

Draft Decision

Jemena (NSW) Gas Networks

1 July 2010 to 30 June 2015

24 February 2010

Mr Steve Edwell, AER Chairman

Overview of operating environment

- First access arrangement revision for JGN under the NGL
- Current access arrangement - 30 June 2010

IPART approved access arrangement

	IPART Approved	Estimated
Operating expenditure	\$683.8m	\$633.7m
Capital expenditure	\$563.4m	\$556.6m
Nominal vanilla WACC	8.14-9.03%	8.59%*
Total revenue	\$1905m	

* This is an estimate based on a tax rate of 30 per cent and gamma of 0.5.

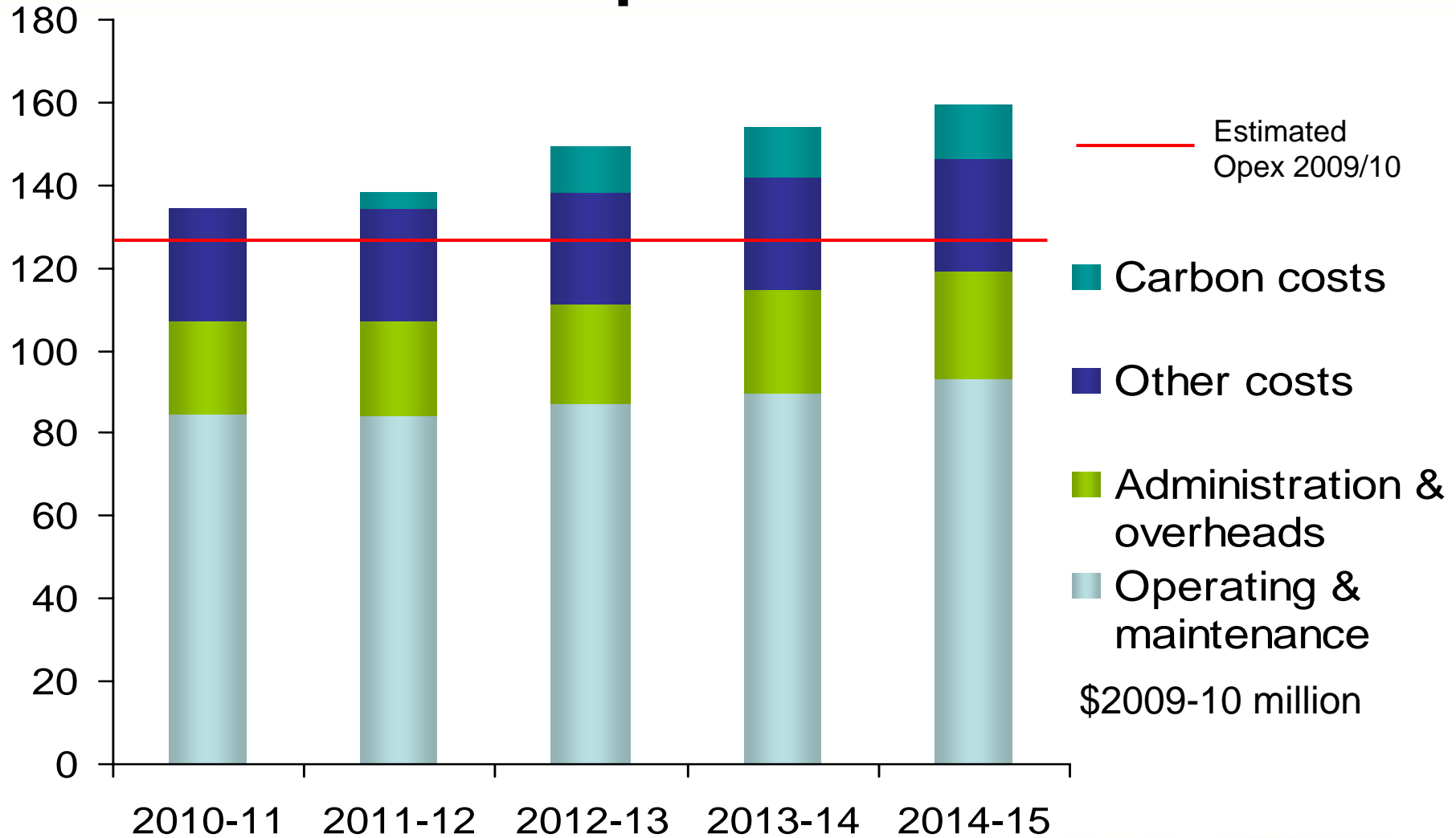
New developments

- Change in operating environment
 - Ownership changes
 - Operational changes
- External, regulatory, and policy changes
 - Global financial crisis
 - STTM
 - NCC approval of trunk pipeline reclassification
 - Climate change policy

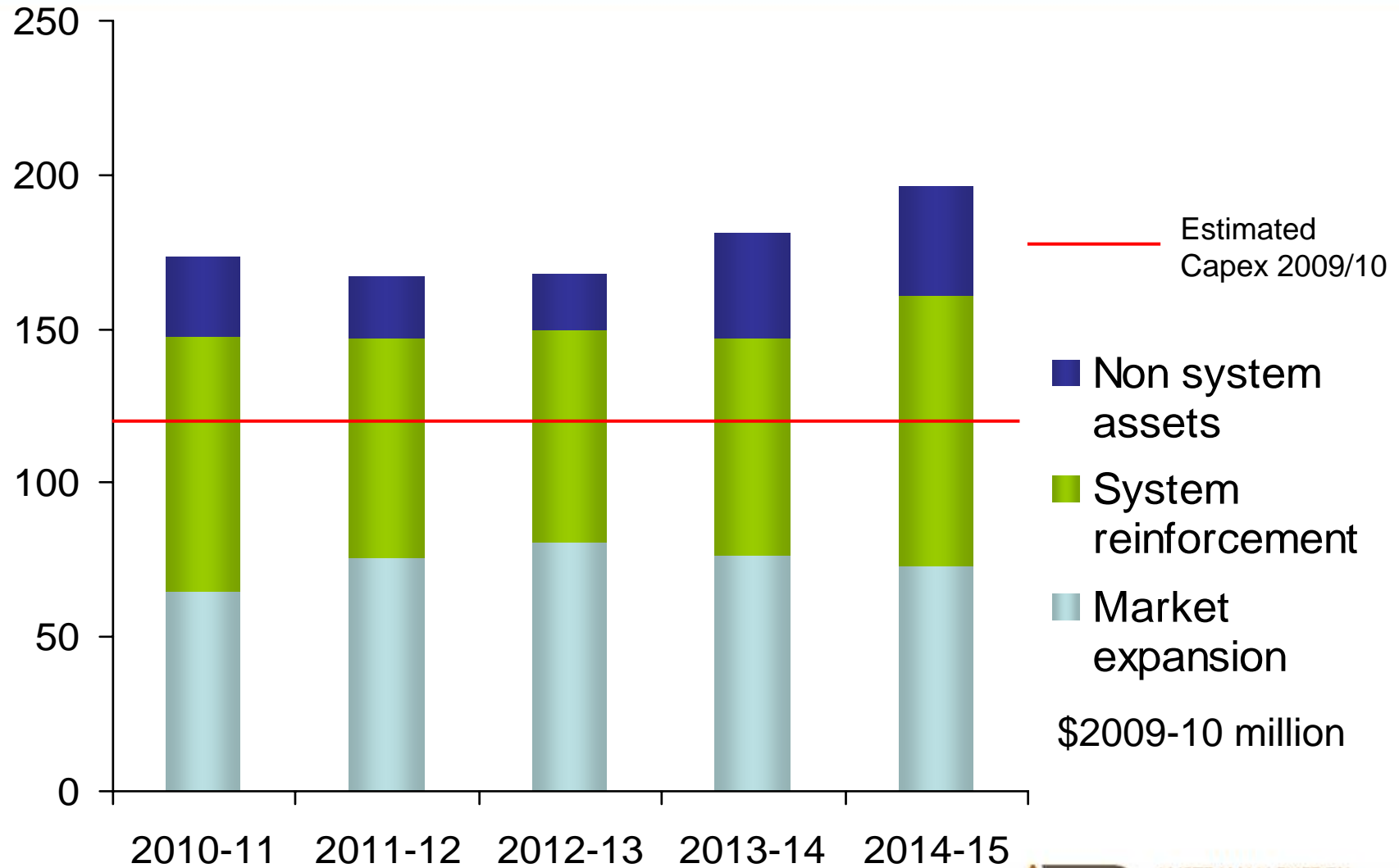
Key aspects of Jemena's proposal

- Building block components
 - Capital expenditure  59%
 - Cost of capital using FFM  23%
 - Operating expenditure  16%
- Demand forecasts  1%
- Total revenue \$2548m  34%
- Terms & conditions of access

Jemena's proposal – operating expenditure



Jemena's proposal – capital expenditure

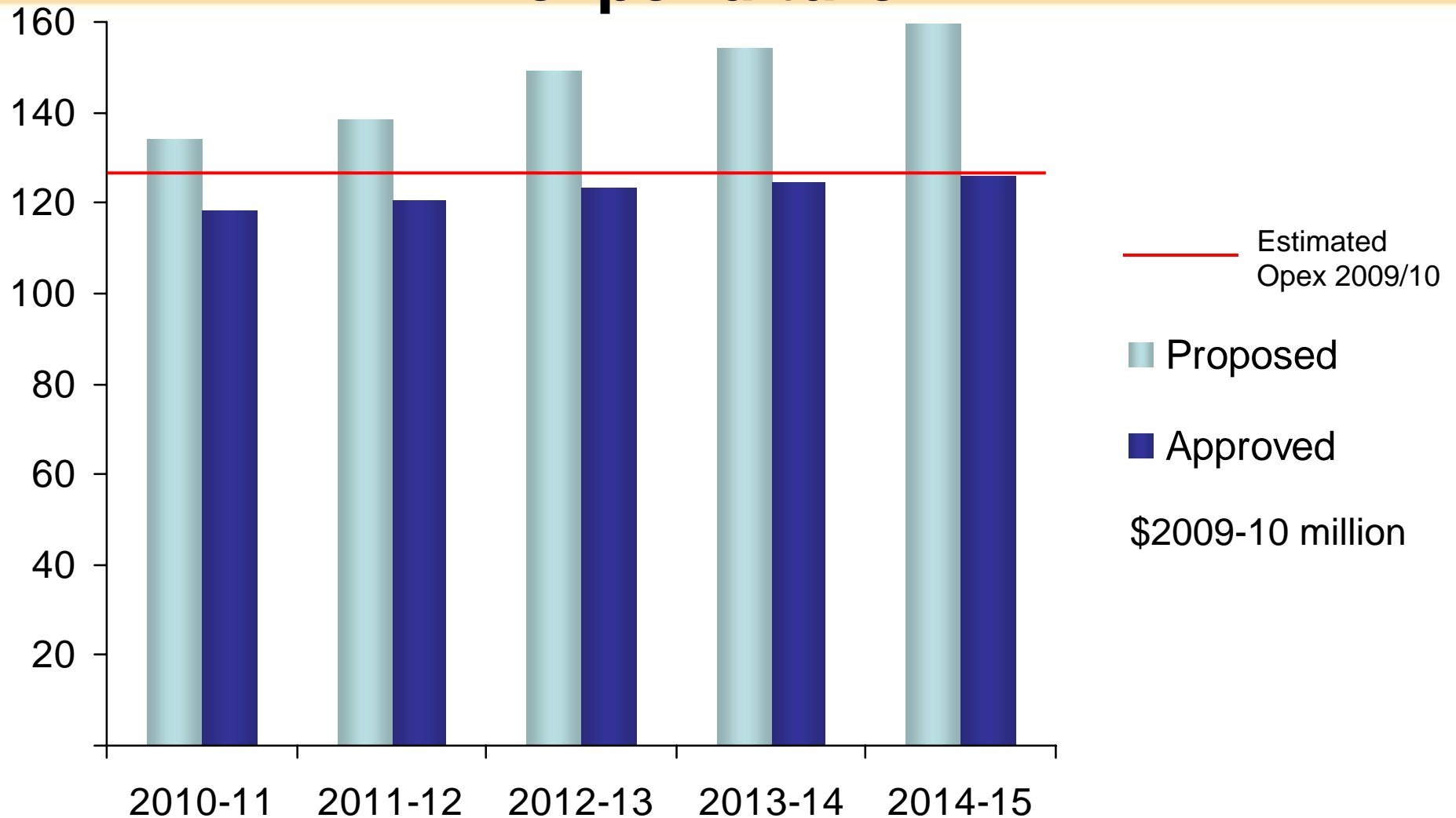


Jemena's proposal – return on capital

	Past AA	Proposed
Nominal Vanilla WACC (%)	8.14-9.03	11.21
RFR (%)	5.70	5.60
MRP (%)	5.5-6.5	6.5
Equity Beta	0.8-1.0	N/A*
DRP (%)	1.13-1.22	5.04
Gamma	0.5-0.3	0.20

* JGN has proposed to use Fama-French three factor model (FFM) instead of standard Sharpe-Lintner CAPM. Equity beta is used in CAPM but not used in the FFM.

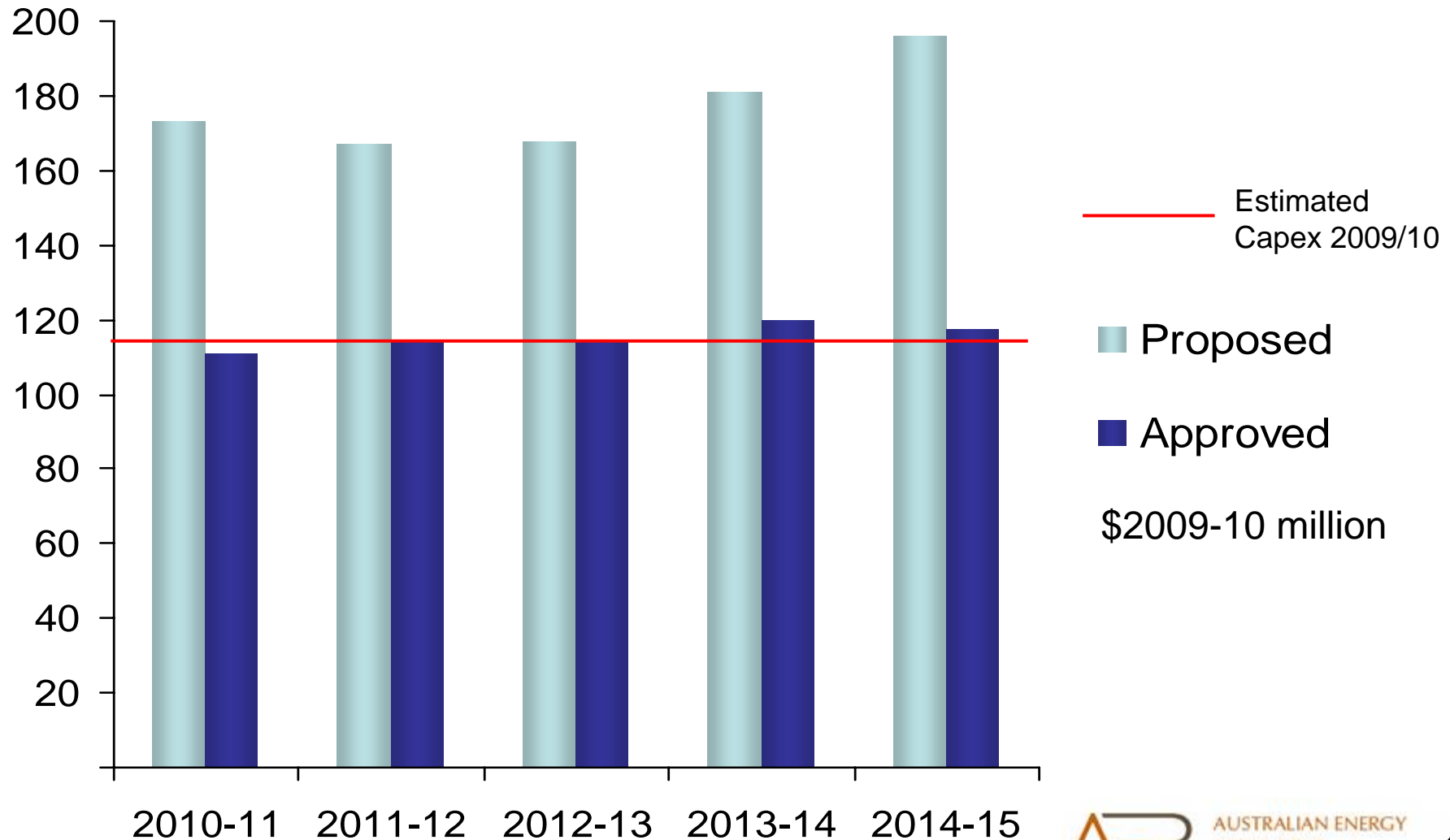
AER's consideration - operating expenditure



AER's consideration - operating expenditure

- AER approved total operating expenditure of \$612.5m which is 16.7% lower than proposed
- Reductions to operating & maintenance costs and administration & overheads
- Reductions to base & rejection of step changes

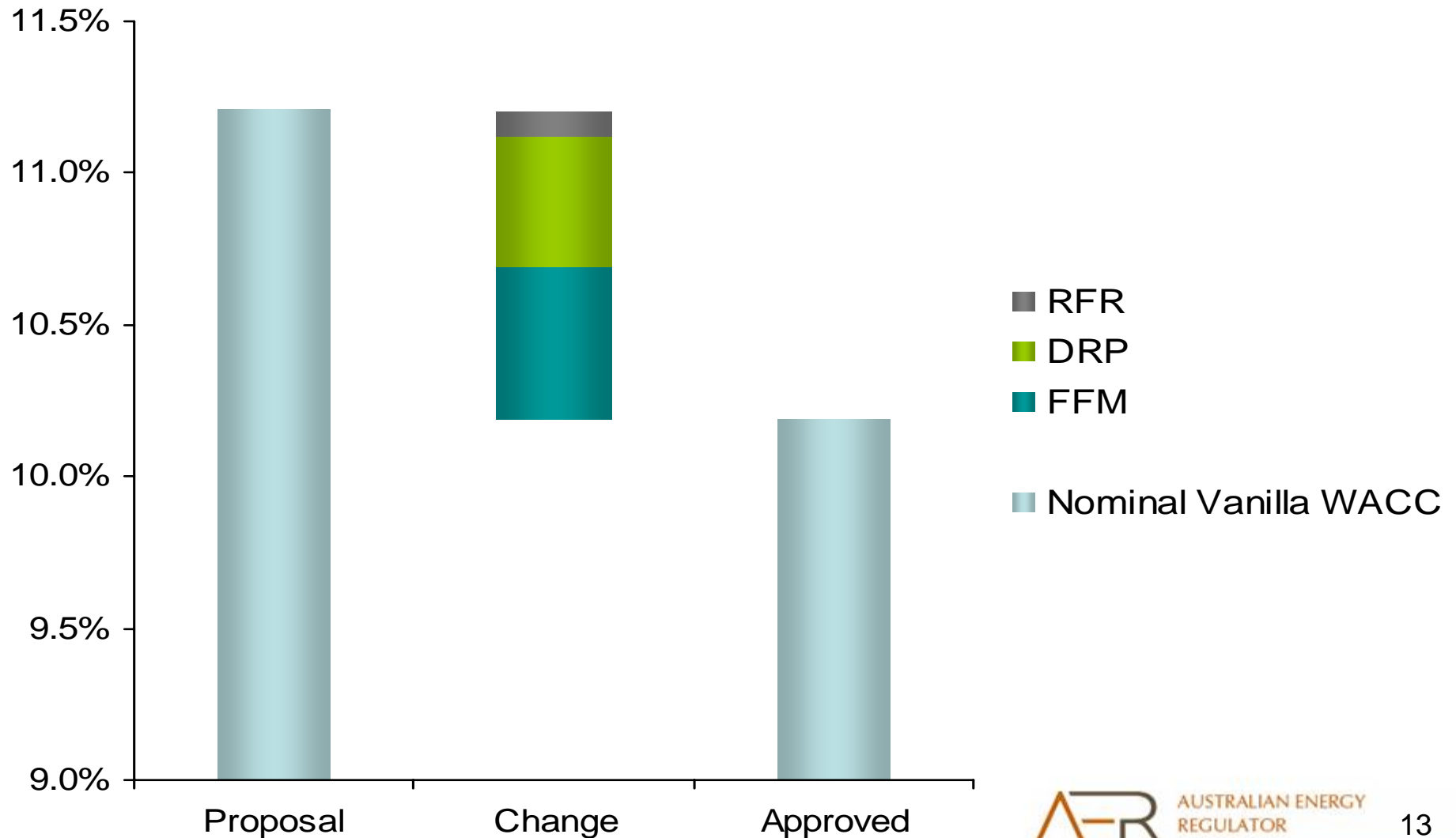
AER's consideration - capital expenditure



AER's consideration - capital expenditure

- Forecast capital expenditure:
 - Margin and 6% overhead cost removed
 - Some of the capital expenditure approved on historical levels
 - Certain projects approved as forecast
 - Reclassification of capital expenditure as operating expenditure

AER's consideration - WACC



AER's consideration - WACC

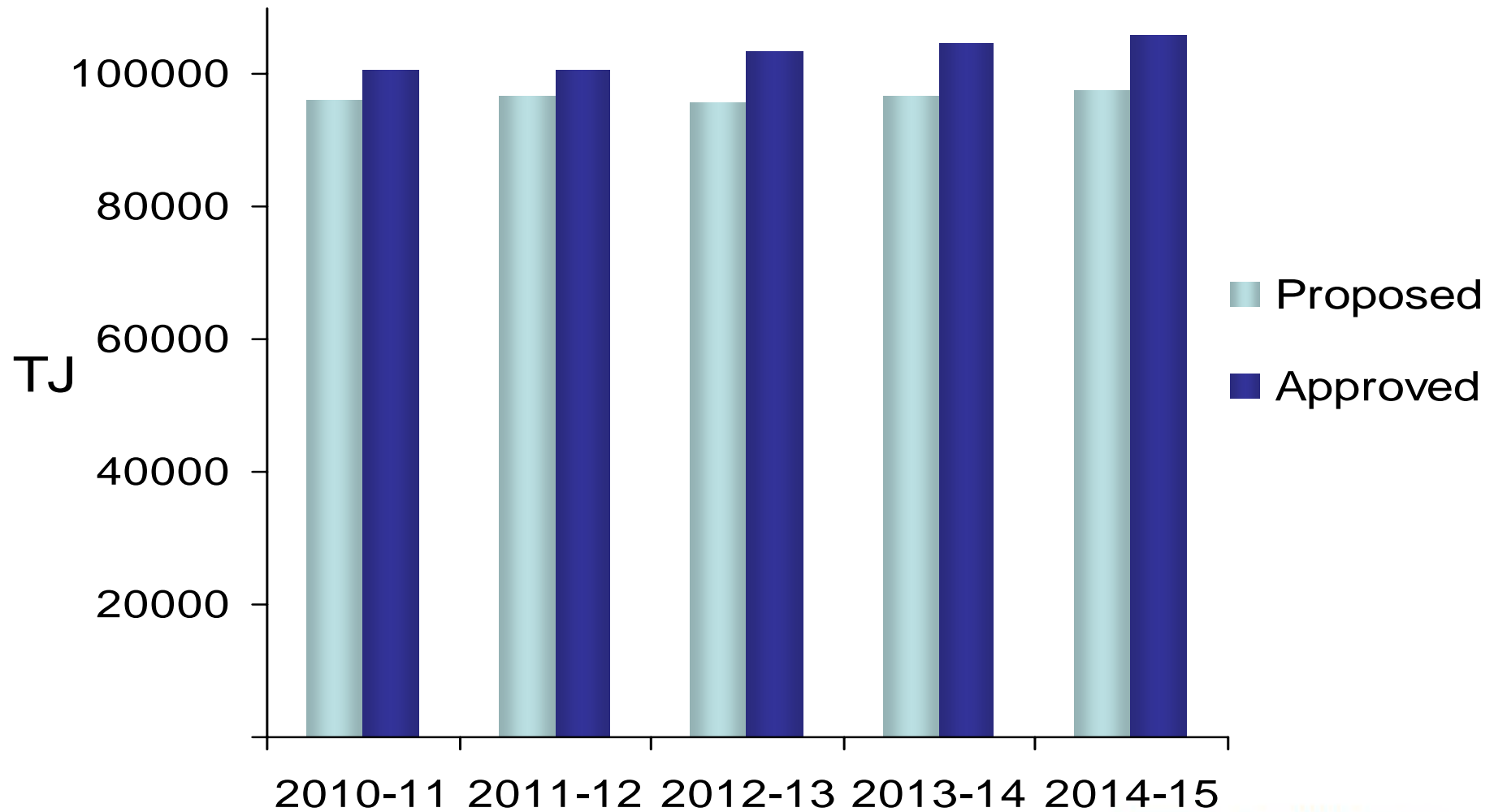
	Proposed	Approved
Nominal Vanilla WACC (%)	11.21	10.11
RFR (%)	5.60	5.52
MRP (%)	6.5	6.5
Equity Beta	N/A*	0.8
DRP (%)	5.04	4.18
Gamma	0.20	0.65

* JGN has proposed to use Fama-French three factor model (FFM) instead of standard Sharpe-Lintner CAPM. Equity beta is used in CAPM but not used in the FFM.

AER's consideration - WACC

- AER decision:
 - FFM did not meet the requirements of the NGR that it be a 'well accepted' financial model
 - Directed JGN to use the (standard) CAPM instead
 - DRP based on CBA Spectrum fair value curve, not one bond.

AER's consideration – demand forecast



AER's consideration - tariff changes

Tariff Type	Year 1 Increase (Nominal, %)
Volume	3.73%
Demand	-9.26%

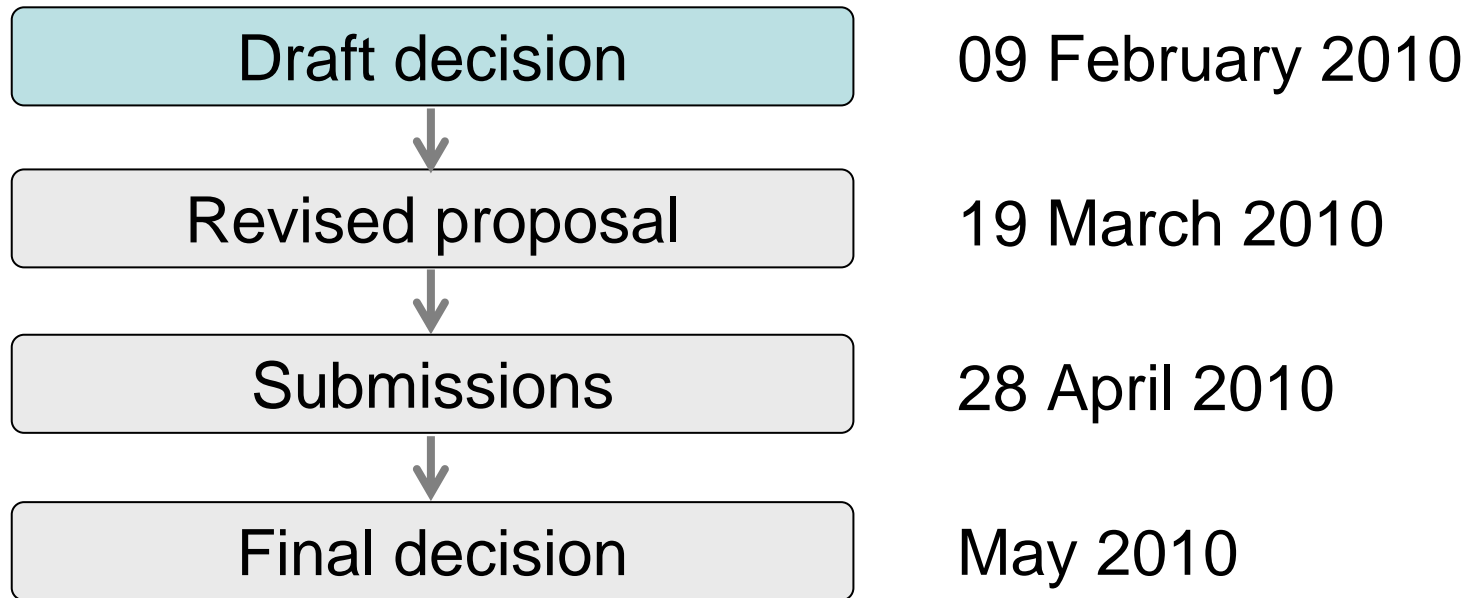
AER's consideration - tariff variation mechanisms

- Annual tariff mechanism
 - Annually volume and demand tariff will on average increase in line with CPI plus 1.96 per cent
- Cost pass through mechanism
 - The access arrangement includes a pass through arrangement for certain events. If these events eventuate in the access arrangement, tariffs will increase or decrease as a result

AER's consideration - non-tariff terms & conditions of access

- Reference services agreement approved with amendments
 - Extensions & expansions policy
 - Trigger events
 - Pipeline services

Process – where to from here?



Questions

