER, *Final decision: WACC review*, 1 May 2009, pp. 121–127.

<sup>204</sup> NGR, r. 74(2).

<sup>205</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 126. See also, NGR, r. 87(1).

The AER notes that a gearing of 60 per cent is consistent with the recent gas transmission decision.<sup>206</sup> This gearing ratio has also been applied in recent electricity distribution and transmission determinations by the AER.<sup>207</sup>

The AER considers that the gearing of 60 per cent proposed by Country Energy is the best estimate arrived at on a reasonable basis<sup>208</sup> and meets the requirements of r. 87 of the NGR.

## 5.10 Gamma

Gamma is a measure of the value of imputation credits and is defined as a product of the ‘imputation credit payout ratio’ and the ‘utilisation rate’ (theta).<sup>209</sup> The gamma value does not explicitly appear in the nominal vanilla WACC, but is implicitly linked to the MRP. Under the post-taxation framework all adjustments for taxation are made in the cash flows, and these are detailed in chapter 6 of this decision.

Under the Australian imputation taxation system, domestic investors receive a credit for taxation paid at the company level (an ‘imputation credit’) that offsets part or all of their personal income taxation liabilities. For eligible shareholders, imputation credits represent a benefit from the investment in addition to any cash dividend or capital gains received.<sup>210</sup> Standard regulatory practice in Australia is to incorporate a value for imputation credits in determining the taxation building block for total revenue of regulated businesses.<sup>211</sup>

### 5.10.1 Country Energy’s proposal

Country Energy proposes a gamma of 0.3 and submits the following reasons to support its proposal:<sup>212</sup>

- Consistency with prior regulatory decisions made by IPART in 2005, where evidence supported a gamma between 0 and 0.35 and a value of 0.3 was applied.
- Evidence in a Joint Industry Associations (JIA) submission to the recent AER’s WACC review, which suggested a gamma between 0.15 and 0.25.<sup>213</sup>

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<sup>206</sup> ACCC, *Final decision: Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008, p. 71.

<sup>207</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 113.

<sup>208</sup> NGR, r. 74(2).

<sup>209</sup> This is the Monkhouse definition. See AER, *Final decision: WACC review*, 1 May 2009, p. xix. and P. Monkhouse, ‘Adapting the APV valuation methodology and the beta gearing formula to the dividend imputation tax system’, *Accounting and Finance*, 1997, vol. 37, pp. 69–88.

<sup>210</sup> Although foreign investors do not pay Australian personal income taxes, they may receive a credit for company taxation paid from their home country government, depending on the inter-country taxation arrangements.

<sup>211</sup> When deriving a vanilla WACC using the Officer framework in a regulatory context, the gamma will also influence the allowed revenues through the Monkhouse leveraging formula, which is used to lever and de-lever asset and equity betas. R. Officer, ‘The cost of capital of a company under an imputation tax system’, *Accounting and Finance*, 1994, vol. 31, pp. 1–17; P. Monkhouse, ‘Adapting the APV valuation methodology and the beta gearing formula to the dividend imputation tax system’, *Accounting and Finance*, 1997, vol. 37, pp. 69–88.

<sup>212</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 34–35.

<sup>213</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 393–471.

### 5.10.2 AER's analysis and considerations

The AER notes that while consistency with previous decisions (including those made by other regulators) is important,<sup>214</sup> substantial new research has been published since 2005 that provides a better estimation of gamma.<sup>215</sup> The AER considers that the estimate is to be commensurate with the prevailing market conditions as specified in r. 87(1) of the NGR.

The JIA submission cited by Country Energy was made in response to an issues paper published by the AER at the commencement of the WACC review.<sup>216</sup> The WACC review gave full consideration to the JIA submissions, as well as numerous other consultant reports, articles from academic literature, empirical data and service provider submissions. At the end of this consultation process the AER concluded that the best estimate arrived at on a reasonable basis of gamma arrived<sup>217</sup> over the relevant period is 0.65.<sup>218</sup> Therefore, the AER considers that the JIA submission cited by Country Energy has been previously assessed in full.

The AER considers that a gamma of 0.65 provides the best estimate in the prevailing market conditions.<sup>219</sup> A synopsis of the AER's reasoning on gamma is provided below.

#### *Market practice*

Consistent with the findings of the WACC review, the AER considers that there is consensus among market practitioners to value imputation credits.<sup>220</sup> The AER observes that market practice may not reflect the value of imputation credits in cash flow calculations. The AER considers that this occurs because of modelling complexities and the use of alternative valuation frameworks, not a decision to ascribe a zero value to imputation credits.<sup>221</sup> The AER therefore considers that the best estimate arrived at on a reasonable basis<sup>222</sup>, when determining the rate of return for a service provider, takes account of the positive value of imputation credits.

#### *Estimating the payout ratio*

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<sup>214</sup> IPART, *Final decision: Revised access arrangement for Country Energy gas network*, November 2005, p. 66.

<sup>215</sup> In particular, see D. Beggs and C. Skeels, 'Market arbitrage of cash dividends and franking credits', *The Economic Record*, September 2006, vol. 82(258), pp. 239–252; and J. Handley and K. Maheswaran, 'A measure of the efficacy of the Australian imputation tax system', *The Economic Record*, March 2008, vol. 84(264), pp. 82–94.

<sup>216</sup> Joint Industry Association, *Network industry submission—AER Issues Paper—Review of the WACC parameters for electricity transmission and distribution*, September 2008. AER, *Issues paper: Review of the weighted average cost of capital (WACC) parameters for electricity transmission and distribution*, August 2008.

<sup>217</sup> NGR, r. 74(2).

<sup>218</sup> In particular, the AER notes that gamma is estimated at a market wide level, so there should be no difference in the value assigned to electricity and gas network service providers. See AER, *Final decision: WACC review*, 1 May 2009.

<sup>219</sup> NGR, r. 74(2)(b) and r. 87(1).

<sup>220</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 404.

<sup>221</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 407–409. See also Handley, 15 April 2009, p. 35.

<sup>222</sup> NGR, r. 74(2).

The AER considers that, as found in the WACC review, the best estimate arrived at on a reasonable basis of the imputation credit payout ratio<sup>223</sup> must be determined with regard to the valuation framework for free cash flows and the value of a retained credit (i.e. accounting for time value loss before the retained credit is distributed). The AER uses the (well accepted) Officer WACC framework that assumes distribution of all free cash flows, and accordingly considers an imputation credit payout ratio of 1.0 should be adopted.<sup>224</sup> There is not a significant loss from the time value of money associated with retained credits such that the adoption of an estimate for the payout ratio of 1.0 is unreasonable. The AER considers that modelling the loss of time value of money using a range of reasonable discount rates and retention periods finds that the average value of imputation credits paid out across all scenarios is very close to 1.0.<sup>225</sup> Therefore the AER maintains its position that the best estimate arrived at on a reasonable basis payout ratio for determining the value of imputation credits is 1.0.<sup>226</sup>

*The appropriate time period for estimating theta*

The AER considers that, as stated in the WACC review, amendments to the taxation law in July 2000, which allow a full cash rebate to resident investors for imputation credits in excess of income taxation liabilities, cause a structural break in the long-term trend for theta values. This view is based on both conceptual grounds,<sup>227</sup> since the taxation changes effectively removes the impact of marginal taxation rates, and empirical grounds,<sup>228</sup> including the studies by Beggs and Skeels<sup>229</sup> and Handley and Maheswaran.<sup>230</sup> The rate of return must be commensurate with prevailing conditions<sup>231</sup> so for the purposes of this decision the AER bases its estimate of theta on post-2000 data only.

*Inferring theta from market prices*

One key methodology for determining theta is the dividend drop-off study, which utilises the drop in share price around the ex-dividend date to infer a value for the imputation credits attached to the dividend. The AER considers that, based on evaluation of multiple alternative studies in the WACC review,<sup>232</sup> the Beggs and Skeels study provides the most comprehensive, reliable and robust estimate of theta inferred from market prices in the post-2000 period.<sup>233</sup> In comparison with alternative dividend drop-off studies, the Beggs and Skeels study is directly relevant to the current imputation taxation regime, reliable (based on the statistical tests undertaken and presented in the paper), peer-reviewed and independently published.<sup>234</sup> The AER

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<sup>223</sup> NGR, r. 74(2).

<sup>224</sup> R. Officer, 'The cost of capital of a company under an imputation tax system', *Accounting and Finance*, 1994, vol. 31, pp. 1-17; AER, *Final decision: WACC review*, 1 May 2009, p. 416-420.

<sup>225</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 418-419, table 10.6.

<sup>226</sup> NGR, r. 74(2).

<sup>227</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 428.

<sup>228</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 428-430, table 10.7.

<sup>229</sup> Beggs and Skeels, September 2006.

<sup>230</sup> Handley and Maheswaran, March 2008.

<sup>231</sup> NGR, r. 87(1).

<sup>232</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 436-448.

<sup>233</sup> Beggs and Skeels, 2006.

<sup>234</sup> Beggs and Skeels, 2006.

remains of the view that the 2001–2004 estimate NGR, r. 74(2) of theta of 0.57 from this study is the best estimate arrived at on a reasonable basis.<sup>235</sup>

#### *Estimating theta from taxation statistics*

Another key methodology for determining theta is the analysis of ATO taxation statistics, which record aggregate issuance and redemption of imputation credits. The AER considers that, consistent with the WACC review, the methodology provided by the Handley and Maheswaran study provides a relevant and reliable estimate of theta in the prevailing market conditions (i.e. the post–July 2000 period).<sup>236</sup> The AER notes that the value of imputation credits is affected by the taxation status of the recipient, who may be either a domestic resident investor (who pays personal Australian taxes) or a foreign investor (who does not). The AER adopts a market definition under a domestic CAPM framework, where foreign investors in the Australian market will be recognised in defining the representative investor, but only to the extent they invest in the domestic capital market.<sup>237</sup> In this context, the estimation of theta from ATO taxation statistics is a reliable upper value for theta, since it reflects the mix of domestic and foreign investors. Therefore, the AER considers that the best estimate arrived at on a reasonable basis<sup>238</sup> commensurate with prevailing conditions<sup>239</sup> in the market for theta from taxation statistics for the post–2000 period is 0.74 from the Handley and Maheswaran study.<sup>240</sup>

#### *Consistency issues*

The AER also has regard to the requirement for consistency between WACC parameters, in particular:

- consistency between gamma and the MRP, and
- consistency between gamma and the treatment of cash dividends under the CAPM.

The AER discusses the relationship between gamma and the MRP in appendix B. The relationship between gamma and cash dividends under the CAPM is more complicated. The AER observes some contrasting results from academic studies:<sup>241</sup>

- dividend yield studies suggest that cash dividends are fully valued in total equity returns, and
- dividend drop–off studies suggest that cash dividends are less than fully valued.

After extensive evaluation, the AER considers that the weight of empirical evidence supports the position that imputation credits have a positive value. This position is consistent with the use of the standard Sharpe CAPM (as a well accepted financial model) to estimate equity returns.

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<sup>235</sup> NGR, r. 74(2).

<sup>236</sup> Handley and Maheswaran, 2008.

<sup>237</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 425–426.

<sup>238</sup> NGR, r.74(2).

<sup>239</sup> NGR, r. 87(1).

<sup>240</sup> Handley and Maheswaran, 2008.

<sup>241</sup> AER, *Final decision: WACC review*, 1 May 2009, pp. 461–466.

This involves adopting an imputation credit payout ratio of 1.0, consistent with a free cash flow approach to valuation and the Officer WACC framework. This payout ratio is then multiplied by the utilisation rate, theta, to derive the value for gamma. The AER considers that the reasonable range to determine a best estimate arrived at on a reasonable basis<sup>242</sup> for theta is between 0.57 and 0.74, based upon the AER's best estimates of theta inferred from dividend drop-off studies and ATO taxation statistics.<sup>243</sup>

In summary, the AER considers that:

- a gamma value of between 0.57 and 0.74 is determined by multiplying a payout ratio of 1 by a theta of between 0.57 and 0.74,
- the terminology used in the WACC review in referring to an 'upper bound' and 'lower bound' may be inappropriate. In particular, naming the Beggs and Skeels point estimate as a 'lower bound' does not reflect the correct statistical sense in which this terminology should be used,<sup>244</sup> and
- the empirical evidence supports the selection of a best estimate for theta of 0.65, as the mid point of the reasonable range.

The AER notes that the two approaches relied on to determine a best estimate arrived at on a reasonable basis<sup>245</sup> (i.e. market prices around ex-dividend date and taxation statistics) are consistent with the conceptual framework established for estimating gamma. That is, both of these approaches attempt to estimate theta (and therefore gamma) based on a weighted average valuation of all investors in the domestic capital market, recognising the presence of foreign investors, but only to the extent that they invest domestically.

The AER considers that a gamma of 0.65 provides a best estimate arrived at on a reasonable basis and is the best estimate determined on a responsible basis taking into consideration the prevailing market conditions.<sup>246</sup> Therefore the AER requires Country Energy to amend its access arrangement information as outlined in amendment 5.1.

## 5.11 Summary

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 WACC is less than that proposed by Country Energy due to the amendments required to parameters such as the nominal risk-free rate, equity beta, market risk premium and debt risk premium.

Table 5.3 outlines the WACC parameter values for this draft decision. The AER's final decision will update the nominal risk-free rate and debt risk premium (and all

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<sup>242</sup> NGR, r. 74(2).

<sup>243</sup> Beggs and Skeels, 2006.

<sup>244</sup> AER, *Final decision: WACC review*, 1 May 2009, p. 467.

<sup>245</sup> NGR, r. 74(2).

<sup>246</sup> NGR, r. 74(2) and r. 87(1).

values that depend on these parameters), based on the averaging period closer to the final decision date as stated in confidential appendix A. The AER's final decision will also update the inflation rate as outlined earlier in this chapter.

## 5.12 Conclusion

The AER does not propose to approve Country Energy's proposed rate of return on capital for the access arrangement period as it does not comply with r. 87 and r. 74 of the NGR and requires Country Energy to make the amendment set out below.

## 5.13 Amendments required to the access arrangement proposal

Before the proposed access arrangement can be approved, Country Energy must make the following amendment:

**Amendment 5.1:** delete the rate of return in chapter 6 in the access arrangement information and replace it with the following:

**Table 5.3: WACC parameters**

Parameter	AER's draft decision
Nominal risk-free rate (%)	5.54 <sup>a</sup>
Inflation (%)	2.45 <sup>b</sup>
Real risk-free rate (%)	3.02 <sup>a</sup>
Equity beta	0.8
Market risk premium (%)	6.5
Debt risk premium (%)	4.24 <sup>a</sup>
Debt to total assets (gearing) (%)	60
<b>Nominal vanilla WACC (%)</b>	<b>10.16<sup>a</sup></b>
Gamma (utilisation of imputation credits)	0.65

a: These figures are current to 23 October 2009, but should be considered indicative only. They will be updated for the final decision (in accordance with the averaging period set out in confidential appendix A).

b: This figure will be updated for the final decision using the latest data from the RBA statement of monetary policy.



## 6 Taxation

### 6.1 Introduction

This chapter sets out Country Energy's submissions and the AER's analysis and consideration of Country Energy's estimated cost of corporate income taxation for the access arrangement period.

### 6.2 Regulatory requirements

Rule 72(1)(h) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the proposed method for dealing with taxation, and a demonstration of how the allowance for taxation is calculated.

Rule 76(c) of the NGR provides for, the estimated cost of corporate taxation as a building block of the total revenue.

### 6.3 Country Energy's proposal

Country Energy proposes using a post-taxation framework to estimate total revenue. It includes a taxation building block in its total revenue estimate.

Country Energy used a pre-taxation framework in the previous access arrangement period. In order to transition to a post-taxation framework it is necessary to estimate the value of the taxation asset base as at the commencement of the access arrangement period. To estimate the taxation value at the capital base Country Energy has used actual taxation asset values as at 30 June 2008 and has rolled this taxation asset base forward to 30 June 2010 using actual and forecast capital expenditure, capital contributions, disposals and taxation depreciation. Country Energy proposes estimating taxation depreciation on a straight line basis using the effective lives published by the Australian Taxation Office (ATO).

Country Energy proposes to estimate cost of corporate income taxation for each regulatory year of the access arrangement period as follows:

$$ETC_t = (ETI_t \times r_t)(1 - \gamma)$$

where:

$ETC_t$  is the estimated cost of corporate income taxation for year t.

$ETI_t$  is the estimate of taxable income for year t.

$r_t$  is the expected statutory income taxation rate for the year t.

$\gamma$  is the assumed utilisation of imputation credits, set at 0.3.

The estimated cost of taxation for each year of the access arrangement period is set out in Table 6.1 following.

**Table 6.1: Estimated cost of corporate income taxation (\$m, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Estimated cost of corporate income taxation	0.53	0.50	0.54	0.58	0.62

Source: Country Energy, *Access arrangement information*, July 2009 p. 35.

## 6.4 AER's analysis and considerations

As Country Energy previously used a pre-taxation framework, the transition to a post-taxation framework requires the estimation of a taxation asset base as at the start of the access arrangement period. Country Energy's approach to setting the taxation value of the capital base largely reflects the approach outlined by the AER in its issue paper on transitioning from pre-taxation to post-taxation frameworks.<sup>247</sup> The only difference is that Country Energy had not established its taxation value for the capital base when it entered the national taxation equivalent regime (NTER). The AER considers that this approach is reasonable in the circumstances but that establishing the taxation base at the date the service provider enters the NTER regime is generally preferable.

Country Energy's estimated cost of taxation is estimated using the AER's (PTRM). Taxable income is represented by total revenue (estimated in accordance with r. 76 of the NGR) less taxation expenses and taxation losses carried forward.

Taxation depreciation is estimated by Country Energy using the PTRM based on Country Energy's proposed remaining lives, standard lives, capital base and capital expenditure relevant for taxation purposes. The AER has reviewed and considers Country Energy's proposed remaining lives, standard lives and capital base values for taxation purposes are reasonable. The only exception is that the standard life for high pressure mains for taxation purposes should be 50 years not 80 years as proposed by Country Energy.<sup>248</sup> A 50 year standard life for high pressure mains for taxation purposes is based on the standard life used by the Australian Taxation Office (ATO).<sup>249</sup>

After estimating taxable income, taxation payable is determined by applying the corporate income taxation rate of 30 per cent to taxable income. The estimate of the cost of corporate income taxation, for use as a total revenue building block, is arrived at by reducing the taxation payable by the value of imputation credits.

## 6.5 Conclusion

The AER does not propose to approve Country Energy's estimated cost of corporate taxation for each regulatory year of the access arrangement period as it does not

<sup>247</sup> AER, *Electricity Distribution Network Service Providers: Transition of energy businesses from pre-tax to post-tax regulation*, June 2007, pp. 51–53.

<sup>248</sup> Country Energy, *Country Energy Wagga Wagga Gas - PTRM Final*, July 2009.

<sup>249</sup> Australian Taxation Office, *Taxation Ruling—Income tax: effective life of depreciating assets*, 2002, viewed 20 July 2009, pg. 32, <<http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR200018%2FNAT%2FATO%2F00001&filename=pdf/pbr/tr2000-018c4.pdf&PiT=20020626000001>>.

comply with r. 76(c) and r. 74 of the NGR and requires Country Energy to make the amendments below.

## **6.6 Amendments required to the access arrangement proposal**

Before the access arrangement proposal can be accepted, Country Energy must make the following amendment:

**Amendment 6.1:** delete the taxation standard life of 80 years for high pressure mains in the PTRM and replace it with 50 years.

## 7 Operating expenditure

### 7.1 Introduction

Operating expenditure includes operating, maintenance and other costs as well as expenditure of a non-capital nature incurred in providing pipeline services. Operating expenditure may include expenditure incurred in increasing long-term demand for pipeline services and otherwise in developing the market for pipeline services.<sup>250</sup>

This chapter sets out the AER's analysis and consideration of Country Energy's proposed operating expenditure.

### 7.2 Regulatory requirements

Rules 72(1)(a)(ii) and 72(1)(e) of the NGR provide that the access arrangement information for a full access arrangement proposal must include:

- if the access arrangement period commences at the end of an earlier access arrangement period, operating expenditure (by category) over the earlier access arrangement period, and
- a forecast of operating expenditure over the access arrangement period and the basis of which the forecast has been derived.

Rule 72(1)(f) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the key performance indicators to be used by the service provider to support expenditure to be incurred over the access arrangement period.

Rule 91 of the NGR provides that operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

### 7.3 Country Energy's proposal

#### 7.3.1 Operating expenditure in the earlier access arrangement period

Country Energy's total operating expenditure during the earlier access arrangement period is expected to be \$9.1 million (\$2009–10). This is \$ 2.1 million or 18.8 per cent below the forecast approved by the IPART.<sup>251</sup> This is despite a significant increase (23.7 per cent) in the total operating expenditure forecast in the last year of the earlier access arrangement period (2009–10).<sup>252</sup>

Country Energy attributes the lower than expected operating expenditure in the earlier access arrangement period to the fact that direct gas network management costs were allocated to both capital and operating expenditure (rather than solely to operating

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<sup>250</sup> NGR, r. 69.

<sup>251</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

<sup>252</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

expenditure as approved in the earlier access arrangement decision).<sup>253</sup> Country Energy submits that lower operating expenditure was achieved despite increased uncontrollable costs. Input costs are identified as a major driver of these uncontrollable costs.

### 7.3.2 Forecast operating expenditure

Country Energy forecasts operating expenditure of \$13.0 million (\$2009–10) over the access arrangement period.<sup>254</sup> This represents a significant increase over the expected total operating expenditure for the earlier access arrangement period. The average annual increase in total forecast operating expenditure over the earlier access arrangement period is 12.4 per cent per annum in real terms. However, there is a significant increase in forecast operating expenditure (23.7 per cent) for the last year of the earlier access arrangement period and a further significant increase (9.5 per cent) from year five of the earlier access arrangement period to the first year of the access arrangement period (2010–11).<sup>255</sup>

Country Energy proposes to introduce self insurance and debt raising costs as forecast operating expenditure in the access arrangement period.<sup>256</sup> It also proposes increases in real terms for operating expenditure associated with network operations and maintenance, marketing, direct gas network management and corporate allocation.<sup>257</sup> Country Energy's forecast operating expenditure for the access arrangement period is set out in Table 7.1.

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<sup>253</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

<sup>254</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 31.

<sup>255</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>256</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 36.

<sup>257</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

**Table 7.1: Country Energy's forecast operating expenditure (\$'000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Controllable costs <sup>a</sup>						
Network operations and maintenance	1275	1303	1329	1349	1372	6628
Marketing	144	148	150	153	155	750
Direct gas network management	404	413	421	428	435	2101
Corporate allocation	523	534	545	553	562	2717
Sub total	2346	2398	2445	2483	2524	12 196
Non controllable costs <sup>a</sup>						
Self insurance	127	127	127	127	127	635
Debt raising costs	30	31	31	32	33	157
Sub total	157	158	158	159	160	792
Total operating expenditure	2503	2556	2603	2642	2684	12 988

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

a: Note that Country Energy does not separate operating expenditure into controllable and non-controllable costs.

### 7.3.3 Methodology for estimating forecast operating expenditure

Country Energy proposes using the 2009–10 budget year as the basis for projecting forecast operating expenditure for the access arrangement period. Country Energy submits that its forecast operating expenditure satisfies the criteria contained in r. 91 of the NGR.<sup>258</sup>

Country Energy submits that the rate of change in operating expenditure expected over the access arrangement period is related to the growth in demand and real wage and material cost increases. For growth in demand, Country Energy submits that the rate of change in operating expenditure is appropriately correlated to the growth in capital expenditure. Country Energy increases its forecast operating expenditure by the proportion of average annual growth related capital expenditure to the total replacement costs of the distribution assets.<sup>259</sup> This ratio is reduced by 25 per cent to reflect the fact that new assets will not incur condition based asset maintenance.<sup>260</sup>

Country Energy submits that the cost of wages and materials has increased in excess of inflation. Accordingly price indices for these inputs should be used as operating

<sup>258</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 31.

<sup>259</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 31–32.

<sup>260</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

expenditure cost inflators instead of CPI. CPI had been approved in the earlier access arrangement decision.<sup>261</sup>

In support of its submission Country Energy submits a report commissioned from the Competition Economists Group (CEG). This report estimates cost escalation factors over the term of the access arrangement period.<sup>262</sup> Country Energy also submits key performance indicators in support of its proposed operating expenditure.<sup>263</sup>

### **7.3.4 Forecast controllable operating expenditure**

#### **7.3.4.1 Network operating and maintenance costs**

Network operating and maintenance costs are the direct costs of operating and maintaining Country Energy's Wagga Wagga gas distribution network. They include receipt point maintenance, regular maintenance, leak repairs, inventory and supplies, network engineering, environment management, technical assurance, training, subscriptions to standards and code preparation bodies, cost of gas control and network planning, design and scheduling..<sup>264</sup>

Operating and maintenance costs that represent more than half of total controllable costs in 2009–10 are forecasts to increase by 2.0 per cent per annum in real terms over the access arrangement period. However, when compared to the earlier access arrangement period, total operating and maintenance costs for the access arrangement period are forecast to increase by about 12.0 per cent in real terms.<sup>265</sup>

#### **7.3.4.2 Marketing costs**

Marketing costs include promotional programs to attract new customers and to promote the use of gas to existing customers. They also include expenditure on a generic state based marketing campaign run by the NSW natural gas networks industry group.<sup>266</sup>

Marketing costs which make up 6.2 per cent of total controllable costs in 2009–10 are forecast to increase by 1.9 per cent per annum in real terms over the access arrangement period. However, when compared to the earlier access arrangement period, total marketing costs for the access arrangement period are forecast to more than double in real terms.<sup>267</sup>

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<sup>261</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

<sup>262</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix F: CEG, *Escalation factors affecting expenditure forecasts – A report for Country Energy*.

<sup>263</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 46.

<sup>264</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 33.

<sup>265</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>266</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 33.

<sup>267</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

### 7.3.4.3 Direct gas network management

Direct gas network management costs include directly attributable costs of managing the gas network, such as asset management, network data and billing, strategic planning and compliance activities.<sup>268</sup>

Direct gas network management costs which make up 17.2 per cent of total controllable costs in 2009–10 are forecast to increase by 2.0 per cent per annum in real terms over the access arrangement period. However, when compared to the earlier access arrangement period, total direct gas network management costs for the access arrangement period are forecast to increase by about 14.0 per cent in real terms.<sup>269</sup>

### 7.3.4.4 Corporate allocation

Country Energy submits that it has allocated total corporate costs<sup>270</sup> (i.e. between electricity and gas networks) using the cost allocation method approved by the AER in the NSW electricity distribution cost allocation decision.<sup>271</sup> In respect to the corporate costs for the gas networks, these costs have been allocated between the regulated and unregulated gas networks based on the regulated network's share of budgeted direct total costs as a proportion of the total direct costs for all the gas distribution networks.<sup>272</sup>

Corporate allocation costs which make up 22.3 per cent of total controllable costs in 2009–10 are forecast to increase by 2.0 per cent per annum in real terms over the access arrangement period. However, when compared to the earlier access arrangement period, total corporate allocation costs for the access arrangement period are forecast to increase by about 51.0 per cent in real terms.<sup>273</sup>

## 7.3.5 Forecast non controllable operating expenditure

### 7.3.5.1 Debt raising costs

Country Energy proposes total debt raising costs of 8.1 basis points per annum in its access arrangement proposal.<sup>274</sup> Debt raising costs are forecast to increase by 2.4 per cent per annum in real terms over the next access arrangement period in line with expected movements in the capital base.

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<sup>268</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 33.

<sup>269</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>270</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 34.

<sup>271</sup> AER, *Final decision: NSW electricity distribution network service providers cost allocation method*, March 2008, p. 12.

<sup>272</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 34.

<sup>273</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>274</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 36.



### **7.3.5.2 Equity raising costs**

Country Energy proposes no allowance for equity raising costs due to an immaterial level calculated using the access arrangement building blocks.<sup>275</sup>

### **7.3.5.3 Self insurance costs**

Country Energy proposes an annual insurance premium of \$127 000 (\$2009–10), totalling \$635 000 (\$2009–10) over the access arrangement period.<sup>276</sup>

Country Energy supports its annual insurance premium by reference to a confidential report provided by SAHA International Limited.<sup>277</sup> While it does not state that the Country Energy Board has signed off the self insurance proposal, the AER notes that Country Energy's submission proposal includes a statutory declaration that the information and documentation provided are accurate in all material aspects.<sup>278</sup>

Country Energy has not provided details about the administration of self insurance events.

### **7.3.5.4 Unaccounted for gas**

Country Energy does not include the cost of unaccounted for gas (UAG) in its forecast operating expenditure.

## **7.4 AER's analysis and considerations**

### **7.4.1 Earlier access arrangement period**

The AER is not required to assess whether Country Energy's operating expenditure in the earlier access arrangement period was prudent. An overview of actual operating expenditure is included earlier in this chapter as it provides a context for Country Energy's proposed forecast operating expenditure.

### **7.4.2 Forecast operating expenditure**

The AER notes significant increases in Country Energy's operating expenditure corresponding to the last year of the earlier access arrangement period (2009–10) and the first year of the access arrangement period (2010–11). These increases in operating expenditure (23.7 and 9.5 per cent respectively) are observed in all expenditure categories. The increases are in contrast to an average growth rate of 3.3 per cent per annum forecast over the access arrangement period. Country Energy's justification of these increases is assessed below.

Country Energy submits that the increase in operating expenditure in the earlier access arrangement period is the result of a number of events outside its control. Country Energy also identifies a number of input cost events such as labour and material input costs, and network growth as major drivers of the increased operating expenditure in the earlier access arrangement period. Country Energy further submits

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<sup>275</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 28.

<sup>276</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 36.

<sup>277</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix G (confidential).

<sup>278</sup> Country Energy, *Statutory declaration by Craig Murray, Managing Director of Country Energy Gas*, 30 June 2009.

that these input cost events are not one-off items but have created a step change increase in the operating expenditure in the access arrangement period.<sup>279</sup>

The AER does not consider that Country Energy provides sufficient analysis to support these cost increases in the earlier access arrangement period. Further, the AER considers that Country Energy only provides limited justification for why these increases should be sustained and reflected in forecast operating expenditure over the access arrangement period.<sup>280</sup>

However, the AER notes that about three quarters of the step change in Country Energy's forecast total operating expenditure that occurs in the first year of the access arrangement period (2010–11) is attributable to the introduction of debt raising costs and self insurance costs.

### **7.4.3 Methodology for developing forecast operating expenditure**

#### **7.4.3.1 Selection of a base year**

Country Energy proposes to use 2009–10 as the base year for projecting forecast operating expenditure over the access arrangement period.<sup>281</sup> As discussed previously, there is a significant increase in Country Energy's operating expenditure forecast for 2009–10 (23.7 per cent in real terms). This is in contrast to the previous two years (2007–08 and 2008–09) where total operating expenditure fell by 11.0 and 7.0 per cent respectively. Country Energy submits that it achieved some efficiency gains in 2007–08 and subsequent years through greater autonomy of work scheduling with respect to its gas network. This is because prior to 2007–08, field staff comprised a shared workforce undertaking projects for Country Energy's electricity networks and its gas networks, whereas now there is a dedicated gas network workforce.<sup>282</sup>

The AER notes that the operating expenditure for 2007–08 is referable to actual (incurred) expenditure while 2008–09 is an estimate of incurred expenditure (as it includes both actual and forecast operating expenditure). The 2009–10 year proposed by Country Energy as the base year is comprised of entirely forecast operating expenditure.<sup>283</sup>

The AER considers that the following conditions should be met when selecting and adjusting a base year for projecting efficient operating costs:

- the base year should not include substantial one-off expenditure
- the expenditure should reflect actual or estimated rather than forecast expenditure, and
- the base year generally should be as close as possible to the forecast period. A year proximate to the commencement of the access arrangement period, excluding

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<sup>279</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 12–13.

<sup>280</sup> NGR, r. 74.

<sup>281</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 31.

<sup>282</sup> Country Energy, meeting with the AER on 14 August 2009.

<sup>283</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

one-off factors, is likely to better reflect the current operating and organisational structure of a business than earlier years.

The AER notes that the base year selected by Country Energy includes costs derived from forecast rather than actual expenditure.<sup>284</sup> Although 2009–10 is the year closest to the forecast period, expenditure in this year is materially different to actual (and estimated) expenditure incurred in the two preceding years (2007–08 and 2008–09). Country Energy does not support how this forecast is arrived at on a reasonable basis to derive the best estimate or forecast for the base year, as required by r. 74 of the NGR. In particular, the AER considers that Country Energy needs to explain or justify the relevance of the significant increase in operating expenditure forecast in 2009–10 as a sustained trend for the access arrangement period.<sup>285</sup>

The AER notes that Country Energy provides a qualitative list of input cost increases that have occurred during the earlier access arrangement period, which it submits are not one-off or abnormal items beyond its control.<sup>286</sup> However, Country Energy also states that it was able to spend less than its regulatory allowance for operating expenditure despite these input cost pressures.<sup>287</sup> Further, it is not clear to the AER that the additional compliance and regulatory obligations listed in section 2.3.4 of Country Energy's access arrangement information affect forecast expenditure and not actual expenditure incurred in 2008–09.<sup>288</sup> In any case, the effect of these 'new' obligations has not been quantified in terms of cost and timing by Country Energy in its proposed access arrangement revisions. The AER considers that such quantification is required to meet the requirements of r. 91 and r. 74 of the NGR.

In contrast to the information provided by Country Energy, the 2008–09 year does not appear to include expenditure outside normal operations. In addition, expenditure in this year reflects actual and estimated expenditure. This year also represents the first full year of operation of the gas network workforce, which was previously a shared workforce employed within Country Energy's electricity business.<sup>289</sup> Country Energy's operating expenditure for the direct gas network management and corporate activities were lower in 2008–09 than the previous year. Country Energy does not provide any information to suggest that 2008–09 is not a year of normal operations that cannot be used as a base year for forecasting operating expenditure in this access arrangement period.<sup>290</sup> Therefore, the AER does not consider that Country Energy's forecast operating expenditure using 2009–10 as the base year is arrived at on a reasonable basis to support a best estimate of forecast operating expenditure for the access arrangement period.

For the reasons discussed, the AER does not consider that the proposed base year complies with the requirements of r. 91 of the NGR. Therefore, the AER considers that 2008–09 is a more reasonable base year for establishing forecast operating expenditure for the access arrangement period.

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<sup>284</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

<sup>285</sup> NGR, r. 74.

<sup>286</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 12–13.

<sup>287</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 12.

<sup>288</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 13.

<sup>289</sup> Country Energy, meeting with the AER on 14 August 2009.

<sup>290</sup> NGR, r. 74.

The AER requires Country Energy to amend its access arrangement proposal so that its forecast operating expenditure is derived using 2008–09 expenditure. The AER requires Country Energy to adjust its forecast operating expenditure as set out in amendment 7.1.

#### **7.4.3.2 Accounting for network growth**

Country Energy proposes to adjust operating expenditure over the access arrangement period with changes in capital expenditure for network growth. Country Energy submits that the rate of change in operating expenditure is directly correlated to level of growth related capital expenditure. Country Energy proposes to increase its forecast operating expenditure by the proportion of average annual growth related capital expenditure to the total replacement costs of the network. Country Energy proposes to reduce this ratio by 25.0 per cent to reflect the fact that new assets require less maintenance.<sup>291</sup> Country Energy further submits that this is the same assumption that it applied and which was approved by the AER in the recent NSW electricity distribution decision.<sup>292</sup> The AER notes that in its submission on the draft decision for its electricity distribution network regulatory proposal, Country Energy proposed to apply the asset growth escalator to vegetation management.<sup>293</sup> This was not approved by the AER in its final decision on Country Energy’s electricity distribution network regulatory proposal.<sup>294</sup> The AER notes that the link to growth capital expenditure was only approved by the AER where it considered a link between network growth and growth in a particular expense category had been established. For example, such a link was not established for vegetation management and this is relevant to the consideration of Country Energy’s proposed marketing expenditure.

In assessing the impact of network growth on Country Energy’s forecast operating expenditure, the AER could apply a bottom up approach where each expenditure category is assessed in detail, or the AER could assess the proposed methodology as an appropriate top down approach. However, Country Energy provides insufficient detail or analysis about the increases in each expenditure category for the AER to undertake a bottom up approach in assessing the impact of network growth. In the circumstances, the AER considers that the proposed top down approach is reasonable and appropriate to account for the impact of network growth on certain operating expenditure categories over the access arrangement period. The relevance of the network growth adjustment is discussed with reference to specific operating expenditure categories below.

#### **7.4.3.3 Labour cost escalators**

Country Energy proposes to use a real cost escalator for operating expenditure. Country Energy’s approach is to break down base year costs into input cost categories and then escalate these categories individually.<sup>295</sup>

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<sup>291</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

<sup>292</sup> Country Energy, *email response to the AER’s questions*, 7 August 2009, q. 16, p. 4.

<sup>293</sup> Country Energy, *Country Energy’s Electricity Network Regulatory Proposal 2009–14*, 2 June 2008, p. 64.

<sup>294</sup> AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 159.

<sup>295</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 31.

Country Energy proposes to break down costs into the categories of labour, plant and materials. Labour is composed of Electricity Gas Water (EGW) labour and general labour. For the purposes of operating expenditure, Country Energy does not propose a real cost escalator for plant or materials. Plant and materials are to be escalated in line with forecast inflation.<sup>296</sup>

**Table 7.2: Real cost escalators for labour (%)**

	2009–10	2010–11	2011–12	2012–13	2013–14	2014–15
Final labour escalator (weighted)	2.2	3.3	2.1	1.5	0.4	0.8

Source: Country Energy, *email response to the AER's questions*, 7 August 2009, attachment 1.

The above escalation rates for labour are derived from forecasts detailed in a recent Econtech report.<sup>297</sup> Country Energy multiplies the Enterprise Bargaining Agreement (EBA) labour escalators by the EBA component percentage and the general labour escalators by the general labour component. Country Energy then adds the two to derive a single real escalation factor for labour.<sup>298</sup> The AER notes that the most recent EBA provided by Country Energy has expired.

The AER considers that Country Energy's approach to forecasting increases in labour costs is arrived at on a reasonable basis but may not represent the best forecast possible in the circumstances, given changes in economic conditions—particularly the improved macroeconomic outlook and relevant labour escalation forecasts.<sup>299</sup> The AER commissioned a report from Access Economics to forecast labour costs for the electricity, gas and water sector of the Australian economy on a state by state basis.<sup>300</sup> The AER considers it appropriate to use this updated forecast for the purposes of forecasting real increases in labour costs as it accounts for recent changes in the macroeconomic outlook and so provides the best forecast possible in the circumstances, as required by r. 74 (2) of the NGR. The updated labour forecast cost escalators are presented in Table 7.3. These cost escalators will need to be updated in the final decision to reflect the best estimates possible.<sup>301</sup>

<sup>296</sup> Country Energy, *email response to the AER's questions*, 7 August 2009, attachment 1.

<sup>297</sup> Econtech, *Updated labour cost growth forecasts*, 25 March 2009.

<sup>298</sup> Country Energy, *email response to the AER's questions*, 7 August 2009, attachment 1.

<sup>299</sup> RBA, *Statement on monetary policy*, 7 August 2009, p. 73.

<sup>300</sup> Access Economics, *Forecast growth in labour costs*, 16 September 2009.

<sup>301</sup> NGR, r. 74 (2)(b).

**Table 7.3: AER's conclusion on real cost escalators for labour (%)**

	2008–09a	2009–10	2010–11	2011–12	2012–13	2013–14	2014–15
EBA labour	-1.3	0.8	0.1	0.5	0.9	1.5	1.7
General labour	0.7	1.8	1.2	1.4	1.4	1.9	2.0
Final labour escalator (weighted)	-1.0	0.9	0.3	0.6	1.0	1.6	1.7

Source: Access Economics, *Forecast growth in labour costs*, September 2009, pp. xiii–xiv and AER calculations.

a: As the AER considers that 2008–09 should be used as the base year in forecasting operating expenditure, this requires the addition of a cost escalator for 2008–09.

For the reasons discussed and as a result of the AER's analysis of Country Energy's access arrangement proposal, the AER does not consider that the proposed labour cost escalators comply with the requirements of r. 91 of the NGR. In particular, the forecasts derived by applying Country Energy's proposed escalators to the base year costs would not be incurred by a prudent service provider acting efficiently and in accordance with accepted good industry practice.

The AER requires Country Energy to amend its access arrangement proposal so that its forecast operating expenditure is derived using the escalators set out in amendment 7.1.

#### 7.4.3.4 Escalation of operating expenditure for inflation

The AER notes that Country Energy, when projecting its operating expenditure, incorrectly inflates expenditure for the base year (2009–10) to account for the CPI escalation for that year.<sup>302</sup> This means that Country Energy's proposed forecast operating expenditure which is labelled as real 2009–10 dollars,<sup>303</sup> incorrectly includes an additional year of escalation for inflation.

The AER proposes the use of 2008–09 as the base year to forecast operating expenditure. In this circumstance it is appropriate for the 2008–09 base year expenditure to be escalated by CPI as the basis for forecasting operating expenditure in 2009–10 dollars. The AER considers that the forecast operating expenditure based on the CPI is consistent with that which would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services as required by r. 91 of the NGR. The AER requires Country Energy to amend the CPI used to estimate forecast operating expenditure and update proposed operating expenditure as set out in amendment 7.1.

#### 7.4.4 Forecast controllable operating expenditure

The AER notes significant increases for all controllable cost categories when comparing Country Energy's actual and forecast expenditure for the earlier access

<sup>302</sup> Country Energy, *email response to the AER's questions*, 7 August 2009, attachment 4.

<sup>303</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 32.

arrangement period with its proposed forecast expenditure for the access arrangement period. In particular, expenditure attributed to marketing costs and corporate allocation has increased substantially between these access arrangement periods. The AER's analysis and consideration of Country Energy's controllable costs by category is discussed below.

#### **7.4.4.1 Network operations and maintenance**

The AER notes that over the earlier access arrangement period there has been a significant variation in Country Energy's network operations and maintenance costs. Actual operating and maintenance costs peaked in 2006–07 at \$1 389 000 (\$2009–10) then fell to \$1 232 000 (\$2009–10) in 2008–09 and is forecast to reach \$1 372 000 (\$2009–10) in 2014–15.<sup>304</sup>

The AER notes a possible explanation for the fall in actual network operations and maintenance costs in the earlier access arrangement period is the change in the way work has been scheduled. Country Energy explains that it has achieved some efficiency gains in the 2007–08 and subsequent years through greater autonomy of work scheduling with respect to its gas network.<sup>305</sup>

For the reasons discussed and as a result of the AER's analysis of Country Energy's access arrangement proposal, the AER does not consider that the proposed network operations and maintenance expenditure complies with the requirements of r. 74 and r. 91 of the NGR. In particular, the AER does not consider that this expenditure would be incurred by a prudent service provider acting efficiently and in accordance with accepted good industry practice. The AER considers that the network operating and maintenance costs for 2008–09 are more appropriate for projecting forecast costs for the same reasons as previously discussed in the AER's consideration of the selection of the base year. The AER also considers that the 2008–09 costs should be escalated in accordance with the AER's approved escalators.

The AER requires Country Energy to amend its access arrangement proposal for the forecast network operations and maintenance expenditure set out in amendment 7.1.

#### **7.4.4.2 Marketing costs**

Country Energy's marketing costs are forecast to more than double in real terms over the access arrangement period when compared to the earlier access arrangement period. Marketing expenditure increased from zero in 2006–07 to \$111 000 (\$2009–10) in 2008–09 and is forecast to reach \$155 000 (\$2009–10) in 2014–15. Country Energy states that increases in expenditure in the earlier access arrangement period are due to its appliance incentive program and participation in a generic state-wide marketing campaign.<sup>306</sup>

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<sup>304</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>305</sup> Country Energy, *meeting with the AER on 14 August 2009*.

<sup>306</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 13.

The AER notes that for the earlier access arrangement period the IPART rejected a proposal for increases in marketing costs as Country Energy had not provided sufficient evidence of the business case for increasing marketing expenditure.<sup>307</sup> The AER has similar concerns for the current access arrangement review and considers that Country Energy does not propose a business case to support the increases in marketing state-wide expenditure, nor does it explain for what purpose the expenditure is sought.

The AER does not accept Country Energy's submission that marketing expenditure should increase in line with the growth in capital expenditure, without information to justify this increase. The AER considers that in the absence of information to support that the forecast operating expenditure for marketing expenditure is arrived at on a reasonable basis and represents the best estimate,<sup>308</sup> Country Energy's marketing expenditure should be based on the level of expenditure in 2008–09. This expenditure should only be inflated by the relevant escalators over the access arrangement period, excluding the proposed growth escalator.

As previously outlined, the AER considers that expenditure in 2008–09 provides a reasonable basis for establishing forecast marketing expenditure for the access arrangement period. It is of note that 2008–09 provides for a significantly higher level of actual marketing expenditure incurred than any other year of the earlier access arrangement period. Therefore, the AER considers that Country Energy's proposed marketing expenditure would not be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest

The AER requires Country Energy to amend its forecast marketing operating expenditure as set out in amendment 7.1.

#### **7.4.4.3 Direct gas network management**

Direct gas network management costs are direct operating costs for managing the network such as asset management, network data and billing, and strategic planning and compliance activities.<sup>309</sup> The IPART approved approximately \$2.8 million (\$2009–10) for direct gas network management over the earlier access arrangement period.<sup>310</sup> However, Country Energy expects to spend approximately \$1.6 million (\$2009–10) (56 per cent of the IPART's approved expenditure).

Country Energy submits that direct gas network management costs are allocated to both capital and operating expenditure based on their relative share of direct expenditure.<sup>311</sup> This is different to the methodology approved in the earlier access arrangement period where all direct gas network management costs were classified as operating expenditure. Country Energy submits that the methodology approved by the IPART does not reflect Country Energy's internal accounting practice which allocates these costs between operating and capital expenditure. Country Energy outlines that

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<sup>307</sup> IPART, *Final Decision: revised access arrangement for Country Energy Gas Network*, November 2005, p. 77.

<sup>308</sup> NGR, r. 74(2).

<sup>309</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 33.

<sup>310</sup> IPART, *Final Decision: revised access arrangement for Country Energy Gas Network*, November 2005, p. 75. This figure was converted from \$2005–06 to \$2009–10.

<sup>311</sup> Country Energy, *email response to the AER's questions*, 7 August 2009, p. 1.



this oversight was not identified at the time of the previous access arrangement review.<sup>312</sup>

The characterisation of direct gas network management costs as operating costs rather than capital expenditure is the main reason for a substantial variation between the IPART approved expenditure and actual expenditure for direct gas network management during the earlier access arrangement period.

Nonetheless, the AER notes that over the earlier access arrangement period there has been a significant variation from year to year in the value of direct gas network management costs. Actual direct gas network management costs increased from \$265 000 to \$375 000 (\$2009–10) in 2007–08 then fell to \$316 000 (\$2009–10) in 2008–09. These costs are forecast to reach \$435 000 (\$2009–10) in 2014–15. The proposed base year (2009–10) level of expenditure is \$394 000 (\$2009–10).

For the reasons outlined above concerning the selection of the base year, and in the absence of adequate information from Country Energy to support the increase in direct gas network management costs forecast for 2009–10, the AER considers that the actual costs for 2008–09 provide a reasonable basis for arriving at a best forecast of gas network management costs.<sup>313</sup>

The AER also considers that the 2008–09 costs should be escalated in accordance with the AER’s approved escalators. Therefore the AER considers that Country Energy’s proposed direct gas network management expenditure would not be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services as required by r. 91 of the NGR.

The AER requires Country Energy to amend its forecast direct gas network management expenditure as set out in amendment 7.1.

#### **7.4.4.4 Corporate allocation**

The AER notes that in the earlier access arrangement period there is a large variation from year to year in Country Energy’s corporate allocation costs including a large increase from \$189 000 in 2008–09 to \$509 000 (\$2009–10) in 2009–10. There is also a substantial increase in forecast corporate allocation costs in the access arrangement period compared to the earlier access arrangement period.<sup>314</sup>

In the absence of information from Country Energy to support the increase in these costs, the AER considers that the actual corporate allocation costs for 2008–09 provide a more reasonable basis for arriving at a best forecast of corporate costs in the access arrangement period.<sup>315</sup> The AER also considers that the 2008–09 costs should be escalated in accordance with the approved AER escalators. The AER considers

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<sup>312</sup> Country Energy, *email response to the AER’s questions*, 7 August 2009, p. 1.

<sup>313</sup> NGR, r. 74(2).

<sup>314</sup> The basis of this analysis is data sourced from Country Energy, *Access arrangement information*, 1 July 2009, table 7, p. 12 and table 23, p. 32. In undertaking this analysis nominal dollars have been converted to real dollars (2009–10) and an estimate of full year expenditure for year 1 of the earlier access arrangement period has been calculated.

<sup>315</sup> NGR, r. 74(2).

that Country Energy's proposed corporate allocation expenditure would not be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services as required by r. 91 of the NGR.

The AER requires Country Energy to amend its forecast corporate allocation expenditure with the corporate allocation expenditure set out in amendment 7.1.

#### **7.4.5 Forecast as non-controllable operating expenditure**

The AER notes that previously, Country Energy had not proposed debt raising and self insurance costs as part of its operating expenditure forecasts. The inclusion of debt raising and self insurance costs in the access arrangement proposal therefore represent step changes in Country Energy's total operating expenditure for the access arrangement period.

The AER's analysis and consideration of Country Energy's debt raising costs, self insurance and unaccounted for gas costs is discussed below. Though not included in total operating expenditure, the AER's analysis of Country Energy's equity raising costs is also presented.

##### **7.4.5.1 Debt raising costs**

Country Energy proposes the inclusion of \$30 000 to \$33 000 per annum for debt raising costs in accordance with the methodology applied by the AER in recent electricity decisions.<sup>316</sup> However, the AER considers that Country Energy has underestimated its debt raising costs by applying an inappropriate benchmark rate (8.1 basis points per annum) that is consistent with large capital raising and many bond issues.<sup>317</sup>

The AER has estimated Country Energy's debt raising costs using the methodology prepared by Country Energy, but apply a different benchmark rate of 10.4 basis points per annum for a limited number of bond issues.<sup>318</sup> The AER considers that the debt raising costs presented in amendment 7.1 are arrived at on a reasonable basis and represent the best forecast possible in the circumstances, as required by r. 74(2) of the NGR.

The AER requires Country Energy to amend the forecast debt raising costs as set out in amendment 7.1.

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<sup>316</sup> AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, appendix N.

<sup>317</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 36.

<sup>318</sup> Country Energy proposes a unit rate of 8.1 bppa, consistent with the unit rate applied by the AER in its final decision for Country Energy's electricity distribution network. However, implicit in this unit rate is an assumption of a one-off credit rating expense which can be spread between multiple bond issues. In the case of Country Energy's gas network, due to a smaller capital base relative to the electricity network, there are fewer bond issues expected, which leads to a higher unit rate. For further details see AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, table 8.16, p. 187.

#### 7.4.5.2 Equity raising costs

The AER notes that Country Energy considers equity raising costs are justifiable but immaterial in this instance.<sup>319</sup>

The AER has undertaken an assessment of Country Energy's benchmark cash flows and has found that the funding requirements for capital expenditure can be met using retained earnings. Therefore, the AER does not consider that Country Energy requires any operating expenditure for equity raising costs. The AER agrees with Country Energy's submission and considers that in the circumstances of Country Energy's expected cash flows, equity raising costs would not be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services as required by r. 91 of the NGR.

#### 7.4.5.3 Self insurance

Country Energy has proposed the inclusion of operating expenditure of \$635 000 (\$2009–10) for self insurance of specific business risks, which are not covered by actual insurance policies or provided for elsewhere in its proposal. Country Energy did not seek operating expenditure for self insurance in its earlier access arrangement that was approved by the IPART.

Self insurance is appropriate for the coverage of risks that may not be fully or partially externally insured and are not otherwise remunerated in another total revenue building block. The AER has assessed the proposal in accordance with r. 91 of the NGR, which requires that the premium for risk events is incurred by a prudent service provider acting efficiently in accordance with good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

Country Energy seeks self insurance for specific business risks. The AER analysis and consideration of Country Energy's self insurance allowance is provided at appendix C. 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 set out a self insurance premium arrived at on a reasonable basis to provide a best forecast. In the case of events for general public liability the AER approves \$3865 over five years (\$2009–10) as a best estimate arrived at on a reasonable basis, as required by r. 74(2) of the NGR. Therefore the AER requires Country Energy to amend its forecast operating expenditure for self insurance as set out in amendment 7.1.

The AER notes that in the circumstance of an adverse event occurring, Country Energy can apply to vary its access arrangement<sup>320</sup> and in some cases seek a cost pass through in order to recover the cost of the adverse event.

The AER notes that Country Energy could also consider how it keeps records and maintains information of incurred costs for self insurance events. This history of

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<sup>319</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 28.

<sup>320</sup> NGR, r. 65.

incurred costs can then be used as a basis to determine reasonable estimates of self insurance premiums in future access arrangement revisions.

#### 7.4.5.4 Unaccounted for gas

Country Energy has identified a percentage of gas which users must add to the quantity withdrawn from delivery points in order to calculate the volume of gas required to be delivered at the receipt point. Country Energy submits that this percentage reflects UAG in the network and has been reflected in its access arrangement proposal. Country Energy submits that the average actual unaccounted for gas from the earlier access arrangement is 5.75 per cent and it proposes to continue to use this average for the access arrangement.<sup>321</sup>

Country Energy proposes that in calculating the amounts owed by customers to the user for transportation services, the volume of gas withdrawn at delivery points must be increased by 1 per cent for contract loads and 5.75 per cent as a weighted average for all other delivery points, to reflect the cost of unaccounted for gas assumed in the network demand forecast.<sup>322</sup>

Country Energy has advised that it has not included a provision or allowance for unaccounted for gas in any category within its proposed operating and maintenance expenditure.<sup>323</sup>

As discussed in chapter 10, the AER considers that Country Energy's proposed method of recovering the cost of UAG is inconsistent with the building block approach for determining total revenue, which is required under r. 76 of the NGR. While Country Energy does not propose to include the cost of UAG in forecast operating expenditure, the AER considers it is appropriate to account for the cost of UAG explicitly as a building block component, in order for it to be reflected in reference tariffs for transportation services. The AER considers that UAG costs should be contained in Country Energy's forecast operating expenditure rather than being treated as an uplift volume factor charged at the reference tariff as it was in the earlier access arrangement period. This approach will provide Country Energy with an incentive to minimise UAG. The approach is also supported by the AER's consultant ACIL.<sup>324</sup>

In our opinion it would be preferable, in the interests of transparency, for costs of UAG to be included in the cost base and reflected in the total revenue requirement. This would result in the reference tariffs, calculated on the basis of the net market demand, increasing to a level that would cover costs of UAG without the need for the grossing-up provision.

The AER estimates Country Energy's forecast UAG costs over the access arrangement period based on:

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<sup>321</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 40.

<sup>322</sup> Country Energy, *Access arrangement*, 1 July 2009, p. 16.

<sup>323</sup> Country Energy, *email response to the AER's questions*, 7 August 2009, p. 3.

<sup>324</sup> ACIL, *Review of demand forecasts for Country Energy gas network for the access arrangement period commencing 1 July 2010*, 18 September 2009, p. 19.

- the AER's revised total demand forecast for Country Energy as set out in chapter 9
- the Wilson Cook report's recommendation about weighted average UAG percentages,<sup>325</sup> which represent a reasonable level of reduction in UAG over the access arrangement period commensurate with Country Energy's proposed capital expenditure for network refurbishment (as discussed in chapter 3). Unlike Country Energy's proposed weighted average UAG which does not take into account the impact of network refurbishment on forecast levels of UAG, the AER considers that Wilson Cook's estimated weighted average UAG has been arrived at on a reasonable basis and represents the best estimate or forecast possible in the circumstances as required by r. 74(2) of the NGR
- a UAG quantity calculated from Country Energy's total demand forecast and Wilson Cook's recommended weighted average UAG percentages, and
- the ACIL report's forecast delivered gas prices to Wagga Wagga sourced from a report prepared for NEMMCO.<sup>326</sup> The AER considers the estimate for UAG cost set out in table 7.4 are arrived at on a reasonable basis and represent the best estimate or forecast possible in the circumstances.<sup>327</sup>

**Table 7.4: Country Energy's forecast unaccounted for gas (units as stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
Total load (GJ)	1 596 697	1 608 637	1 618 593	1 629 427	1 640 187	8 093 541
Weighted average UAG (%)	5.75	5.40	5.10	4.80	4.50	
UAG quantity (GJ) = total load x weighted average UAG	91 810	86 866	82 548	78 212	73 808	413 246
Delivered gas price (\$'000, real 2009–10/GJ)	5.98	6.02	5.99	6.00	6.02	
Total UAG costs (\$'000, real 2009–10) = UAG quantity x delivered gas price / 1000	549	523	494	469	444	2480

Source: Table is based on information from Chapter 9 of this draft decision; Wilson Cook, *Review of expenditure of ACT and NSW gas DNSPs: Country Energy's Wagga Wagga Network*, 29 October 2009, p. 11; ACIL, *Fuel resource, new entry and generation costs in the NEM, Final report*, April 2009, p. 69 (for new CCGT SWNSW).

<sup>325</sup> Wilson Cook, *Review of expenditure of ACT and NSW gas DNSPs: Country Energy's Wagga Wagga Network*, 29 October 2009, p. 11.

<sup>326</sup> ACIL, *Fuel resource, new entry and generation costs in the NEM, Final report*, April 2009, p. 69.

<sup>327</sup> NGR r. 74(2).

Therefore the AER requires Country Energy to amend its forecast operating expenditure as outlined in amendment 7.1. In addition Country Energy is required to amend the existing text in section 5.3.3 of its access arrangement proposal and section 8.1.4 of its access arrangement information as outlined in amendments 7.2 and 7.3.

For the same reason, the AER requires Country Energy to amend section 5.2.1(d) of its access arrangement proposal to remove reference to unaccounted for gas as set out in amendment 7.4.

#### **7.4.6 Conclusion on total operating expenditure**

The AER does not approve the forecast operating expenditure proposed by Country Energy because it does not consider that the proposed expenditure would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services as required by r. 91 of the NGR. Therefore the AER requires Country Energy to amend its forecast operating expenditure as outlined in amendment 7.1. In summary, the AER requires Country Energy to:

- use the 2008–09 expenditure (rather than 2009–10) as the base year on which to project operating expenditure over the access arrangement period
- use different labour cost escalators resulting in the geometric average of the weighted average labour cost escalator decreasing from around 1.7 per cent per annum to 1.6 per annum
- not escalate marketing expenditure to account for network growth
- apply a higher unit rate to forecast debt raising costs (10.4 bppa instead of 8.1 bppa) in accordance with the number of expected bond issues for the size of Country Energy’s capital base
- apply a lower forecast operating expenditure for self insurance, and
- include forecast operating expenditure for UAG.

#### **7.5 Conclusion**

The AER does not propose to approve the operating expenditure proposed by Country Energy as it does not comply with r. 74(2) and r. 91 of the NGR and requires Country Energy to make the amendments set out below.

#### **7.6 Amendments required to the access arrangement proposal**

Before the proposed access arrangement can be approved, Country Energy must make the following amendments:

##### **Amendment 7.1:**

- delete Table 23 in the access arrangement information and replace it with the following table

- make any and all consequential amendments necessary to take account of and reflect the table below.

**Table 7.5: Country Energy’s forecast operating expenditure (\$’000, real, 2009–10)**

	2010–11	2011–12	2012–13	2013–14	2014–15	Total
<b>Controllable costs</b>						
Network operations and maintenance	1259	1279	1302	1328	1356	6524
Marketing	111	111	111	112	113	557
Direct gas network management	322	327	333	340	347	1670
Corporate allocation	193	196	199	203	208	999
Sub total	1885	1914	1946	1983	2023	9750
<b>Non-controllable costs</b>						
Self insurance	1	1	1	1	1	4
Debt raising costs	36	37	38	39	40	192
Unaccounted for gas	549	523	494	469	444	2 480
Sub total	586	561	534	509	485	2 676
<b>Total operating expenditure</b>	<b>2 471</b>	<b>2 475</b>	<b>2 480</b>	<b>2 493</b>	<b>2 508</b>	<b>12 426</b>

**Amendment 7.2:** delete section 5.3.3 in the access arrangement proposal including the table and replace it with the following:

An allowance for the cost of unaccounted for gas has been included in Country Energy’s operating expenditure.

**Amendment 7.3:** delete section 8.1.4 in the access arrangement information and replace it with the following:

An allowance for the cost of unaccounted for gas has been included in Country Energy’s operating expenditure.

**Amendment 7.4:** delete the text in brackets in section 5.2.1 (d) of the access arrangement proposal that states ‘including an amount for *unaccounted for gas*’.

## **8 Total revenue**

### **8.1 Introduction**

This chapter sets out the AER's calculation of annual revenue requirements for Country Energy for the provision of pipeline services for each year of the access arrangement period. This chapter also sets out the X factors for Country Energy's reference services as part of the calculation of the weighted average price cap (WAPC).

### **8.2 Regulatory requirements**

Rule 72(1)(m) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the total revenue to be derived from pipeline services for each regulatory year of the access arrangement period.

Rule 76 of the NGR provides that total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach in which the building blocks are:

- a return on the projected capital base for the year
- depreciation on the projected capital base for the year
- if applicable—the estimated cost of corporate income taxation for the year
- increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency, and
- a forecast of operating expenditure for the year.

### **8.3 Country Energy's proposal**

Country Energy's proposed total revenue requirement for each year of the access arrangement period and X factors are set out in Table 8.1.



**Table 8.1: Country Energy's proposed annual revenue requirements and X factors (\$'000, nominal unless otherwise stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	6635	6973	7361	7732	8068
Return of capital	852	694	758	831	921
Operating expenditure	2565	2684	2801	2913	3032
Benchmark taxation liability	526	502	543	584	624
Total costs	10 578	10 853	11 463	12 060	12 645
X factor <sup>a</sup> (%)	-33.6	-2.5	-2.5	-2.5	-2.5

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 37.

a: Negative values for X indicate real price increases under the CPI-X formula.

## 8.4 AER's analysis and considerations

The building blocks proposed by Country Energy are addressed in the AER's considerations of Country Energy's proposed depreciation, return on capital, taxation and operating expenditure in chapters in Part A respectively of the draft decision.

### 8.4.1 Country Energy's proposed P0 adjustment and X factors

The P0 adjustment indicated the increase in the total revenue requirement in the first year of the access arrangement, while the X factors indicate subsequent increases. Country Energy's proposed P0 adjustment is greater than its proposed X factors<sup>328</sup> to reflect that a large amount of the increase in total revenue is due to adjustments between forecasts and actual values in the earlier access arrangement period.

### 8.4.2 Total revenue, P0 adjustment and X factors

The AER has calculated Country Energy's total revenue, P0 adjustment and X factors based on its decisions regarding the building block components discussed in chapters in Part A of the draft decision. These calculations are summarised in Table 8.2.

The AER's draft decision results in a total revenue requirement over the next access arrangement period of \$47.5 million (real 2009–10), compared to \$57.6 million (real 2009–10) proposed by Country Energy. The main reasons for this difference reflect:

- the use of 2008–09 as the base year to forecast operating expenditure instead of 2009–10
- the AER not approving Country Energy's proposed WACC.

<sup>328</sup> Country Energy, *Access arrangement information*, 1 July 2009, p.37.

**Table 8.2: AER's conclusion on Country Energy's annual revenue requirements and X factors (\$'000, nominal unless otherwise stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	6.1	6.4	6.7	7.1	7.4
Depreciation	0.8	0.7	0.8	0.8	0.9
Operating and maintenance	2.5	2.6	2.7	2.7	2.8
Corporate income tax	0.2	0.2	0.2	0.2	0.2
Total	9.6	9.8	10.3	10.8	11.3
X factor tariff revenue <sup>a</sup> (%)	-16.6	-2.5	-2.5	-2.5	-2.5
Smooth revenue path	9.2	9.8	10.4	11.0	11.7

Source: Table 8.2 is based on information from Part A of the draft decision.

a: Negative values for X indicate real price increases under the CPI-X formula..

Country Energy must amend the access arrangement information as outlined in amendment 8.1.

## 8.5 Conclusions

The AER does not propose to approve the proposed total revenue figures proposed for each regulatory year of the access arrangement period as these do not comply with r. 76 of the NGR and requires Country Energy to make the amendments set out below.

## 8.6 Amendments required to the access arrangement proposal

Before the access arrangement proposal can be accepted, Country Energy must make the following amendments:

**Amendment 8.1:** delete Tables 28 and 29 in the access arrangement information and replace them with the following:

**Table 8.3 – Forecast total revenue requirements for the Access Arrangement (\$m, nominal)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Return on capital	5.9	6.2	6.6	6.9	7.2
Depreciation	0.8	0.7	0.8	0.8	0.9
Operating and maintenance	2.5	2.6	2.7	2.7	2.8
Corporate income tax	0.2	0.2	0.2	0.2	0.2
Total	9.5	9.7	10.2	10.7	11.2

**Table 8.4 – Real price adjustments for the *Access Arrangement* (%)**

	2010–11	2011–12	2012–13	2013–14	2014–15
X factor tariff revenue <sup>a</sup>	-16.6	-2.5	-2.5	-2.5	-2.5

(a) Negative values for X indicate real price increases under the CPI–X formula.

## **Part B—Tariffs**

## 9 Demand forecasts

### 9.1 Introduction

This chapter examines Country Energy's demand forecasts and the AER's analysis and considerations as to whether they reflect a reasonable estimate of growth in demand over the access arrangement period. Accurate and reasonable demand forecasts are important for two reasons. First, they affect the calculation of total revenue and through this reference tariffs. Second, they underpin capital expenditure and operating expenditure forecasts.

If demand forecasts are overstated, reference tariffs will be set too low to recover total revenue over the access arrangement period. In addition, the forecasts for capital and operating expenditure will likely be overstated because the service provider will plan for higher usage and growth on the network, as well as for the earlier replacement of assets assuming higher usage rates. The converse may be true if demand forecasts are understated.

### 9.2 Regulatory requirements

Rules 72(1)(a)(iii) and 72(1)(d) of the NGR provide that the access arrangement information for a full access arrangement proposal must include:

- usage of the pipeline over the earlier access arrangement period showing, for a distribution pipeline, minimum, maximum and average demand; and customer numbers in total and by tariff class, and
- to the extent that it is practicable to forecast pipeline capacity and utilisation of pipeline capacity over the access arrangement period, a forecast of pipeline capacity and utilisation of pipeline capacity over that period and the basis on which the forecast has been derived.

Rule 74(1) of the NGR provides that any information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate. Rule 74(2) of the NGR provides that a forecast or estimate must be arrived at on a reasonable basis and represent the best forecast or estimate possible in the circumstances.

### 9.3 Country Energy's proposal

To support its proposal Country Energy submits a confidential report by Infrastructure and Regulation Services (IRS) which includes details about the key drivers behind the demand forecasts and the methodology used to support the demand forecasts.<sup>329</sup>

Table 9.1 summarises Country Energy's annual demand for customer numbers and load. The number of volume customers (primarily residential and small business) is increasing, consistent with historical trends. The number of contract customers (large commercial users) is flat with no anticipated growth.

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<sup>329</sup> Country Energy, *Access arrangement information*, 1 July 2009, appendix A (confidential).

In the earlier access arrangement period, volume load exhibited a noticeable peak in 2005–06 and a trough in 2006–07. Country Energy submits that these fluctuations were the result of a very cold winter in 2005–06 and milder winter temperatures in 2006–07.<sup>330</sup>

Country Energy submits that total volume load is forecast to increase. Total contract load and maximum daily quantity is forecast to remain relatively flat over the access arrangement period.

Table 9.2 shows Country Energy’s average, minimum and maximum daily demand figures for the earlier access arrangement period and the access arrangement period. Average and maximum daily demand exhibit slight upward trends associated with network and customer growth.

Country Energy submits that forecast pipeline capacity and utilisation cannot be provided as the Wagga Wagga network is a meshed network.<sup>331</sup>

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<sup>330</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 6.

<sup>331</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 19.

**Table 9.1: Total annual forecast load, customer numbers and volume load**

	2005–06	2006–07	2007–08	2008–09 <sup>a</sup>	2009–10 <sup>a</sup>	2010–11 <sup>a</sup>	2011–12 <sup>a</sup>	2012–13 <sup>a</sup>	2013–14 <sup>a</sup>	2014–15 <sup>a</sup>
<b>Volume Load<sup>b</sup></b>										
Volume Customers (no)	17 272	17 378	17 999	18 149	18 299	18 449	18 599	18 749	18 899	19 049
Total volume load (GJ)	924 104	810 992	856 547	885 718	890 517	895 278	900 925	904 682	909 326	913 929
<b>Contract Load</b>										
Contract Customers (no)	15	16	17	15	15	15	15	15	15	15
Bomen zone load (GJ)	c	c	c	c	c	496 372	496 193	496 013	495 834	495 655
Central/Fringe zone load (GJ)	c	c	c	c	c	184 972	184 802	184 632	184 461	184 291
Total contract load (GJ)	627 876	628 662	705 879	682 043	681 694	681 344	680 995	680 645	680 295	679 946
<b>Total load</b>	1 551 980	1 439 654	1 562 426	1 567 761	1 572 211	1 576 622	1 581 920	1 585 327	1 589 621	1 593 875
<b>Contract MDQ</b>										
Bomen zone MDQ (GJ)	c	c	c	c	c	3099	3099	3099	3099	3099
Central/Fringe zone MDQ (GJ)	c	c	c	c	c	1084	1084	1084	1084	1084

Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 6, 20.

a: Forecast.

b: Volume load forecasts are an aggregate of domestic, commercial and industrial volume customers. The total number of volume customers is lower than reported in the earlier access arrangement due to a change of systems used for calculating customer numbers. The original customer numbers were derived from an internal database. The new method uses a dynamic system based on the billing system which now accounts for vacant premises and disconnections.

c: Actual contract load and MDQ disaggregated by zones for the previous access arrangement period was not provided.

no. Numbers

**Table 9.2: Forecast average, maximum and minimum daily demand**

	<b>Jan to Jun 2006</b>	<b>2006–07</b>	<b>2007–08</b>	<b>2008–09<sup>a</sup></b>	<b>2009–10<sup>a</sup></b>	<b>2010–11<sup>a</sup></b>	<b>2011–12<sup>a</sup></b>	<b>2012–13<sup>a</sup></b>	<b>2013–14<sup>a</sup></b>	<b>2014–15<sup>a</sup></b>
Minimum (GJ/day)	1102	1131	1100	1852	1166	b	b	b	b	b
Maximum (GJ/day)	10 351	9475	10 523	10 223	10 622	10 922	10 928	10 981	11 010	11 039
Average (GJ/day/annum)	4022	3979	4305	6219	4307	4429	4431	4453	4464	4476

Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 7, 20

a: Forecast.

b: Data not available.



## 9.4 Consultant's report

The AER engaged ACIL to assess the reasonableness of Country Energy's demand forecasts and assess the actual demand compared with the forecasts in the earlier access arrangement period.

ACIL undertook a desktop review of the methodology and the assumptions used by Country Energy and its consultants IRS.

For the earlier access arrangement period the ACIL report notes that:

- there is an apparent anomaly with the minimum, maximum and average daily demand figures in 2008–09<sup>332</sup>
- there is no explanation of an apparent anomaly evidenced by customer numbers rising more quickly than connection numbers from 2006–07 to 2007–08.<sup>333</sup> Actual demand for volume customers exceeded forecasts, although actual demand was trending down for the period. This was despite growth in customer numbers, and<sup>334</sup>
- the IRS's modelling using heating degree day deficiency data (HDD) demonstrates a strong correlation between temperature and demand.<sup>335</sup>

For the current access arrangement period the ACIL report found that:

- the IRS's methodology used to develop forecasts was based on micro analysis (customer surveys, market analysis plans for network extension), was principally applicable to contract customers and macro analysis (historical trends and drivers of demand such as population growth and weather) was applicable to volume customers<sup>336</sup>
- the IRS's forecasts require more robust estimates of existing customer numbers in view of anomalies with connection and customer data in order to establish an accurate starting point for customer growth forecasts, and<sup>337</sup>
- the IRS's approach to use a 50 per cent penetration rate, resulting in 175 new connections per year, is not adequately supported and considers that a growth rate of 315 customers per year in the volume sector (based on 90 per cent penetration of 350 new dwellings per year) represents a more likely estimate of the future customer growth trend.<sup>338</sup>

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<sup>332</sup> ACIL Tasman, *Review of demand forecasts for Country Energy for the access arrangement period commencing 1 July 2010*, 18 September 2009, p. 6 (ACIL, Demand forecast report, 28 September 2009).

<sup>333</sup> ACIL, Demand forecasts report, 18 September 2009 p. 9.

<sup>334</sup> ACIL, Demand forecast report, 18 September 2009 pp. 9–10.

<sup>335</sup> ACIL, Demand forecast report, 18 September 2009 p. 10.

<sup>336</sup> ACIL, Demand forecast report, 18 September 2009 p. 11–12.

<sup>337</sup> ACIL, Demand forecast report, 18 September 2009 p. 14.

<sup>338</sup> ACIL, Demand forecast report, 18 September 2009 p. 16–17.

Despite the limitations described above, the ACIL report considers that the application of the forecast methodology is sound<sup>339</sup> and overall, the approach is systematic, the data is generally of a good quality and the forecasts are for the most part reasonable.<sup>340</sup> However, the ACIL report expresses concern over some data ambiguities and inconsistencies which should be clarified in order to establish a reliable starting point for the demand forecasts.<sup>341</sup>

## **9.5 AER's analysis and considerations**

### **9.5.1 Introduction**

Rule 72(1)(a)(iii) of the NGR requires a service provider to show minimum, maximum, and average demand, and customer numbers in total by tariff class. Rule 72(1)(d) of the NGR requires a forecast of pipeline capacity and utilisation, to the extent it is practicable, over the access arrangement period. The basis on which this forecast is derived must be included.

Of increasing importance, is a service provider's ability to manage fluctuations in demand during the day. The increased use of instantaneous gas heaters or gas boosted solar water heaters, has had the effect of reducing the amount of gas used by customers because of increased efficiency of these appliances, but placing large constraints on the network at certain (peak) times during the day such as in the evening. So overall demand is slowing but this demand is concentrated during the evening and morning peaks, rather than smoothed over the day. Therefore, in addition to total volume demand growth, a service provider must also consider the pipeline's capacity to deliver gas at these peak times during the day.

However, normal variations in the supply and demand parameters dictate that pressure variations across a gas network are not unusual. Unlike electricity, which may have to respond instantaneously to peak demand in order to maintain system integrity, gas pipelines maintain system integrity despite a reduction in pressure across the network. Up to the point when a gas pipeline drops to a certain threshold pressure (close to ambient pressure), a gas pipeline will continue to deliver stored gas. Gas can then be reinjected at a later time to account for the drop in pressure. However, to provide for the reliability of gas supply caused by increasingly volatile peak demand may in the future, justify expenditure on network upgrades.

For the reasons discussed below, the AER considers that Country Energy's demand forecasts are not arrived at on a reasonable basis and do not represent a best forecast consistent with r. 74(2) of the NGR. The AER requires amendments to Country Energy's demand forecasts.

### **9.5.2 Load forecasts**

Forecast average annual growth in demand is lower for the access arrangement period at 0.3 per cent compared with 0.5 per cent for the earlier access arrangement period.

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<sup>339</sup> ACIL, Demand forecast report, 18 September 2009 pp. 21, 23.

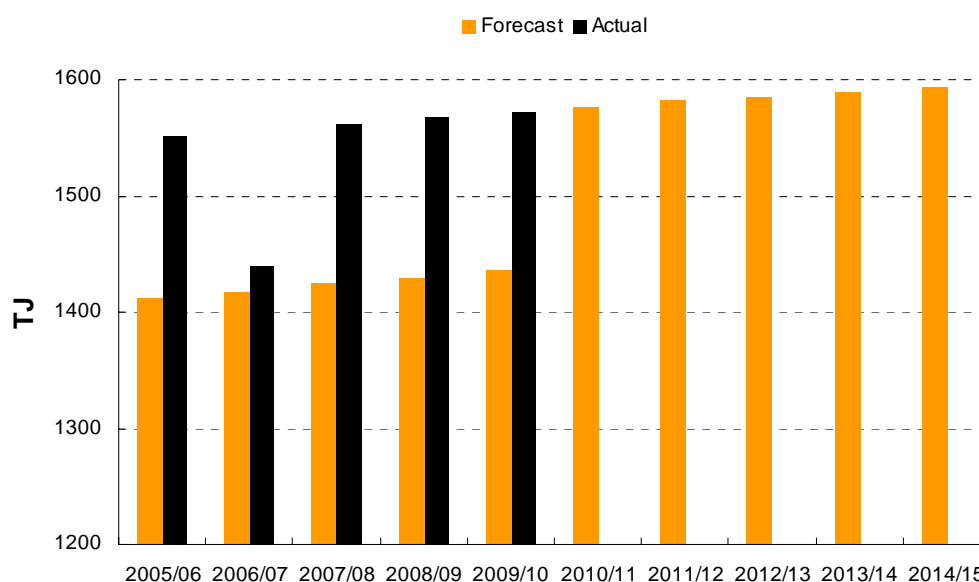
<sup>340</sup> ACIL, Demand forecast report, 18 September 2009 p. 24.

<sup>341</sup> ACIL, Demand forecast report, 18 September 2009 p. 24.

Figure 9.1 compares the load forecasts in the earlier access arrangement with the access arrangement period and shows that:

- in the earlier access arrangement period, forecasts in aggregate were 7.5 per cent lower than actual, with individual yearly forecasts within 10 per cent of actual load forecasts,
- the starting point for the load forecast in 2010–11 is comparable to what is expected to be observed in 2008–09 and 2009–10, and
- apart from 2006–07, demand grew constantly in the earlier access arrangement period, and in the access arrangement period is forecast to continue at constant growth albeit lower annual rate.

**Figure 9.1: Actual and forecast annual demand volumes (TJ)**



Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 6, 20. Note: 2008–09 and 2009–10 actual values are estimated values.

The AER considers that Country Energy’s forecasts for a declining growth rate in forecast annual demand, confirmed by advice from ACIL, are for the most part reasonable<sup>342</sup> and the AER considers represent the best forecast in the circumstances, arrived at on a reasonable basis consistent with r. 74(2) of the NGR.

### 9.5.3 Minimum, maximum and average demand

For the earlier access arrangement period, apart from the figures reported for 2006–07 (refer to table 9.1 and table 9.2), annual growth in average daily demand is flat, and maximum daily demand is relatively stable. For the access arrangement period, average daily and maximum daily demand are forecast to increase marginally and no more than a nominal rate of 0.5 per cent per year. The ACIL report notes an apparent

<sup>342</sup> ACIL, Demand forecast report, 18 September 2009 p. 24.

anomaly in the 2008–09 estimates for minimum, maximum and average daily demand, in particular, that the average daily demand on a simple average basis for that year should be 4295 GJ per day.<sup>343</sup>

The AER notes that the figure for maximum demand for 2008–09 is sourced from the peak demand estimate provided by the IRS. These maximum daily demand figures are calculated based on daily/hourly metering data by taking the maximum value of the sum of contract customers load and adding this to the maximum value of the total daily load minus the sum of the contract customer's load.<sup>344</sup> The AER notes that the basis of the 2008–09 estimates appears to be the IRS forecast whereas the average demand figure for 2009–10 appears to be based on a simple average daily load.

While the AER acknowledges the apparent anomaly for average, maximum and minimum demand for 2008–09, and considers the data that Country Energy submits is the most up-to-date and best available data. The AER further considers the method the IRS uses to estimate minimum, maximum and average demand for Country Energy is arrived at on a reasonable basis and represents the best estimate possible in the circumstances.<sup>345</sup>

#### **9.5.4 Customer numbers and demand by tariff class**

Average annual customer growth for the earlier access arrangement period is 1.5 per cent, compared to the slower growth of 0.8 per cent per annum forecast for the access arrangement period. Volume customers (residential and small business customers) comprise around 57 per cent of the total load. The remaining 43 per cent is attributable to contract customers (large or industrial customers).

Figure 9.2 shows average annual consumption by customer group – volume (or low volume) customers (GJ) and contract (or large volume) customers (TJ) and demonstrates that:

- each volume customer on average is forecast to use around 48 GJ per year in the access arrangement period. The demand per volume customer is forecast to decrease over the access arrangement period by about 1 per cent. This declining trend may be due to improved efficiency of gas appliances, switching from gas appliances to reverse cycle air conditioning systems and government policies, and
- contract customers on average will continue to consume around 45 TJ per year, with no change in demand forecast over the access arrangement period. In addition, Country Energy submits that there is no expectation that the demand or the number of contract customers will grow in the access arrangement period.

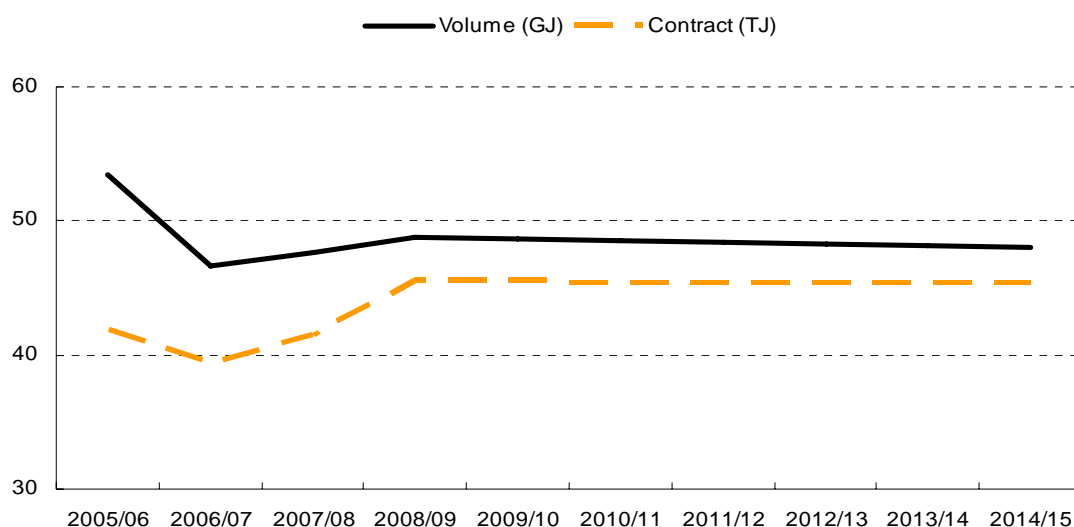
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<sup>343</sup> ACIL, Demand forecast report, 18 September 2009 p. 6.

<sup>344</sup> IRS, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, pp. 49–51.

<sup>345</sup> NGR, r. 74.

**Figure 9.2: Actual and forecast annual demand per customer**



Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 6, 20.

In addition to the customer numbers presented in section 9.3, table 9.3 shows customer numbers and annual growth rates from 2003–04 to 2009–10.

**Table 9.3: Load growth and customer numbers**

	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10
Volume Customers (no.)	17 329	17 798	17 272	17 378	17 999	18 149	18 299
Annual growth (%)		2.7	–3.0	0.6	3.6	0.8	0.8

Source: Country Energy, *Access arrangement information*, 1 July 2009, pp. 6, 20 and the IRS, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, p. 25, (confidential)

The AER notes that actual customer numbers from 2004–05 to 2005–06 fell by 3 per cent. The IRS report notes that this is due to adjusting for approximately 1000 connections before 2005–06 that were subsequently found to be inactive connections.<sup>346</sup> In 2007–08, customer numbers increased by 3.6 percent, and then in the final years of the earlier access arrangement period, are estimated to grow by about 0.8 per cent per year. The ACIL report notes that neither Country Energy nor the IRS report provides a reason for the uplift in customer numbers in 2007–08.<sup>347</sup> However, the AER notes that the adjustment downwards made to the customer numbers in 2005–06 was an approximation which may have been overstated, and that customer numbers in 2007–08, unless shown to be otherwise, represent the most up-to-date and best available data.

<sup>346</sup> IRS, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, p. 8. (confidential).

<sup>347</sup> ACIL, Demand forecast report, 18 September 2009 p. 9.

To forecast the growth rate of new volume customers, the IRS report assumes that only 50 per cent of land released by Wagga Wagga City Council will be developed in the forecast period. This was reflected in the forecast by reducing the assumed rate of penetration of new development from 90 per cent to 50 per cent. The effect of this adjustment is to reduce the 2015 forecast customers by 980 and reduce the volume load forecast by about 5 per cent, and the total load forecast by approximately 2.8 per cent.<sup>348</sup>

In reviewing the customer numbers and demand by tariff forecasts, the ACIL report sought further justification for the assumption of a 50 per cent penetration. Country Energy referred to the impact of the global financial crisis and softening economic conditions. However, the ACIL report outlines that this ignores the 2008 National Institute of Economic and Industry Research (NIEIR) report update, which now forecasts a slightly increased population growth rate. The ACIL report considers that the global financial crisis and softening economic conditions leading to a decrease in the rate of new dwelling growth is not supported by the NIEIR growth forecasts. Therefore, the ACIL report considers that this assumption is unsupported.<sup>349</sup> Consistent with this, the AER does not consider that Country Energy has adequately demonstrated with supporting statements as required by r. 74(1) of the NGR that the global wide economic trends are directly relevant to the Wagga Wagga new housing development rates or penetration rates

On the basis of Wagga Wagga Council's assumption of a housing growth rate, ACIL considers that a growth rate of 315 customers per year in the volume sector (based on 90 per cent penetration of 350 new dwellings per year) represents a more likely estimate of the future trend than the assumption currently used by Country Energy. The ACIL report further confirms that Wagga Wagga City Council's expectation is that the rate of new housing development in the district over the next five years, will if anything, be higher than the 350 units per year assumed in the planning studies. Therefore, the ACIL report considers the new dwellings estimate of 350 new dwellings per year and the penetration rate of 90 per cent represents a more likely estimate than the 50 per cent penetration rate proposed by the IRS report.<sup>350</sup>

In light of the analysis of the growth in customer numbers in the access arrangement period in the ACIL report, the AER considers that the IRS report does not provide adequate supporting statements which form the basis of the forecasts for customer numbers and demand.<sup>351</sup>

In addition, the forecast of the penetration rate is not arrived at on a reasonable basis.<sup>352</sup> Therefore the forecast demand does not represent the best forecast arrived at on a reasonable basis.<sup>353</sup>

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<sup>348</sup> IRS, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, p. 15. (confidential)

<sup>349</sup> ACIL, Demand forecast report, 18 September 2009 p. 16.

<sup>350</sup> ACIL, Demand forecast report, 18 September 2009 p. 17.

<sup>351</sup> NGR, r. 74(1).

<sup>352</sup> NGR r. 74(2)(a).

<sup>353</sup> NGR, r. 74(2).

While noting that Wagga Wagga City Council's growth rate of 350 new dwellings per year is conservative based on the average of the annual increases over the last five years of 477 new dwellings per year,<sup>354</sup> the AER considers that the ACIL report's assessment, that volume customer growth forecasts should reflect a new customer growth rate of 315 per year based on a 90 per cent penetration of 350 new dwellings per year, is arrived at on a reasonable basis and represent the best forecast in the circumstances.<sup>355</sup> Therefore, Country Energy must make the proposed amendment 9.1.

### **9.5.5 Forecast pipeline capacity and utilisation**

The AER acknowledges that a distribution network is a meshed network made up of inter-connected pipes and there are a number of practical considerations governing why the calculation of utilisation is not straightforward, and so therefore may not be practicable. The AER accepts Country Energy's submission that capacity and utilisation information is not available for a distribution network. The AER accepts this statement and considers this meets the requirements of r. 72(1)(d) of the NGR.

### **9.5.6 Summary**

With reference to the ACIL report and the AER's own analysis, the AER considers that:

- Country Energy includes use of the network over the earlier access arrangement period showing minimum, maximum and average demand, and customer number in total and by tariff class<sup>356</sup>
- Country Energy provides a statement that a forecast of pipeline capacity and utilisation of pipeline capacity over the access arrangement period is not practicable<sup>357</sup>
- Country Energy provides support in the main for the basis of forecasts or estimates by means of a statement in the form of the IRS report<sup>358</sup> which is the basis on which estimates and forecasts were developed. The AER however does not consider that Country Energy has adequately supported the statements made in relation to the global financial crisis and general economic slow down as relevant to forecasts for customer connections,<sup>359</sup> and
- Country Energy's customer numbers and demand forecasts are not best forecasts arrived at on a reasonable basis.<sup>360</sup>

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<sup>354</sup> ACIL, Demand forecast report, 18 September 2009 p. 17.

<sup>355</sup> NGR, r. 74.

<sup>356</sup> NGR, r. 72(1)(a)(iii) of the NGR.

<sup>357</sup> NGR, 72(1)(d).

<sup>358</sup> IRS, *Country Energy load forecast Wagga Wagga gas distribution system*, June 2009, (confidential)

<sup>359</sup> NGR, 74(1).

<sup>360</sup> This does not meet the requirements of r. 74(2) of the NGR.

## 9.6 Conclusion

The AER does not propose to approve the demand forecasts proposed by Country Energy as they do not comply with r. 72(1)(a)(iii), r. 72(1)(d) and r. 74 of the NGR and requires Country Energy to make the amendment below.

## 9.7 Amendments required to the access arrangement proposal

Before the proposed revised access arrangement can be approved, Country Energy must make the following amendment set out below:

**Amendment 9.1:** delete Table 8 in the access arrangement information and replace it with the following:

**Table 9.4: Country Energy’s forecast demand and customer numbers for the access arrangement period (units as stated)**

	2010–11	2011–12	2012–13	2013–14	2014–15
<b>Volume Load Forecasts</b>					
Volume customers (no.)	18 869	19 159	19 449	19 739	20 029
Total volume load (GJ)	915 353	927 642	937 948	949 132	960 241
<b>Contract Load Forecasts</b>					
Contract Customer (no.)	15	15	15	15	15
Bomen Load Zone (GJ)	496 372	496 193	496 013	495 834	495 655
Central / Fringe zone load (GJ.)	184 972	184 802	184 632	184 461	184 291
Total contract load (GJ)	681 344	680 995	680 645	680 295	679 946
<b>Total load</b>	<b>1 596 697</b>	<b>1 608 637</b>	<b>1 618 593</b>	<b>1 629 427</b>	<b>1 640 187</b>
<b>Contract MDQ</b>					
Bomen zone MDQ (GJ)	3099	3099	3099	3099	3099
Central/Fringe zone MDQ (GJ)	1084	1084	1084	1084	1084



# 10 Reference tariffs

## 10.1 Introduction

This chapter sets out the AER's consideration of Country Energy's tariff proposal against the distribution pricing requirements in the NGR.

## 10.2 Regulatory requirements

Rule 48(1)(d)(i) of the NGR provides that a full access arrangement must specify for each reference service the reference tariff.

Rule 72(1)(j) of the NGR provides that the access arrangement information for a full access arrangement must include the proposed approach to the setting of tariffs including:

- (i) the suggested basis of reference tariffs, including the method used to allocate costs and a demonstration of the relationship between costs and tariffs; and
- (ii) a description of any pricing principles employed but not otherwise disclosed under this rule.

Rule 93(1) of the NGR provides that total revenue is to be allocated between reference and other services in the ratio in which costs are allocated between reference and other services. Rule 93(2) of the NGR provides that costs are to be allocated between reference and other services as follows:

- (a) costs directly attributable to reference services are to be allocated to those services; and
- (b) costs directly attributable to pipeline services that are not reference services are to be allocated to those services; and
- (c) other costs are to be allocated between reference and other services on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.

Rule 94(1) of the NGR provides that for the purpose of determining reference tariffs, customers for reference services provided by means of a distribution pipeline must be divided into tariff classes. Rule 94(2) of the NGR provides that a tariff class must be constituted with regard to the need to group customers for reference services together on an economically efficient basis and to avoid unnecessary transaction costs.

Rule 94(3) of the NGR provides that for each tariff class, the revenue expected to be recovered should lie on or between:

- (a) an upper bound representing the stand alone cost of providing the reference service to customers who belong to that class; and
- (b) a lower bound representing the avoidable cost of not providing the reference service to those customers.

Rule 94(4) of the NGR provides that a tariff, and if it consists of 2 or more charging parameters, each charging parameter for a tariff class:

- (a) must take into account the long run marginal cost for the reference service or, in the case of a charging parameter, for the element of the service to which the charging parameter relates;
- (b) must be determined having regard to:
  - (i) transaction costs associated with the tariff or each charging parameter; and
  - (ii) whether customers belonging to the relevant tariff class are able or likely to respond to price signals.

If the operation of r. 94(4) of the NGR is that the service provider may not recover the expected revenue, then r. 94(5) of the NGR provides that the tariffs must be adjusted to ensure recovery of expected revenue with minimum distortion to efficient patterns of consumption.

### 10.3 Country Energy's proposal

Country Energy proposes two transport reference services and additional services such as meter reading, disconnection and reconnection and deactivation services as non-reference services.<sup>361</sup> Country Energy proposes tariffs based on a GST exclusive basis.<sup>362</sup>

Country Energy proposes two tariff classes:

- volume transportation service, and
- contract transportation service.<sup>363</sup>

The tariff structure remains largely unchanged from the earlier access arrangement, except for the merger of the central and fringe zone tariffs for contract transportation services.<sup>364</sup>

The reference tariff for contract services is a monthly capacity charge determined by the location of the end user (zone) and a monthly metering charge. The reference tariff for the volume transportation service consists of a monthly fixed charge and a volumetric charge.<sup>365</sup>

Country Energy submits that the expected revenue and allocated costs for the 2010–11 tariff year is as set out in Table 10.1.

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<sup>361</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 16–18.

<sup>362</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 55.

<sup>363</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 33.

<sup>364</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 39.

<sup>365</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 33.

**Table 10.1: Revenue recovered and allocated costs (\$'000)<sup>366</sup>**

Customer Type	Revenue Recovered	Allocated costs
Volume Customers		
Small	9210	9719
Medium	359	310
Large	113	99
Contract Customers		
Bomen	302	297
Central	163	152

Source: Country Energy, *Access arrangement information*, 1 July 2009, p. 39.

Country Energy submits that while the tariff classes may not be cost reflective in the first year of the access arrangement period, they become cost reflective by the end of the access arrangement period.<sup>367</sup> Country Energy submits that the reference tariff price paths are designed to minimise price volatility between years.<sup>368</sup>

Country Energy allocates asset and operating costs including overheads according to certain drives and these costs allocated equal total revenue.<sup>369</sup> Country Energy proposes that different costs be distributed to various customers based on how the costs are directly attributable to customers.<sup>370</sup> Country Energy submits that its process for allocating total revenue and costs identifies costs assigned to each customer class and determines whether the proposed revenue levels are consistent with those costs.<sup>371</sup>

Country Energy submits that the reference tariffs reflect the cost of providing the services.<sup>372</sup> In a confidential model Country Energy demonstrates that the tariffs for volume customers and contract customers are between marginal and stand alone costs.<sup>373</sup>

Country Energy proposes an arrangement to add or delete reference tariffs or components during the access arrangement period if it obtains prior approval from the AER.<sup>374</sup> Country Energy also proposes an overruns basis for contract customers.<sup>375</sup>

<sup>366</sup> Country Energy has not specified whether the figures in Table 10.1 are in real or nominal terms.

<sup>367</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 39.

<sup>368</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 39.

<sup>369</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 38.

<sup>370</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 38.

<sup>371</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 38.

<sup>372</sup> Country Energy, *Access arrangement information*, 1 July 2009, pp. 38–39.

<sup>373</sup> Country Energy, *Access arrangement information*, 1 July 2009, Marginal standalone cost analysis model (confidential).

<sup>374</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 41.

<sup>375</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 34.

## 10.4 AER's analysis and considerations

Country Energy's proposed tariff structure results in volume nominal tariffs for small customers increasing more than 70 per cent between 2009–10 to 2014–15, while central zone tariffs decrease in nominal terms.<sup>376</sup>

### 10.4.1 Allocation of total revenue and costs

Country Energy proposes that the additional services are not reference services.<sup>377</sup> However, as outlined in chapter 2 of this draft decision, the AER considers that additional services are reference services. As a consequence, no allocation of total revenue and costs is required between reference and non-reference services, as required by r. 93 of the NGR.

### 10.4.2 Division of customers into tariff classes

Country Energy groups customers into contract and volume tariffs for transport services.<sup>378</sup> The tariff classes for volume and contract customers are broadly consistent with those included in the earlier access arrangement except that two contract zones (fringe and central) have now been merged. There is also a separate tariff class for additional services.<sup>379</sup>

The AER considers that the merger of the fringe and central zones relate to a small number of customers with similar attributes— contract customers seeking more than 10 TJ per annum and avoid unnecessary transactions costs.

The AER considers that Country Energy's proposed tariff classes are consistent with the requirements of r. 94(2) of the NGR to group customers on an economically efficient basis and to avoid unnecessary transaction costs.

### 10.4.3 Stand alone and avoidable cost

Country Energy allocates revenue expected to be recovered on the basis of the costs (both capital and operating costs including overheads) of providing the reference service to the relevant tariff class.<sup>380</sup> Country Energy states that costs may vary by system throughput, number of customers and others by level of peak demand.<sup>381</sup>

The AER notes that County Energy demonstrates the requirement<sup>382</sup> with reference to stand alone and marginal costs, where marginal cost is the cost of service excluding the return on or return of capital. While the AER does not necessarily agree with Country Energy's interpretation or definition of avoidable costs, the AER considers that range of costs between avoidable and stand alone costs is large and provides wide scope for establishing tariffs where the revenue expected to be recovered is consistent

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<sup>376</sup> Nominal tariffs for 2009–10 are obtained from post tax revenue model. Nominal tariffs for the period 2010–11 to 2014–15 are obtained from the indicative reference tariffs: Country Energy, *Access arrangement proposal*, 1 July 2010, p. 55.

<sup>377</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 8.

<sup>378</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 33.

<sup>379</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 8–11.

<sup>380</sup> Country Energy, *Access arrangement information*, 1 July 2010, p. 38.

<sup>381</sup> Country Energy, *Access arrangement information*, 1 July 2010, p. 38.

<sup>382</sup> NGR, r. 94(3).

with r. 94(3) of the NGR. Further, given that Country Energy submits it uses a cost of service methodology to determine tariffs, the AER considers that the expected revenue will be between the avoidable cost and stand alone cost of providing reference services.<sup>383</sup>

#### **10.4.4 Charging parameters**

The NGR requires that both a tariff and each charging parameter must take into consideration long run marginal cost and must be determined having regard to transaction costs that are associated with the tariff or each charging parameter.<sup>384</sup> Further, the tariff and charging parameter must be determined having regard to whether customers within a tariff class are able or likely to respond to price signals.<sup>385</sup>

The AER considers that Country Energy has not explicitly provided evidence that each tariff or each charging parameter in a tariff class takes into account the long run marginal cost. However, this is implicitly done by increasing the capital base for capital expenditure consistent with r. 79 of the NGR. In circumstances where capital expenditure is above the long run marginal cost, these amounts take the form of capital contributions and are not added to the capital base.<sup>386</sup>

The charging parameters have been determined having regard to transaction costs and responsiveness of customers to price signals in relation to transport services, as required by r. 94(4)(b) of the NGR. Country Energy provides analysis to support its claim that it has considered how large fixed charges might impact customer disconnection and connection rates, even if this provides the most efficient tariff structure.

The AER considers that it would be more informative and representative of how additional services are charged, if the charging parameters for additional services were separately itemised and referable to a quantity of demand for each additional service. However, the AER is not seeking an amendment for this matter. The AER considers that the post taxation revenue model could better demonstrate how expected revenue for additional services was derived.

#### **10.4.5 Ensuring recovery of expected revenue**

Country Energy's tariff structure becomes more cost reflective over the access arrangement period, this infers the total revenue tends toward the expected revenue, and therefore no adjustment is required to be made under r. 94(5) of the NGR.

#### **10.4.6 Other Considerations**

Country Energy proposes a procedure in section 13.6 of the access arrangement proposal for additions and deletions of reference tariffs. The AER considers the NGR provides a means for consideration of such matters through an application for variation of an access arrangement, as set out in r. 65 of the NGR. The AER considers that this is the appropriate process to consider changes to reference tariffs during the

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<sup>383</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 39.

<sup>384</sup> NGR, r. 94(4).

<sup>385</sup> NGR, r. 94(4)(b).

<sup>386</sup> Country Energy, *Access arrangement proposal*, 1 July 2010, p. 27.

access arrangement period. In addition, the AER has proposed an amendment as part of the draft decision to include a trigger event, which operates to provide for an earlier review date if certain circumstances that may impact reference tariffs transpire. The AER considers that this would provide another means through which to consider changes to the reference tariffs during the access arrangement period. Therefore, the AER requires that Country Energy remove section 13.6 from its access arrangement, as set out in amendment 10.1.

As discussed in the operating expenditure chapter, the AER considers it inappropriate to charge customers for transportation services based on the volume of gas withdrawn at delivery points, which have been increased to reflect the cost of unaccounted for gas. The uplift factor that Country Energy applies to volume of gas withdrawn at the delivery points does not comply with r. 92(2) of the NGR. The uplift factor results in the present value of forecast revenue from reference services increasing, while the portion of total revenue allocated to reference services remains unchanged due to no extra costs being allocated to the building block costs as required by r. 76 of the NGR. As discussed in the operating expenditure chapter, the AER considers that the cost of unaccounted for gas should be included in operating expenditure and not recouped with an uplift factor, which is applied to the volume of gas withdrawn at the delivery points. The AER considers that when unaccounted for gas is considered as an operating expense, it can then be reflected as expected revenue from reference tariffs.

Similarly, Country Energy proposes monthly metering charges for contract customers that connect to the network after 1 July 2010.<sup>387</sup> However, like the uplift factor for UAG costs the AER considers that these charges for contract customers connected after 1 July 2010 must be removed as no building block costs<sup>388</sup> have been allocated to this service. Therefore the AER requires Country Energy to remove these metering charges. This required amendment is outlined in amendment 2.7.

## 10.5 Conclusion

The AER does not propose to approve the allocation of total revenue proposed by Country Energy as it does not comply with r. 92, r. 93 and r. 94 of the NGR and requires Country Energy to make the amendments set out below.

## 10.6 Amendments required to the access arrangement proposal

Before the access arrangement proposal can be approved, Country Energy must make the following amendments:

**Amendment 10.1:** delete section 13.6 in the access arrangement proposal and section 8.2.4 in the access arrangement information.

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<sup>387</sup> Country Energy, *Access arrangement proposal*, 1 July 2010, p. 56.

<sup>388</sup> NGR, r. 76.

# 11 Tariff variation mechanism

## 11.1 Introduction

This chapter sets out the AER's consideration of Country Energy's tariff variation mechanism. Country Energy has nominated two tariff variation mechanisms: an annual tariff variation formula mechanism and a cost pass through mechanism. Under the NGR a cost pass through is a tariff variation mechanism. Unlike under the Code and the National Electricity Rules, the NGR does not prescribe any procedures for approval and assessment for the tariff variation mechanism. These are instead proposed by the service provider.

## 11.2 Regulatory requirements

Rule 72(1)(k) of the NGR provides that the access arrangement information for a full access arrangement proposal must include the service provider's rationale for any proposed reference tariff variation mechanism.

Rule 92(1) of the NGR provides that a full access arrangement must include a mechanism for variation of a reference tariff over the course of an access arrangement period. Rule 92(2) of the NGR provides that the reference tariff variation mechanism must be designed to equalise in present value terms forecast revenue from reference services over the access arrangement period and the portion of total revenue allocated to reference services for the access arrangement period.

Rule 97(1) of the NGR provides that a reference tariff variation mechanism may provide for variation of a reference tariff:

- (a) in accordance with a schedule of fixed tariffs; or
- (b) in accordance with a formula set out in the access arrangement; or
- (c) as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax); or
- (d) by a combined operation of 2 or more or [sic] the above.

Rule 97(2) of the NGR provides that a formula for variation of a reference tariff may (for example) provide for:

- (a) variable caps on the revenue to be derived from a particular combination of reference services; or
- (b) tariff basket price control; or
- (c) revenue yield control; or
- (d) a combination of all or any of the above.

In deciding whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement, the AER must have regard to the factors in r. 97(3) of the NGR:

- (a) the need for efficient tariff structures; and
- (b) the possible effects of the reference tariff variation mechanism on administrative costs of the AER, the service provider, and users or potential users; and
- (c) the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism; and
- (d) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
- (e) any other relevant factor.

Rule 97(4) of the NGR provides that a reference tariff variation mechanism must give the AER adequate oversight or powers of approval over variation of the reference tariff.

### 11.3 Country Energy's proposal

Country Energy proposes two reference tariff variation mechanisms as part of its access arrangement proposal:

- An annual tariff variation formula mechanism, through which reference tariffs (excluding monthly metering charges) and additional services will vary in accordance with the formula:

$$(1 + CPI_t) * (1 - X_t) > \frac{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t * Q_{ij}^{t-2}}{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^{t-1} * Q_{ij}^{t-2}}$$

where

$P_{ij}^t$  is the proposed price from component j of tariff i in the coming year

$P_{ij}^{t-1}$  is the price currently being charged for component j of tariff i

$Q_{ij}^{t-2}$  is the quantity of component j or tariff i sold in the previous year

$CPI_t$  is the change in the CPI

$X_t$  is the real change in average price from year t-1 to year t.<sup>389</sup>

- A cost pass through mechanism.<sup>390</sup>

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<sup>389</sup> Country Energy, *Access arrangement information*, 1 July 2009, p. 41.



### 11.3.1 Annual tariff variation formula mechanism

Country Energy proposes using a similar annual tariff variation mechanism as applied in the earlier access arrangement.<sup>391</sup> Country Energy proposes adjusting reference tariffs for transportation services by CPI and X applying to a weighted average tariff basket of services, where X is equal to –33.6 per cent for 2010–11 and –2.5 per cent for all the other years of the access arrangement.<sup>392</sup> Country Energy also proposes that the monthly metering charges and additional service be adjusted by CPI annually.<sup>393</sup>

### 11.3.2 Cost pass through tariff variation mechanism

#### 11.3.2.1 Events

Country Energy proposes the following cost pass through events:

- regulatory change —mandated by a government or regulatory department, body, instrumentality, minister, agency or authority or any body which is the successor to the administrative responsibilities of that department, body, instrumentality, minister, agency or authority<sup>394</sup>
- service standard change—this relates to any decision made by the regulator or any other Authority, or any introduction of or amendment to applicable laws or the NGL<sup>395</sup>
- tax change —this relates to any change in royalty, duty, excise, tax, impost, levy, and fee charge imposed by any authority, with certain exceptions, such as income tax and capital gains tax<sup>396</sup>
- terrorism or natural disaster<sup>397</sup>
- force majeure—this relates to any act of God, riot, civil disorder or rebellion or other similar cause<sup>398</sup>
- insurance—this relates to insurance taken out by or for CE. That is to say, the cost or premium paid changes materially or the insurance becomes unavailable<sup>399</sup>
- retail project—this relates to the separation of the retail gas business in whole in part from the gas distribution function of the network, and<sup>400</sup>

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<sup>390</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 36–38 and Country Energy, *Access arrangement information*, 1 July 2009, p. 42.

<sup>391</sup> Country Energy, *Access arrangement information*, 1 July 2010, p. 41.

<sup>392</sup> Country Energy, *Access arrangement information*, 1 July 2010, p. 37.

<sup>393</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 36.

<sup>394</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 37.

<sup>395</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 37.

<sup>396</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 37.

<sup>397</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 37.

<sup>398</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 37.

<sup>399</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 38.

<sup>400</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 38.

- climate change (CPRS)—this relates to the introduction or operation of a carbon emission trading scheme.<sup>401</sup>

### 11.3.2.2 Administrative threshold

Country Energy proposes a materiality threshold for the cost pass through tariff variation mechanism. The materiality threshold is:

...where the annualised cost incurred, or forecasted to be incurred, by *Country Energy Gas* as a result of the event occurring, exceeds the annual revenue requirement for *Country Energy Gas* for that regulatory year by 1 per cent (in 2009-10 dollar terms) or the proposed capital expenditure exceeds 5 per cent of the aggregate annual revenue requirement in the first year of this *Access Arrangement*.<sup>402</sup>

### 11.3.3 Oversight procedures tariff variation mechanisms

Country Energy proposes to adjust reference tariffs on 1 July of each year of the access arrangement period, in accordance with the proposed tariff variation formula mechanism and the cost pass through mechanism.<sup>403</sup>

Country Energy proposes to notify the AER 50 business days prior to 1 July each year of the access arrangement period. Country Energy submits that if the AER does not make a decision within 30 business days following receipt of the application, the application will be deemed to be approved. The approval will come into effect 31 days after receipt of the application.<sup>404</sup>

## 11.4 AER's analysis and considerations

### 11.4.1 Revenue equalisation

Rule 92(2) of the NGR provides that a reference tariff variation must be designed to equalise in present value terms, forecast revenue from reference services over the access arrangement period and the portion of total revenue allocated to reference services for the access arrangement period. The AER considers that if additional services are categorised as non-reference services as submitted by Country Energy<sup>405</sup> then it has not demonstrated compliance with r. 92(2) of the NGR. However, as outlined in the pipeline services chapter, Country Energy's additional services must be classified as reference services, resulting in compliance with r. 92(2) of the NGR.

The forecast revenue from reference services needs to equal the present value of total revenue approved for reference services in the access arrangement period.<sup>406</sup>

Amendment 2.7 is the new tariffs adjusted (using the same percentage) for the lower approved total revenue to meet this requirement of r. 92(2) of the NGR.

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<sup>401</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 38.

<sup>402</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 38.

<sup>403</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 36.

<sup>404</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 39–40.

<sup>405</sup> Country Energy, *Access arrangement proposal*, 1 July 2010, p. 8.

<sup>406</sup> NGR, r. 92(2).

## 11.4.2 Annual tariff variation formula mechanism

### 11.4.2.1 Proposed annual reference tariff variation mechanism

Country Energy proposes an annual tariff variation formula mechanism using a CPI–X formula consistent with the earlier access arrangement period.<sup>407</sup> In the access arrangement period Country Energy proposes to adjust a basket of tariffs using a CPI–X mechanism. The tariff formula mechanism is a tariff basket price control mechanism consistent with r. 97(1) and r. 97(2) of the NGR.

The proposed tariff variation formula does not achieve efficient tariff structures over the access arrangement period for a number of reasons. These are outlined below.

The tariff variation formula proposed affords Country Energy flexibility about how tariffs within the tariff classes change, subject to the constraint that the entire basket of tariffs does not increase by more than CPI–X. The AER is concerned that without a side constraint, Country Energy is able to rebalance tariffs in such a way that the outcome of an efficient tariff structure may not be achieved during the access arrangement period.<sup>408</sup> In order to address this issue, the AER requires Country Energy to include a side constraint on how much tariffs may change within tariff classes in any one year of the access arrangement period, as outlined in amendment 11.1.

There are also minor specification issues with the proposed commencement date and the formula itself as outlined below.<sup>409</sup>

Country Energy proposes that the tariff variation formula mechanism will adjust tariffs annually on 1 July 2010 and then on 1 July each year during the access arrangement period.<sup>410</sup> The AER does not consider that a tariff variation mechanism which requires tariffs to be varied on the first day of the access arrangement period, i.e. on 1 July 2010, is practical and will result in unnecessary administrative costs.<sup>411</sup> The AER requires this to be amended as set out in amendment 11.2.

The specification of the time period used to describe the CPI inputs, needs to be reformulated as outlined in amendment 11. 3 so that the subscript for CPI reflect CPI inputs available at the time when the annual tariff variation process is undertaken. The CPI subscript needs to be changed from “t” to “t–1”. This is because the tariffs for year t (where t is the end of the tariff year) are assessed early in year t–1 and therefore the latest entire year in which CPI data is available is year t–2.

In order for the annual tariff variation mechanism to be applied consistently in every year of the access arrangement period, the AER considers it appropriate for Country Energy to include a rounding convention as required by amendment 11.4. For example, Country Energy may propose to round at the last computational step and to

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<sup>407</sup> NGR, r. 97(3(d)).

<sup>408</sup> NGR, r. 97(3)(a).

<sup>409</sup> NGR, r. 97(3)(e).

<sup>410</sup> Country Energy, *Access arrangement proposal*, 1 July 2010, p. 36.

<sup>411</sup> NGR, r. 97(3)(b).

the nearest cent for tariffs denominated in dollars (i.e. two decimal places).<sup>412</sup> Alternatively, rounding can take place at every computational step<sup>413</sup> and tariffs can be rounded to several decimal places.

The AER also notes that Country Energy's reference tariff variation formula requires that current tariffs are used as a basis to set tariffs in the following year of the access arrangement period. Therefore the approval tariffs should only include tariffs for the period 1 July 2010 to 20 June 2011 as outlined in amendment 2.7.

Further, if an error was to occur in any one year of the access arrangement period this would be compounded over the access arrangement period, and the basis for setting tariffs in subsequent periods would be incorrect. Country Energy needs to include a clause in its access arrangement to correct for errors in subsequent years arising from a tariff variation mechanism as outlined in amendment 11.5.

#### **11.4.2.2 Oversight procedures or powers of approval for the annual tariff variation mechanism**

The AER considers that there are two relevant factors that will enhance the AER's oversight and powers of approval for the annual tariff variation.<sup>414</sup> These are discussed below.

An important input in the annual tariff variation mechanism is the use of past gas quantities to weight each tariff. The AER considers it is appropriate that Country Energy be required to provide an independent statement to allow the AER to verify the actual gas quantities used in the tariff formula variation mechanism, and to ensure it is applied consistently every year. The independent verification statement should provide for audited or verified quarterly and annual quantities for the calendar year consistent with the proposed changes in CPI. For this reason the AER requires Country Energy to amend its access arrangement proposal as outlined in amendment 11.6 to provide for a verified statement of past actual gas quantities used to determine tariffs each year of the access arrangement period.

Further, the AER requires an amendment which will require Country Energy to provide its workings which demonstrate how the proposed tariffs have been calculated in accordance with the tariff variation formula mechanism. This will allow the AER to more easily assess whether the tariff variation mechanism has been applied correctly and to facilitate the efficiency of the approval process. It will also assist in mitigating the need to seek further information from Country Energy. This is outlined in amendment 11.7.

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<sup>412</sup> If tariffs are very small, rounding to the nearest cent may be inappropriate. For instance a five cent tariff rounded to the nearest cent would require a minimum ten per cent increase in a year in order for the tariff to increase to six cents. With a simple inflation adjustment a ten per cent increase may never occur throughout the access arrangement, causing the tariff to remain constant in nominal terms throughout the access arrangement.

<sup>413</sup> Every computational step would have to be explained in this situation.

<sup>414</sup> NGR, r. 97(4).

### 11.4.3 Tariff variation mechanism for a pass through

#### 11.4.3.1 Proposed events

Country Energy proposes the following cost pass through events: regulatory change; service standard change; tax change; terrorism or natural disaster; force majeure; insurance; retail project; and climate change (carbon pollution reduction scheme).<sup>415</sup>

The AER considers that the proposed events can be considered to constitute cost pass throughs for a defined event tariff variation mechanism for the purpose of r. 97(1)(c) of the NGR.

In addition, the proposed events are consistent with a mechanism that provides for an efficient tariff structure because the cost pass through mechanism is symmetrical.<sup>416</sup>

#### 11.4.3.2 Additional event

The AER considers a general pass through event with an administrative cost threshold of 1 per cent of total revenue in the relevant year needs to be included in the access arrangement proposal in addition to the events proposed.

For example, events that are not approved for self insurance premiums may be considered as general pass through events for the access arrangement period. This is consistent with the approach applied in revenue determinations in electricity under the NEL and meets desirability to have consistency between similar services beyond the relevant jurisdiction.<sup>417</sup> This is reflected in amendment 11.8.

#### 11.4.3.3 Other matters

Country Energy proposes a materiality threshold of 1 per cent of total revenue or 5 per cent of capital expenditure.<sup>418</sup>

For material cost pass through events the proposed administrative cost threshold for capital expenditure is not necessary as the alternative administrative cost threshold of 1 per cent proposed also covers both capital expenditure and operating expenditure. Therefore the AER requires Country Energy to amend its access arrangement to remove the capital expenditure materiality threshold as outlined in amendment 11.9.

Further the AER considers that this materiality threshold is not consistent with administrative thresholds for tax change events for similar services within and beyond the jurisdiction.<sup>419</sup> The AER considers that a lower threshold could apply for the tax change event. This is because the costs of a tax change event can be readily discernable and verifiable from a third party or independent source of information. Therefore the administrative costs for a tax change event for the service provider, users and the AER are much lower for these types of events than other pass through

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<sup>415</sup> Country Energy, *Access arrangement proposal*, 1 July 2010, p. 36.

<sup>416</sup> NGR, r. 97(3)(a).

<sup>417</sup> AER, *Final decision: New South Wales distribution determination 2009–10 to 2013–14*, April 2009, pp. 277–280 and NGR, r. 97(3).

<sup>418</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 38.

<sup>419</sup> NGR, r. 97(3)(d).

events.<sup>420</sup> The AER considers Country Energy needs to amend its access arrangement as outlined in amendment 11.9 to reflect a lower administrative cost threshold for a tax change event.

And as a minor point, the materiality threshold does not include the words “material impact”. These are defined separately for tax change and other pass through events, consistent with the materiality threshold amendment 11.9.

Country Energy must amend its access arrangement proposal as outlined in amendment 11.10 to include the following factors which the AER needs to consider in assessing a cost pass through event:<sup>421</sup>

- whether the costs have been funded by alternative means such as self insurance, external insurance or some other third party compensation
- whether the costs are relevant to the delivery of pipeline services
- whether the costs are building block components for determining total revenue and the determination of reference tariffs under the NGR, and
- whether the costs meet the relevant criteria for the different building block components in determining total revenue.

In relation to Country Energy’s proposal about the engagement of an auditor, the AER considers that the engagement of an auditor or other experts by the AER to assist it in assessing a cost pass through event is a matter for the AER, rather than a condition relevant for a pass through procedure for Country Energy’s access arrangement and should be removed as outlined in amendment 11.10.

#### **11.4.3.4 Oversight procedures and powers of approval for the pass through tariff variation mechanism**

Country Energy has outlined a procedure for the approval and amendment of reference tariffs for the pass through tariff mechanism which includes oversight powers of approval.<sup>422</sup> However, the AER considers these procedures for the pass through tariff variation mechanism require amendment, as outlined below.

Country Energy needs to correct for typographical errors in sections 13.4.3 and 13.4.5 of the access arrangement, to ensure the cost pass through mechanism operates as intended as outlined in amendment 11.11.

The access arrangement proposal needs to include a requirement that the costs for any pass through event are net of any payments made by an insurer or third party which partially or wholly offsets the financial impact of that event. This is to ensure that only the net financial impact of an event is considered for a pass through event, as the financial impact of some events like insurance events may be partially or wholly compensated or reimbursed by insurers or third parties and need not be recouped through an increase in tariffs from users. This is outlined in amendment 11.12

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<sup>420</sup> NGR, r. 97(3)(b).

<sup>421</sup> NGR, r. 97(3)(e).

<sup>422</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 39.

The AER considers Country Energy must provide supporting information for a tax change event from the relevant taxing authority about the financial impact of the tax change event and as relevant support for the financial impact of other pass through events against relevant NGR criteria. The purpose of amendment 11.12 is to include a requirement to provide justifiable and verifiable information about the efficient cost of the pass through event, which the AER considers can be readily verifiable for the tax change event.

In addition, the access arrangement proposal needs to include an extension of decision making time provision for cost pass through events. The purpose of this extension of the decision making time clause is to enable the AER, if required, to undertake public consultation or consideration by an expert consultant because of the difficulty of assessing or quantifying the effect of the relevant cost pass through event or to account for a circumstance beyond the AER's control. The AER proposes that an overall time limit is set for the assessment of a cost pass through applications within 90 business days including extension of decision making time as outlined in amendment 11.13.

Further, the AER considers that Country Energy should notify the AER when a pass through event occurs within a certain period of time and no later than 3 months after a pass through event has occurred. The purpose of amendment 11.14 is to remove discretion regarding if and when Country Energy needs to notify the AER that an event occurred that meets the relevant pass through definitions.

The AER also considers that to make it clear that section 13.5 applies to the annual tariff variation mechanism and incorporates previously approved pass through events as outlined in amendment 11.15.

A further additional minor issue is that Country Energy's proposal does not clearly outline whether the materiality threshold applies to one or more simultaneous events. The AER considers that the access arrangement proposal should make it clear that in the circumstances that more than one cost pass through event is proposed by Country Energy at the same time, that the threshold relates to each separate event. This is outlined in amendment 11.16.

## **11.5 Conclusion**

The AER does not propose to approve the tariff variation mechanism proposed by Country Energy as it does not comply with r. 97 of the NGR and requires Country Energy to make the amendments set out below.

## **11.6 Amendments required to the access arrangement proposal**

Before the access arrangement proposal can be approved, Country Energy must make the following amendments:

**Amendment 11.1:** amend section 8.2.2.1 in the access arrangement information to include the following:

$$\frac{\sum_{j=1}^m P_{ij}^t * Q_{ij}^{t-2}}{\sum_{j=1}^m P_{ij}^{t-1} * Q_{ij}^{t-2}} \leq 1.1 + \% \Delta CPI$$

For all tariff i where i = 1, ..., n

Where the tariff class has up to 'j' components where j = 1, ..., m

Note: this side constraint formula applies to CPI changes only (and not cost pass throughs).

**Amendment 11.2:**

- delete the first sentence of clause 13.1 of the access arrangement proposal and replace it with the following:

The manner in which the *Reference Tariff* for the *Contract Transportation Service* and the *Volume Transportation Service* will change annually on 1 July 2011 and 1 July in each *Year* thereafter throughout this *Access Arrangement* is set out in section 8 of the *Access Arrangement Information*.

- delete the first sentence of clause 8.2.2 in the access arrangement information and replace it with the following:

This clause sets out the manner in which *Reference Tariffs* (including *Monthly Metering Charges*) and *Additional Services* will change on 1 July 2011 and 1 July each *Year* thereafter throughout the *Access Arrangement Period*.

**Amendment 11.3:**

- delete section 8.2.2.1 in the access arrangement information and replace it with the following:

As occurred in the previous *Access Arrangement*, *Reference Tariffs* (excluding *Monthly Metering Charges*) will change on 1 July each *year* (starting from 1 July 2011) in accordance with the following formula:

$$(1 + CPI_{t-1}) * (1 - X_t) > \left( \frac{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t Q_{ij}^{t-2}}{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^{t-1} Q_{ij}^{t-2}} \right)$$

where:

$P_{ij}^t$  is the proposed price for component j of tariff I in the coming *year*

$P_{ij}^{t-1}$  is the price currently being charged for component j of tariff i



$Q_{ij}^{t-2}$  is the *Quantity* of component *j* of tariff *I* sold in the previous year

$X_t$  is the real change in average prices from year *t-1* to year *t*, as set out in section 7.2 above

*Change in the CPI* for a Year *t-1* means the average of the *CPI* for the four quarters to the December quarter immediately preceding Year *t-1* divided by the average of the *CPI* for the four quarters to the December quarter immediately preceding Year *t-2*, as set out on page 45 of this *Access Arrangement* .

Year *t* is defined in the *Access Arrangement* as the financial year ending 30 June each Year of the access arrangement period. For example *t* = 2011 means the period 1 July 2010 to 30 June 2011.

- delete the definition of ‘Change in the CPI’ in section 15 in the access arrangement proposal and replace it with the following:

‘*Change in the CPI* for a Year *t-1* means the average of the *CPI* for the four quarters to the December quarter immediately preceding Year *t-1* divided by the average of the *CPI* for the four quarters to the December quarter immediately preceding year *t-2*.

**Amendment 11.4:** amend the access arrangement proposal to include a new subsection in section 13 for a rounding convention for the tariff variation formula mechanism.

**Amendment 11.5:** amend section 13.5 in the access arrangement proposal to include a new paragraph (h):

if it appears that the past tariff variations contain a material error or deficiency because of a clerical mistake, accidental slip or omission, miscalculation or misdescription the *Regulator* may change subsequent tariffs to account for these past issues.

**Amendment 11.6:** amend section 13.5 in the access arrangement proposal to include a new subsection 13.5 g(3):

a statement must be provided to support the *Gas Quantity* inputs in the tariff variation formula. The statement must be independently audited or verified and the *Quantity* input must reflect the most recent actual annual quantities available at the time of tariff variation assessment. The actual annual *Quantity* should be provided as four quarters of *Gas Quantity* data reconciling to an annual total *Quantity of Gas*.

**Amendment 11.7:** amend the end of subsection 13.5(f)(2) in the access arrangement proposal to include the following:

which is supported by relevant workings

**Amendment 11.8:**

- amend section 13.4 in the access arrangement proposal to include the following:

General pass through event: any other *Pass Through Event* whose costs is not already included in building block revenue or reimbursed by a third party. These events will be assessed at the time of application for consistency with the relevant NGR criteria.

- amend section 8.2.3 in the access arrangement information to include a new bullet point:

- General pass through event

**Amendment 11.9:** delete section 13.4.1 in the access arrangement proposal and replace it with the following:

(a) Material impact for a *Pass Through Event* is one per cent of the approved total revenue in 2009–10 dollars in the *Year* the cost is incurred for each event except each Tax Change event in 13.4.1(b).

(b) Material impact for a Tax Change event is commensurate with the administrative costs of the service provider, user and the *Regulator* in making and reviewing a notification.

**Amendment 11.10:** delete section 13.4.3(g) in the access arrangement proposal and replace it with the following:

In assessing pass through application, the Relevant *Regulator* must take into account the following:

- the costs to be passed through are for the delivery of *Pipeline* services
- the costs to be passed through are building block components of total revenue
- the costs to be passed through meet the relevant NGR criteria for determining the building block for total revenue for *Reference Services*
- the costs to be passed through have not been funded by other means including self insurance, external insurance or paid for or compensated by another third party, and
- any other factors the Relevant *Regulator* considers are relevant and consistent with the NGL and NGR.

**Amendment 11.11:** correct the following typographical and drafting errors in the access arrangement proposal:

- in section 13.4.2(b): delete 13.4.1(a) and replace it with 13.4.2(a)
- in section 13.4.3(a): delete 13.4.1 and replace it with 13.4.2 and delete 13.4.4 and replace it with 13.4.5
- in section 13.4.3(b): delete 13.4.1 and replace it with 13.4.2
- in section 13.4.3(c): delete 13.4.2(b) and replace it with 13.4.3(b)
- in section 13.4.3(d): delete 13.4.2(b) and replace it with 13.4.3(b)
- in section 13.4.3(f): delete 13.4.2(e) and replace it with 13.4.3(e)
- in section 13.4.5: delete 13.4.2(b), (c) or (f) and replace it with 13.4.3(b), (c) or (f).

**Amendment 11.12:** amend section to 13.4.2(b) in the access arrangement proposal to include two new clauses:

- using a verification statement by an officer of the service provider that the financial impact of the *Pass Through Event* in an application under clause 13.4.2(a) is net of any third party including insurer payment or reimbursement in connection with the event. The verification statement will also provide information about the financial impact of the event less any reimbursement or payment made by a third party in connection with the event to verify the financial impact of the event in an application under clause 13.4.2(a).
- an application under clause 13.4.2(a) for a Tax Change event must be supported by information about the financial impact of taxation change event from the relevant taxation or regulatory authority. An application for a *Pass Through Event* other than a Tax Change event must be supported by relevant information to justify the financial impact of the events with reference to the relevant capital and/or operating expenditure criteria.

**Amendment 11.13:** delete section 13.4.3(c) in the access arrangement proposal and replace it with the following:

The *Regulator* must give notice to *Country Energy Gas* under section 13.4.3(b) within 30 *Business Days* of receiving an application from *Country Energy Gas*. This period may be extended for the time taken by the *Regulator* to obtain information from *Country Energy Gas*, obtain expert advice or consult about the *Pass Through Event*. The AER must assess a pass through application within 90 *Business Days* including any extension of decision making time. Excluding the extension of decision making time, on the 31st *Business Day* the *Regulator* is deemed to have notified *Country Energy Gas* that the proposed amendments to *Reference Tariffs* are to apply as specified in the application.

**Amendment 11.14:** delete section 13.4.3(e) in the access arrangement proposal and replace it with the following:

*Country Energy Gas* must notify the *Regulator* of a *Pass Through Event* within 3 months of the occurrence of that event.

**Amendment 11.15:** amend the access arrangement proposal to:

- delete section 13.5(a) and replace it with the following:
  - (a) This Notification and Approval process applies to notifications for annual changes in *Reference Tariffs* under section 13.3 and includes the financial impact of *Pass Through Event* approvals made under section 13.4.3(b) following a notification under section 13.4.2. When *Country Energy Gas* proposes to vary tariffs it is required to provide the *Regulator* with 50 *Business Days* notice prior to the effective date of the variation.
- delete section 13.5(d) and replace it with the following:
  - (d) The decision making time under section 13.5(c) of the *Access Arrangement* does not include time where the *Regulator* has requested information from *Country Energy Gas* related to the Notification of Annual Changes in *Reference Tariffs* under section 13.3.

**Amendment 11.16:** amend the first sentence of section 13.4 in the access arrangement proposal and replace it with the following:

*Reference Tariffs* may be varied if there is a material impact on the cost to *Country Energy Gas* of providing *Reference Services* as a result of one *Pass Through Event* listed below (*Pass Through Events*), where the costs were not incorporated in the determination of *Reference Tariff* incorporated in this *Access Arrangement* or, if there has been a previous review of the *Reference Tariffs*, at that review.

**Part C—Other provisions of an access arrangement**

## 12 Non-tariff components

### 12.1 Introduction

This chapter considers the non-tariff elements of Country Energy's access arrangement proposal. The NGR sets out criteria for determining the terms and conditions on which service providers are to grant third parties access to these services.

### 12.2 Terms and conditions

#### 12.2.1 Regulatory requirements

Rule 48(1)(d)(ii) of the NGR provides that a full access arrangement must specify for reference services, the other terms and conditions on which reference services will be provided (additional to the reference tariff).<sup>423</sup>

#### 12.2.2 Country Energy's proposal

The general terms and conditions (additional to the reference tariff) on which Country Energy proposes to provide reference services are set out in of the access arrangement proposal and, in particular, annexure 1 to the proposal.

#### 12.2.3 AER's analysis and considerations

##### 12.2.3.1 Standard agreement for network users

In the earlier access arrangement, Country Energy's standard reference service agreement for access to Country Energy's Wagga Wagga gas distribution network was attached to its access arrangement.<sup>424</sup>

The terms and conditions Country Energy proposes to enter into with users seeking access to its Wagga Wagga gas distribution network are attached to Country Energy's access arrangement proposal and forms part of the proposal (Standard User Agreement).<sup>425</sup> These terms and conditions have been substantially revised and rewritten from those for the earlier access arrangement period.

The AER notes that it has not received any submissions on the terms and conditions. Rule 100 of the NGR provides that the provisions of an access arrangement proposal must be consistent with the national gas objective and the rules and procedures in force when the terms and conditions of the access arrangement are determined or revised. The AER has identified a number of concerns with the terms and conditions which are discussed below.

##### 12.2.3.2 Definitions for the Standard User Agreement

The AER notes that there are no definitions for terms used in the Standard User Agreement. The AER considers that the definitions are the same as those for the

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<sup>423</sup> NGR, r. 48(1)(d).

<sup>424</sup> Country Energy, *Access arrangement*, 1 January 2006, appendix 1, Reference Service Agreement.

<sup>425</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, appendix 1, Terms and Conditions.

access arrangement set out in the access arrangement proposal. In order that the Standard User Agreement can be properly interpreted by users, Country Energy must include a provision in the Standard User Agreement which states that defined terms have the meaning given to them in the access arrangement. The AER has used these definitions in its review of the Standard User Agreement.

*Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.1:** amend the terms and conditions in appendix 1 in the access arrangement proposal to include the following:

In the *Terms and Conditions* of this *Agreement*, where a word or phrase is capitalised and italicised the term has the meaning set out in the NGL and NGR, unless the word or phrase is defined in the glossary in section 15 of the *Access Arrangement* in which case the word or phrase has the meaning given to that word or phrase in the glossary.

**12.2.3.3 Unaccounted for gas**

The AER notes its decision that unaccounted for gas is to be included as a building block cost.<sup>426</sup> Clause 3.22 of the Standard User Agreement provides that a user accepts risk of loss of all gas injected by it into the distribution system and Country Energy is not liable to the user for unaccounted for gas. Clause 3.23 of the Standard User Agreement provides that charges for the contract and volume transportation services will be determined inclusive of the level of unaccounted for gas set out in section 5.3.3 of the access arrangement. Since the AER has decided that unaccounted for gas costs are to be included explicitly within forecast operating expenditure, it would be inconsistent with r. 100 of the NGR for Country Energy to add a percentage for unaccounted for gas in the network to the quantity of gas withdrawn from delivery points because the associated costs have already been taken into account. Country Energy must remove the unaccounted for gas provisions in the Standard User Agreement.

*Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.2:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- delete the heading '**Unaccounted for Gas**' which appears immediately above clause 3.22.
- delete clauses 3.22 and 3.23.

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<sup>426</sup> See chapter 7 of the draft decision.

#### 12.2.3.4 Exclusion of liability

Country Energy has proposed an amendment to the exclusion of liability provision in clause 16.2 of the standard reference service agreement in appendix 1 of the earlier access arrangement. Country Energy proposes not to be liable for penalties or damages for failing to convey gas through the distribution system if the failure arises out of any accident or cause beyond Country Energy's reasonable control.<sup>427</sup> The AER considers that it would be inconsistent with r. 100 of the NGR, for the exclusion of liability to apply to penalties or damages arising from Country Energy's negligence.

#### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.3:** amend clause 12.12 of the terms and conditions in appendix 1 in the access arrangement proposal to include the following words after the word 'control':

unless that liability results from *Country Energy Gas*' negligence

#### 12.2.3.5 Invoicing, payments and charges

#### *Contents of invoices*

Country Energy proposes that the items to appear on its invoices<sup>428</sup> should be those covered by the amendment required by the IPART for the earlier access arrangement. The IPART required Country Energy to insert a general requirement to include sufficient information so users can assess charges and comply with obligations to provide charge related information to customers.<sup>429</sup> The AER considers that the Standard User Agreement should also contain the detailed list of invoice items set out in the reference services agreement for the earlier access arrangement period (for example, gas received, gas delivered and charges).<sup>430</sup> Country Energy has not explained why it did not include this more detailed list. The IPART required Country Energy to insert a general requirement to include sufficient information so users can assess charges and comply with obligations to provide charge related information to customers.<sup>431</sup>

The AER considers that this missing level of detail may assist transparency for users by providing them with information to reconcile charges and invoice customers and it is not aware of any reason why this list would no longer be appropriate. This is consistent with r. 100 of the NGR because it will minimise procedural inefficiencies

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<sup>427</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, appendix 1, Terms and Conditions, clause 12.12, p. 25.

<sup>428</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, appendix 1, Terms and Conditions, clause 6.14, p. 11.

<sup>429</sup> IPART, *Final decision, Revised access arrangement for Country Energy Gas network*, November 2005, pp. 123–124, 131.

<sup>430</sup> Country Energy, *Access arrangement*, 1 January 2006, appendix 1, Reference Service Agreement, clause 12.2.

<sup>431</sup> IPART, *Final decision, Revised access arrangement for Country Energy Gas network*, November 2005, pp. 123–124, 131.



and enhance transparency. Therefore, Country Energy should provide the complete list of information which was made mandatory for invoices in clause 12.2 under the standard reference services agreement for the earlier access arrangement period.<sup>432</sup>

#### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.4:** delete clause 6.14 in the terms and conditions in appendix 1 in the access arrangement proposal and replace it with the following:

Invoices will be in a format determined by Country Energy Gas. *Country Energy Gas* will ensure that its invoices will include, without limitation, the following information:

- (a) **(gas received):** the quantity of *Gas* deemed to be received from the *User* at the *Receipt Points* in the billing period;
- (b) **(gas delivered):** the quantity of *Gas* delivered to the *User* at each *Delivery Point* in the billing period;
- (c) **(monthly capacity charge):** the *Monthly Capacity Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Contract Transportation Service* is provided, as well as the *MDQ* for that *Delivery Point*;
- (d) **(monthly metering charge):** the *Monthly Metering Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Contract Transportation Service* is provided;
- (e) **(volumetric charge):** the *Volumetric Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Volume Transportation Service* is provided;
- (f) **(monthly fixed charge):** the *Monthly Fixed Charge* payable pursuant to clause 6 for the billing period for each *Delivery Point* to which the *Volume Transportation Service* is provided;
- (g) **(Additional Services charges):** the number of each *Additional Service* provided during the billing period and the total charge for the billing period for each *Additional Service*;
- (h) **(other amounts):** any other charge payable by the *User* in respect of the billing period;
- (i) **(other information):** sufficient information as is reasonable to allow the *User*:
  - (i) to assess the accuracy of the *Charges* specified in each invoice; and

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<sup>432</sup> Country Energy, *Access arrangement proposal*, 1 January 2006, appendix 1, Reference Service Agreement, clause 12.2. pp. 21–22.

- (ii) to comply with its obligations under the *Regulatory Instruments* in relation to the provision to the *Customer* of information concerning such *Charges*.

### ***Disputed invoices and retrospective adjustments***

Clause 6.23 of the Standard User Agreement provides that if there is an error in an invoice rendered under the Standard User Agreement then the error can only be corrected by Country Energy in a subsequent invoice.<sup>433</sup> Clause 6.27 of the Standard User Agreement provides that if a notice of dispute is not given then the invoice must be paid in full subject to the right to seek a subsequent adjustment under clauses 6.23 to 6.25 of the Standard User Agreement or to dispute the amount of the invoice under clause 6.29 of the Standard User Agreement after the invoice has been paid in full. As a consequence of clause 6.27, clause 6.23 can only apply to invoices which have been paid. Clause 6.23 of the Standard User Agreement should be amended so it is clear that it only applies to paid invoices.

### ***Conclusion***

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.5:** include the words 'and paid' after the word 'rendered' in clause 6.23 of the terms and conditions in appendix 1 in the access arrangement proposal.

### ***Charges***

The defined term 'Charges' in section 15 of the access arrangement proposal provides that a charge payable by a user under clause 6 of the terms and conditions set out in appendix 1 to the proposal includes:

- (b) where *Additional Services* other than *Reference Services* are provided by *Country Energy Gas*, as set out in section 4.3.3;
- (c) *Connection Charges*

It is unclear to the AER what meaning should be given to paragraph (b) of the definition. In any event, the AER notes that since all additional services are reference services, it is not necessary to include paragraph (b) in the definition of 'Charges'. The AER also notes that the term 'Connection Charges' is not defined in the access arrangement proposal so the term should not be included in the definition of 'Charges'.

### ***Conclusion***

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

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<sup>433</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, appendix 1, Terms and Conditions, clause 6.23, p. 12.

**Amendment 12.6:** delete the definition of ‘Charges’ in section 15 in the access arrangement proposal and replace it with the following:

**Charges** means the charges payable by the *User* to *Country Energy Gas* under clause 6 of the *Terms and Conditions* and includes:

- (a) the amount determined from the application of the *Reference Tariffs* in respect of the *Reference Services* provided to the *User* in respect of its *Customers* or such other amount as agreed in writing; and
- (b) Additional Charges.

#### 12.2.3.6 Ombudsman complaints

The AER notes that the effect of clauses 8.18 and 8.20 of the Standard User Agreement is that if a party to the agreement is required by the ombudsman or agrees to pay compensation to settle a customer complaint which relates directly to an act or omission of the other party, then the amount to be reimbursed by the other party includes the ombudsman’s handling charges. The AER considers that the amount reimbursed should also include the reasonable disbursement incurred by the party required to pay the compensation or which settled the customer complaint.

#### *Conclusion*

The AER does not propose to approve Country Energy’s specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.7:** include the following words after the word ‘includes’ in clause 8.20 of the terms and conditions in appendix 1 in the access arrangement proposal:

the reasonable disbursements incurred by the *First Party*, including

#### 12.2.3.7 Force Majeure

The AER notes that the force majeure provision in section 9 of the Standard User Agreement only applies for the benefit of Country Energy and cannot be relied upon by users in the event they are unable to perform an obligation due to circumstances beyond their reasonable control. The AER notes the equivalent provision in the terms and conditions for the earlier access arrangement applied for the benefit of both users and Country Energy.<sup>434</sup> Country Energy has not explained why the proposed provision does not apply to users. The AER also notes that the term ‘Force Majeure Event’ is not defined in the access arrangement proposal in a manner which is meaningful. The term is defined as having the meaning in clause 9 of the Standard User Agreement.<sup>435</sup> The AER notes that clause 9 does not define the term ‘Force Majeure Event’, however, the term was defined in the earlier access arrangement.<sup>436</sup> The AER considers that the force majeure provision in the access arrangement

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<sup>434</sup> Country Energy, *Access arrangement*, 1 January 2006, appendix 1, Reference Service Agreement, clause 15, pp. 28–29.

<sup>435</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 15, p. 48.

<sup>436</sup> See the definition of ‘Force Majeure’ in Country Energy, *Access arrangement*, 1 January 2006, appendix 1, Reference Service Agreement, clause 1.1, p. 5.

proposal should apply for the benefit of both users and Country Energy and that the term ‘Force Majeure Event’ should be given the same meaning as the term ‘Force Majeure’ in the standard reference services agreement for the earlier access arrangement.

#### *Conclusion*

The AER does not propose to approve Country Energy’s specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.8:** amend section 9 of the terms and conditions in appendix 1 in the access arrangement proposal so the section applies to all parties to the agreement.

**Amendment 12.9:** delete the definition of the term ‘Force Majeure Event’ in section 15 in the access arrangement proposal and replace it with the following:

**Force Majeure Event** means an event or circumstance beyond the reasonable control of a party, as the case may be, which results in or causes a failure by such party in the performance of any obligations imposed on it by the *Agreement* notwithstanding the exercise by such party of reasonable care and will include but will not be limited to acts of God, sabotage, acts of war, blockades, insurrections, riots, epidemics, floods, storms, fires, washouts, explosions, breakage of or accident to machines or lines of pipe, freezing of wells or delivery facilities, well blowouts, craterings, the necessity for making repairs to or reconditioning wells, machinery, equipment or pipelines (not resulting from the fault or negligence of the relevant party), arrests and restraints of rulers and peoples, civil disturbances and the order of any court or government authority.

#### **12.2.3.8 Country Energy’s rights against customers**

The AER notes that clause 10 of the Standard User Agreement sets out:

- the circumstances when Country Energy will consult with users before disconnecting a customer from the network
- the obligations which users must inform customers about, and
- when users must notify customers and Country Energy of breaches of certain obligations.

The AER also notes that Country Energy and the user must use reasonable endeavours to agree on the procedures to be followed in effecting the disconnection.<sup>437</sup> The AER considers that if such an agreement is reached then Country Energy should indemnify the user against claims arising from any action taken by the user to enforce Country Energy’s rights at the request of Country Energy. The AER also considers that it should be made clear in clause 10 that nothing in the clause is intended to affect or impose on a user any of Country Energy’s rights or obligations under any regulatory instrument.

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<sup>437</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, appendix 1, Terms and Conditions, clause 10.1, p. 20.

### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.10:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- include a new clause 10.6:

**Country Energy to indemnify the User**

10.6 *Country Energy Gas* shall indemnify the *User* against *Claims* arising from, or incurred by the *User* as a consequence of, any action taken by the *User* under this clause 10 to enforce the *Country Energy Gas*' rights at the request of *Country Energy Gas*, except to the extent that the *Claim* arises from the negligent or reckless act or omission of the *User* or from any breach or non-observance by the *User* of the *Agreement* or the *Regulatory Instruments*.

- include a new clause 10.7:

**Limitation of the User's obligations**

10.7 Nothing in this clause is intended to affect or impose on the *User* any of *Country Energy Gas*' rights or obligations under the *Regulatory Instruments*.

### **12.2.3.9 Liabilities and indemnities**

The AER notes that clause 12.2 of the Standard User Agreement states that if the Trade Practices Act 1974 (Cth) or any equivalent state or territory legislation implies a condition or warranty into the Standard User Agreement which cannot be excluded, then Country Energy's liability to the user for breach of the condition or warranty will be limited to the re-supply of the service or payment of having the service re-supplied.<sup>438</sup> The AER also notes that section 68A of the Trade Practices Act states that liability cannot be limited in that way if the person supplied with the goods or services establishes that it is not fair or reasonable to rely on the provision or the condition or warranty is implied by section 69 of the Trade Practices Act. The AER considers that this restriction applies to the operation of the proposed clause 12.2 should be stated in the Standard User Agreement.

The AER notes that clause 12.13 of the Standard User Agreement limits Country Energy's liability to direct loss or damage and its liability will be limited to a maximum of \$20,000 for any single event with a total liability of \$100,000 for any 365 day period. The AER considers that this provision should be made subject to clause 12.2 of the Standard User Agreement and the amendment referred to above.

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<sup>438</sup> Country Energy, *Access arrangement proposal* 1 July 2009, appendix 1, Terms and Conditions, clause 12.2, p. 23.

*Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.11:** amend the terms and conditions in appendix 1 in the access arrangement proposal to:

- include a new clause 12.2A after clause 12.2:

12.2A *Country Energy Gas*' liability will not be limited in this way if:

  - (a) the *User* establishes that such a limitation is not fair or reasonable in the circumstances; or
  - (b) the condition or warranty is implied under section 69 of the *Trade Practices Act 1974* (Cth).
- include at the start of before clause 12.13: 'Subject to clauses 12.2 to 12.2A,'.

**12.2.3.10 Required bank guarantee amount**

The defined term 'Required Bank Guarantee Amount' in the access arrangement proposal is not used in the proposal or the terms and conditions in appendix 1 to the proposal. The term is defined in section 15 of the access arrangement proposal as having the meaning in schedule 1 of the terms and conditions set out in appendix 1 of the proposal. Schedule 1 sets out a pro forma bank guarantee which is not referred to in the main text of the terms and conditions. The AER notes that section 5.6.2 of the access arrangement proposal defines the term 'Credit Support'. The AER considers that reference to the pro forma bank guarantee should be made in this provision and, as a consequence, the defined term 'Required Bank Guarantee Amount' in section 15 should be redefined in the manner described below.

*Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.12:** amend clause 5.6.2 in the access arrangement proposal to include after the first paragraph:

In the case of a guarantee, it must be in the form of the *Required Bank Guarantee*.

**Amendment 12.13:** delete the definition of 'Required Bank Guarantee Amount' in section 15 in the access arrangement proposal and replace it with a definition of the term 'Required Bank Guarantee' where by the term 'Required Bank Guarantee' should be defined as the pro forma bank guarantee set out in the appropriate appendix in the access arrangement proposal.

**12.2.3.11 Consistency between Standard User Agreement and access arrangement**

Recital C of the Standard User Agreement provides that Country Energy has agreed to grant the user access to its distribution network pursuant to the access arrangement

and the terms and conditions set out in the Standard User Agreement. Clause 1.11 of the Standard User Agreement provides that the terms and conditions in the Standard User Agreement prevail to the extent of any inconsistency between those terms and conditions and the access arrangement. The AER considers that there should not be any inconsistency between those terms and conditions and the access arrangement and, in the event that there is, the access arrangement should prevail.

#### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.14:** delete clause 1.11 of the terms and conditions in appendix 1 in the access arrangement proposal and replace it with:

1.11 The *Access Arrangement* prevails to the extent of any inconsistency between the *Terms and Conditions* and the *Access Arrangement*.

#### **12.2.3.12 Changes to Standard User Agreement**

Section 5.1(g) of the access arrangement proposal states that Country Energy will provide services in accordance with the Standard User Agreement as amended by Country Energy from time to time.

In relation to the earlier access arrangement period, the IPART required Country Energy to amend its proposal to provide that any variation to the standard terms and conditions will be treated as a revision to the earlier access arrangement. The IPART noted that Country Energy may agree different terms and conditions directly with users as part of a negotiated service without seeking the IPART's approval to vary the standard terms and conditions contained in the earlier access arrangement.<sup>439</sup>

The AER considers that since the Standard User Agreement forms part of the access arrangement, Country Energy is not permitted under the NGR to unilaterally amend it or the Standard User Agreements entered into with users during the access arrangement period. The AER is of the view that any proposed amendments during the access arrangement period to the terms and conditions of the access arrangement are to be brought to the AER's attention for assessment. However, this does not prevent Country Energy negotiating different terms from those approved with users and prospective users.

The AER considers that section 5.1(g) of the access arrangement proposal and clauses 18.3, 18.4 and 18.13 of the Standard User Agreement should be amended to make it clear that changes can only be made to the terms and conditions of the Standard User Agreement if those changes have been approved by the AER.

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<sup>439</sup> IPART, *Final decision, Revised access arrangement for Country Energy Gas network*, November 2005, p. 119.

### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

#### **12.2.3.13 Miscellaneous changes**

In reviewing the access arrangement proposal and access arrangement information, the AER has identified the following typographical and other errors which need to be corrected:

**Amendment 12.15:** amend the end of the first sentence at section 5.1(g) in the access arrangement proposal to include:

'and approved by the Regulator in accordance with r. 66 and r. 67 of the NGR'

**Amendment 12.16:** amend the beginning of clause 18.3 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Subject to clause 18.4

**Amendment 12.17:** amend the beginning of clause 18.4 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Amendments to the *Agreement* can only be approved by the *Regulator*.

**Amendment 12.18:** amend the beginning of clause 18.13 of the terms and conditions in appendix 1 in the access arrangement proposal to include:

Subject to clauses 18.3 and 18.4

Section 4.5.1 of the access arrangement proposal provides that a user must enter into agreements with its customers which are in accordance with the provisions of schedule 1 of the Standard User Agreement and of the Gas Supply (Natural Gas Retail Competition) Regulation 2001. The AER notes that schedule 1 of the Standard User Agreement sets out a pro forma bank guarantee while schedule 2 sets out matters to be notified to customers by users. The AER considers that the correct reference should be to schedule 2 of the Standard User Agreement and not schedule 1. The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.19:** delete section 4.5.1 in the access arrangement proposal and replace it with the following:

The *User* must enter into agreements with its *Customers* which are in accordance with the provisions of Schedule 2 of the *Terms and Conditions* and Schedule 1 of the Gas Supply (Natural Gas Retail Competition) Regulation 2001.



Paragraph (c) of section 5.1 of the access arrangement proposal states that Country Energy will provide services in accordance with the service standards and terms and conditions set out in the *Retail Gas Market (NSW and ACT) Procedures* as amended from time to time. The AER considers that the reference should be to the retail market procedures made by the AEMO<sup>440</sup> and not to the *Retail Gas Market (NSW and ACT) Procedures*. The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.20:** delete paragraph (c) in section 5.1 in the access arrangement proposal and replace it with the following:

(c) the Retail Market Procedures

The term '*Service Agreement*' is used in section 5.7.1 of the access arrangement proposal but is not defined in the section 15 glossary. The AER considers that the term should be replaced with the words 'service agreement'. The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.21:** delete the term '*Service Agreement*' in section 5.7.1 in the access arrangement proposal and replace it with 'service agreement'.

Section 8 of the access arrangement proposal and section 9.2 of the access arrangement information deal with subject matter which was required under the Code. The AER considers that it is not necessary for this material to be included in the proposal and information. That said, the AER has no reason to delete the material but it considers that the heading for both sections should be changed to 'Contract Carriage Pipeline'. The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.22:** delete the headings in section 8 in the access arrangement proposal and section 9.2 in the access arrangement information and replace them with 'Contract Carriage Pipeline'.

There are two definitions of the term 'Contracted Capacity' in section 15 of the access arrangement proposal. The definitions are substantially the same. The AER considers that one of these definitions should be deleted to avoid any confusion in interpreting the access arrangement proposal. The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be

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<sup>440</sup> See analysis in section 2.4.1.1 of the draft decision.

provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.23:** delete the definition of ‘Contracted Capacity’ in section 15 in the access arrangement proposal following:

**Contracted Capacity** means, in respect of a *User*, the part of the *Capacity* which has been reserved by that *User* pursuant to an agreement entered into with *Country Energy Gas*.

The AER does not propose to approve Country Energy’s specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.24:** correct the following typographical and drafting errors in the terms and conditions in appendix 1 in the access arrangement proposal:

- there are two clauses 3.11. The second clause 3.11 should be numbered 3.12 and the remaining clauses should be renumbered.
- in clause 3.18: delete clause 3.15 and replace it with clause 3.17(c)
- delete the words ‘and the Asset Removal Policy’ from clause 5.17
- in clause 8.6: delete clause 8.7(a) and replace it with clause 8.5
- delete the word ‘If’ from the second line of clause 11.13 and delete the words ‘under the *Regulatory Instruments*, then *Country Energy Gas* may terminate the *Agreement* by notice to the *User*, effective from the date specified in the notice’ from the end of the clause.
- in clause 13.15(a): delete clause 14.5(b) and replace it with clause 13.12
- the content of clause 14.1 is a heading for the two clauses which follow it. Therefore, it should not be numbered as a clause and, instead, should be made into a heading.
- in clause 14.6: delete clauses 5.5 and 5.6 and replace them with clause 5.9
- delete the word ‘or’ from the end of clause 15.2(d)
- delete the words ‘Conditions on disclosure’ in clause 16.1(h) and replace them with ‘Information Exchange’
- italicise and capitalise the first letter of, the word ‘producer’ in clause 16.2.

#### 12.2.4 Load shedding

In the IPART's final decision on the earlier access arrangement, Country Energy was required to amend its load shedding procedures.<sup>441</sup> The substance of these amendments are included in the access arrangement proposal other than a requirement in the event of load shedding to advise users on request of their load shedding priority category.<sup>442</sup>

The AER considers this wording makes it clear to users how access will be affected by load shedding events in constrained capacity circumstances and should be included in the current proposal. This change is consistent with r. 100 of the NGR.<sup>443</sup>

##### *Conclusion*

The AER does not propose to approve Country Energy's specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.25:** amend end of section 5.4.1 in the access arrangement proposal to include the following:

In the event that load shedding is required, *Country Energy Gas* will advise any *User* what load shedding priority category the *User* falls into at the *User's* request.

#### 12.2.5 Overruns

An overrun occurs when on any day a user's withdrawals at a delivery point exceeds, or is forecast to exceed, its capacity entitlement for that day at that delivery point.<sup>444</sup>

The AER has reviewed the overrun requirements set out in Country Energy's access arrangement proposal and notes:

- Section 11.2.4(d) provides that the revised capacity charge applies for the duration of the agreement including the month in which the unauthorised overruns occurred. The IPART in its final decision on the earlier access arrangement required Country Energy to replace the words 'duration of agreement' with 'remaining duration of the agreement'.<sup>445</sup> Country Energy made this change to the earlier access arrangement but the change has not been included in section 11.2.4(d) of the access arrangement proposal.<sup>446</sup> The AER considers that Country Energy should make this change so the charges cannot be back dated.

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<sup>441</sup> IPART, *Final decision, Revised access arrangement for Country Energy Gas network*, November 2005, pp. 120–121, 129.

<sup>442</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 5.4.1, p. 17.

<sup>443</sup> The national gas objectives is set out in s. 23 of the NGL.

<sup>444</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 50.

<sup>445</sup> IPART, *Final decision, revised access arrangement for Country Energy Gas network*, November 2005, p. 122–123, 131.

<sup>446</sup> Country Energy, *Access arrangement*, 1 January 2006, Appendix 1, Reference Service Agreement, clause 6.4.

- Country Energy proposes to include five unauthorised overruns in a year as an additional trigger for the resetting of capacity charges.<sup>447</sup> Previously, the only trigger was three unauthorised overruns in a month.<sup>448</sup> In light of the inclusion of the new trigger, Country Energy deleted ‘three’ from the last sentence of the provision. The AER considers that this deletion does not adequately address the inclusion of the new trigger. In order to address this concern, the AER considers that Country Energy should insert the following words at the end of the last sentence in section 11.2.4(d): ‘or, in the case of the fifth unauthorised *Overrun* in that *Year*, the month in which the fifth unauthorised *Overrun* occurred’.

#### *Conclusion*

The AER does not propose to approve Country Energy’s specification of the terms and conditions on which reference services will be provided as it does not comply with r. 48(1)(d)(ii) of the NGR and requires Country Energy to:

**Amendment 12.26:** amend section 11.2.4(d) in the access arrangement proposal to:

- delete the words ‘duration of the *Agreement*’ and replace them with ‘remaining duration of the *Agreement*’
- include the following words at the end of the last sentence of the section: ‘or, in the case of the fifth unauthorised *Overrun* in that *Year*, the month in which the fifth unauthorised *Overrun* occurred’.

## 12.3 Capacity trading requirements

### 12.3.1 Regulatory requirements

Rule 48(1)(f) of the NGR provides that a full access arrangement must set out the capacity trading requirements are to be included.<sup>449</sup>

Rule 105(1) of the NGR provides that capacity trading requirements must provide for the transfer of capacity. This must be in accordance with any rules or procedures of the gas market that are applicable to the service provider, or r. 105 if there are no such applicable rules or procedures.

Rule 105(2) of the NGR covers the transfer of capacity trading requirements without the service provider’s consent. The transfer of capacity with a service provider’s consent is detailed in rule 105(3) of the NGR. Capacity trading requirements may specify conditions under which consent will or will not be given and conditions to be complied with if consent is given.<sup>450</sup> A service provider is precluded from

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<sup>447</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 11.2.4(d), p. 34.

<sup>448</sup> Country Energy, *Access arrangement*, 1 January 2006, Appendix 1, Reference Service Agreement, clause 6.4.

<sup>449</sup> NGR, r. 48(1)(f).

<sup>450</sup> NGR, r. 105(6).

withholding its consent unless it has reasonable grounds, based on technical or commercial considerations, for doing so.<sup>451</sup>

### 12.3.2 Country Energy's proposal

Country Energy's proposed trading policy provides users with the ability to alter their rights in the following circumstances:

- a user may make a 'capacity transfer'<sup>452</sup> without Country Energy's consent so long as it gives Country Energy notice of the subcontract and its likely duration, the identity of the third party and the amount of the maximum daily quantity transferred<sup>453</sup>
- a user may otherwise transfer or assign all or part of its contracted capacity with Country Energy's prior written consent.<sup>454</sup>

Country Energy proposes that it may give or withhold its consent to a proposed capacity trade (other than a 'capacity transfer') on reasonable commercial and technical (including safety) grounds and impose reasonable conditions on the consent, including where:

- there is insufficient capacity to permit for delivery of the traded amount to be delivered to the proposed new delivery point
- the transfer or assignment would cause Country Energy to receive less revenue
- the proposed transferee is unable to satisfy Country Energy that it is able to meet the preconditions to the provision of services.<sup>455</sup>

Country Energy's access arrangement proposal sets out the information needed to enable it to make this assessment<sup>456</sup> and the timelines for responding to users' capacity transfer requests.<sup>457</sup>

### 12.3.3 AER's analysis and considerations

Country Energy has proposed a number of changes to the trading policy in its earlier access arrangement. Most of these changes relate to the transition from the Code to the NGL and NGR.

While Country Energy has not indicated whether it is registered as a participant in a particular gas market, on a preliminary review, the AER considers that Country

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<sup>451</sup> NGR, r. 105(4).

<sup>452</sup> The transfer of contracted capacity is a 'capacity transfer' if the obligations under the agreement and the terms and conditions of the contract between the user and the service provider are unaltered by the transfer. Country Energy, *Access arrangement proposal*, 1 July 2009, p. 45.

<sup>453</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 9.1, p. 29.

<sup>454</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 9.2, p. 29.

<sup>455</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 9.2.1(c), p. 29.

<sup>456</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 29–30.

<sup>457</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 30.

Energy is a registered participant of a gas market and is subject to the *Gas Retail Market Business Rules to Support Retail Competition in Gas* (Business Rules).<sup>458</sup>

The AER has reviewed the capacity trading requirements set out in Country Energy's access arrangement proposal and notes:

- The requirements have not been made subject to the Business Rules. The AER considers that in order to comply with r. 105 of the NGR, the requirements must be made subject to the Business Rules. The AER notes that to the extent to which the Business Rules do not address capacity trading requirements, Country Energy will remain subject to the NGL and NGR.
- Section 9.3 provides that the user is liable to Country Energy for all charges and other amounts in respect of the maximum daily quantity (MDQ) transferred (whether with or without Country Energy's consent). Section 9.3 also provides that the user will not be liable for such charges and amounts if Country Energy expressly agrees in writing that some other person will be liable and that other person has agreed to be liable to Country Energy. The AER notes that:
  - Rule 105(2)(a) of the NGR provides that in respect of a capacity transfer by way of subcontract, the user's rights against, and obligations to, the service provider are unaffected by the transfer (subject to giving the notice required by r. 105(2)(b)). Such a transfer does not require the services provider's consent.
  - Rule 105(3) of the NGR provides that a user may with the service provider's consent transfer any of the user's contracted capacity to a third party. In which case, the user's rights against, and obligations to, the service provider are terminated or modified in accordance with the capacity trading requirements and a contract arises between the service provider and third party on terms determined in accordance with the capacity trading requirements.<sup>459</sup>

The AER considers that section 9.3 should be amended so that liability for the charges and other amounts following the transfer with consent are consistent with the capacity trading requirements in the NGR as amended on 1 July 2009.

- There is a typographical error in the section 15 definition of 'Capacity Transfer'. The AER considers that the words 'the agreement' should be replaced with 'the Agreement' so it is clear the definition is referring to the defined term 'Agreement'.

#### *Conclusion*

The AER does not propose to approve Country Energy's capacity trading requirements as they do not comply with r. 105 of the NGR and requires Country Energy to:

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<sup>458</sup> Gas Market Company Ltd, *NSW and ACT Gas Retail Market, Gas Retail Market Business Rules to Support Retail Competition in Gas*, version 47, February 2009.

<sup>459</sup> NGR, r. 105(3)(a) and (b).

**Amendment 12.27:** amend section 9 in the access arrangement proposal to include at the end of the first sentence:

To the extent that the NGR does not apply (because *Country Energy Gas* is registered as a participant in a gas market and the rules or procedures of the gas market deal with capacity trading), the capacity trading requirements in this *Access Arrangement* are subject to the Gas Retail Market Business Rules to Support Retail Competition in Gas for the NSW and ACT gas retail market (or, if these rules are no longer applicable, any other rules or procedures which govern the gas market in which *Country Energy Gas* is a registered participant) in force from time to time

**Amendment 12.28:** amend the end of section 9.3 in the access arrangement proposal to include:

in accordance with the capacity trading requirements

**Amendment 12.29:** amend the definition of *Capacity Transfer* in section 15 in the access arrangement proposal to italicise and capitalise the first letter of, the word 'agreement'.

## 12.4 Queuing

### 12.4.1 Regulatory requirements

Rule 48(1)(e) of the NGR provides that a full access arrangement must set out the queuing requirements if the AER has given prior notification of the need to include queuing requirements under r. 103 of the NGR.

Rule 103(3) of the NGR provides that queuing requirements must establish a process or mechanism (or both) for establishing an order of priority between prospective users of spare or developable capacity (or both) on which all prospective users (whether associates of, or unrelated to, the service provider) are treated on a fair and equal basis.

Rule 103(5) of the NGR provides that queuing requirements must be sufficiently detailed to enable prospective users:

- (a) to understand the basis on which an order of priority between them has been, or will be, determined; and
- (b) if an order of priority has been determined – to determine the prospective user's position in the queue.

### 12.4.2 Country Energy's proposal

Country Energy's queuing requirements state that the priority of access requests will be determined according to the order in which they are received and the ability of the available capacity to fully satisfy the applicant's requirement.<sup>460</sup>

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<sup>460</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 6.1.3, p. 25.

Where a current user seeks access to the same tranche of capacity as a prospective user, requests may, nonetheless, be dealt with out of order of receipt.<sup>461</sup> Requests for reference services will also receive priority over requests for negotiated services.<sup>462</sup>

### **12.4.3 AER's analysis and considerations**

Country Energy is not required to include queuing requirements as it operates a distribution pipeline and the AER has not required Country Energy to include queuing requirements.<sup>463</sup> However, Country Energy has included queuing requirements in its access arrangement proposal.<sup>464</sup>

Country Energy states that queuing is predominately used for commercial, industrial and contract customers and outlines that several areas in the network are capacity constrained.<sup>465</sup> Country Energy submits that queuing will ensure that all parties requiring natural gas will be dealt with fairly and appropriately.<sup>466</sup>

The AER has reviewed the queuing requirements set out in Country Energy's access arrangement proposal and notes that section 6.1.4 outlines the procedure for determining a user's priority in the queue. The AER notes that Country Energy will prioritise requests for reference services over requests for negotiated services. The AER accepts that a supply of a reference service over a negotiated service is more likely to lead to the optimal use of the pipeline.

#### *Conclusion*

The AER proposes to approve Country Energy's queuing requirements as they comply with r. 48(1)(e) and r. 103 of the NGR.

## **12.5 Extensions and expansions requirements**

### **12.5.1 Regulatory requirements**

Rule 48(1)(g) of the NGR provides that a full access arrangement must set out the extension and expansion requirements.

Rule 104(1) of the NGR provides that extension and expansion requirements may state whether the applicable access arrangement will apply to incremental services provided as a result of a particular extension or expansion or may allow for later resolution of this on a basis stated in the requirements. Insofar as the requirements provide that an access arrangement applies to incremental services, r. 104(2) of the NGR provides that the requirements must deal with the effect of the extension or expansion on tariffs.

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<sup>461</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 6.1.1(d), p. 24.

<sup>462</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 6.1.4, p. 25.

<sup>463</sup> NGR, r. 103(1)(b).

<sup>464</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 24–25.

<sup>465</sup> Country Energy, *Email to the AER, attachment responding to proposal follow-up questions*, 7 August 2009, p. 1.

<sup>466</sup> Country Energy, *Email to the AER, attachment responding to proposal follow-up questions*, 7 August 2009, p. 1.



### 12.5.2 Country Energy's proposal

Country Energy proposes that all extensions to its covered pipeline<sup>467</sup> will by default be taken to form part of its covered pipeline unless the AER makes a determination otherwise.<sup>468</sup> Any expansions to Country Energy's distribution network<sup>469</sup> will be treated as part of its network and be covered by the access arrangement. No provision is made for the exclusion of expansions from the network and the access arrangement.<sup>470</sup>

Country Energy provides that where an extension or an expansion is treated as part of the covered pipeline the reference tariff will apply unchanged.<sup>471</sup> Country Energy submits that it will notify the AER of any proposed surcharges for incremental services and when recovering non-conforming capital expenditure or a specified portion of non-conforming capital expenditure.<sup>472</sup> Country Energy also provides that where it enters into extension or expansion funding arrangements with actual or potential users or third parties, the level of funding and subsequent tariff arrangements will be by agreement between the parties.<sup>473</sup>

Country Energy submits that where the delivery of services to new developments requires extensions or expansions, Country Energy's costs may be partially or wholly reimbursed by the developer or the developer may arrange and pay for the necessary construction. It may also require a developer to contribute to extensions or expansions outside of the geographic boundary of the new development where the new capital expenditure criteria would otherwise not be met.

Country Energy submits that despite developers' contributions, expansions or extensions will be owned by Country Energy. The amount of the capital expenditure entering the capital base will be the total costs of the project less the contribution from the developer.<sup>474</sup> Where the developer is required to pay for the expansion or extension, Country Energy will not include the capital expenditure in the capital base for the purpose of calculating the reference tariffs.<sup>475</sup>

### 12.5.3 AER's analysis and considerations

Country Energy has proposed a number of changes to its policy for extensions to, and expansions of the capacity of, the pipeline. Most of these changes relate to the transition from the Code to the NGL and NGR.

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<sup>467</sup> This takes the meaning set out in the NGL.

<sup>468</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 26.

<sup>469</sup> That is Country Energy's distribution system serving the Wagga Wagga and surrounding areas in place at 1 January 2010, plus any additions covered though its extension and expansion policy as outlined in section 7 of its access arrangement proposal.

<sup>470</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 26.

<sup>471</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 26.

<sup>472</sup> Non-conforming capital expenditure which is recovered by means of a surcharge will not be rolled into the capital base: Country Energy, *Access arrangement proposal*, 1 July 2009, section 7.2(c), p. 26.

<sup>473</sup> Country Energy, *Access arrangement proposal* 1 July 2009, section 7.2(d), p. 26.

<sup>474</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 7.3.2, p. 27.

<sup>475</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, section 7.3.3, p. 27.

The AER has reviewed the extensions and expansions requirements set out in Country Energy's access arrangement proposal and notes:

- Section 7.1.1(a) provides that all extensions are covered by default under the access arrangement but section 7.1.1(b) provides that Country Energy can elect whether or not to apply to the AER for a declaration that an extension will not be treated as part of the covered pipeline. The AER considers that whether a particular extension should receive coverage by default under the access arrangement will depend on whether it is an extension to a high pressure pipeline or if it falls into the category of an extension to a low or medium pressure pipeline.
- *High pressure pipeline extensions*—If Country Energy wants to make a high pressure pipeline extension then it should apply to the AER for a decision regarding whether or not the proposed extension will be taken to form part of the covered pipeline and, therefore, covered by the access arrangement. This will enable the AER to consider on each occasion whether it is appropriate in the circumstances at the time for the proposed extension to be covered by the access arrangement and whether it is in accordance with the national gas objective.<sup>476</sup> The AER notes that high pressure pipeline extensions have characteristics similar to transmission pipelines and, from a pipeline coverage perspective, should not receive default coverage under the access arrangement. The pipeline can be extended for a variety of reasons such as servicing a large industrial user requiring the network to be extended to its premises or supporting the distribution network generally. Therefore, the reasons for the extension and the degree of its integration into the existing network will assist in determining whether the extension should be covered. In the circumstances, the AER considers it is not appropriate for high pressure pipeline extensions to receive coverage under the access arrangement by default. The AER will be best placed to consider such matters at the time it is notified of a proposed high pressure pipeline extension. The AER should be notified of each proposed high pressure pipeline extension so it can decide at that time whether it should be covered by the access arrangement. Section 7.1.1 of the access arrangement proposal should be amended accordingly.
- *Low and medium pressure pipeline extensions*—The AER considers that low and medium pressure pipeline extensions should be covered by default under the access arrangement subject to the AER being notified that the extensions have occurred. Low and medium pressure pipeline extensions to distribution networks are often embedded in and occur throughout the network. Coverage by default will allow such extensions to be built and covered by the access arrangement. This is likely to contribute to the promotion of the efficient investment in, and efficient operation and use of, natural gas services for the long-term interests of consumers of natural gas with respect to safety, reliability and security of supply of natural gas.<sup>477</sup> Country Energy must advise the AER within 20 business days of completion of its financial year of all low and medium pressure pipeline extensions including all extensions commenced, in progress and completed during that financial year. The AER considers that a new provision for low and medium

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<sup>476</sup> NGL, s. 23.

<sup>477</sup> NGL, s. 23

pressure pipeline extensions should be inserted into the access arrangement proposal.

- Section 7.1.2 provides that all expansions are covered by default under the access arrangement. The AER accepts that expansions of pipeline capacity should be covered by default under the access arrangement subject to the AER being notified that each expansion has occurred. Coverage by default will address any concerns regarding the potential for a service provider to exercise a degree of market power if the expansion did not form part of the covered pipeline. This is likely to contribute to the promotion of the efficient investment in, and efficient operation and use of, natural gas services for the long-term interests of consumers of natural gas with respect to safety, reliability and security of supply of natural gas.<sup>478</sup> The AER considers that section 7.1.2 should be amended to require Country Energy to advise the AER within 20 business days of completion of its financial year of all expansions of capacity including all expansions commenced, in progress and completed during that financial year.
- Section 7.2(b) provides that Country Energy may levy a surcharge in respect of the reference services in respect of extensions and expansions treated as part of the covered pipeline if the surcharge is permitted under r. 83 of the NGR. Section 7.2(c) provides that Country Energy will notify the AER of any proposed surcharge for incremental services (that is, pipeline services provided by means of the extension or expansion<sup>479</sup>) and when recovering all or part of non-conforming capital expenditure. Section 7.2(c) also provides that non-conforming capital expenditure which is recovered by means of a surcharge will not be rolled into the capital base. The AER considers that the text of section 7.2(c) should be amended so it more closely follows the wording in r. 83(2) of the NGR. Section 7.2(c) should be amended so it is clear that the proposed surcharge is to be levied on users of incremental services and are designed to recover non-conforming capital expenditure or a specified portion of non-conforming capital expenditure.
- Section 7.2(d) provides that Country Energy and a prospective user, user or a third party can agree that the prospective user, user or third party contributes to the funding of an extension or expansion. The section also provides that the level of funding and subsequent tariff arrangements will be as agreed between the parties. The AER considers that the section is referring to r. 82 of the NGR which deals with capital contributions by users to new capital expenditure. The AER considers that the section is in accordance with r.104 provided the section is amended to make it subject to the NGR and the last sentence of the section which deals with funding and tariff arrangements is deleted.
- Section 7.3 deals with extensions and expansions required to provide services to new developments. The AER considers that it should be made clear that the provisions dealing with payment and construction by developers (that is, sections 7.3.2 and 7.3.3) are subject to the NGR.

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<sup>478</sup> NGL, s. 23

<sup>479</sup> See the definition of 'incremental services' in r. 3 of the NGR.

The AER also notes that an extension or expansion, depending on the circumstances at the time, could be an event sufficient to move forward the review submission date (see section 12.8.3 of the draft decision).

#### *Conclusion*

The AER does not propose to approve Country Energy's extensions and expansions requirements as they do not comply with r. 104 of the NGR and requires Country Energy to:

**Amendment 12.30:** delete the text in section 7.1.1 in the access arrangement proposal and replace it with the following:

#### **7.1.1.1 High pressure pipeline extensions**

- (a) If *Country Energy Gas* proposes a high pressure pipeline extension of the *Covered Pipeline* it must apply to the *Regulator* in writing to decide whether the proposed extension will be taken to form part of the *Covered Pipeline* and will be covered by this *Access Arrangement*. The application must describe the extension and set out why the extension is necessary.
- (b) The application must be made before the proposed high pressure pipeline extension comes into service.
- (c) After considering the application, and undertaking such consultation as the *Regulator* considers appropriate, the *Regulator* will inform *Country Energy Gas* of its decision.
- (d) The decision may be made on such reasonable conditions determined by the *Regulator* and will have the operation specified in the decision.

#### **7.1.1.2 Low and medium pressure pipeline extensions**

Any low or medium pressure pipeline extension of the *Capacity* of the *Network* will be treated as part of the *Network* and accordingly will be the subject of coverage under this *Access Arrangement*. No later than 20 *Business Days* following the expiration of each *Year*, *Country Energy* must notify the *Regulator* of all low and medium pressure pipeline extensions of the *Capacity of the Network* (including all extensions commenced, in progress and completed) during that *Year*. The notice must describe each extension and set out why the extension was necessary.

**Amendment 12.31:** amend the end of section 7.1.2 in the access arrangement proposal to include:

No later than 20 *Business Days* following the expiration of each *Year*, *Country Energy* must notify the *Regulator* of all expansions of the *Capacity* of the *Network* (including all expansions commenced, in progress and completed) during that *Year*. The notice must describe each expansion and set out why the expansion was necessary.

**Amendment 12.32:** delete section 7.2(c) in the access arrangement proposal and replace it with the following:

Country Energy will notify the *Regulator* of any proposed *Surcharge* to be levied on users of incremental services and designed to recover non-conforming capital expenditure or a specified portion of non-conforming capital expenditure (non-conforming capital expenditure which is recovered by means of a *Surcharge* will

not be rolled into the capital base).

**Amendment 12.33:** delete section 7.2(d) in the access arrangement proposal and replace it with the following:

Despite sections 7.2 (a) and (b), but subject to the NGR, *Country Energy Gas* and a *Prospective User* or *Users* or a third party may agree that the *Prospective User* or *Users* or a third party will contribute to the funding of an extension or expansion.

**Amendment 12.34:** delete the word ‘Where’ at the beginning of sections 7.3.2 and 7.3.3 in the access arrangement proposal and replace it with the following:

Subject to the NGR, where

## 12.6 Terms and conditions for changing receipt and delivery points

### 12.6.1 Regulatory requirements

Rule 48(1)(h) of the NGR provides that a full access arrangement must set out the terms and conditions for changing receipt and delivery points.

Rule 106 of the NGR provides that an access arrangement must provide for the change of a receipt or delivery point with the service provider’s consent. The service provider is precluded from withholding its consent unless it has reasonable grounds, based on technical or commercial considerations, for doing so.<sup>480</sup> The access arrangement may specify conditions under which consent will or will not be given and conditions to be complied with if consent is given.<sup>481</sup>

### 12.6.2 Country Energy’s proposal

Country Energy proposes that users may change receipt and delivery points with prior written consent.<sup>482</sup> Country Energy may refuse its consent or make its consent subject to conditions where this is commercially or technically reasonable.<sup>483</sup>

In order to assess whether the transfer or assignment is reasonable on commercial or technical (including safety) grounds, the user needs to inform Country Energy of the locations of the delivery and receipt points which are to change, the amount of the maximum daily quantity which is the subject of the change and the proposed date upon which the change in delivery and receipt points is to occur.<sup>484</sup>

Country Energy provides that it will charge users any costs incurred as a result of a change of delivery point (but is silent on this in respect of receipt points).<sup>485</sup>

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<sup>480</sup> NGR, r. 106(1).

<sup>481</sup> NGR, r. 106(2).

<sup>482</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 30–31.

<sup>483</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 30–31.

<sup>484</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, pp. 30–31.

<sup>485</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 30.

### 12.6.3 AER's analysis and considerations

Country Energy has proposed a number of changes to its terms and conditions for changes in receipt and delivery points.

The AER has reviewed the terms and conditions for changing receipt and delivery points set out in Country Energy's access arrangement proposal and notes:

- Section 9.4 provides for changes in delivery point with Country Energy's consent. Country Energy may refuse its consent or grant its consent subject to conditions where it is commercially or technically reasonable to do so. Examples are provided in the access arrangement proposal.<sup>486</sup> While this is in accordance with r. 106 of the NGR, the AER considers that the relevant costs of doing so should be the efficient incurred costs<sup>487</sup> and, therefore, section 9.4.2 should be amended accordingly.
- Section 9.5 provides for changes in receipt point with Country Energy's consent. Consent can be withheld only on reasonable commercial or technical grounds and can be given subject to reasonable commercial and technical conditions.<sup>488</sup> This is in accordance with r. 106 of the NGR. The AER notes that Country Energy has not provided any examples of reasonable commercial and technical grounds and conditions for the purposes of its proposed section 9.5.1, as permitted by r. 106(2) of the NGR. The AER considers that the section should be amended to provide that Country Energy can refuse its consent to a change if it would not, after the change, receive at least the same amount of revenue it would have received before the change. This is likely to contribute to the promotion of the efficient operation and use of natural gas services for the long-term interests of consumers of natural gas with respect to reliability and security of supply of natural gas.<sup>489</sup>

#### *Conclusion*

The AER does not propose to approve Country Energy's terms and conditions for changing receipt and delivery points as they do not comply with r. 106 of the NGR and requires Country Energy to:

**Amendment 12.35:** delete the last sentence of section 9.4.2 in the access arrangement proposal and replace it with the following:

The efficient costs incurred as a result of a change of *Delivery Point* will be charged to the *User*.

**Amendment 12.36:** delete the last sentence of section 9.5.1 in the access arrangement proposal and replace it with the following:

*Country Energy Gas* may refuse its consent or make the granting of consent subject to conditions where this is commercially and technically reasonable including where *Country Energy Gas* would not, after the change, receive at least the same

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<sup>486</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 30.

<sup>487</sup> NGL, s. 24(2).

<sup>488</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 31.

<sup>489</sup> NGL, s. 23.

amount of revenue it would have received before the change.

## 12.7 Review dates

### 12.7.1 Regulatory requirements

Unless the full access arrangement is voluntary,<sup>490</sup> it must contain a review submission date and the revision commencement date. However, it may not include an expiry date.<sup>491</sup>

As a general rule, a review submission date will fall four years and a revision commencement date will fall five years after the access arrangement took effect or the last revision commencement date.<sup>492</sup> The AER is obligated to accept a service provider's proposed review submission and revision commencement dates if these are made in accordance with the general rule set out in r. 50 of the NGR.<sup>493</sup>

### 12.7.2 Country Energy's proposal

Country Energy proposes a review submission date of 1 July 2014 and a revision commencement date of 1 July 2015.<sup>494</sup>

### 12.7.3 AER's analysis and considerations

The AER considers that the review submission and revision commencement dates proposed by Country Energy comply with the NGR.

#### *Conclusion*

The AER proposes to accept Country Energy's review submission date and revision commencement date in the access arrangement proposal as they comply with r. 50(2) of the NGR.

## 12.8 Acceleration of review submission date triggers

### 12.8.1 Regulatory requirements

The review submission date may advance to an earlier date than that fixed in the access arrangement if the access arrangement provides for acceleration on the occurrence of a trigger event and this event occurs.<sup>495</sup> Rule 51(2) of the NGR provides examples of possible trigger events. The AER may insist on the inclusion of trigger events and may specify the nature of the trigger events.<sup>496</sup>

### 12.8.2 Country Energy's proposal

Country Energy proposes the following trigger events, when:

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<sup>490</sup> NGR, r. 49(1).

<sup>491</sup> NGR, r. 48(1)(i) and r. 49(1)(b).

<sup>492</sup> NGR, r. 50(1).

<sup>493</sup> NGR, r. 50(2). The AER has no discretion under r. 50(2) of the NGR. See r. 50(3) of the NGR.

<sup>494</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 32.

<sup>495</sup> NGR, r. 51(1).

<sup>496</sup> NGR, r. 51(3).

- a new service has been sought by a significant part of the market, and
- a significant extension, expansion or interconnection occurs.<sup>497</sup>

### 12.8.3 AER's analysis and considerations

#### 12.8.3.1 Proposed trigger events

The AER notes that Country Energy has not provided any justification for its proposed trigger events. That said, the AER considers it would be prudent to include events in an access arrangement which comprise significant circumstances, or conjunction of circumstances, that would trigger an obligation on Country Energy to submit revisions before 1 July 2014. This will enable the AER to reconsider the terms and conditions of access for a pipeline when the pipeline services provided by the pipeline to a significant part of the market changes. This can be as a result of changes in the nature of pipeline services delivered or a change in the market. To some extent, Country Energy's proposed trigger events account for these factors.

The AER has considered the proposed trigger events and is of the view that they are concerned with unexpected and significant increases in demand for new services and significant changes in costs. The reason for this is that these issues potentially impact the relationship between total revenue and demand which may need to be factored into reference tariffs. However, the AER notes that a trigger event needs to be designed to balance the interest of users, prospective users and those of the service provider. In addition, there are means other than trigger events to account for significant increases in costs, such as through a cost pass through mechanism, which also need to be taken into consideration. Therefore the AER proposes amendments to better reflect additional factors which may influence the relativity between total revenue and demand.

These include to account for the change in demand for existing and new services to account for services that may be sought by a significant part of the market over the access arrangement period. The AER considers that the proposed cost pass through mechanism captures most of the unexpected cost increases over the access arrangement period. However, significant other expenditure proposed by Country Energy such as for an extension, expansion or interconnection is an appropriate trigger event with some minor modifications.

As a result, the AER considers the events should be described as follows:

- a new or existing service is sought by a significant part of the market such that a non-temporary increase in actual throughput is in excess of 15 per cent of the demand forecast for the financial year as provided in the access arrangement information, and
- an extension, expansion or interconnection occurs such that capital expenditure incurred for that extension, expansion or interconnection for a financial year is in excess of five per cent of the forecast capital base for that year.

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<sup>497</sup> Country Energy, *Access arrangement proposal*, 1 July 2009, p. 32.



In considering the percentage threshold for non-temporary increases in actual throughput over forecast demand, the AER compared variances between Country Energy's actual and forecast demand for each financial year of the earlier access arrangement period. The AER has also taken into account the nature of Country Energy's network. In the circumstances the AER considers 15 per cent is appropriate for this threshold. The AER notes that Country Energy's proposed trigger event of a new service sought by a significant part of the market did not apply to existing services. The AER considers it is appropriate for the trigger event to also cover existing services as a consequence of its decision to require Country Energy to delete section 13.6 from its access arrangement proposal. Section 13.6 dealt with the addition and deletion of reference tariffs.<sup>498</sup>

The AER has considered for each financial year of the access arrangement period Country Energy's forecast capital expenditure as a percentage of its forecast capital base for the purposes of determining the percentage threshold for the extension, expansion or interconnection trigger event. The AER has also taken into account the nature of Country Energy's network. In the circumstances the AER considers 5 per cent is an appropriate threshold for this trigger event.

The AER considers that events which are at or below the percentage threshold for each trigger are not significant enough to move the review submission date forward because to do so would not promote the efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas. Therefore, a lower threshold for each trigger event would not be consistent with the national gas objective.

The AER considers that an event which is a cost pass through for the purposes of section 13.4 of the access arrangement proposal cannot be a trigger event for the purposes of section 10.3(b) of the access arrangement proposal. The AER notes that if during the access arrangement period, unforeseen events occur which are not covered by the trigger event mechanism but have a significant impact on the access arrangement then Country Energy can submit an access arrangement variation proposal under r. 65 of the NGR.

After the occurrence of a trigger event, the fixed review submission date should advance to require Country Energy to submit an access arrangement revision proposal to the AER within six calendar months of the event, but in any case before the fixed review submission date. The AER considers that six calendar months is a sufficient period of time for Country Energy to draft an access arrangement revision proposal factoring in the change.

The AER considers that it is suitable to require Country Energy to notify the AER of the trigger event no later than five business days following the occurrence of the event. The notice must provide a description of the event, specify when the event occurred and state the level of the non-temporary increase in actual throughput or the capital expenditure incurred for that extension, expansion or interconnection (as applicable).

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<sup>498</sup> See chapter 10 of the draft decision.

*Conclusion*

The AER does not propose to approve Country Energy's trigger events. In accordance with r. 51(3) of the NGR, the AER requires Country Energy to:

**Amendment 12.37:** delete section 10.3 in the access arrangement proposal and replace it with the following:

**10.3 Trigger events**

10.3.1 Increases in demand or capital expenditure

If one of the following trigger events occurs:

- (a) a new or existing service is sought by a significant part of the market such that a non-temporary increase in actual throughput is in excess of 15 per cent of the demand forecast for the *Year* as provided in the *Access Arrangement Information*; or
- (b) an extension, expansion or interconnection occurs such that capital expenditure incurred for that extension, expansion or interconnection for a *Year* is in excess of 5 per cent of the forecast capital base for that *Year*,

the *Revisions Submission Date* stated in section 10.2 of the *Access Arrangement* will advance and require *Country Energy Gas* to submit an access arrangement revision proposal to the *Regulator* within six calendar months of the occurrence of the trigger event, but in any case before the *Revisions Submission Date*. *Country Energy Gas* must notify the *Regulator* of the occurrence of a trigger event as soon as it is practically possible and, in any event, no later than five *Business Days* following the occurrence of the trigger event. The notice must contain a description of the event, specify when it occurred and state the level: (i) for the purpose of (a) above, of the non-temporary increase in actual throughput; and (ii) for the purpose of (b) above, of the capital expenditure incurred for that extension, expansion or interconnection. An event which is a *Pass Through Event* cannot be a trigger event for the purposes of section 10.3(b).

**12.8.3.2 Additional trigger event**

The AER notes that the retail energy and gas connections frameworks are expected to be introduced in the access arrangement period. These frameworks may impact the terms and conditions of access for users and potential users, such as the credit support provisions proposed under the National Customer Energy Framework. In these circumstances the AER considers that a trigger event should be included to enable the AER to review the approved terms and conditions of access for consistency with the arrangements proposed under these new frameworks.

Therefore the AER requires Country Energy to amend its access arrangement proposal as outlined in amendment 12.39.

*Conclusion*

The AER does not propose to approve Country Energy's trigger events. In accordance with r. 51(3) of the NGR, the AER requires Country Energy to:

**Amendment 12.38:** amend section 10.3 in the access arrangement proposal to include the following new section 10.3.2:

10.3.2 Amendments to the NGL and NGR

10.3.2.1 The *Revisions Submission Date* stated in section 10.2 of this *Access Arrangement* will advance on the occurrence of a *NGL or NGR Trigger Event* described in clause 10.3.2.2.

10.3.2.2 For the purposes of clause 10.3.2.1, a “*NGL or NGR Trigger Event*” occurs if:

(a) there is an amendment to the *NGL* or *NGR*; and

(b) the *Regulator* provides *Country Energy Gas* with a notice stating that the amendment described in clause 10.3.2.2(a) affects this *Access Arrangement*.

10.3.2.3 The new *Revisions Submission Date* will be the date which is the earlier of six calendar months from the date of the notice provided by the *Regulator* under clause 10.3.2.2 and the original *Revisions Submission Date* stated in section 10.2 of this *Access Arrangement*.

## **A. Confidential–Averaging period**

## **B. Confidential–WACC parameters**

## **C. Confidential–Self insurance**

## D. Reference Tariffs

### D.1 Reference Tariff Changes

*Reference Tariffs* (including *Monthly Metering Charges*) will change over time in accordance with the procedures and formulae set out in section 13 of this *Access Arrangement* and section 8 of the *Access Arrangement Information*.

All charges are exclusive of GST.

### D.2 Volume Transportation Services – Initial Monthly Fixed Charges and Volumetric Charges

The *Reference Tariff* for the *Volume Transportation Service* consists of a *Monthly Fixed Charge* and a *Volumetric Charge*.

The *Monthly Fixed Charge* and *Volumetric Charge* for the period 1 July 2010 to 30 June 2011 are detailed in the table below.

	Maximum Meter Flow Rate (m <sup>3</sup> /hr)	(\$nominal), excluding GST 1 July 2010–30 June 2011
<i>Volume</i>		
Small	10	
<i>Monthly Charge \$</i>		187.27
<i>\$/GJ</i>		6.98
Medium	30	
<i>Monthly Charge \$</i>		287.86
<i>\$/GJ</i>		1.45
Large	150	
<i>Monthly Charge \$</i>		918.45
<i>\$/GJ</i>		1.55

### D.3 Contract Transportation Services – Initial Monthly Capacity Charges

The *Reference Tariff* for the *Contract Transportation Service* consists of a *Monthly Capacity Charge*.

The *Monthly Capacity Charges* for the period 1 July 2010 to 30 June 2011 are detailed in the table below.

(\$nominal), excluding GST 1 July 2010–30 June 2011	
<i>Contract</i>	
<i>(\$/GJ of MDQ/month)</i>	
Bomen	89.04
Central	134.18

## D.4 Contract Transportation Services – Monthly Metering Charges

The *Reference Tariff* for the *Contract Transportation Service* also consists of a *Monthly Metering Charge*.

*Monthly Metering Charges* for *Contract Customers* with the meter types in the table below at a *Delivery Point*, for the period 1 July 2010 to 30 June 2011 are:

Meter Type	Initial Monthly Metering Charge (\$nominal) excluding GST July 2010– 30 June 2011
6GT	487.09
4GT	473.51
AL5000	510.29
AL2300	482.23
AL1000	425.89
7M175	428.83
5M175	421.33
3M175	445.44

## D.5 Additional Services

The *Reference Tariffs* for *Additional Services* for the period 1 July 2010 to 30 June 2011 are detailed in the table below.



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<b>Additional Service</b>	<b>Initial Charges 1 July 2010– 30 June 2011 (\$ nominal) excluding GST</b>
Meter Testing Service	210.76
Special Meter Reading Service	36.48
Reconnection Service	42.56
Disconnection Service	36.48
Business Disconnection/Reconnection Service	86.13
After Hours Reconnection Service	101.33
Deactivation Service	395.41

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## Glossary

AAG	Access arrangement guideline
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
Access Economics	Access Economics Pty Ltd
ACIL	ACIL Tasman Pty Ltd.
ACG	The Allen Consulting Group
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
ASX	Australian Stock Exchange
ATO	Australian Taxation Office
bppa	basis points per annum
CAPM	Capital Asset Pricing Model
CCGT	combined cycle gas turbine
CEG	Competition Economists Group
CGS	Commonwealth government securities
CIPD Report	CIPD Survey Report (2008)
Country Energy Group	The Country Energy Group includes the Country Energy electricity and gas businesses. Country Energy Gas Pty Limited (Country Energy) is a part of the Country Energy Group, which owns and operates the Wagga Wagga gas distribution network.
CPRS	Carbon Pollution Reduction Scheme
DGM	dividend growth model
DRP	debt risk premium

EBA	enterprise bargaining agreement
Econtech	KPMG Econtech Pty Ltd
EDD	effective degree day
EGW	electricity, gas and water
ETSA	ETSA Utilities
GasNet	GasNet Australia Group
GFC	Global Financial Crisis
GJ	gigajoule (1 000 000 000 joules)
HDD	Heating degree day efficiency data
IMF	International Monetary Fund
IRS	Infrastructure and Regulation Service Pty Ltd
ISR	Industrial special risk
JIA	Joint Industry Association
KPMG fraud survey	2004 KPMG fraud survey
MDQ	maximum daily quantity
MRP	market risk premium
NBER	National Bureau of Economic Research
NECF	National Energy Customer Framework
NEMMCO	National Electricity Market Management Company
NERA	NERA Economic Consulting
NIEIR	National Institute of Economic and Industry Research
NSW	New South Wales
NTER	National Tax Equivalent regime
NYMEX	New York Mercantile Exchange
OECD	Organisation for Economic Co-operation and Development

ORG	Victorian Office of Regulator General
PJ	petajoule (equal to 1000 terajoules)
PTRM	post taxation revenue model
QCA	Queensland Competition Authority
RBA	Reserve Bank of Australia
SAHA	SAHA International Limited
SAIDI	system average interruption duration index
SCADA	supervisory control and data acquisition
SKM	Sinclair Knight Merz Pty Ltd
TJ	terajoules (equal to 1000 gigajoules)
UAG	unaccounted for gas
UBS	Union Bank of Switzerland
WACC	weighted average cost of capital
WAPC	weighted average price cap
WDV	written down value
Wilson Cook	Wilson Cook & Co Limited