ActewAGL Distribution

Access arrangement information addendum for the ACT, Queanbeyan and Palerang gas distribution network

January 2010

Required by Rule 43 (1) of the National Gas Rules 2008

ActewAGL

Always.

ActewAGL Distribution
Addendum to Access Arrangement Information
for the ACT, Queanbeyan and Palerang Gas Distribution Network

6 January 2010

Under Rule 60 of the *National Gas Rules 2008*

ActewAGL Distribution partners are
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Overview

This document is submitted in response to the draft decision of the Australian Energy Regulator (AER) on the access arrangement proposal of 30 June 2009 for ActewAGL Distribution's ACT, Queanbeyan and Palerang gas distribution network. It forms an addendum to the Access Arrangement Information of 30 June 2009 and should be read in conjunction with that document.

This Access Arrangement Information Addendum contains detailed responses to all 72 amendments required by the AER's draft decision. A majority of the required amendments has been accepted as written. ActewAGL Distribution's responses to the changes required are summarised in Table 1.1 and discussed in detail in the remainder of the document.

Revised building block revenue proposal

In response to the AER's draft decision, ActewAGL Distribution has revised its forecast capital and operating expenditures for the access arrangement period as shown in Table 0.1.

Table 0.1 Revised forecast capital and operating expenditures

$m (real 2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
AER draft decision						
Net capital expenditure*	25.4	24.3	11.0	9.9	10.4	81.1
Total operating expenditure	20.2	22.0	22.2	21.8	22.0	108.2
Revised access arrangement proposal						
Net capital expenditure*	32.9	26.0	12.5	11.1	11.7	94.1
Total operating expenditure	21.1	28.6	29.0	28.8	29.1	136.6

*Net of capital contributions and equity raising costs

Forecast capital expenditure for the access arrangement period is higher than in the AER's draft decision principally as the result of revised capital cost escalators (in addition to a new capital project discussed below). The escalators have been updated from those in ActewAGL's 30 June 2009 access arrangement proposal to incorporate the most recent data and to address concerns raised by the AER in the draft decision. ActewAGL Distribution maintains that, given that these now represent the best available estimate in the circumstances, no further amendment to escalators is warranted in the final decision. This issue is discussed in chapter 3 of the Addendum.

ActewAGL Distribution accepts the removal of the Hoskinstown Fyshwick Loop security of supply project from its capital program. However, ActewAGL Distribution, along with the AER, continues to recognise the existence of a security of supply issue and that market developments now point to a solution that, rather than attempting to insulate the network from a security of supply event, seek to integrate a diversity of sources and supply options.

ActewAGL Distribution now proposes installation of a compression facility augmenting the Dalton to Watson lateral pipeline, to accommodate the required peak volumes to improve gas supply reliability in the ACT. This involves primarily additions to operating and maintenance expenditure to the pipeline operator for compression services, and the operation and maintenance of the assets. These form part of updated operating and maintenance expenditure proposal in Chapter 5 of this Addendum.

Capital expenditure is also impacted through the need to construct facilities at Watson to accommodate increased pressure and flows to the network and additional operating and maintenance expenditure. This is discussed in Chapter 3 of this Addendum.

In addition to the impact of this security of supply project, revised operating expenditures are also increased as the result of revisions to proposed escalators and partial reinstatement of self insurance costs.

ActewAGL Distribution has also revised its weighted average cost of capital (WACC) proposal in response to the draft decision. The revised proposed nominal vanilla WACC is 11.08 per cent. This is higher than the 10.14 per cent in the draft decision as ActewAGL Distribution has retained its proposed values for the equity beta (1.0, compared with 0.8 in the draft decision), and the market risk premium (7.5 per cent, compared with 6.5 per cent in the draft decision). In addition, ActewAGL Distribution has updated the values for the nominal risk free rate and inflation, and has calculated the debt margin using the method of averaging the values from the CBA Spectrum and Bloomberg series. The detail of these responses is in Chapter 4 of the Addendum.

The net impacts of the revisions to the building block components are shown in table 0.2. The higher X factors, compared with the draft decision, reflect the impacts of the higher capital and operating expenditures and WACC.

Table 0.2 Revised revenue requirements and X factors

	2010/11	2011/12	2012/13	2013/14	2014/15
AER draft decision					
Smoothed revenue requirement ($m nominal)	51.4	55.2	59.9	65.2	71.2
X factors (%)	5.2	5.2	5.2	5.2	5.2
Revised access arrangement proposal					
Smoothed revenue requirement($m nominal)	54.4	61.9	70.6	80.8	92.8
X factors (%)	10.9	10.9	10.9	10.9	10.9

Responses to other draft decision amendments

The AER’s 72 draft decision amendments range from relatively minor drafting changes through to significant changes affecting the terms and conditions of the access arrangement and the determination of revenues and tariffs. In the revised access arrangement proposal ActewAGL Distribution has accepted many of the major required amendments, for example:

- ancillary services, previously treated separately to reference services, have been included as reference services, and revenues and tariffs have been adjusted accordingly. This has also involved the inclusion of corresponding costs, previously excluded from consideration;
- tariffs are presented in real 2010/11 dollars;
- the tariff block structure has been simplified, by reducing the previous 6 steps to 4; and
- the Annual Reference Tariff Adjustment Formula Mechanism has been revised to include adjustment for CPI.

ActewAGL Distribution has accepted many of the AER's amendments in principle, while adopting alternative means to achieve the intent behind the amendments. For example, the Reference Tariff Variation Mechanism has been revised to:

- improve AER governance and oversight of the tariff variation process;
- include new cost pass through events for specified uncontrollable costs and supply curtailment; and
- adopt new materiality thresholds for cost pass through events.

ActewAGL Distribution has also amended the access arrangement to:

- include a requirement to compile an annual statement of costs subject to appropriate consultation on content; and
- provide the AER with an approval power for determining coverage of high pressure pipeline extensions, as well as other changes to the extensions and expansions policy.

ActewAGL Distribution does not accept several of the draft decision amendments, in addition to those noted above in relation to the building block proposal, for example:

- exclusion of capital expenditure from the efficiency carryover mechanism; and
- inclusion of a trigger event in the access arrangement related to the National Energy Customer Framework.

Accompanying this Access Arrangement Information Addendum is a revised Access Arrangement incorporating changes, including updated tariffs, discussed in this document.

1 Introduction

1.1 Purpose of this document

On 30 June 2009, ActewAGL Distribution submitted to the Australian Energy Regulator (AER) a proposed Access Arrangement[1] for its Australian Capital Territory (ACT), Queanbeyan and Palerang gas distribution network for the period 2010/11 to 2014/15 (the access arrangement period) together with the required Access Arrangement Information.[2]

On 11 November 2009, following assessment of the proposed access arrangement and public submissions, the AER issued a draft decision[3] under Rule 59(1) of the *National Gas Rules 2008* (NGR).[4] As permitted under Rule 59(2), the AER chose not to approve the access arrangement as proposed, instead requiring ActewAGL Distribution to undertake 72 amendments. In circumstances where amendments are required, the NGR require the published draft decision to contain a statement of reasons for the decision, to fix a revision period of at least 15 business days and to invite written submissions within a period of at least 20 business days. The service provider may within the revision period submit additions or other amendments to the access arrangement proposal to address matters raised in the access arrangement draft decision.[5] The NGR further stipulate that amendments are to be limited to those necessary to address matters raised in the access arrangement draft decision unless the AER approves further amendments.[6]

Consistent with Rule 60(1), the amendments to ActewAGL Distribution's access arrangement and access arrangement information outlined in this document (the Access Arrangement Information Addendum) are submitted as necessary to address matters raised by the draft decision.

This Access Arrangement Information Addendum does not seek to replicate information included in ActewAGL Distribution's 30 June 2009 access arrangement information but rather indicates areas of revision to the access arrangement information formerly submitted to the AER and, where relevant, updates and amends it in response to the proposed amendments and discussion included in the AER's draft decision. As such, it supplements ActewAGL Distribution's access arrangement information and should be read in conjunction with that earlier document.

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[1] ActewAGL Distribution 2009, *Access arrangement for the ACT, Queanbeyan and Palerang gas distribution network*, 30 June

[2] ActewAGL Distribution 2009, *Access arrangement information for the ACT, Queanbeyan and Palerang gas distribution network*, 30 June

[3] Australian Energy Regulator 2009, *Draft Decision*, ActewAGL – Access arrangement proposal for the ACT, Queanbeyan and Palerang gas distribution network, 1 July 2010 – 30 June 2015, November

[4] Hereinafter, a reference to a Rule, Division or Part shall, unless otherwise specified, be understood to refer to a Rule, Division or Part as applicable of the *National Gas Rules 2008*.

[5] Rule 60(1)

[6] Rule 60(2). The NGR example of circumstances in which the AER might approve "further amendments" to the access arrangement proposal is where there has been a change in circumstances of the service provider's business since submission of the access arrangement proposal.

Together, these documents (the Access Arrangement Information and the Access Arrangement Information Addendum) fulfil ActewAGL Distribution's obligation to submit to the AER Access Arrangement Information that includes information that is reasonably necessary for users or prospective users to understand the background to the access arrangement proposal, and the basis and derivation of the various elements of the access arrangement proposal.[7]

As required by the NGR, this Access Arrangement Information Addendum is accompanied by a revised access arrangement proposal incorporating the amendments as described and together they form ActewAGL Distribution's revised access arrangement proposal.[8]

1.2 Layout of the document

This document focuses on areas of revision to the access arrangement and access arrangement information submitted to the AER on 30 June 2009. Each chapter canvasses AER amendments relevant to the subject matter of that chapter, ActewAGL Distribution's response to those amendments, and analysis of their impact. Subsequent chapters are set out as follows:

- Chapter 2 supplements ActewAGL Distribution's network demand and utilisation forecast (chapter 5 of the June 2009 Access Arrangement Information) and addresses the AER's discussion of the demand forecast in chapter 11 of the draft decision;
- Chapter 3 supplements ActewAGL Distribution's capital base and capital expenditure proposal (chapters 7 and 8 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the capital base, capital expenditure and the capital redundancy mechanism in chapters 3 and 4 of the draft decision;
- Chapter 4 supplements ActewAGL Distribution's rate of return and forecast inflation proposal (chapter 8 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the capital base in chapter 5 of the draft decision;
- Chapter 5 supplements ActewAGL Distribution's operating expenditure proposal (chapter 9 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to forecast operating expenditure in chapter 9 of the draft decision;
- Chapter 6 supplements ActewAGL Distribution's derivation of total revenue (chapter 10 of the June 2009 Access Arrangement Information) and addresses the AER's draft decision on taxation, and proposed amendments to the incentive mechanism and total revenue set out in chapters 6, 7 and 10 of the draft decision;
- Chapter 7 supplements ActewAGL Distribution's services, cost allocation and pricing proposal (chapter 11 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to pipeline and reference services and reference tariffs set out in chapters 2, 12, 13 and 14 of the draft decision;

[7] Rule 42(1)
[8] Rule 60(3)

- Chapter 8 supplements ActewAGL Distribution's services, cost allocation and pricing proposal chapter (chapter 11 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the reference tariff variation mechanism set out in chapter 13 of the draft decision;
- Chapter 9 supplements ActewAGL Distribution's changes to the access arrangement (chapter 12 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to access arrangement drafting and non-tariff components of the access arrangement in chapters 2, 3, 5, 8, 10, 12, and 14 of the draft decision;
- Attachments include further supporting documents and information, and the relevant models incorporating the effects of amendments.

1.3 Proposed amendments

Table 1.1 provides summary information on proposed amendments and additions to address matters raised in the AER's draft decision, as provided for by Rule 60(1).

Table 1.1 Proposed actions to address amendments required by the AER draft decision

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Include ancillary service as a reference service in relevant parts of the access arrangement.	2.1, 2.4, 2.5	Accept amendments. Required text included in access arrangement, amended slightly for consistency of style. Consequential amendments also made to the access arrangement.	7.1
Amend access arrangement information to reflect inclusion of Ancillary Service as a reference service.	2.2, 2.3, 2.6	Accept amendments. Replacement text set out in Access Arrangement Information Addendum.	Attachment H
Bundling of metering services.	2.7, 2.8	Accept amendment. Required text included in relevant attachments to the access arrangement.	9.3
Removal of capitalised regulatory costs.	3.1, 3.2	Reject amendment. Costs included in proposed opening capital base for access arrangement period.	3.1.2.1
Adjustment of opening capital base for amended method of estimation of inflation.	3.2	Accept amendment. Adjustment made to opening capital base for access arrangement period, updated with the latest RBA forecast.	3.1.2.2
Adjustment of opening capital base for the return on the difference between actual and estimated capital expenditure in 2003/04.	3.2	Accept amendment. Adjustment made to opening capital base for access arrangement period, updated with the latest RBA forecast.	3.1.2.3
Removal of forecast capital expenditure for proposed Hoskinstown Fyshwick Loop security of supply project.	3.5	Accept amendment. Adjustments made to forecast capital base in the access arrangement period. Alternative security of supply expenditure proposed.	3.2.2.1 and 5.2.2.6
Substitution of capital cost escalators for labour, aluminium and steel.	3.3, 3.5	Reject amendment. Substitute updated escalators in proposed capital expenditure. Adjustments made to forecast capital base in the access arrangement period.	Attachment E 3.2.2.2 3.2.3
Removal of capital cost escalator for polyethylene.	3.3, 3.5	Reject amendment. Reinstate updated escalator for polyethylene. Adjustments made to forecast capital base in the access arrangement period.	Attachment E 3.2.2.3 3.2.3
Removal of capital cost escalator for impact of CPRS.	3.4, 3.5	Reject amendment. Retain escalators for CPRS. Adjustments made to forecast capital base in the access arrangement period.	Attachment E 3.2.2.4
Amend forecast depreciation for changes in forecast capital expenditure.	3.6	Accept amendment. Depreciation forecast updated for new capital expenditure	3.3 6.2

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Amend projected capital base for changes in capital expenditure, depreciation and inflation.	3.7	Accept amendment. Projected capital base updated using new capital expenditure and CPI.	3.3
Delete capital redundancy mechanism from access arrangement and amend access arrangement information accordingly.	3.8	Accept amendment.	3.4
Amend clause 4.17 of the access arrangement to include reference to capital contributions in relation to the capital base.	3.9	Reject amendment. Reference tariffs are determined on the basis of capital base without capital contributions included.	9.2
Amend clause 4.19 of the access arrangement to include reference to capital contributions in relation to the capital base.	3.10	Accept amendment in part. Included reference in footnote and clarified that capital base does not include capital contributions.	9.2
Amend clause 4.20 to include AER amended text.	3.11	Accept amendment.	9.2
Amend clause 4.21 to include AER amended text.	3.12	Accept amendment.	9.2
Amend clause 4.18 to include AER amended text.	3.13	Accept amendment.	9.2
Amend clause 4.3 to include AER amended text.	5.1	Accept amendment in part. Further amendments made to clause to update language and for consistency of style.	9.1
Delete ActewAGL's proposed rate of return and replace with the AER's values.	5.2	Reject amendment. Further discussions contained in chapter 4.	Chapter 4
Amend Table 10.6 to correct transcription error.	6.1	Accept amendment.	6.3.2
Delete rolling carryover mechanism for capital expenditure from access arrangement and access arrangement information.	7.1	Reject amendment. Capital mechanism included in access arrangement and described in access arrangement information.	6.5.2.1
Replace formula in clause 4.11 with new formula for the first year of the access arrangement period.	7.2	Accept amendment. Amendment also made to formula for capital expenditure mechanism.	6.5.3

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Replace formula in clause 4.11 with new formula for the last year of the access arrangement period.	7.3	Accept amendment. Amendment also made to formula for capital expenditure mechanism.	6.5.3
Replace formula in clause 4.11 with new formula for the second, third and fourth years of the access arrangement period.	7.4	Accept amendment. Amendment also made to formula for capital expenditure mechanism.	6.5.3
Replace formula in clause 4.11 with new formula for the first year in the next access arrangement period.	7.5	Accept amendment. Drafting also amended to note there is no double counting of efficiency gains or losses.	6.5.3
Include provision requiring ActewAGL to adjust its forecasts if it changes approach to classifying costs.	7.6	Accept amendment.	6.5.4
Include provision requiring ActewAGL to provide a detailed description of any change to classifying costs.	7.7	Accept amendment.	6.5.4
Delete reference to rolling carryover mechanism for capital expenditure in fixed principle 4.27(a).	8.1	Reject amendment. Rolling carryover mechanism for capital expenditure retained in access arrangement.	9.4 and 6.5.2.1
Delete fixed principle 4.27(c).	8.2	Accept amendment. Alternative approach included in reference tariff variation mechanism.	9.4 and 8.3.6
Amend forecast operating expenditure.	9.1	Parts of amendment regarding step changes accepted. Amendments to escalators and self insurance rejected. New security of supply expenditure included in the revised proposal.	Chapter 5
Make subsequent amendments to take account of amendment 9.1	9.2	Consequential amendments arising from ActewAGL's response to Amendment 9.1 have been carried out.	Chapter 5
Include a Statement of costs section in the access arrangement.	9.3	Accept in principle. Requirement to maintain statement costs included in access arrangement as per amendment. Mechanism changed to support agreement to template after final decision.	5.8
Include indicative statement of costs template in access arrangement.	9.4	Reject amendment. Further development of table required to ensure ability to comply. Negotiating framework included in access arrangement.	5.8

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Amend Table 10.1 and consequential change to Table 10.4.	10.1	ActewAGL has updated tables based on updated capital and operating expenditure and rate of return forecast.	6.3
Amend Table 10.12.	10.2	Accept amendment. Table updated.	6.3
Amend clause 4.2 as per AER drafting.	10.3	Reject amendment. Clause amendment with alternative drafting to clarify intent.	9.1
Amend clause 4.1 as per AER drafting.	12.1	Accept amendment. Clause also amended to include intent in AER amendment 10.3.	9.1
Amend clause 4.4 as per AER drafting.	12.1	Accept amendment in part. AER drafting amended to update language.	9.1
Tariffs in the access arrangement service schedule to be indexed in real 2010-11 dollars.	13.1	Accept amendment. Tariffs and tariff tables adjusted in the access arrangement.	7.2.3
Tariffs in the access arrangement service schedule must be expressed as GST exclusive.	13.1	Accept amendment. Tariffs and tariff tables adjusted in the access arrangement.	7.2.3
Collapse the tariff structure into 4 steps rather than 6	13.1	Accept amendment.	7.2
Remove Adjustment factor from tariff variation formula.	13.2	Accept amendment. Consequential amendment made to access arrangement.	8.1.1
Amend CPI formula to reflect availability of CPI data.	13.3	Reject amendment. Example included in access arrangement to demonstrate operation of formula. Parameter definitions revised and clarified.	8.1.3
Amend CPI formula to reflect relevant base year.	13.3	Accept amendment.	8.1.3
Amend CPI formula removing "-1" from the formula.	13.3	Reject amendment. Required to retain consistency with tariff formula in 6.3 of access arrangement.	8.1.3
Redefine "t" in CPI formula as per AER amendment.	13.4	Reject amendment. Definition of t needs to define which year's reference tariffs are being varied. Further amendments made to some formulae parameter definitions for greater clarity.	8.1.3
Include a rounding convention in the access arrangement.	13.5	Accept amendment.	8.1.4
Include scope for extension of AER decision-making time for cost pass through mechanism.	13.6	Reject amendment. Access arrangement amended to include alternative proposal to require a tariff variation notification to be provided to the AER earlier in the year.	8.3.1

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Include requirement for ActewAGL Distribution to provide the AER with its workings under the tariff variation formula.	13.7	Accept amendment.	8.3.3
Remove reference to automatic tariff variation by operation of the tariff variation formula.	13.8	Accept amendment.	8.3.5
Amend definition of STTM event in access arrangement and access arrangement information.	13.9	Accept amendment.	8.2.1
Include a new low administrative cost event as a pass through event in tariff variation mechanism.	13.10	Accept amendment.	8.2.2
Categorise the Change in tax event as a low administrative cost event.	13.10	Accept amendment in principle. AER intent delivered through alternative drafting.	8.4
Amend definition of Change in tax event.	13.10	Accept amendment.	8.2.1
Amend access arrangement information to reflect applicability of materiality thresholds to particular events.	13.10	Accept amendment in principle. Access arrangement information updated to reflect ActewAGL Distribution's revised materiality threshold proposal.	8.4
Change definition of Material Impact to refer to Administrative Cost Impact.	13.11	Accept amendment.	8.4
Revise definition of Administrative Cost Impact as per AER amendment.	13.11	Reject amendment. Alternative proposal for definition of an Administrative Cost Impact included in access arrangement.	8.4
Amend definition of Change in Cost.	13.11	Accept amendment in part. Definition updated to account for capital and operating expenditure, and also foregone revenue under proposed Supply Curtailment Event.	8.4
Amend definitions of Service standard event, General pass through event, and Regulatory change event.	13.11	Accept amendment. Further amendment made to Service standard event in line with AER intent.	8.2.1
Amend access arrangement information to reflect changes in definitions of pass through events.	13.11	Accept amendment.	8.2.4

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Include provision that each pass through event must take into account the Administrative Cost Impact.	13.12	Accept amendment in principle. AER intent achieve through alternative drafting approach.	8.3.3
Replace factors for consideration in approving cost pass through event with AER amendment.	13.13	Accept amendment in part. Adopted AER factors in combination with some of ActewAGL Distribution's original factors.	8.3.4
Include requirement for verification statement for third party payments.	13.14	Accept amendment in part. Included requirement to specify that claims are net of third party payments.	8.3.3
Include requirement that low administrative cost events be supported by verifiable information.	13.14	Accept amendment. Drafting amended to include UAG information.	8.3.3
Include requirement that low administrative cost events can only vary tariffs once a year on 1 July.	13.15	Accept amendment in principle. AER intent achieved through alternative drafting approach.	8.3.5
Include requirement to notify regulator of cost pass through event within 3 months.	13.15	Accept amendment in part. Alternative approach adopted requiring ActewAGL Distribution to advise AER of cost pass through event having an Administrative Cost Impact.	8.3.2
Amend access arrangement to delete clauses in tariff schedules related to ancillary services.	14.1	Accept amendment. Access arrangement proposal amended.	7.1
Amend access arrangement information to update prices as per amendment 14.1.	14.2	Accept amendment. Tariffs updated based on updated revenue forecast.	7.3
Specify terms and conditions on which ancillary services will be provided.	14.3	Accept amendment. New schedule included in access arrangement and discussion in access arrangement information.	7.1
Include definition of OBG in access arrangement.	14.4	Accept amendment.	9.8
Correct typographical error in footnote 14.	14.5	Accept amendment.	9.8
Amend description of relationship between business rules and NGR in trading policy.	14.6	Reject amendment. Drafting revised to provide further clarity on arrangements.	9.6

Matter	Amendment reference in draft decision	Treatment	Discussion (this document)
Amend definition of business rules.	14.7	Accept amendment. Further amendments to definition and other parts of access arrangement to reflect changes in nomenclature.	9.6
Amend definition of bare transfer.	14.8	Accept amendment.	9.6
Include example of a reasonable ground on which to withhold consent to a transfer in access arrangement.	14.9	Accept amendment.	9.6
Responsiveness to urgent requests for transfer.	14.10	Accept amendment.	9.6
Delete clauses 7.1 and 7.2 and replace with AER amendment to require approval of coverage of high pressure pipeline extensions and reporting of all other extensions.	14.11, 14.15	Reject amendment. Replace with alternative approval requirement and process. Replace reporting requirement with alternative reporting.	9.5.2.1
Delete clause 7.3 and replace with AER amendment, including information requirements for all expansions.	14.12, 14.15	Reject amendment. Replace with provision of default coverage with option to apply to AER for extension or expansion not to be covered.	9.5.2.2 and 9.5.2.3
Information requirements only relate to extensions and expansions not already included in reference tariffs.	14.13, 14.15	Reject amendment. Replace with general reporting requirements for all extensions.	9.5.2.3
Replace clause 7.6 with AER amendment.	14.14, 14.15	Accept amendment.	9.5.2.4
Include Trigger event in access arrangement related to the National Energy Customer Framework.	14.16	Reject amendment. No trigger event included in access arrangement	9.7

2 Network demand and utilisation

This chapter supplements ActewAGL Distribution's network demand and utilisation forecast (chapter 5 of the June 2009 Access Arrangement Information) and addresses the AER's discussion of the demand forecast in chapter 11 of the draft decision.

2.1 AER Draft Decision

The AER engaged ACIL Tasman to review ActewAGL Distribution's forecasts for network demand and utilisation. The ACIL Tasman final report to the AER concludes that:

> ACIL Tasman considers that the forecast developed by NIEIR on behalf of ActewAGL distribution is appropriate and is forecast or estimated on a reasonable basis taking into consideration the data available at the time the forecasts were prepared.
>
> ACIL Tasman notes that the forecasts result in demand that is around 4.4 per cent below a trend based on the past six years. The differences between forecast demand growth and the historical trends can be attributed to a combination of the cumulative effect of various energy efficiency and policy measures, together with lower economic growth forecasts.
>
> ACIL Tasman notes that the macroeconomic outlook of the Australian economy is now less pessimistic than in the NIEIR projections. However uncertainty over the future course of economic growth in Australia remains and ACIL Tasman does not believe that a change in outlook is justified for the purposes of developing the forecasts of gas demand.[9]

Consistent with the conclusion of its consultant, the AER accepted the demand forecast proposed by ActewAGL Distribution for the access arrangement period. The AER analysis concludes that, consistent with the requirement of Rule 74(2):

> The AER considers that ActewAGL's demand forecasts are arrived at on a reasonable basis and represent a best forecast.[10]

As a result of this process of review, the AER required no amendments to ActewAGL Distribution's network demand forecast.

2.2 ActewAGL Distribution response

ActewAGL Distribution proposes no further amendment to its demand forecasts as proposed in its access arrangement submitted to the AER on 30 June 2009.

[9] ACIL Tasman 2009, *Review of Demand Forecasts for ActewAGL for the Access Arrangement period commencing 1 July 2010*, Prepared for the Australian Energy Regulator, 18 September, p 17
[10] AER 2009, *Draft Decision*, p 139

3 Capital base

This chapter supplements ActewAGL Distribution's capital base and capital expenditure proposal (chapters 7 and 8 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the capital base, capital expenditure and the capital redundancy mechanism in chapters 3 and 4 of the draft decision.

3.1 Opening capital base for the access arrangement period

As required by Rule 72(1)(b), ActewAGL Distribution's June 2009 access arrangement information includes relevant information on how the capital base for the network is arrived at and a demonstration of how the capital base increased or diminished over the previous access arrangement period.[11] Rule 77(2) specifies the process for rolling forward the capital base from one period to the next. This involves adding to the opening capital base at the commencement of the earlier access arrangement period conforming capital expenditure in the earlier access arrangement period and amounts, if any, applied under Rules 82, 84 and 86, less depreciation and the values of redundant assets and asset disposals over the earlier access arrangement period. This calculation yielded an opening capital base in 2010/11, the initial year of the access arrangement period, of $278.3 million (nominal).

3.1.1 AER Draft Decision

The draft decision accepted ActewAGL Distribution's proposed method of estimating depreciation. It also accepted all capital expenditure in the earlier access arrangement period with the exception of capitalised regulatory costs in 2008/09 and 2009/10.[12] In addition, the draft decision on the opening capital base for the access arrangement period seeks further amendments to the proposal to amend the rate of inflation applied to the indexation of the capital base and to marginally adjust the calculated return on the difference between actual and forecast capital expenditure in 2003/04. These requirements are included in AER amendments 3.1 and 3.2.

3.1.2 ActewAGL Distribution response

3.1.2.1 Capitalised regulatory costs

The AER has not allowed ActewAGL Distribution's capitalised regulatory costs for the last two years of the earlier access arrangement period to be included in the opening capital base for the access arrangement period and requires that the proposed access

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[11] ActewAGL Distribution 2009, *Access Arrangement Information*, pp 133-138

[12] The acceptance of all ActewAGL Distribution's physical capital expenditure in the earlier access arrangement period notwithstanding, the AER noted in its draft decision that it considered that ActewAGL Distribution had failed to assess the expenditure against the criteria in Rule 79. ActewAGL Distribution can confirm it did assess against Rule 79 and considers that the AER has not considered relevant material in its proposal. As explained in the access arrangement Information (section 3.2.2), market expansion capital expenditure is subject to the *Request Utility for Gas Service* (RUGS) process, in which proposed expenditure is assessed consistent with Rule 79(4). All capacity development projects are assessed against Rule 79(2)(c)(iv) for meeting future levels of demand, while all stay in business capital expenditure is assessed against Rules 79(2)(c)(i)-(iii).

arrangement be amended to remove them. This decision highlights a transitional problem that has arisen because the previous regulator of ActewAGL Distribution's network preferred a different approach to the AER in categorising these costs.

Capitalisation of regulatory costs has been an accepted regulatory treatment of ActewAGL Distribution's electricity[13] and gas[14] networks, and ACTEW Corporation's water and wastewater network,[15] under the Independent Competition and Regulatory Commission (ICRC).[16] This approach recognised that regulatory review costs were not regular *year on year* costs like many other operating expenditures, but have a life related to a five-year regulatory cycle. As such, these costs, analogous to capital expenditure on an intangible asset, were depreciated over five years, thus delivering a smoother revenue requirement for ActewAGL Distribution for the energy networks, and ACTEW Corporation for the water network.

In moving to the new regulatory regimes established for electricity and gas, ActewAGL Distribution has sought to change this treatment in line with the AER's preferred approach, consistent with ActewAGL's accounting treatment of such costs, including them in its operating expenditure forecast.[17] Regulatory costs for the next access arrangement period have been approved in the draft decision as part of ActewAGL Distribution's operating expenditure allowance.[18] This access arrangement revision marks the transition from the approach under the jurisdictional regulator to the AER's preferred approach.[19]

In requiring ActewAGL Distribution to amend its access arrangement to remove its capitalised regulatory costs in the final years of the earlier access arrangement period, the AER notes that these costs were not forecast as part of the earlier access arrangement and therefore not recovered through tariffs in the earlier access arrangement period.[20] In the absence of a forecast amount included in capital expenditure, the AER has determined that costs incurred in the earlier access arrangement period should be judged against the requirements of the NGR for conforming capital expenditure stating:

> Capital expenditure is defined in the NGR as costs and expenditure of a capital nature incurred to provide, or in providing, pipeline services. The AER does not consider that the regulatory costs incurred by ActewAGL in the earlier access arrangement period represent expenditure of a capital nature.[21]

ActewAGL Distribution notes that the phrase "of a capital nature" (reflecting the requirement of Rule 69) is not defined in the NGL or NGR. ActewAGL Distribution considers that the essential nature of capital expenditure is that of future economic benefits accruing over time.

[13] ActewAGL Distribution 2008, *ActewAGL Distribution Determination 2009-14, Regulatory Proposal to the Australian Energy Regulator*, June, p 168
[14] ICRC 2004, Access arrangement for ActewAGL gas distribution system in the ACT and Greater Queanbeyan, Final Report, November, p 8
[15] ICRC 2008, Water and Wastewater Price Review: Final Report and Price Determination, Report 1 of 2008, April
[16] The ICRC formerly regulated ActewAGL regulated energy businesses and remains the regulator of ACTEW Corporation's water and wastewater services.
[17] ActewAGL Distribution 2009, *Access Arrangement Information*, p 171
[18] AER 2009, *Draft Decision*, pp 114-15
[19] AER 2009, *Draft Decision*, p 27
[20] AER 2009, *Draft Decision*, pp 26-27
[21] AER 2009, *Draft Decision,* p 26

Under the NGR, capital expenditure meeting the test of conforming capital expenditure is included in the opening capital base for the access arrangement period regardless of whether it was forecast in the earlier access arrangement. For this reason, ActewAGL Distribution had a reasonable expectation that its efficient regulatory costs in the earlier access arrangement period would, consistent with the approach adopted by the ICRC, be added to the capital base, even where those costs had not been forecast. The change in regulator to the AER during the period has meant that this expectation has not been followed through. The treatment of these costs now required by the AER effectively denies ActewAGL Distribution the opportunity to recover them, even though their legitimacy as efficient costs as would be incurred by a prudent service provider is not under question. This would be rectified by allowing these incurred costs into the opening capital base for the next period.

In its final decision in the review of ActewAGL Distribution's electricity network prices, the AER approved capitalised regulatory costs in the previous regulatory period, with the next regulatory period including those costs as operating expenditure. This was done in the context of an *ex post* prudency review of capital expenditure for the 2004-09 electricity network regulatory period.[22] ActewAGL Distribution considers that the amendment required in the AER's draft decision on the gas network access arrangement results in it not having a reasonable opportunity to recover its efficient costs in providing pipeline services.[23] ActewAGL Distribution therefore proposes to retain capitalised regulatory costs of $1.44 million ($2009/10) in the opening capital base. This position is reflected in Table 3.2.

ActewAGL Distribution also confirms that these costs were not included in the non-capital costs (operating expenditure) forecast in the earlier access arrangement period. In the ICRC's final decision in respect of this period, the category "other direct costs", where these costs would be included if they were in the operating expenditure forecast, remains constant over the final years of the period, and does not show an increase in 2009 of approximately $0.5 million, as would be expected if these costs were included in the forecast. Instead the forecasts for other direct costs remain constant at $0.24 ($2004/05) throughout the whole earlier access arrangement period.[24]

3.1.2.2 Adjustment to the capital base for inflation

ActewAGL Distribution accepts the AER's amendments to the inflation rates for adjusting the capital base in the earlier access arrangement. In the revised proposal, ActewAGL Distribution has updated the inflation forecast for 2009 with the Reserve Bank of Australia's (RBA's) last inflation forecast as at 6 November 2009 and Australian Bureau of Statistics (ABS) actual outcome in September 2009. This results in the inflation rates as set out in Table 3.1. ActewAGL Distribution has for consistency used these inflation rates when calculating the capital expenditure, operating expenditure and capital base values in $09/10 in this Access Arrangement Information Addendum.

[22] AER 2009, *Australian Capital Territory distribution determination 2009-10 to 2013-14*, Draft Decision, p 53
[23] National Gas Law, section 24
[24] ICRC, Access Arrangement Information for ActewAGL Gas Distribution System in ACT and Greater Queanbeyan, p 10

Table 3.1 Inflation rates for adjusting the capital base

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Inflation rates (%)	2.34	2.67	3.54	2.33	4.35	1.79

Sources: ABS, 6401- Consumer price index, Australia, June 2009 and RBA Monetary Policy, November 2009.

3.1.2.3 Return on the variance from forecast 2003/04 capital expenditure

ActewAGL Distribution adjusted the opening capital base at the commencement of the earlier access arrangement period for outturn capital expenditure in 2003/04. Using a calculation based on the actual asset classes comprising the difference between forecast and actual capital expenditure in 2003/04, the AER arrives at a lower return on the difference than estimated by ActewAGL Distribution using a single asset class.

ActewAGL Distribution accepts the AER's method for estimating the return on the variance from the 2003/04 capital expenditure. Due to the more recent RBA forecast of inflation, ActewAGL Distribution has updated the calculation and arrives at an adjustment of the opening capital base in 2010 of $12,747. This adjustment has been incorporated in the revised Roll Forward Model (RFM) and is set out in Table 3.2, replacing Table 7.3 in ActewAGL Distribution's access arrangement information document submitted to the AER on 30 June 2009.

3.1.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has revised the opening capital base for the access arrangement period by:

- Indexing the capital base using the AER's methodology for determining inflation, using up-to-date inflation forecasts (consistent with Table 3.5 in the draft decision, but using RBA's November 2009 forecast and ABS outcome in September 2009) (AER amendment 3.2); and
- Revising its estimate of the return on the difference between actual and forecast capital expenditure using the AER's methodology in the draft decision (AER amendment 3.2).

ActewAGL Distribution does not concur with the AER's decision to exclude capitalised regulatory costs for 2008/09 and 2009/10, and has therefore reinstated these costs in its opening capital base for the access arrangement period. As a result, ActewAGL Distribution has revised the depreciation allowance included by the AER in its draft decision to reinstate this value. The new depreciation schedule is set out in Table 3.2 and replaces Table 7.3 and 7.2 in the access arrangement information submitted to the AER on 30 June 2009. ActewAGL Distribution notes that it has otherwise applied the same methodology in determining the depreciation allowance, as approved by the AER in its draft decision.

Combining these elements, including the capital base value as at 1 July 2003 of $219.6 million, ActewAGL Distribution has rolled forward the capital base of the earlier access arrangement consistent with the methodology applied in the draft decision and by ActewAGL Distribution in the original proposal to calculate the opening capital base at the commencement of the access arrangement period starting 1 July 2010. This is demonstrated in Table 3.2, which replaces Table 7.3 in the original access arrangement information proposal.

Table 3.2 Derivation of the opening capital base at 1 July 2010

$ million (nominal)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Opening capital base	**225.9**	**233.8**	**239.3**	**250.4**	**255.6**	**266.8**	**278.0**
plus Capital expenditure	9.8	7.2	11.1	7.6	8.6	15.5	
plus Speculative capital expenditure	-	-	-	-	-	-	
plus Re-used redundant assets	-	-	-	-	-	-	
less Depreciation	7.3	8.0	8.6	8.4	8.8	9.2	
less Redundant assets	-	-	-	-	-	-	
less Disposals	-	-	-	-	-	-	
plus Indexation	5.4	6.3	8.7	5.9	11.3	4.9	
Closing capital base	**233.8**	**239.3**	**250.4**	**255.6**	**266.8**	**278.0**	
Adjustment to opening value						0.01	

Source: Roll Forward Model

3.2 Forecast capital expenditure

As per the requirement of Rule 72(1)(c), ActewAGL Distribution's access arrangement information submitted to the AER on 30 June 2009 included a calculation of the projected capital base over the access arrangement period. This included forecasts of conforming capital expenditure for the period and supporting information.

3.2.1 AER Draft Decision

While accepting the majority of ActewAGL Distribution's proposed capital projects, the AER's draft decision requires the following amendments to ActewAGL Distribution's forecast capital expenditure:

- Remove stay-in-business capital expenditure associated with the proposed Hoskinstown to Fyshwick loop (HFL) security of supply project (AER amendment 3.5);[25]
- Replace ActewAGL Distribution's forecast labour, aluminium and steel cost escalators with AER's escalators developed by Access Economics, on the basis that the updated forecasts represent the best possible forecast in the circumstances by virtue of being more up-to-date (AER amendment 3.3);[26] and
- Replace ActewAGL Distribution's forecast polyethylene and CPRS escalators with a zero real cost escalation value, as the AER does not accept ActewAGL Distribution's

[25] AER 2009, *Draft Decision*, p 36
[26] AER 2009, *Draft Decision*, pp 36-7

methodology in determining forecasts for these factors (AER amendments 3.3 and 3.4).[27]

As a result of these amendments, the AER required ActewAGL Distribution to amend its access arrangement information proposal in accordance with AER amendment 3.5, to include new values for forecast capital expenditure by driver and asset type.

3.2.2 ActewAGL Distribution response

3.2.2.1 Security of supply

In its access arrangement information submitted to the AER on 30 June 2009, ActewAGL Distribution outlined a case for the Hoskinstown Fyshwick Loop (HFL) security of supply project to reduce the risk to security of supply on the distribution network posed by upstream supply events.[28] Such events have become increasingly frequent in recent years, each requiring urgent mitigation action to avoid network shutdown and further major disruption to supply in ACT and Queanbeyan.

The proposed construction of the HFL reflected an underlying strategy by ActewAGL Distribution to insulate the network from security of supply incidents by increasing the storage capacity of the network. By taking direct action to mitigate the risk, ActewAGL Distribution could also control the timing of the solution. ActewAGL Distribution had supported the proposed project with a cost effectiveness analysis of the options that were fully within its control.

As part of its terms of reference from the AER, Wilson Cook reviewed the HFL proposal and concluded that ActewAGL Distribution had provided insufficient justification for the proposed expenditure.[29] Wilson Cook concluded that in order to properly justify a security of supply project, ActewAGL Distribution would need to conduct an appropriate cost benefit analysis of any proposed security of supply project.[30] In doing so, Wilson Cook noted that "the security of bulk gas supply to the network is demonstrably an issue that warrants further review".[31]

The AER's draft decision required amendment of the access arrangement proposal to remove relevant forecast expenditure and consequential adjustment of the capital base proposed for the access arrangement period.[32] The AER further noted that:

> The risk that ActewAGL is attempting to mitigate relates not to the integrity of its gas network, but to risks associated with the upstream supply of gas. This raises the issue of whether significant capital expenditure should be expended on ActewAGL's network to address upstream supply issues. In this regard the AER notes that ActewAGL has only considered options within its control where as options upstream of ActewAGL's gas network may be more appropriate to address upstream supply issues.

[27] AER 2009, *Draft Decision*, pp 38-41
[28] ActewAGL Distribution 2009, *Access Arrangement Information*, pp 119-123
[29] AER 2009, Draft Decision, p22
[30] Wilson Cook and Co 2009, Review of expenditure of ACT and NSW gas DNSPs: ActewAGL Distribution's network, October, p 10-13
[31] Wilson Cook and Co 2009, Review of expenditure of ACT and NSW gas DNSPs: ActewAGL Distribution's network, October, p 12
[32] AER amendment 3.7

> As outlined by ActewAGL, one of the key issues with security of supply in recent years to the ACT market were operational difficulties at the Moomba gas field. In respect to the security of supply, disruptions to gas supply and production from Moomba occurred in 2007 and 2008.[33]

ActewAGL Distribution accepts the removal of the $134.7 million forecast cost of the HFL from its capital expenditure forecast (AER amendment 3.5) and in the consequent calculation of its proposed capital base for the access arrangement period (AER amendment 3.7).

As an alternative to the HFL for addressing security of supply concerns, and in light of recent network supply diversification options (outlined below), and further analysis undertaken of upstream options, ActewAGL Distribution proposes the installation of a compression facility augmenting the Dalton to Watson lateral, to enable achievement of the required peak volumes.

ActewAGL Distribution engaged the Centre for International Economics (CIE) to conduct an economic appraisal of the Dalton to Watson compression option, discussed in detail below.

In making its draft decision, the AER took account of a submission from the APA Group, owner of the Moomba to Sydney Pipeline (MSP) and Dalton to Watson lateral, claiming that more cost effective solutions for network security of supply than the HFL were available, with an alternative being based on the enhanced utilisation of the existing large diameter MSP.[34] The AER's view was also informed by recent developments involving diversification of supply options for that network due to the completion of the QSN Link pipeline from Ballera to Moomba, sourcing gas from southern Queensland, and the NSW–Victoria interconnect through Culcairn which can supply gas from Victoria. The capacity of the MSP between Young and Wilton has also recently been substantially increased by compression augmentation. Taking this information into account, and noting the rapidly changing context in which ActewAGL Distribution had prepared its access arrangement proposal, ActewAGL Distribution believes there is now greater benefit in achieving security in supply through supply options to the network from the MSP rather than through a large network storage solution.

ActewAGL Distribution is currently continuing to explore the Dalton to Watson compression option with the APA Group, and has drawn up a relevant heads of agreement for the APA Group to build, own and operate a compressor at Dalton subject to receiving a stream of income from ActewAGL Distribution equivalent to a return on the capital, depreciation and operating and maintenance costs of the compression facilities. Notwithstanding that the Dalton to Watson compression option is not an option that is totally within ActewAGL Distribution's control (and therefore carries with it more risk and uncertainty),[35] ActewAGL Distribution submits the proposal as an efficient solution to the security of supply issue given the new and changed upstream circumstances.

[33] AER 2009, *Draft Decision*, p33
[34] APA Group 2009, *APA Submission on the ActewAGL Distribution Network Access Arrangement Proposal for the ACT, Queanbeyan and Palerang Gas Distribution Network*, 11 September
[35] Total ownership and control (and the corresponding minimising of risks and uncertainties) of the security of supply project was a key driver for ActewAGL Distribution's initial preference for the HFL rather than the Dalton to Watson compression option. ActewAGL Distribution 2009, *Access Arrangement Information*, p.122

ActewAGL Distribution proposes the addition to its operating and maintenance expenditure of $4.87 million per annum from 2011/12 for the Dalton to Watson compression services discussed above to be provided by the APA Group, and a further $0.6 million per annum for APA Group to operate and maintain the assets. These form part of the updated operating and maintenance expenditure proposal in chapter 5 of this Addendum.

Arising from introduction of the compression service, ActewAGL Distribution would need to construct a trunk receiving station and water bath heater at Watson to accommodate increased pressure and flows to the network. This requires capital expenditure of $5.0 million in 2011/12. These facilities will require additional operating and maintenance expenditure of $50,000 per annum. The latter amount forms part of the updated operating and maintenance proposal in chapter 5 of this Addendum.

Based on the cost benefit analysis undertaken to date, consideration of unquantifiable factors, the significant impact of a supply failure event, the need to further assess the probability of supply failure, cost estimates from the APA, and uncertainties about market dynamics following the introduction of the STTM, ActewAGL Distribution believes the Dalton to Watson compression option to be most efficient solution to the security of supply issue. ActewAGL Distribution believes this option will result in the maximum net benefit to the ACT community whilst mitigating to the greatest extent possible the risks associated with security of supply. Further, ActewAGL Distribution notes that this security of supply initiative is consistent with the national gas objective as contained in section 23 of the National Gas Law.

Economic evaluation of Dalton to Watson compression option

ActewAGL Distribution provided information in the June 2009 proposal on the economic benefits of the HFL to support this case, including consideration of willingness to pay valuations. However, the AER concluded in the draft decision that the HFL option was deemed to have insufficient economic justification, including a consideration of the benefits and risks associated with the HFL.[36]

ActewAGL Distribution have since engaged the CIE to conduct a cost benefit analysis of the security of supply impact of the Dalton–Watson compression option from the perspective of the entire ACT and Queanbeyan community. The CIE report,[37] presented as a threshold benefit cost analysis, draws on updated network modelling undertaken by Jemena Asset Management (JAM) on the probability and consequence of gas supply outages for the community and data on customer willingness to pay to avoid outages derived from the 2003 Willingness to Pay Study conducted for ActewAGL by NERA and ACNielsen.[38]

Modelling undertaken by JAM of the probability and consequence of outages demonstrates that the effect of the statistically most common security of supply event resulting in loss of supply would currently affect 50,000 customers at the extremity of the network—essentially

[36] AER 2009, Draft Decision, p34
[37] CIE 2009, Economic value of reducing the risk of gas supply outage: A threshold benefit cost analysis, 24 December
[38] CIE 2009, Economic value of reducing the risk of gas supply outage: A threshold benefit cost analysis, 24 December , p1

areas to the south of the Phillip PRS, primarily the Tuggeranong district of the ACT. CIE calculates that the cost in 2009 of such an outage of average expected length, should it occur, is up to $80 million in total (or $1600 per affected residential or commercial customer).[39] By 2029, the total cost would rise to up to $216 million in total for 84,000 customers, including forecast customer growth, (or $2600 per affected customer).

While the potential impact of the event is highly significant and would cause extreme inconvenience, losses and hardship for broad sections of the community, the expected annual cost for the purposes of an economic evaluation is substantially lessened by the probability of the event occurring in any year. For such an event to occur requires winter peak demand to occur concurrent to a failure of the EGP supply. At other times, the ACT network currently has a built in redundancy in that demand can be fully supplied, if required, from either transmission pipeline source.

To clarify the position, the JAM study demonstrates there is a greater than 10 per cent probability of an event occurring by 2023 (and a nearly 15 per cent probability by 2027) that would result in between 50,000 and nearly 80,000 gas consumers being without gas in winter for an expected average of 5 to 10 days. Conversely, the annual cost per customer of negating this risk is approximately $50 ($2009/10).[40]

Based on only the factors quantified in their analysis, CIE's report, at Attachment C of this Addendum, finds that the expected economic loss arising from a supply outage event is $14.1 million in the initial base case scenario.[41] However, CIE note that the report has not quantified all the risks to gas supply in the ACT.[42] In addition to its analysis of base probabilities, CIE performed sensitivity analysis of several of the variables used in reaching its conclusion on the probable threshold value for a project to mitigate the identified risk to security of supply.[43] Of particular relevance, this analysis shows that the results of the study are very sensitive to the length of outage in the supply train on the MSP. For an outage of two weeks, rather than the 5 days (130 hours) assumed, the threshold value of economic losses more than doubles to $24.8 million.

However, the sensitivity testing of the key assumptions particularly related to outage length and probability of failure need to be closely assessed as well as the range of non quantified factors to be taken into account in relation to the risks of gas supply in the ACT.

The total cost of the proposed security supply project is approximately $42 million. This consists of total capital expenditure of approximately $37 million ($32 million from the compressor and $5 million from augmentation of the Watson PRS and WBH), and a net present value of operating expenditure over 15 years (consistent with the expected life of the compressor) of $4.7 million to operate and maintain the new facilities. This has been calculated applying a discount rate consistent with ActewAGL Distribution's return on capital in its revised proposal.

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[39] CIE 2009, *Gas supply outage cost benefit analysis*, p 12

[40] It is assumed here that the cost of mitigation would be spread among all customers while the risk discussed is limited to affected customers (those in Tuggeranong).

[41] CIE 2009, p5

[42] CIE 2009, p17

[43] CIE 2009, *Gas supply outage cost benefit analysis*, pp 14-15

ActewAGL Distribution believes the project should proceed given the range of results arising from the sensitivity testing of the key input assumptions and the impact of potentially significant unquantified factors.

While the major focus of the economic appraisal report is probable failure modes of the physical infrastructure that supplies gas to the network, CIE comment on other sources of uncertainty, in particular, the impact of shipper under-nominations (not ordering enough gas to satisfy demand).[44] On this issue, CIE states:

> Under-nomination could become an issue if there is an increasing likelihood of some other external reason why additional gas cannot be sourced in the short term to correct the under-nomination. This may be, for example, because of very high demand (as would be expected in a sudden cold snap) or perhaps because of changing pattern of demands and nature of gas supply to the ACT following the introduction of the short term trading market (STTM).
>
> In this case, the risk posed by under-nomination depends on whether it exceeds the threshold that can be managed within the ACT network. Analysis by [JAM] suggests that this threshold would be 22 per cent (of demand) in 2009, 6 per cent in 2019 and 1.5 per cent in 2029. That is, if the under-nomination is greater than 22 per cent of demand (in 2009), then there is a risk of disconnecting customers. By 2029 this threshold is reduced considerably because of demand growth — an under-nomination of greater than 1.5 per cent of demand leads to the risk of disconnecting customers.
>
> A quantitative measure of the risk posed by under-nomination in these circumstances is not currently available. Indeed, because under-nomination is in many ways a behavioural issue, the risk probably depends on currently unknown choices that may be made in the future — particularly surrounding the STTM. At this stage we are therefore unable to quantify the risks associated with under-nomination.[45]

This and other factors lead CIE to conclude that:

> The underlying low probability of a supply failure to the ACT puts a limit on the amount of mitigation spending that could be justified.
>
> It is important to note, however, that as the risk is expected to increase over time (as demand on the system increases), the willingness to pay for increases in security will also increase over time. Mitigation projects that are not easily justified today may become so in the near future.
>
> In addition, this report has not been able to quantify all risks to gas supply in the ACT — particularly risks or unintended consequences that may be associated with the operation of the STTM. It is expected that these risks will be better understood over time. It may, therefore, be worthwhile updating the risk evaluation on a regular basis.

In considering its revised proposal for the security of supply issue, ActewAGL Distribution has taken account of these and other unquantified factors. These pertain to the greater range of supply options that become available through addressing the current constraint on supply from the MSP. This is especially relevant to a medium to long term view of an expected burgeoning of gas demand and positioning the ACT/Queanbeyan network to be able to take advantage of the predicted dominance of gas reserves in South-West Queensland and the integral transmission role of the MSP.

[44] CIE 2009, *Gas supply outage cost benefit analysis*, pp 15-16
[45] CIE 2009, *Gas supply outage cost benefit analysis*, p15

This position is reinforced by the Australian Energy Market Operator (AEMO) in its recent *Gas Statement of Opportunities – 2009* (GSOO) where the AEMO identifies a number of key influencing factors in how the future production and supply of natural gas to meet demand will change over the period to 2029. Most notably the change in supply arrangements for the various demand groups (market areas – for example, 'Demand Group 4' being NSW/ACT). The GSOO concludes that[46]:

> projected changes in supply and demand indicated that flow patterns may change, with proportionally less gas flowing north from Victoria, and more flowing south from Queensland. Such changes would impact the way the existing production and transmission infrastructure is used.

These changes will impact the availability and delivery of gas to the various Demand Groups and it can be deduced that ActewAGL Distribution needs to place a greater reliance for its network deliveries being delivered via the MSP, as a result of increasing gas flows from Queensland to the ACT.[47]

This position is reflected in the GSOO long range gas reserve forecasts, indicating a decline in both Victorian and South Australian gas reserves over the next two decades, whilst forecasting an increase in reserves in Queensland and northern New South Wales. These forecasts reinforce ActewAGL Distribution's resolve to support the ongoing development of a robust transmission supply chain for its future network deliveries via alignment with upstream production and transmission strategies. ActewAGL Distribution views the long term production and transmission forecasts as being key determinants of its security of supply initiative.

In view of the imminent introduction of the Sydney hub of the short term trading market (STTM), ActewAGL Distribution will further monitor the nomination behaviour of shippers and keep under review for implementation in the next access arrangement period (or earlier if required) the purchase of winter gas storage on the MSP to facilitate a park and loan service for shippers. Priced at a multiple of the prevailing Sydney STTM price, this facility would be designed to encourage shippers to ensure adequate nominations in respect of the Canberra market and utilised at ActewAGL Distribution's discretion (in the event of a supply shortage) to ensure sufficient gas becomes available through the Dalton to Watson lateral to maintain security of supply on the ACT and Queanbeyan network. The costs of the service would be recovered from users in proportion to their shares of total shipments. ActewAGL Distribution intends to consult with prospective users of this proposed initiative.

Conclusion

ActewAGL proposes an upstream network enhancement option to improve gas supply reliability in the ACT. Several very recent security events have identified weaknesses in the supply regime and new and emerging information since the time of the initial Access Arrangement submission have warranted a re-appraisal of a preferred supply solution; one relying less on insulating the network from failure and more on the security offered by recent diversification of gas sources and strengthening of the transmission network.

[46] Australian Energy Market Operator 2009, *Gas Statement of Opportunities – Executive Briefing*, p3
[47] Australian Energy Market Operator 2009, *Gas Statement of Opportunities – Executive Briefing*, p12

The consequences of major supply failure in Canberra have been shown to be substantial and a cost benefit analysis has been conducted of the proposed solution.

However, the cost benefit analysis has only partially quantified the benefits of the security of supply solution and the sensitivity testing of key assumptions, including assessment of the probability of a supply failure, demonstrates that there is a significant range in the expected benefits of the project. This is not unusual with low probability, but high impact events. The results of this economic analysis, combined with the probability of such events increasing with the growth of demand on the network, and the behaviour of shippers in the emerging market environment as a substantial unknown, confirms the need for network action to manage and resolve the problem in the interests of gas consumers and the ACT and Queanbeyan communities. ActewAGL Distribution considers it cannot ignore the need to ensure a secure gas supply to the ACT and Queanbeyan communities, and proposes the Dalton–Watson compression option as an efficient solution to resolving this issue.

3.2.2.2 Labour, aluminium and steel cost escalators

In view of the volatility of commodity prices which underpin the prices of capital materials, and real increases in wages and salaries as the result of skill shortages, the Competition Economists Group (CEG) was commissioned to compile a set of escalators for the access arrangement period. These escalators were applied to ActewAGL Distribution's forecast conforming capital expenditure using weightings for input costs determined on the basis of each respective project description.

In its draft decision, the AER did not raise any methodological issues with ActewAGL Distribution's labour, steel or aluminium escalator forecasts prepared by CEG, however, the AER stated that since the publication of the CEG report and the information on which it relies, there have been significant changes in the macroeconomic outlook, as well as fluctuations in some relevant economic data.[48] The AER notes particularly a decline in employment in the electricity, gas and water (EGW) sector since March 2009 and weaker than expected wage data in June.[49] The AER therefore engaged Access Economics to forecast labour, steel and aluminium costs and required ActewAGL Distribution to amend its cost escalators to use the more recent Access Economics escalators.

ActewAGL Distribution notes that the AER's concerns with ActewAGL Distribution's labour steel and aluminium escalators included in its original proposal are limited to the changing economic environment since submission of its proposal. Further changes in the economic outlook mean that ActewAGL Distribution considers it appropriate to update its forecast escalators to take account of recent market developments, and ensure that they remain the "best available forecast or estimate possible in the circumstances", consistent with Rule 74. Further information on changes to the economic environment, particularly in relation to labour cost escalators, is provided in section 5.3 in relation to the operating expenditure escalators.

[48] AER 2009, *Draft Decision*, p 37
[49] AER 2009, *Draft Decision*, p 37

Consistent with the AER's conclusions in regard to the methodology adopted by CEG in developing its original forecasts, these escalators have been prepared using the same methodology has used in the forecast submitted in June 2009. Updated escalators are set out in Table 3.3 below.

3.2.2.3 Polyethylene cost escalator

In relation to ActewAGL Distribution's proposed escalators for polyethylene, the AER noted two concerns in the draft decision regarding two elements of the CEG methodology:

- the construction of the forecast price index, using price indexes from the Bureau of Labour Statistics in nominal prices but using crude oil prices based on change in real prices for forecasting crude oil. The AER argued that this approach may lead to double counting of inflation;[50] and
- the notion that a link could be drawn between the price of crude oil and the price of nylon-11.

Based on these concerns, the AER required that ActewAGL Distribution's proposal be amended to reflect a polyethylene price in line with general price movements (a zero real cost escalator) across the access arrangement period.

As discussed in the CEG report in attachment E, there is no direct market estimate available for nylon-11, which ActewAGL Distribution predominantly uses for its pipes. Polyethylene was therefore used as a reasonable substitute. CEG has reviewed the AER's critique and in respect of the concern relating to the application of real forecasts for forecasting crude oil, CEG has in its update used forecast crude oil price movements expressed in *nominal* dollar terms as this is more appropriate for the result of the regression and thereby addressing the AER's first concern.

On the second point regarding the price relationship between crude oil and nylon-11, CEG has put forward further evidence that there is a relationship by obtaining a long term monthly pricing history for crude oil and thermoplastic resins from the United States Bureau of Labour Statistics from July 1991 to October 2009. CEG has used this data series to run econometric estimates of the relationship between these commodities. CEG found that using an iterated inclusion of lagged crude oil price changes, the coefficients on the lags are statistically significant up to (but not including) the fourth lag. The result shows that movements in the price of crude oil explains approximately 22 per cent of the variation in the price changes of polyethylene, and that this relationship is significant at lags of 1, 2 and 3 months. The full discussion of CEG's calculation is contained in attachment E.

Based on this analysis, ActewAGL Distribution does not consider that the AER's concerns in regard to the price relationship between crude oil and nylon-11 justify setting aside the escalation factors estimated in the CEG report. Even though there is an indirect price relationship between the materials, ActewAGL Distribution considers that the AER's assumed zero real escalation is a significantly weaker and conceptually less precise estimate than ActewAGL Distribution's estimate. Further, ActewAGL Distribution does not

[50] AER 2009, *Draft Decision*, pp 39-40

consider that the AER's forecast has been arrived at on a reasonable basis and represents the best forecast or estimate possible in the circumstances.

ActewAGL Distribution has therefore applied an updated escalator developed by CEG derived using the same methodology as used in its original proposal (with the exception of using forecast to crude oil price movements expressed in *nominal* dollar terms as discussed above) as it considers this method represents the best forecast or estimate possible in the circumstance in accordance with Rule 74(2) of the NGR. The updated escalator is set out in Table 3.3 below and replaces Table 6.10 in the June 2009 access arrangement information and AER amendment 3.3 (Table 3.9) in the AER's draft decision.

3.2.2.4 CPRS escalator

The AER's draft decision rejected ActewAGL Distribution's proposed CPRS escalator in forecasting its capital expenditure for the access arrangement period.[51]

The AER raised a number of concerns regarding the application of escalators for the proposed CPRS. These centred on the uncertainty around the implementation of such a scheme and the degree to which the anticipated effects of the CPRS are already factored into market-driven anticipated future prices of commodities. As a result, the AER concluded that it was not appropriate to apply separate escalators for the CPRS, and required ActewAGL Distribution to amend its proposal to exclude them.[52]

ActewAGL Distribution has sought advice from CEG with regards to the AER's concern that the costs for the CPRS would be included in the available forecasts in the market. CEG's advice is included in the updated escalation report provided in attachment E. CEG notes that the futures prices used by CEG to develop the escalators were all based on US dollar prices in world markets for the relevant basic commodity (aluminium, steel and crude oil). Even if investors in these markets fully factored in the expected impact of the Australian CPRS on world prices, this would have no significant effect on these prices. The impact of the CPRS is therefore not captured in CEG's escalators prior to the CPRS adjustment.

CEG has therefore added the impact of the CPRS on the commodities into the finished products purchased by ActewAGL Distribution based on the carbon intensity in relevant industries.

The AER also questioned whether the potential cost increase from the introduction of the CPRS is material. ActewAGL Distribution considers that these estimates are based on more robust evidence than a simple assumption of zero real cost escalation, provided the CPRS is introduced in Australia.

ActewAGL Distribution notes that the CPRS legislation, which was under considerable doubt at the time that the AER made its draft decision, was not passed into Australian law in December 2009. This means that there is continued uncertainty in relation to the introduction of the CPRS. ActewAGL Distribution believes that should the current legislation before the Parliament, or similar legislation introducing an emissions trading scheme be

[51] AER 2009, *Draft Decision*, pp 40-41
[52] AER 2009, *Draft Decision*, pp 40-41, AER amendment 3.4

passed, the costs should be passed through consistent with Council of Australian Governments (COAG) and the Australian Energy Market Agreement (AEMA) that requires all additional climate change policy costs to be passed through to customers, where prices are regulated.[53]

ActewAGL Distribution considers that the current level of uncertainty around the timing of the introduction of the CPRS does not mean that it cannot adequately forecast expected costs associated with the CPRS with the information currently available. The alternative is that, absent other suitable regulatory mechanisms to compensate for increased material and project costs associated with the CPRS, ActewAGL Distribution will be subject to increased costs without adequate compensation. This option would be contrary to the revenue and pricing principles set out in section 24 of the NGL that:

> A service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs in providing reference services.

In rejecting ActewAGL Distribution's proposed CPRS escalator, the AER noted that alternative regulatory mechanisms may be more appropriate for addressing this potential future cost:

> The AER also notes that ActewAGL has proposed a cost pass through for costs relating to a carbon pollution reduction scheme. The AER considers that it is appropriate for uncertain future costs, such as those relating to the CPRS, to be treated as a pass through event.[54]

ActewAGL Distribution's CPRS cost pass through event was drafted to allow ActewAGL Distribution to recover certain costs associated with the introduction of the CPRS, in particular the costs of acquiring emissions permits, costs incurred to reduce liability for carbon emissions, and administrative costs associated with the scheme, including reporting costs. ActewAGL Distribution does not consider that the pass through mechanism necessarily offers reasonable opportunity to recover input price changes associated with the CPRS. This is because it will be difficult to:

- isolate and attribute increased costs to the operation of the CPRS outside other price effects;
- quantify the cost effects into a single "event" which satisfies the materiality threshold, considering that the cost effects are likely to be seen across multiple contracts for materials and projects contributing to both operating and capital expenditure; and
- identify an event trigger to allow cost pass through claims.

For these reasons, while ActewAGL Distribution considers that cost pass through is *in principle* a mechanism able to compensate ActewAGL Distribution for the material costs associated with the CPRS, in *practice* this mechanism may be very difficult to use. One option to address these difficulties, however, may be to use the CPRS pass through event approved by the AER in its draft decision to pass through changes in costs derived by applying the CPRS escalators once the CPRS is introduced. This would only be

[53] Council of Australian Governments 2009, *Australian Energy Market Agreement*, July, Clause 4.17
[54] AER 2009, *Draft Decision*, p 40

appropriate, however, if there remains considerable uncertainty over the introduction of such a scheme during the access arrangement period at the time the AER makes its final decision. At this stage, ActewAGL Distribution considers that it is almost certain that a scheme will apply during the period, making it appropriate that the AER approve ActewAGL Distribution's CPRS cost escalators in its final decision.

ActewAGL Distribution therefore considers that the CPRS escalators calculated by CEG are reasonable and represent the best forecast possible in the circumstances, consistent with Rule 74. ActewAGL Distribution further considers that they are appropriate to use at this stage given the likelihood of a CPRS being introduced during the access arrangement period. ActewAGL Distribution has, however, updated the escalators to ensure that they remain the best forecast possible in the circumstance of this revised proposal. The updated escalators are set out in Table 3.4, which replaces Table 6.11 in the original proposal.

3.2.2.5 Use of updated escalator forecasts in the AER's draft and final decisions

The AER's decision to require ActewAGL Distribution to amend its labour, steel and aluminium escalators is based on the AER's assessment that the replacement escalators represent a better forecast of the economic outlook than those provided by ActewAGL Distribution, and as such are the best forecast possible in the circumstances, as required under Rule 74(2)(b). [55]

This is despite noting that the revised forecasts developed by Access Economics may not be as accurate as those provided by ActewAGL Distribution in some other respects:

> Even though Access Economics uses industry sector data to forecast labour cost escalators, the AER considers the fact that these forecasts are able to take into account recent developments in the labour market more than offsets any limitation in not being able to forecast EBA and non-EBA cost escalators.[56]

The AER has also signalled in both the draft decision and in comments at the public forum that it will obtain a further updated escalator report and apply new escalators in its final decision.[57]

ActewAGL Distribution considers that the AER's approach raises serious concerns, and is inconsistent with the NGL and NGR.

First, the AER's approach appears contrary to the intent of the NGL and NGR, in particular the capital and operating expenditure provisions, where the AER has limited discretion not to approve a proposal. Rule 40 describes the AER's discretion in decision making. In respect of limited discretion provisions, the AER "may not withhold its approval to an element of an access arrangement proposal … if it is satisfied that it complies with applicable requirements of the Law, and is consistent with applicable criteria (if any) prescribed by the law"[58]. Capital and operating expenditure decisions are limited discretion provisions, and escalators are a component of capital and operating expenditure forecasts.

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[55] AER 2009, *Draft Decision*, p 37
[56] AER 2009, *Draft Decision*, p 37
[57] AER 2009, *Forum on the AER's draft decision for ActewAGL's ACT, Palerang and Queanbeyan gas distribution network Reference to public forum notes on AER website*, 17 November, p 8
[58] Rule 40(2)

As forecasts or estimates, ActewAGL Distribution’s escalators are subject to Rule 74, requiring that forecasts or estimates must be supported by a statement of the basis of the forecast or estimate, and must be arrived at on a reasonable basis, and must represent the best forecast or estimate possible in the circumstances. This provision falls under Division 2 of the NGR related to the service provider’s access arrangement information proposal.

The AER draft decision accepted the methodology followed by ActewAGL Distribution in its escalator report (prepared by CEG), with the exception of the methodology for forecasting polyethylene price movements. In the case of the ActewAGL Distribution’s proposed labour cost escalators, the draft decision conceded that the Access Economics methodology was inferior to that of CEG, but that “the fact that [Access Economics’] forecasts are able to take into account recent developments in the labour market more than offsets any limitation…”.[59] On this basis the AER substituted its own escalators, stating that their own escalators are “the best forecast possible in the circumstances”, as they take account of recent developments in the market.

In determining whether the AER is correct in using its own escalator forecasts, the relevant question is how the reference in the NGR to “in the circumstances” is to be interpreted, and, in particular, whether the phrase relates to the circumstances at the time of the access arrangement initial or revised proposal, or at the time of the AER draft or final decision. The interpretation of this provision informs consideration under Rule 40(2), as it governs the applicable criteria and the stage of the decision making process at which this consideration is relevant.

If “in the circumstances” also applies to AER draft and final decisions, then the AER may be correct in substituting its own values on the basis of those values being more recent, if it can demonstrate that their being more recent makes them more reasonable. However, this interpretation would suggest that the service provider could *never* comply with rule 74, as it will always be making a submission some time before the final decision at which time the AER would always be able to substitute values. It does not appear appropriate to adopt an interpretation of rule 74 that service providers can never comply with - the correct interpretation must be that the service provider’s escalator is to be the best available at the time of the service provider’s submission.

Secondly, the approach undermines the status of the access arrangement proposal. The approach makes it certain that the AER will not approve an initial or revised access arrangement proposal put forward by a service provider, even where the service provider accepts all amendments required by the AER, as the AER will regardless apply escalators updated at the time of its decision. In such cases, the AER will always write a service provider’s access arrangement. It is difficult to see how this process affords natural justice to service providers who do not have opportunity to respond to the final escalators prepared and applied by the AER.

ActewAGL Distribution also considers the AER’s draft decision to be inconsistent with its limited discretion under rule 40. If the AER considers that ActewAGL Distribution’s

[59] AER 2009, *Draft Decision*, p 105

methodology was correct but that the estimate was not the best available, the AER is limited to replacing that estimate with an updated estimate using the same methodology. The AER did not do this, but suggested the fact that the AER's forecast was more up-to-date overcame this issue. ActewAGL Distribution submits that it this reasoning is incorrect.

A case was recently considered by the Australia Competition Tribunal where the AER had made a similar decision affecting EnergyAustralia, by assuming that more up-to-date estimates were necessarily better. In overturning the AER's decision, the Australian Competition Tribunal commented (at page 24):

> Rather than assume that the rate at a closer date would give a better estimate, the AER should have examined the evidence regarding expected future rates.   … it follows from the Tribunal's reasoning that it would be insufficient and inappropriate to only compare with rates expected to prevail close to the time of the final determination.

In other words, the AER should have looked at the substantive issue, rather than focusing on the date of the report.

ActewAGL Distribution considers that its updated escalators represent the best forecast or estimate possible in the circumstances, and is therefore consistent with rule 74. The report addresses any methodological concerns raised by the AER in respect of its earlier escalator forecasts, and updates those forecasts to use the most recent information available. The report also examines and questions the AER's consultant's estimate of labour escalation in relation to those of Macromonitor, BIS Shrapnel and, previously, Econtech.

3.2.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has revised its forecast capital expenditure for the access arrangement period as follows:

- Security of supply project changes;
- Applied updated forecasts for labour, steel, aluminium, polyethylene and CPRS escalators as set out in Table 3.3 and Table 3.4, using the weightings approved by the AER is its draft decision.

Table 3.3 and Table 3.4 replace Table 6.10 and Table 6.11 in the original proposal of June 2009 (response to AER amendments 3.3 and 3.4). ActewAGL Distribution believes that these escalators are consistent with Rule 74 and represent a forecast or estimate that is arrived at on a reasonable basis and represent the best forecast or estimate possible in the circumstances. ActewAGL Distribution also notes that the AER's limited discretion with regard to Rule 74 as discussed in section 3.2.2.2.

Table 3.3 Real escalation factors for ActewAGL capital expenditure

	2009	2010	2011	2012	2013	2014
EBA EGW labour	1.2%	1.9%	1.3%	1.5%	1.9%	2.3%
Contract EGW labour	0.9%	1.2%	1.5%	2.7%	3.8%	3.7%
Aluminium	-16.7%	46.7%	11.9%	1.4%	0.2%	0.4%
Steel	-28.5%	45.6%	17.0%	1.7%	-2.4%	-1.9%
Polyethylene	-9.1%	25.7%	7.7%	-1.9%	-2.8%	-2.4%

Table 3.4 Effect of emissions trading scheme on escalation factors

	2009	2010	2011	2012	2013	2014
Aluminium	0.0%	0.0%	0.1%	0.4%	0.3%	0.0%
Steel	0.0%	0.0%	0.3%	1.1%	0.7%	0.1%
Polyethylene	0.0%	0.0%	0.1%	0.4%	0.3%	0.0%

Updated forecast capital expenditure is presented in Table 3.5 and Table 3.6 and replaces Table 6.8, Table 6.9 and Table 6.21 in the access arrangement information of June 2009[60], as required in AER amendment 3.5. Due to the lower capital expenditure requirement compared with the original proposal in June 2009, ActewAGL Distribution does not see a case to seek equity raising costs.

ActewAGL Distribution reiterates that the forecast capital expenditure should be used to calculate depreciation in establishing the opening capital base for the access arrangement period commencing 1 July 2015. This is consistent with ActewAGL Distribution's original proposal in June 2009 and the AER's draft decision.[61]

[60] ActewAGL Distribution 2009, *Access Arrangement Information*, p 131
[61] AER 2009, *Draft Decision*, p 43

Table 3.5 ActewAGL Distribution revised forecast net capital expenditure including contributions and disposals 2010/11 – 2014/15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Distribution system capital expenditure						
Market expansion	9.47	7.88	7.67	6.64	6.16	37.82
Capacity development	5.42	15.54	0.70	0.33	2.42	24.40
Stay in business	17.71	2.25	3.67	4.15	3.22	31.00
Total distribution system capital expenditure	**32.60**	**25.66**	**12.04**	**11.11**	**11.80**	**93.22**
Non-system capital expenditure						
IT System	0.32	0.31	0.44	0.10	0.00	1.17
Total non system capital expenditure	0.32	0.31	0.44	0.10	0.00	1.17
Capital contributions	0.06	0.06	0.07	0.07	0.07	0.32
Equity raising costs	0	0	0	0	0	0
Disposals	0	0	0	0	0	0
Total capital expenditure	**32.85**	**25.91**	**12.42**	**11.14**	**11.74**	**94.06**

Table 3.6 Forecast capital expenditure 2010/11–2014/15 by asset type (gross)

$ million (2008/09)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Distribution system						
TRS & DRS - Valves & Regulators	18.77	4.08	0.42	0.95	0.42	24.64
HP Mains (inc DRS & TRS)	0.98	11.54	0.00	0.00	1.49	14.01
MP Mains	5.25	3.94	3.95	2.85	3.09	19.08
Meters - Tariff	3.81	2.82	4.41	4.17	3.84	19.06
Meters - Contract	0.64	0.20	0.23	0.32	0.22	1.62
MP Services	3.15	3.07	3.03	2.82	2.74	14.80
HP Services	0.00	0.00	0.00	0.00	0.00	0.00
Non system						
IT System	0.32	0.31	0.44	0.10	0.00	1.17
Total capital expenditure	**32.91**	**25.97**	**12.49**	**11.21**	**11.80**	**94.39**

ActewAGL Distribution has also updated other tables affected by the new escalators and updated inflation forecasts described above and as required by the AER in amendment 3.5. These tables are set out in attachment A.

3.3 Forecast capital base

3.3.1 AER Draft Decision

The projected capital base was calculated in accordance with Rule 78 as the opening capital base, plus forecast conforming capital expenditure, less forecast depreciation and forecast value of assets to be disposed of in the period.[62] The AER accepted ActewAGL Distribution's general method of rolling the forecast capital base forward. However, due to the amendments to the capital expenditures and the inflation forecast, the forecast capital base was updated to incorporate these changes.

In particular, the AER requires the following amendments to the forecast capital base:

- incorporate updated capital expenditure forecasts (AER amendment 3.7);
- amend inflation forecast to apply AER preferred methodology (AER amendment 3.6); and
- update forecast depreciation to reflect changed capital and inflation forecasts (AER amendment 3.6).

3.3.2 ActewAGL Distribution response

ActewAGL Distribution has used the opening capital base of $278.0 million derived in section 3.1 above. The capital base has been forecast consistent with Rule 78 using the elements discussed above.

Asset standard lives applied are consistent with the original proposal. However, due to updates to the opening capital base, the remaining lives as at 1 July 2010 have been amended as set out in Table 3.7, replacing Table 7.5 in the original proposal.

Table 3.7 ActewAGL Distribution asset lives and remaining lives 1 July 2010

Asset Category	Standard life	Remaining lives
Primary (HP) Mains	80	64.85
HP Services	50	32.50
MP Mains	50	29.86
MP Services	50	39.22
Regulators, Valves (TRS, SRS)	15	10.90
Contract meters	15	12.94
Tariff meters	15	11.44
IT System	5	3.66
Regulatory Costs	5	3.87

ActewAGL Distribution does not propose any changes with regard to the method of calculating depreciation for the 2015 opening capital base compared to the original

[62] ActewAGL Distribution 2009, *Access Arrangement Information*, pp 138-143

proposal in June 2009 and confirmed in the draft decision by the AER. The forecast depreciation for the 2010/11 to 2014/15 presented in Table 7.6 in the original proposal in June 2009 has been amended following the changes to the capital expenditure and forecast inflation and is set out in Table 3.8 (AER amendment 3.6).

Table 3.8 Economic depreciation 2010/11 to 2014/15

$000 nominal	2010/11	2011/12	2012/13	2013/14	2014/15
Straight line depreciation	9.5	11.7	12.9	13.8	14.3
Inflation adjustment	-6.9	-7.7	-8.3	-8.5	-8.7
Economic depreciation	2.6	4.0	4.6	5.2	5.6

The updated forecast capital base, which can be indirectly calculated by using the information provided in the PTRM in attachment F, is presented in Table 3.9 and replaces Table 7.7 and Table 10.3 in the proposal of 30 June 2009 (AER amendment 3.7).

Table 3.9 Projected capital base 2010/11 – 2014/15

$ million ($2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15
Opening capital base	278.0	302.9	318.8	319.7	318.8
plus Forecast capital expenditure	34.2	27.0	12.9	11.6	12.2
less Forecast depreciation	9.3	11.1	12.0	12.5	12.7
less Projected redundant assets	-	-	-	-	-
less Forecast disposals	-	-	-	-	-
Closing capital base	302.9	318.8	319.7	318.8	318.4

3.4 Capital redundancy mechanism

3.4.1 AER Draft Decision

Rule 85 provides that a service provider may include, and the AER may require it to include, a mechanism to ensure that assets that cease to contribute in any way to the delivery of pipeline services are removed from the capital base.

In the draft decision, the AER requires ActewAGL Distribution to remove the capital redundancy mechanism proposed by ActewAGL Distribution on the grounds that it is inconsistent with Rule 77(2)(e) which provides no discretion to the regulator on whether or not redundant assets are removed from the capital base in the subsequent access arrangement period. This is set out in AER amendment 3.8. The AER also requires ActewAGL Distribution to amend its access arrangement information to reflect this amendment.

3.4.2 ActewAGL Distribution response

ActewAGL Distribution accepts AER amendment 3.8 to delete its proposed capital redundancy mechanism from the access arrangement. ActewAGL Distribution does not propose an alternative capital redundancy mechanism.

ActewAGL Distribution amends its access arrangement information in accordance with this section 3.4, as required under AER amendment 3.8.

4 Rate of return and forecast inflation

This chapter supplements ActewAGL Distribution's rate of return and forecast inflation proposal (chapter 8 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the capital base in chapter 5 of the draft decision.

Table 4.1 sets out ActewAGL Distribution's revised rate of return and replaces Table 8.1 in the access arrangement information document submitted to the AER on 30 June 2009. Table 4.1 also replaces the AER's draft decision amendment 5.2.

Table 4.1 Summary of ActewAGL Distribution's proposed cost of capital parameters

CAPM parameter	Value
Nominal risk free rate	5.50%
Equity beta	1.0
Market risk premium	7.5%
Debt risk premium	4.30%
Debt share of total value (gearing)	60%
Gamma (utilisation of imputation credits)	0.65
Nominal return on equity	13.00%
Nominal return on debt	9.80%
Nominal vanilla WACC	11.08%

Compared with the original proposal in June 2009, the risk free rate has increased, but this has been offset by a lower debt risk premium. ActewAGL Distribution notes that this has increased the nominal return on equity, but decreased the return on debt.

4.1 Treatment of dividend imputation credits

4.1.1 AER Draft Decision

In its June 2009 proposal, ActewAGL Distribution applied a value for gamma of 0.65 for the access arrangement, which was consistent with the AER's WACC review finding. However, ActewAGL Distribution stated that it disagreed with the basis of this number.[63]

The AER noted ActewAGL Distribution's preference for a gamma value lower than 0.5, but noted that no new information has been submitted since the WACC review in May 2009 and decided a gamma value of 0.65 was appropriate.[64]

4.1.2 ActewAGL Distribution response

The gamma is defined as a product of the 'imputation credit payout ratio' and the 'utilisation rate' often referred to as theta. In deriving at a value of 0.65, the AER has assumed a

[63] ActewAGL Distribution 2009, *Access Arrangement Information*, p 148
[64] AER 2009, *Draft Decision*, p 70

payout ratio of imputation credits of 1. ActewAGL Distribution continues to disagree with the AER's WACC review and particularly with regard to the assumption that the payout ratio of imputation credits is 1, noting there is significant empirical evidence as well as regulatory practice suggesting that it should be lower than 1.[65] Since ActewAGL Distribution's original proposal on 30 June 2009, IPART has commenced a WACC review. In its issues paper, IPART has stated the following:

> We [IPART] will monitor the new evidence that was presented as part of the AER review, but at this stage we do not believe that there is sufficient new evidence that would warrant a shift from our current gamma value. Due to the considerable uncertainty in estimating gamma, our preliminary view is that it is appropriate to maintain a gamma range of 0.5 – 0.3 in future decisions.

ActewAGL Distribution agrees with IPART's view that there is insufficient evidence that would warrant a shift of the gamma above 0.5. Since the proposal in June 2009, more material[66] supporting a gamma below 0.5 has been submitted to the AER by the Queensland DNSPs. In its draft decision in November 2009, the AER did not accept their proposed value disagreeing with the Queensland DNSP's consultant Synergies' assumption that retained credits do not have any value and some methodological issues with the utilisation rate. ActewAGL Distribution notes that the AER relies mostly on one source when referring to the payout ratio being 1, again noting this has not convinced IPART in its preliminary review of the gamma.

ActewAGL Distribution notes there is significant evidence indicating that the gamma should be between 0.2 and 0.5. The new information presented by Synergies and the statement also expressed by IPART add further doubt to the AER's decision to apply a gamma of 0.65.

4.2 Sample period

ActewAGL Distribution accepts the sample period in the AER's draft decision[67], subject to the following condition: if, prior to the release of the final determination, there is another extraordinary event which results in returns during the proposed period which are not unbiased estimates of expected returns in the regulatory period, ActewAGL Distribution proposes that the sample period be set prior to the event. ActewAGL Distribution believes this approach is consistent with the November 2009 ruling by the Australian Competition Tribunal on the appeal by Energy Australia and others. The Tribunal found that a proposed period should be rejected if it "would be likely to generate a return that was inappropriate, ie, too high or too low having regard to the period in which it was to be applied" (paragraph 89). ActewAGL Distribution considers that an extraordinary event during a sample period, such as the onset of the global financial crisis, provides a clear basis for rejecting that period and adopting an alternative which results in unbiased estimates of expected future returns.

[65] For example, Table 10.2 and 10.3 in the AER WACC review
[66] Synergies 2009, *New analysis using tax statistics*, May
[67] AER 2009, *Draft Decision*, confidential attachment A.

4.3 Nominal risk free rate

4.3.1 AER Draft Decision

The AER accepted ActewAGL Distribution's proposal to use the *annualised* yield on CGS with a maturity of 10 year as a proxy for the risk free rate of return. Specifically, ActewAGL Distribution proposed to use Treasury Bonds TB122 and TB126, which also was accepted.

4.3.2 ActewAGL Distribution response

ActewAGL Distribution agrees with the draft decision's methodology in setting the nominal risk free rate, using the annualised yield of Treasury Bonds TB122 and TB126.

For the purposes of this revised submission, ActewAGL Distribution has used the 20 business days from 16 November to 11 December 2009 for the abovementioned Treasury Bonds to determine the nominal risk free rate at 5.50 per cent. This is reflected in the amended Table 4.1, summarising ActewAGL Distribution's WACC claim.

4.4 Market Risk Premium

4.4.1 AER Draft Decision

The AER did not accept ActewAGL Distribution's proposal of a market risk premium (MRP) of 7.5 per cent, which was based on a report by CEG, using a dividend growth model (DGM) approach. The AER's draft decision referred to improvement in global financial conditions, high variability of dividend growth market based estimates of MRP, as well as conclusions from its WACC review in May 2009 in support of its position.

4.4.2 ActewAGL Distribution response

ActewAGL Distribution notes the AER's concern about the sensitivity of the DGM's result to small changes in the assumptions. However, as described in the original proposal in June 2009, if the AER assumes that the market risk premium is to return to the AER's previously assumed long term MRP of 6.0 per cent, the "prevailing forward looking short run average MRP" is even higher. Even though the DGM is sensitive to assumptions, the difference between the implied MRP in the CEG report and the AER's WACC is so significant that ActewAGL Distribution believes it demonstrates that an MRP of 6.5 per cent is too low. This was further highlighted by the fact that ActewAGL Distribution also notes that actual dividends would need to be 20 per cent lower than the Bloomberg forecasts in May 2009 to justify a long run market risk premium of less than 7.5 per cent.

The AER also repeated its WACC review conclusion regarding "a relative lack of sources" of estimates justifying cash-flow-based measures of the MRP. ActewAGL Distribution notes that the report by CEG was based on dividend forecasts from all analysts connected to Bloomberg for the ASX 200 companies, implying hundreds of professional financial analysts, who on a daily basis follow the companies in question. This would represent a competent source about the overall market's future dividend expectations.

In addition, the AER raised three other specific issues with regard to the DGM applied by CEG:

- after 2009, it appears that dividends are paid in January of each year rather than each financial year, as 2010 is discounted by seven rather than 12 months and no reason is provided for this adjustment;
- dividends are modelled for 125 years rather than in perpetuity; and
- the long-run average growth rates have been applied to dividends while short run average 10-year CGS yields have been calculated. The AER considers that, given the model is a perpetuity model, a long-run average is more appropriate.

After adjusting for these issues, the AER's estimate of the Market Risk Premium ranged from 6 to 7.8 per cent. ActewAGL Distribution has reviewed the AER's draft decision and makes the following comments:

- CEG has discounted each year's dividends by 6 months and not seven months suggested by the AER. The reason for this is because dividends are spread out over the year (paid biannually and sometimes more often). The AER's proposal to discount by 12 months would only be correct if all dividends occurred on 30 June each year.
- if this assumption were implemented, CEG would have derived a much higher MRP because 100 per cent of the dividends would be received on 30 June. CEG modelled 2009 dividends over the last 2 months of financial year 2009.
- at 125 years and a low cost of equity of 10 per cent, the discount factor is 149,308. That is, a dividend of $150,000 in 125 years has a value of $1 in present value terms. It is therefore immaterial to extend the model beyond 125 years (that is, in perpetuity) and there is no material basis for this adjustment.
- with regard to the AER's concerns about the long-run average growth rate being applied while short-run average 10-year CGS yields have been calculated, ActewAGL Distribution notes that CEG has calculated the MRP at the time (December 2009) against the risk free rate that the business would receive if the regulatory decision was made at that time. CEG has not asked the question "what would the MRP be relative to the risk free rate if the regulatory regime set the risk free rate equal to the long term average", since this is not relevant. CEG has measured what the MRP would be relative to the prevailing risk free rate (which is the rate that would be adopted by the regulatory regime).

Further, the AER noted that global economic conditions have improved since ActewAGL Distribution's original proposal in June 2009. ActewAGL Distribution agrees that global financial conditions have improved since its original submission and therefore asked CEG to update the original analysis dated June 2009, based on the market circumstances in December 2009. In summary, the update showed the following changes since ActewAGL Distribution's original proposal in June 2009:

- Total expected dividends are about 2 per cent higher;
- Long term bond yields are about 0.6 percentage points lower; and

- Market capitalisation is about 20 per cent higher.

Altogether, the update shows that market conditions have improved bringing the forward looking MRP down. However, the updated values still show that the best estimate of the MRP over the next 6 years is 10 per cent, with a lower bound of 6.5 per cent (using the low bound of the long term dividend growth assumption). This is based on the assumption that the market risk premium is expected to fall back to the AER's initial estimate of 6 per cent in 6 years. If the MRP was to fall back to 6 per cent in 10 years the range is between 6.3 and 8.7 per cent, with an average of 7.5 per cent.

ActewAGL Distribution's proposed market risk premium in June 2009 of 7.5 per cent was very low relative to the values generated from the DGM at the time, but this value considered market circumstances at the time. With more stable market conditions as in December 2009, ActewAGL Distribution notes that its original proposal of 7.5 per cent remains valid.

Consistent with its original proposal, ActewAGL Distribution believes that the Market Risk Premium is 7.5 per cent. This is reflected in amended Table 4.1, summarising ActewAGL Distribution's WACC claim.

4.5 Equity beta

4.5.1 AER Draft Decision

ActewAGL Distribution proposed an equity beta of 1.0, consistent with its earlier access arrangement approved by the ICRC and supported by a report by CEG. It also noted that the systematic risk in the gas distribution business is higher than for electricity distribution. In making its decision the AER referenced its electricity WACC review which arrived at an equity beta of 0.8, stating that electricity businesses are close, but not perfect comparators for the benchmark gas business.[68] The AER advised its view that empirical evidence from the electricity WACC review suggests an equity beta between 0.4 and 0.7, but due to "regulatory certainty and adopting a conservative approach, the AER concludes that 0.8 is the best estimate, arrived at on a reasonable basis of the equity beta".[69]

Further, the AER was not convinced that business volatility comparisons between gas and electricity distribution presented by ActewAGL Distribution, represented systematic risk rather than business specific risk. The AER did not accept the CEG's DGM projections of the equity beta as it is an indirect estimate, stating that it was dependent on the relative values of two highly variable projections, and therefore received little weight in determining the equity beta.

4.5.2 ActewAGL Distribution response

ActewAGL Distribution is concerned that the AER has not acknowledged or reflected the increased business risk in the gas distribution compared with electricity distribution when setting the equity beta. Furthermore, ActewAGL Distribution disagrees with AER's

[68] AER 2009, *Draft Decision*, p 197
[69] AER 2009, *Draft Decision*, p 65

conclusion on the DGM methodology, noting that some of the AER's concerns (for example, number of analysts consulted by Bloomberg in estimating the dividend growth) are subjective. Also, the AER's concern regarding the inconsistent timing of assumptions in the model would not change the outcome. ActewAGL Distribution therefore disagrees with the AER's draft decision regarding the use of the DGM methodology.

ActewAGL Distribution notes, as argued in its original submission in June 2009, that the AER acknowledged in the WACC review that gas distribution businesses bear a higher risk than electricity businesses. .[70] However, in its access arrangement draft decision response the AER states that "the difference in systematic risk exposure between gas and electricity businesses is likely to be insignificant, particularly for regulated businesses such as ActewAGL".[71] This position is inconsistent with the view presented in the AER electricity WACC review. ActewAGL Distribution acknowledges that it is difficult to estimate the relative risk difference between gas and electricity distribution businesses. However, ActewAGL Distribution believes that the information presented in its original proposal in June 2009 (CEG report and conceptual arguments) showed that there is a material difference between electricity and gas distribution businesses' systematic risk.

In its original submission, ActewAGL Distribution submitted confidential data to demonstrate that cash flows and EBT vary significantly more within its gas business than its electricity distribution business. Also, customer numbers and throughput vary significantly more. The AER however noted that, apart from EBT, these measures were several steps removed from the final profit of the business and the return to shareholders and therefore are not meaningful measures. ActewAGL Distribution agrees that customer and throughput variation are partly removed from the shareholder return. However, ActewAGL Distribution believes it is wrong to dismiss the measures since the AER is implicitly assuming that businesses do not have any fixed costs. Fluctuations in customer numbers or throughput have impacts on revenues. Only businesses with pure variable costs would be unaffected by revenues changes (assuming price adjustments are not possible). ActewAGL Distribution also believes that cash flows are relevant, since the cash position would be considered as part of the dividend policy.

Since gas is a non-essential service and significantly more weather dependent, ActewAGL Distribution believes, as stated in its June 2009 proposal, that there are significant conceptual arguments for the gas business bearing a higher equity beta than the electricity businesses. In terms of regulatory precedence, regulators in both New Zealand and the UK have acknowledged a higher equity beta is warranted for gas distribution businesses compared to electricity businesses. The Commerce Commission of New Zealand included a specified adjustment to the asset beta for gas distributers to account for the "risk of New Zealand gas businesses relative to electricity line businesses."[72] This followed analysis by LECG submitted to the Commission's initial draft on the differential between betas for gas and electricity customers which concluded "it is clear that gas distribution utilities both in the

[70] ActewAGL Distribution 2009, *Access Arrangement Information*, p152
[71] AER 2009, *Draft Decision*, p 63
[72] Commerce Commission 2004, *Final Report: Gas Control Inquiry*, November, p 188, accessed at http://www.comcom.govt.nz//RegulatoryControl/GasPipelines/ContentFiles/Documents/Public Version Final Report 29 November 2004.pdf)

US and Europe have a higher systematic risk profile than electricity distribution companies."[73] Similarly, advice from Pricewaterhouse-Coopers to the UK regulator Ofgem concluded that, "In general, betas for gas companies are slightly higher than those for electricity companies, both in the case of the overall range, and when comparing individual category sets i.e. GT [Gas Transmission] relative to ET [Electricity Transmission] and GN [Gas Networks] relative to EN [Electricity Networks]. The exception is gas distribution, where the GD [Gas Distribution] beta is roughly twice the ED [Electricity Distribution] beta range."[74] Evidence presented in both gas network reviews indicated there was a higher cost of equity involved in gas distribution compared to electricity distribution. For this reason, the AER should revise its conclusion that the difference is insignificant for ActewAGL Distribution.

ActewAGL Distribution also notes that AER's reference of an electricity beta of 0.4-0.7 would result in the cost of equity, in the draft decision, being lower than the cost of debt for beta values between 0.4 and approximately 0.65. The cost of debt being higher than the cost of equity is contrary to normal observations and practice in the capital market.

The AER was not persuaded in the draft decision that the volatility measures showing that the ActewAGL gas network business is more volatile than electricity network business reflects systematic risk. ActewAGL Distribution believes the provided data is a reflection of the industry and a demonstration of a greater systematic risk in the gas than electricity business. ActewAGL Distribution believes its EBT-data, energy throughput, cash flow and customer number variations support that the systematic risk in a gas distribution business is higher than for electricity and that the equity beta therefore should be higher than 0.8. ActewAGL Distribution has used an equity beta of 1.0 in the revised proposal. This is reflected in the amended Table 4.1, summarising ActewAGL Distribution's WACC claim.

4.6 Debt risk margin and credit rating

4.6.1 AER Draft Decision

In its June 2009 submission, ActewAGL Distribution proposed to use the average of the CBA Spectrum and Bloomberg when determining the debt risk premium. ActewAGL Distribution also proposed a credit rating of BBB+. The AER accepted ActewAGL Distribution's proposed credit rating of BBB+ for the purposes of deriving the benchmark debt risk premium. However, the AER did not accept ActewAGL Distribution's proposed method of applying the average of relevant CBA Spectrum (BBB+, 10 year) and Bloomberg derived yields as the most reasonable method of estimating the debt risk margin. Instead the AER considered that a comparison of Bloomberg's and CBA Spectrum's fair value estimates with a number of observed bond yields should be used to determine which fair value curve (or average) provides the best possible estimate in the circumstances. The AER compared the observed yields of a common sample of BBB+ rated bonds from

[73] LECG 2004, August, p 8, accessed at http://www.comcom.govt.nz//RegulatoryControl/GasPipelines/ContentFiles/Documents/NGC-WACC.pdf

[74] PricewaterhouseCoopers 2009, Report for the Office of Gas and Electricity Markets (OFGEM): Advice on the Cost of Capital Analysis for the fifth Distribution Price Control Review (DPCR5), December, p 83, accessed at http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/Financial Issues - Ofgem Cost of Capital - FINAL - 011209.pdf

different sources with the fair value estimates based on Bloomberg, CBA Spectrum and an average of both. The difference between the observed yields and the fair value estimates were compared using the weighted sum of squared errors, using equal weights to all bonds in the sample. The defined sample used by the AER consisted of Coles Myer, Snow Hydro, GPT Group, Westfarmers and Santos. The AER excluded a Babcock and Brown Infrastructure bond based on application of the Chow test. Applying the weighted sum of squared errors over a 15 and 20 day period to 23 October 2009 resulted in CBA Spectrum having the lowest difference in the sum of the squared errors. The AER therefore used CBA Spectrum as the data source for debt margin for the 20 days period to 23 October 2009 and arrived with a debt risk margin of 4.28 per cent.

4.6.2 ActewAGL Distribution response

In its original submission in June 2009, ActewAGL Distribution assumed a credit rating of BBB+ to calculate the debt risk premium, consistent with established regulatory practice. This indirectly assumed that the AER would accept the proposed equity beta, compensating for the higher systematic risk a gas distribution business faces. In the draft decision, the AER was not convinced that gas distribution businesses face a higher systematic risk than electricity distribution companies, noting that parts of the provided supporting data were specific to ActewAGL Distribution. The AER noted, however, that it:

> considers that there are grounds for including business specific risk (in particular, cash flow volatility) when determining the credit rating for the benchmark business.[75]

ActewAGL Distribution's proposed BBB+, credit rating reflects a gearing of 60 per cent in its original proposal in June 2009. While accepting that business specific risk should be taken into consideration when determining the credit rating, ActewAGL Distribution considers that a deviation from standard regulatory practice is not a preferred option as the costs for the cash flow volatility could be compensated through a direct estimate for the cost of the cash flow volatility. ActewAGL Distribution believes an allowance in operating expenditure for the high cash flow volatility in its gas distribution business through a financial risk and preparedness cost would be appropriate, should the AER not appropriately adjust the equity beta for the higher systematic risk in gas distribution[76]. How this could be calculated, for ActewAGL Distribution's specific situation, is discussed in confidential attachment B.

As late as May 2009, the AER argued strongly for the use of Bloomberg as the best source of information in estimating the debt premium. The discontinuation of the Bloomberg 8-year yield series appears to have changed the AER's strong support for using Bloomberg as data source for the fair yield.

[75] AER 2009, *Draft Decision*, p 201. ActewAGL Distribution understands that the AER's attachment discussing ActewAGL Distribution's WACC was kept confidential to protect ActewAGL Distribution's confidential information provided to the AER. Information disclosed here from the AER's confidential attachment is therefore considered by ActewAGL Distribution to be suitable for public release.

[76] ActewAGL Distribution notes that it has not included any costs for the financial risk and preparedness cost in the revised proposal as ActewAGL Distribution believes that the fluctuations in its cash flows, EBT, customer numbers and energy throughput represent systematic risk and should be compensated for through the equity beta as discussed in section 4.5.

ActewAGL Distribution has previously argued against the use of Bloomberg as a source. However, due to the uncertainties in both Bloomberg and CBA Spectrum's methodologies in estimating the fair value estimates, ActewAGL Distribution has argued, as a reasonable compromise, the averaging of information from these two primary sources.

In considering the AER's approach to determining the debt risk margin in the draft decision, ActewAGL Distribution is not convinced that the AER's method provides a reliable estimate. ActewAGL Distribution is concerned, in particular, about the exclusion of bonds from the AER's sample, due to the identification of "structural breaks"[77] in the data, based on the Chow test.

ActewAGL Distribution therefore maintains its view that the use of the average of the CBA Spectrum and Bloomberg 10-year BBB yield would remain the best forecast possible in the circumstances. Since ActewAGL Distribution's submission in June 2009, Bloomberg has discontinued its eight-year BBB predicted yield used to estimate a 10-year BBB bond rate with the addition of the spread between a 10 and 8 year AAA yields. In this regard, ActewAGL notes that the AER has not described its preferred method of estimating a 10-year bond rate using Bloomberg yield data. When estimating the fair 10-year BBB yield using Bloomberg as source, ActewAGL Distribution has used the 7-year BBB bond rate and extrapolated the difference between a 10-year AAA bond yield and 7-year AAA bond yield. ActewAGL Distribution believes this method is most similar to the previous method applied by the AER and has used this for deriving a robust and consistent regulatory approach.

For the purposes of this revised submission, ActewAGL Distribution has used the sample period of the 20 business days from 16 November to 11 December 2009. For the final decision, ActewAGL Distribution proposes the use of the sample period as referred to in section 4.2 above. The average of the CBA Spectrum and the Bloomberg BBB 10-year yield for the period 16 November to 11 December 2009 is 9.80 per cent. Subtracting the risk free rate as derived in section 4.3 of 5.50 per cent from the fair yield results in a debt risk premium of 4.30 per cent. This is reflected in the amended Table 4.1, summarising ActewAGL Distribution's WACC claim.

4.7 Forecast inflation

4.7.1 AER Draft Decision

ActewAGL Distribution proposed to use the Fischer equation if there is no bias between the nominal and indexed CGS at the time of the final decision. If there is a bias, the average inflation should be based on the RBA's forecast in accordance with the same methodology applied by the AER in other determinations. The main concern with the implied inflation method is due to the limited supply of indexed CGS relative to demand.

In its draft decision, the AER notes that ActewAGL Distribution used a relatively brief period of analysis to demonstrate convergence between the nominal and indexed CGS. Noting the

[77] AER 2009, *Draft Decision*, p 223-224

limited supply of indexed CGS, the AER considered the best estimate of the 10-year inflation forecast is a geometric average of the RBA short-term forecasts and the mid-point of the RBA's target inflation range for the remaining years in the 10-year period.

4.7.2 ActewAGL Distribution response

ActewAGL Distribution notes that at the time of the draft decision, both the Fischer equation (the market method) and the AER's preferred method arrived at similar inflation forecasts. ActewAGL Distribution also notes that the difference between the average yield of the average nominal CGS and the indexed CGS has increased by 0.8 percentage points since May 2009 and, at the time of the revised proposal, again indicating a bias in the market.

Given the reoccurring bias of the indexed CGS and the brief time period as referred to by the AER, ActewAGL Distribution accepts the AER's method applied in the draft decision. The forecast inflation used in this revised proposal is based on RBA's November 2009 Monetary policy statement, which arrives with an inflation forecast of 2.48 per cent. Table 4.2 below replaces Table 8.2 in the original proposal in June 2009.

Table 4.2 ActewAGL Distribution's inflation used in the revised proposal

June	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	**Average**
Forecast inflation	2.25%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	**2.48%**

5 Operating expenditure

This chapter supplements ActewAGL Distribution's operating expenditure proposal (chapter 9 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to forecast operating expenditure in chapter 9 of the draft decision.

Total forecast operating and maintenance expenditure submitted in June 2009 for the access arrangement period was $119.0 million, 36.7 per cent higher (in real terms) than the outturn operating expenditure for the earlier access arrangement period. This increase is due mainly to step changes in costs arising from the requirements of enhanced technical standards and required maintenance of ageing assets, together with additional maintenance required on new and augmented facilities.

5.1 Selection of base year

5.1.1 AER Draft Decision

While the AER's standard practice is to apply a base year derived from the most recent year of actual expenditure, the AER accepted ActewAGL Distribution's proposed base year to be 2009/10. In accepting this proposal, the AER noted that the expenditure level in 2009/10 is broadly consistent with the previous year, but also incorporates new lease costs associated with the move from owning to leasing ActewAGL Distribution's corporate head office.[78] It also noted that the costs in 2009/10 were a reliable estimate of actual costs as those costs were determined through the negotiation of the Services Plan for that year.

5.1.2 ActewAGL Distribution response

ActewAGL Distribution has not made any changes to the selection of the base year compared with the original proposal.

5.2 Step changes

5.2.1 AER Draft Decision

The AER did not accept all of ActewAGL Distribution's step changes and required ActewAGL Distribution to amend step changes related to technical regulation, project specific costs, AEMO fees and to certain gas market developments.

5.2.2 ActewAGL Distribution response

ActewAGL Distribution has reviewed the AER's draft decision and will address each of the categories of step changes. For this addendum and in response to the AER's draft decision, ActewAGL Distribution has also identified the need to introduce certain additional step changes, discussed below.

[78] AER 2009, *Draft Decision*, pp 95-6

ActewAGL Distribution's revised step changes are provided in attachment G and replace the step changes in the access arrangement information proposal (Table 9.5 and Table O.2 in attachment N) submitted to the AER on 30 June 2009.

5.2.2.1 Technical regulation

ActewAGL Distribution proposed step changes for increases in costs associated with complying with the requirements of Australian Standards AS2885 and AS4645, including the conducting of safety management studies, integrity reviews and formal safety assessments.[79] In its draft decision, the AER determined that these step changes have not been arrived at on a reasonable basis, and have re-estimated ActewAGL Distribution's technical regulation compliance costs using a lower daily rate, requiring ActewAGL Distribution to amend its forecast operating expenditure.[80]

In its report to the AER, Wilson Cook did not dispute the need for the proposed actions to comply with technical regulations, and agreed with ActewAGL Distribution's approach.[81] However, Wilson Cook considered the unit rate as high "if it relates mainly to field staff or technical staff on lower salary levels."[82]

ActewAGL Distribution notes that there is often more professional than technical personnel in attendance at these meetings, and the costs associated with this professional level attendance is reflected in the proposed technical regulation step change. To demonstrate this, ActewAGL Distribution has undertaken a more detailed level of cost estimate to test and verify the original proposed cost using the budgetary method. A list of personnel that can be expected to contribute to a safety management studies from time to time is reproduced in Table 5.1. Not all of these personnel would necessarily be included in any one workshop, but this is the group from which general workshop attendance can be expected to be drawn.

[79] ActewAGL Distribution 2009, *Access Arrangement Information*, p 166
[80] AER 2009, *Draft Decision*, p 97
[81] AER 2009, *Draft Decision*, p 96
[82] AER 2009, *Draft Decision*, p 96

Table 5.1 Personnel contributing to safety management studies

Job Title	Role
Principal Engineer, C & I	Facilitator
Integrity Engineer	Scribe
Principal Engineer, Pipelines	Pipeline
Principal Engineer, Facilities	Facility
Environmental Compliance	Environmental
Land Services Manager	Easement
Technical Regulatory Specialist	Safety and operating plan (SAOP)
Manager, Emergency Preparedness & Security Strategy	Security
Senior Integrity Engineer, Corrosion	Cathodic protection/corrosion
Senior Integrity Engineer	Operations
Response and Control Manager	Operations/response
Maintenance Strategy	Asset Management – observer
Records Management Officer	Records Management
Senior HSE Advisor – JAM-GAS	Occupational health and safety
Asset Planning Engineer	Capacity
Delivery Manager	Infrastructure protection
Senior Technical Officer	Cathodic protection
Pipeline Technician	Pipeline patrol

The average daily rate of the above personnel is $922 ($2009/10). While ActewAGL Distribution notes that this value is 25 per cent lower than the $1,138 ($2009/10) which was the basis of the estimate used for ActewAGL Distribution's original submission in June 2009, there are a number of factors that further drive up this rate. These are as follows:

- Like many similar organisations, external engineers will be utilised with expertise in safety management studies to assist in validation and quality assurance. The typical daily rate for these engineers is at least $2,200 per day. This can be expected to increase the average daily rate by approximately $200/day. Moreover, from the above table it is clear that there is more professional than technical personnel, meaning that the original 50% EBA /50% non-EBA input cost split was conservative.
- In addition, while a broad estimate of the time to undertake the two safety management studies of 65 hours was applied, there is considerable potential for this to be an under estimate. That is, there is a considerably greater risk that the workshops or preparation will take longer than the original estimate and very little likelihood that it will be less. This is because the 65 hours assumed 25 hours of preparation for the two workshops. In practice, this preparation is likely to be as high as 25 hours for *each* workshop.

Further, the AER noted in its draft decision that the daily rate ActewAGL Distribution advised for an employee attending the relevant workshops "is significantly higher than the daily rate observed by the AER for similar safety management workshops."[83] However, this daily rate is attributed to a confidential source.[84] ActewAGL Distribution notes that as the source of this information is unknown and is confidential, there is no basis for testing whether or not it is valid or representative of the requirements of ActewAGL Distribution.

This lack of opportunity to make an informed response contravenes the principles of due process and natural justice. Consequently, ActewAGL Distribution considers that this assertion cannot be used by the AER to re-estimate its forecast operating expenditure for technical regulation compliance costs. Therefore, ActewAGL Distribution considers its original forecast operating expenditure for compliance with technical regulations remains reasonable and appropriate and has not amended its forecast operating expenditure as per the AER's draft decision in this respect.

5.2.2.2 Project specific costs

ActewAGL Distribution proposed a number of step changes for costs in relation to specific high pressure system projects, the Canberra primary main integrity project, and the Hoskinstown-Fyshwick trunk main integrity project. The AER accepted the step changes for all the project specific costs subject to two adjustments in respect of the Queanbeyan TRS and the Phillip PRS.

In their report to the AER, Wilson Cook indentified that once the Queanbeyan TRS is complete, the Jerrabomberra packaged off take station (POTS) will no longer be required. However, ActewAGL Distribution submitted operating forecasts inclusive of the Jerrabomberra POTS from 2011-12. Accordingly, the AER required ActewAGL Distribution's forecast operating expenditure to be reduced by $9,480 per year from 2011-12.

Wilson Cook also identified that a timing adjustment is required with respect to the Phillip PRS. In its access arrangement, ActewAGL Distribution submitted operating expenditure based on the commencement of the Phillip PRS project in 2011-12. However, operating expenditure for the Phillip PRS will only commence in 2014-15. Accordingly, the AER also required ActewAGL Distribution to amend its forecast operating expenditure to account for the correct timing of the Phillip PRS.

ActewAGL Distribution accepts the AER's amendments in respect of the Jerrabomberra POTS and Phillip PRS and has amended its forecast operating expenditure as required by the AER (AER amendment 9.1).

5.2.2.3 AEMO fees

ActewAGL Distribution proposed a $50,000 step change in its AEMO fees to reflect the expanded size, scope and complexity of the organisation and its operations. The AER did not approve this step change on the basis that it believed ActewAGL Distribution provided insufficient information to support the proposal, it did not represent the best forecast

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[83] AER 2009, *Draft Decision*, p 97
[84] AER 2009, *Draft Decision*, p 97

possible in the circumstances, and the expenditure did not represent the lowest sustainable cost of delivering pipeline services.

However, ActewAGL Distribution notes that the AER approved the ability to pass through any future increase in AEMO fees through ActewAGL Distribution's proposed tariff variation mechanism as a low materiality threshold pass through event.

Consequently, ActewAGL Distribution accepts the AER's draft decision for this step change and has amended its forecast operating expenditure as outlined in AER amendment 9.1 by removing the AEMO step change.

5.2.2.4 Gas market development

ActewAGL Distribution proposed two step changes for gas market developments which account for costs related to changed behaviour of wholesalers and the introduction of the STTM, scheduled to commence operation in July 2010.

ActewAGL Distribution proposed a step change to account for the costs associated with managing market shortfall incidents due to changed wholesaler behaviour arising from development of the national gas market. ActewAGL Distribution also proposed a step change to account for the costs arising from the introduction of the STTM, namely supply reliability and the management services for balancing gas.

While the AER accepted ActewAGL Distribution's proposed step change for gas balancing following the introduction of the STTM, it did not accept the proposed step changes for market shortfall incidents or STTM supply reliability.

The AER contend that "the resources employed by ActewAGL to manage these market shortfall events are likely to have been reallocated from normal activities rather than deploying new resources."[85] Accordingly, this step change was rejected by the AER in its draft decision, on the basis that no additional operating expenditure is required to manage these market shortfall events, and would not be incurred by a prudent retailer operating efficiently.[86]

ActewAGL Distribution does not consider that this conclusion is correct, and in any case does not recognise the opportunity costs of diverting personnel to these activities. ActewAGL Distribution recognises, however, that the likelihood and occurrence of market shortfall events are difficult to forecast, and may be more appropriately addressed through pass through mechanisms, where they lead to material costs. ActewAGL Distribution therefore proposes that the costs for market shortfall events be covered by the proposed Supply curtailment event in its reference tariff variation mechanism for the costs of domestic load shedding, gas rationing or curtailment. This is discussed in section 8.2.3 below. ActewAGL Distribution has therefore removed the step changes as required by the AER.

[85] AER 2009, *Draft Decision*, p 100
[86] AER 2009, *Draft Decision*, pp 100-101

5.2.2.5 Information Technology application costs

As discussed in section 5.3, in addressing AER's concern relating to the IT application costs in its draft decision, ActewAGL Distribution has identified and specified one step change relating to software licence maintenance. In 2010/11 a change to the licensing requirement for ActewAGL Distribution's financial information management system, supplied by one major supplier, will necessitate investment in licensing due to:

- Increased capacity requirements for the technology platforms on which the application runs. Licensing is tied to these platforms and ActewAGL Distribution has a requirement to increase capacity because of the retirement of lesser powered options, i.e. base models are becoming more equipped thus forcing the increase in the requirement (and ultimately fees); and
- Increased use of software development within the financial information management system, mandating a step up in licensing to maintain compliance with the IT supplier's Corporation's licensing requirements.

The step increase applicable to ActewAGL Distribution's gas access arrangement is $11,000. ActewAGL Distribution has taken this cost increase out of the "IT Application" escalator and included it in its forecast operating expenditure for corporate overheads as a step change. Further supporting information regarding the increased fee is available in confidential attachment G.

5.2.2.6 APA Security of Supply

As discussed under capital expenditure in section 3.2.2.1, ActewAGL Distribution is proposing two operating expenditure programs related to security of supply as part of its forecast operating expenditure.

Following the AER's draft decision rejection of capital expenditure for the proposed HFL security of supply project, ActewAGL Distribution is in the process of negotiating a more effective solution after taking account of new market developments. Under active consideration is an agreement with APA Group to construct a compressor on its Dalton–Watson lateral pipeline, to be owned and maintained by the APA. ActewAGL Distribution will pay utilisation and maintenance fees equivalent to the APA's capital costs for the $32 million investment in the compressor in 2010-11. ActewAGL Distribution has assumed for this purpose the 15-year standard life advised by APA, and a cost of capital consistent with ActewAGL Distribution's revised proposal. The utilisation and maintenance fee calculated is based on the average of the revenue building block ($2009/10) allowances for the four year period 2011-12 to 2014-15. This calculation yields a forecast operating expenditure of $4.87 million per year, commencing in 2011-12. In addition, the payment of an estimated $600,000 per year commencing in 2011-12 will be required by APA to operate and maintain the compressor. The total step increase on ActewAGL Distribution's operating costs in payments to APA for the security of supply project is $5.47 million per year from 2011-12.

In conjunction with the compression of gas on the Dalton–Watson lateral, ActewAGL Distribution will incur additional maintenance costs for the extended Watson PRS and WBH. The maintenance expenditures have been estimated to be $50,000 per year, commencing in 2011-12 and included under operating and maintenance costs in the controllable operating expenditure.

The resulting step changes for the additional costs have been included in ActewAGL Distribution's amended forecast operating expenditure and are included at attachment G.

5.3 Cost escalators

5.3.1 AER Draft Decision

The AER did not accept ActewAGL Distribution's proposed escalators as it considered there had been a significant change in the macroeconomic outlook since May 2009, necessitating updated forecasts. The AER argued that the most up-to-date forecast provided the best forecast possible in the circumstances, as required under Rule 74(2)(b) of the NGR.[87] Therefore, the AER requires ActewAGL Distribution to use escalators prepared by Access Economics in place of its own forecast for ActewAGL Distribution's operating expenditure.

The AER's decision is also relevant to ActewAGL Distribution's operating expenditure forecast as the labour escalators are also applied to operating expenditure.

5.3.2 ActewAGL Distribution response

5.3.2.1 Labour escalators

ActewAGL Distribution does not consider that Access Economics' labour escalator outcomes are reasonable and represent a best forecast. In contrast to other economic forecasts, including those by the Commonwealth Treasury, ANZ, Econtech and CBA, Access Economics' report forecasts significantly lower real escalators. ActewAGL Distribution notes that Access Economics' report results in escalators in the first two years of the access arrangement period that are significantly lower than the escalators prepared by Econtech in March 2009. Access Economics justify this decline based on decreasing employment in the utilities sector. ActewAGL Distribution notes, however, that Access Economics assumed peak of the unemployment rate in Australia in this cycle to reach 6.8 per cent. This is higher than ANZ, CBA, and Commonwealth Treasury which all forecast peak unemployment of 6.5 per cent.[88]

Further, ActewAGL Distribution notes the forecasts in KPMG Econtech's August 2009 Australian National, State and Industry Outlook, prepared at about the same time as Access Economics' escalator report for the AER. KPMG Econtech has forecast gross product growth in the electricity, gas and water industry until their forecast horizon on 2015-16, including continued employment growth until 2011-12.

In considering key national economic indicators, KPMG Econtech has forecast unemployment to peak at around 7.5 per cent in late 2010 compared to Access Economics'

[87] AER 2009, *Draft Decision*, p 106
[88] Treasury 2009-10 Mid Year Economic and Fiscal Outlook, ANZ Australian Markets Weekly 5 November 2009, CBA Economic Update – Labour Force, 10 December 2009

forecast of 6.8 per cent.[89] Despite this more pessimistic forecast, KPMG Econtech has still forecast wage growth of 2.3 per cent in 2009-10 and inflation falling to just 0.5 per cent, resulting in real national wage growth of 1.8 per cent.

Given recent economic events, it is unlikely the situations forecast by either Access Economics or KPMG Econtech will eventuate. Unemployment statistics released by the Australian Bureau of Statistics on 10 December 2009 showed a small fall in the national unemployment rate to 5.7 per cent in November, down from 5.8 per cent in October.[90] Interest rate rises by the Reserve Bank of Australia in October, November and December, with a fourth consecutive rate rise expected in February suggest the Australian economy will continue to improve.

Arguably the low point in the (Australian) economic cycle following the events of late 2008 has already been reached. Even more optimistic is the revised economic outlook in Commonwealth Treasury's Mid-Year Economic and Fiscal Outlook forecasts wage price index in 2009-10 and 2010-11 of 3.25 per cent and 3.5 per cent respectively, with inflation rates of 2.25 per cent in both years, resulting in real wage growth forecasts of at least 1 per cent.[91]

In light of this information, ActewAGL Distribution has commissioned CEG to provide it with new escalators using up-to-date information for this revised access arrangement proposal. CEG has used the same methodology as that used in its original report, and adopted by ActewAGL Distribution in its June 2009 proposal. The report is available in attachment E.

ActewAGL Distribution considers that these updated escalators are the best forecast or estimate available in the circumstances. The updated escalators are summarised in Table 5.2 and replace Table 9.8 in the original proposal. It also replaces the NSW escalators in the draft decision Table 9.5.

Table 5.2 Escalators (excluding CPI) used for operating expenditure (excluding corporate overheads)

Category	2010/11	2011/12	2012/13	2013/14	2014/15
EBA labour	0.0%	1.4%	1.6%	2.2%	2.2%
Non EBA labour	1.2%	1.9%	3.4%	4.0%	3.3%
Other	0.0%	0.0%	0.0%	0.0%	0.0%

5.3.2.2 Corporate overhead and ACT escalators

For corporate overheads, ActewAGL Distribution updated the escalator with reference to the most recent Australian National State and Industry Outlook report by KPMG Econtech (August 2009) to maintain consistency with ActewAGL Distribution's June 2009 proposal. ActewAGL Distribution reiterates that it does not agree with the AER's draft decision with regard to rejecting the EBA that ActewAGL Distribution currently has in place. Having an

[89] KPMG Econtech 2009, *Australian National, State and Industry Outlook*, p 17
[90] ABS 6202 Labour Force Statistical Release, 10 December 2009, p 1
[91] Commonwealth Treasury, 2009-10 Mid Year Economic and Fiscal Outlook, p 2 Table 1.2

EBA agreement across different divisions of the company means that it is unrealistic to renegotiate agreed terms and conditions that have been agreed for gas, electricity and water/wastewater workforces. ActewAGL Distribution does not accept the AER's draft decision, but has nonetheless used Econtech's escalators for 2010/11 instead of the EBA outcome.

The updated escalators for ActewAGL Distribution's corporate overheads and costs for engineers (being located in the ACT) as set out in Table 5.3 below, which replaces Table 9.9 in the original June 2009 proposal. It also replaces the ACT escalators in Table 9.5 in the AER's draft decision.

The AER did not accept ActewAGL Distribution's cost escalator relating to IT application costs as the AER considered that ActewAGL Distribution did not support its claim by past or expected events. ActewAGL Distribution has provided further information in this revised proposal. In the June 2009 proposal, ActewAGL Distribution explained that software licensing costs have increased substantially in the last few years, causing IT application costs (which comprise of licensing for corporate software applications) to increase by approximately 30 per cent. For example, the licence costs related to one major supplier (a different supplier than that referred to in section 5.2.2.5) increased by $170,000 in 2009/10.

For this revised proposal, ActewAGL Distribution has identified a specific one off increase that significantly affects the escalator in 2010/11, which relates to additional licensing requirements for ActewAGL Distribution's financial information management system. ActewAGL Distribution has isolated the increased costs relating to this application and defined it as a step increase, which is further explained in section 5.2.

After adjusting for the step change, ActewAGL Distribution has adjusted its original IT application cost escalator. Aside from the step increase, ActewAGL Distribution has reviewed its corporate software licensing, quotes and invoices on a vendor by vendor basis. ActewAGL Distribution notes that the costs have increased significantly during the last years and will continue to increase over the next 5 years (having reviewed quotes for future costs as well as past invoices). Constant improvements in technology lead to changing licensing requirements and changes to the configuration of licensing arrangements, as determined by the software vendors, for the licences required to serve the same user base. ActewAGL Distribution therefore expects IT application costs to continue to increase above CPI during the access arrangement period at the same rate as in 2010/11. The assessment of the changes in software licensing resulted in a predicted 5 per cent annual nominal escalation that should be applied to this cost in 2010/11. The 5 per cent nominal escalator has been applied to a base 2009/10 cost of approximately $140,000 (for software licence maintenance) and the real escalator is set out in Table 5.3 below. The calculation of the escalator in 2010/11 is included in confidential attachment G.

Consistent with its June 2009 proposal and the AER's draft decision, ActewAGL Distribution has continued to use CPI as the escalator for other corporate operating expenditure.

Table 5.3 below replaces Tables 9.9 and 9.10 in the original proposal and the draft decision Table 9.5.

Table 5.3 ACT labour, IT application and other escalators 2010/11 to 2014/15 (real)

	2010/11	2011/12	2012/13	2013/14	2014/15
General labour	2.1%	1.5%	1.4%	1.6%	2.1%
EGW	2.1%	1.5%	1.4%	1.6%	2.1%
IT application	2.7%	2.4%	2.4%	2.4%	2.4%
Other	0%	0%	0%	0%	0%

5.3.2.3 Use of updated escalator forecasts in the AER draft and final decisions

As discussed above in respect of capital expenditure forecast, ActewAGL Distribution does not consider that the AER is correct in its interpretation of its discretion in relation to applying its own updated escalators values to ActewAGL Distribution's proposal. ActewAGL Distribution considers that this approach is not consistent with the AER's limited discretion under section 40 of the NGR, and the interpretation of the requirements under Rule 74(2)(b). This concern is discussed and addressed in detail in the capital base chapter in section 3.2.2.1.

ActewAGL Distribution considers that its updated escalators represent the best forecast or estimate possible in the circumstances, and is therefore consistent with rule 74. The CEG report in attachment E updates the forecasts in the original proposal to use the most recent information available. The report also examines and questions the AER's consultant's estimate of labour escalation in relation to those of Macromonitor, BIS Shrapnel and, previously, Econtech.

5.4 Forecast controllable operating expenditure

5.4.1 AER Draft Decision

Included in controllable operating expenditure are: operating and maintenance costs, corporate overheads, non-system asset usage charge as well as marketing and other controllable direct costs. As discussed above, the AER did not accept all of ActewAGL Distribution's step changes or the escalators. The AER therefore required ActewAGL Distribution to amend operating and maintenance costs, corporate overheads, and marketing and other controllable direct costs due to changes of the step changes and escalators.

5.4.2 ActewAGL Distribution response

As discussed above, ActewAGL Distribution does not accept aspects of the AER's draft decision in relation to some step changes, and the AER escalators. As a result, ActewAGL Distribution has applied the step changes and escalators from section 5.2 and 5.3 on the ActewAGL Distribution's controllable operating expenditure. No other changes compared with the original proposal or the AER's draft decision has been made. The revised controllable operating expenditure is set out in Table 5.4, which replaces the controllable operating expenditure in Table 9.11 and Table 9.25 from the access arrangement information proposal submitted to the AER on 30 June 2009.

Table 5.4 Forecast controllable operating expenditure 2010-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Controllable costs						
Operating and maintenance	9.47	11.31	11.62	10.44	10.75	53.59
APA Security of supply	0.00	5.47	5.47	5.47	5.47	21.88
Corporate overheads	3.25	3.33	3.41	3.49	3.55	17.03
Non-system asset charge	0.52	0.52	0.52	0.52	0.52	2.61
Marketing	1.33	1.33	1.35	1.36	1.38	6.75
Other controllable costs	0.23	0.23	0.23	1.02	0.83	2.54
Total controllable costs	**14.81**	**22.20**	**22.60**	**22.30**	**22.50**	**104.40**

5.5 Forecast other allowable operating expenditure

5.5.1 AER Draft Decision

Forecast other allowable operating expenditure includes government charges, UNFT, the Contestability charge, unaccounted for gas and other costs. In the draft decision, the AER did not accept the AEMO step change under government charges and also required ActewAGL Distribution to use Access Economics' escalators to the cost categories (contestability charges and other costs) within other allowable operating expenditure.

5.5.2 ActewAGL Distribution response

5.5.2.1 Government charges and UNFT

As discussed above in section 5.2, ActewAGL Distribution accepts the AER's draft decision not to allow the step change relating to increased AEMO fees commencing in 2011-12, instead replacing this with a cost pass through event in the Reference Tariff variation mechanism. ActewAGL Distribution further accepts the AER's decision to allow future differences between actual and forecast UNFT costs to be recovered under the same cost pass through event. The reference tariff variation mechanism is further discussed in section 8.2.2 below.

ActewAGL Distribution's revised government charges and UNFT are set out in Table 5.5 below, which replaces the government charges and UNFT amounts set out in the original proposal in Tables 9.11, 9.16 and 9.25.

5.5.2.2 Contestability charges

The AER required ActewAGL Distribution to change the escalator for rolling the contestability charges forward. As discussed in section 5.3, ActewAGL Distribution has updated its original escalators. The new escalators have been applied to escalate the contestability charges in the revised proposal using the same and approved input assumption. The revised proposal of the contestability charges is set out in Table 5.5 below and replaces the contestability charges in the original proposal set out in Tables 9.11 and 9.17 and 9.25.

5.5.2.3 Unaccounted for gas

ActewAGL Distribution's original proposal included an unaccounted for gas allowance of 1.8 per cent. The Wilson Cook's review recommended a forecast UAG of 1.7 per cent on the basis of actual reported levels of UAG.[92] However, the AER noted that ActewAGL Distribution since April 2008 has made adjustments to the UAG for water bath heater consumption and that ActewAGL Distribution consequently expected a reduction of 0.2 per cent in its UAG level. ActewAGL Distribution disagrees with this adjustment as the UAG forecast proposed by ActewAGL Distribution's modelling had already taken account of the effects from the water bath heater when estimating the unaccounted for gas to be 1.8 per cent. The effect of the water bath heather has therefore, in effect, been double counted in the draft decision.

ActewAGL Distribution notes that the Wilson Cook review recommended adoption of a forecast of 1.7 per cent and accepts this estimate confirming that it does not double count the effect of the water bath heater.

With regard to the forecast price of UAG, ActewAGL Distribution used $8.75/GJ ($2008/09) in the original proposal based on the most recent tenders of UAG. The AER preferred to base the price on a report prepared for NEMMCO that forecast the price to Canberra over the access arrangement period to be an average of $5.27/GJ ($2009/10). In addition, however, the AER also included in its draft decision an amendment that established a cost pass through event to take account of the difference between forecast and actual gas prices in respect of UAG.

While ActewAGL Distribution considers that its original forecast of the cost of UAG was reasonable as it was based on information from a tender process in progress at the time, further negotiation since ActewAGL Distribution submitted its original proposal means that a lower price, commensurate with the AER's amendment, is now a better forecast of expected costs. In addition, ActewAGL Distribution notes that the new cost pass through event (called the Specified Uncontrollable Cost event, which adjusts for actual costs associated with the UNFT, other external fees, and UAG), will ensure that ActewAGL Distribution's actual costs associated with UAG procurement can be recovered. ActewAGL Distribution therefore accepts this part of the AER's amendment to its UAG forecast.

In its revised proposal, ActewAGL Distribution has applied an unaccounted for gas of 1.7 per cent with an average price of $5.27/GJ ($2009/10). The updated unaccounted for gas is set out in Table 5.5 below and replaces Tables 9.11, 9.18 and 9.25 in the access arrangement information document submitted to the AER on 30 June 2009.

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[92] AER, *Draft decision* p118.

5.5.2.4 Ancillary Services

ActewAGL Distribution did not include any ancillary services costs in its forecast for other allowable operating expenditure for the access arrangement period in the original proposal in June 2009. In the earlier access arrangement period, these costs have been treated outside the revenue building blocks as a pure pass through of the ancillary services costs incurred by ActewAGL Distribution for services to customers. However, in the draft decision AER included the revenues from these costs in the tariffs. As these costs were not included in the operating expenditure underpinning the revenue building block, ActewAGL Distribution has included a forecast for the ancillary costs using the same forecast as was submitted to the AER before the draft decision, on which the AER based its forecast revenue.

5.5.2.5 Other costs

ActewAGL Distribution submitted other costs of $1.33 million for the access arrangement period. The AER considered the other costs appropriate and reasonable, but required ActewAGL Distribution to change the escalator applying to these costs. As discussed in section 5.3, ActewAGL Distribution has not adopted the AER escalators and has included its own updated escalator forecasts in this revised proposal. The new escalators have been applied to escalate other costs. The revised proposal of the other costs is set out in Table 5.5 below and replaces the other costs in the original proposal set out in Tables 9.11, 9.21 and 9.25.

5.5.2.6 Summary of forecast other allowable operating expenditure

ActewAGL Distribution's updated forecast for other allowable operating expenditure is set out in Table 5.5.

Table 5.5 Forecast other allowable operating expenditure for the access arrangement period

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Other allowable costs						
Government levies	0.65	0.65	0.65	0.65	0.65	3.23
UNFT	3.38	3.43	3.48	3.53	3.59	17.42
Contestability costs	0.56	0.57	0.58	0.60	0.62	2.93
Unaccounted for gas	0.71	0.70	0.70	0.72	0.73	3.55
Ancillary services	0.15	0.16	0.16	0.17	0.17	0.80
Other costs	0.26	0.26	0.26	0.27	0.27	1.32
Total other allowable costs	**5.71**	**5.76**	**5.84**	**5.93**	**6.01**	**29.25**

5.6 Debt raising costs

5.6.1 AER Draft Decision

The AER considered that ActewAGL Distribution had correctly calculated the debt raising costs in accordance with the methodology approved by the AER in the electricity distribution decisions. However, due to the revised capital expenditure program, the expenditure for debt raising costs was lower.

5.6.2 ActewAGL Distribution response

ActewAGL Distribution has used the same methodology, which was confirmed correct by the AER in the draft decision, to calculate the debt raising costs for the access arrangement period starting 1 July 2010, assuming 10.4 basis points per annum. The cost estimate is based on the revised capital expenditure outlook set out in section 3.2. Table 5.6 below replaces Table 9.24 and Table 9.25 in the original proposal in June 2009.

Table 5.6 Debt raising costs

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Debt raising costs	0.17	0.18	0.19	0.19	0.19	0.94

5.7 Self insurance costs

5.7.1 AER Draft Decision

ActewAGL Distribution included in the building block revenue calculation in its access arrangement proposal of June 2009 expenses related to self insurance of asymmetric risks in undertaking its gas networks business.[93] To prepare estimates the applicable self insurance premiums, ActewAGL Distribution engaged Marsh Pty Ltd (Marsh), a leading insurance broker and risk advisor, to actuarially estimate the expected costs of relevant events based on the information provided by ActewAGL Distribution.[94] The calculation and certification of the estimates by a professional qualified actuary provides a sound basis for satisfying the requirement of Rule 74 that “a forecast or estimate: (a) must be arrived at on a reasonable basis; and (b) must represent the best forecast or estimate possible in the circumstances”.

Marsh’s report formed a confidential attachment to ActewAGL Distribution’s access arrangement information.[95] The total expected cost of self insurance premiums calculated by Marsh was $0.53 million/annum ($ 2009/10) in each year of the access arrangement period. The report included analysis of a number of asymmetric risks identified by Marsh in a formal process with ActewAGL Distribution, including some where self insurance was not recommended as an appropriate means for mitigation.

[93] ActewAGL Distribution 2009, *Access Arrangement Information*, pp 201-207
[94] The Marsh report was also endorsed by the Joint Venture Board’s Audit and Risk Management Committee and ActewAGL’s Board of Management.
[95] ActewAGL Distribution 2009, *Access Arrangement Information*, Appendix C

The AER sets out its analysis of ActewAGL Distribution's self insurance claim in a confidential attachment to the draft decision.[96] The AER concluded that none of the eleven proposed self insurance premiums met the criteria of Rule 91 and as a result no expenditure for self insurance was allowed in the cost building blocks.

In qualifying its statement that "it considers that its approval of this operating expenditure [self insurance premiums] is limited to a discrete number of circumstances", the AER states that it considers:

> that self insurance is appropriate where the risk is of a non-recurring nature. Where the risk is recurring the cost is better considered in the controllable operating expenditure. At the other extreme, the impacts of infrequent catastrophic events are also not appropriately addressed through self insurance [a]s the regulatory framework provides a more effective means of addressing these events via cost pass through or a variation of the access arrangement during the access arrangement period.
>
> Between these situations, other known business risks can be managed through external insurance self insurance or a combination of these two. In some cases a service provider may not identify a risk which by default it self insures.
>
> In relation to uninsured and material risks these are likely to be difficult to predict and therefore it will be difficult to predict and therefore it will be difficult to determine an efficient and reliable self insurance cost. Unlike unregulated entities, which bear these risks regardless, a prudent service provider can cover significant risks through a cost pass through mechanism.[97]

ActewAGL Distribution agrees in general with this statement, but considers that the AER is incorrect in concluding, as it has, that in all cases the proposed operating expenditure for self insurance premiums should not be included in the cost building blocks as estimated self insurance premiums, but rather as either a pass through events, inclusions in base year operating expenditure or at zero value.

ActewAGL Distribution recognised that applicability of self insurance is limited to particular circumstances. Summarising from the June 2009 access arrangement information, there are at least four mechanisms that a service provider can use to address the asymmetric risk arising from exogenous events:

- direct inclusion of costs in maintenance forecasts;
- direct insurance;
- self insurance; and
- cost pass through.

As also stated, a holistic approach to risk management recognises the differing characteristics of each such mechanism and applies each as considered appropriate. This choice will also be influenced by the institutional characteristics of the regulatory regime as implemented by the regulator. Table 5.7 summarises the approach taken by ActewAGL Distribution to determining the appropriate means by which risk would be mitigated.

[96] ActewAGL Distribution understands that this attachment was kept confidential to protect ActewAGL Distribution's confidential information provided to the AER. Information disclosed here from the AER's confidential attachment is therefore considered by ActewAGL Distribution to be suitable for public release.
[97] AER 2009, *Draft Decision*, Confidential attachment C

Table 5.7 Determining the optimal response to risk

	Example 1 – an earthquake	Example 2 – pipeline damage	Example 3 – theft of network assets
Is the cost material?	Yes	No	No
Is it feasible/cost effective to insure directly?	Uncertain	Yes	No
Is self insurance feasible/cost effective?	No	Yes	Yes
Is the exogenous event likely to occur frequently?	No	Yes	No
Most appropriate risk management response	Cost-pass through	Direct insurance (self insure residual risk – limits and deductibles)	Self insurance

ActewAGL Distribution responds to the AER's specific conclusions on the premiums claimed as follows:

- given the irregularity of the events, the self insurance premiums proposed cannot be based on actual annualised or historical costs. The role of Marsh was to apply actuarial assessments to best estimate the risk of these events. ActewAGL Distribution considers the self insurance premiums calculated by Marsh accurately quantify the risks faced by ActewAGL Distribution and subsequently maintain that these estimates are reasonable;
- ActewAGL Distribution does not believe that it is economically feasible to reduce the proposed risks to zero, nor does it consider that a zero premium would be incurred by a prudent service providers acting efficiently and in accordance with good industry practice. ActewAGL Distribution considers that, in association with the Marsh report, it has adequately quantified risk associated with self insurance events. Further, ActewAGL Distribution notes the AER's endorsement of its commitment to manage and finance any loss arising from an event for a self insured risk;[98]
- the efficacy of cost pass through is limited to the extent that it might discourage a service provider from taking cost effective action to mitigate a risk for which it bears no consequence. The AER is only justified in its position insofar as the service provider has an insignificant influence over the impact of an event or where the service provider's ability to hold the consequent risk of a major event is in question; otherwise the AER is creating perverse incentives.

The AER notes also that ActewAGL Distribution did not seek operating expenditure for self insurance in its earlier access arrangement and has therefore not justified the step changes involved. [99] ActewAGL Distribution notes that, though it bore more or less equivalent risks in the earlier access arrangement period, no compensation was claimed in the absence of knowledge of an appropriate mechanism.

[98] AER 2009, *Draft Decision*, p 242
[99] AER 2009, *Draft Decision*, p 122

ActewAGL Distribution's responses to specific matters raised in relation to detailed confidential self insurance proposals are included in confidential attachment D to this Access arrangement information addendum. General comments on the AER's approach and ActewAGL Distribution's response are discussed below for the sake of transparency.

5.7.1.1 Inclusion in operating expenditure

The AER made the assessment that historic losses for events should be included in operating expenditure and precluded some of ActewAGL Distribution's proposed self insured events on this basis. In this regard, the AER says:

> … where incurred (historic) losses for events are used as the basis for determining operating expenditure for self insurance, this operating expenditure should be considered as estimates of costs in forecast operating expenditure. This is because like other operating expenditure these are an estimate of the costs based on the service provider's history of incurred costs.[100]

ActewAGL Distribution, in its June 2009 access arrangement information, provided the distinction between such events which, by their regular and consistent occurrence, can be included in operating expenditure estimates, and those which are irregular with relatively low probably but which have a significant impact and therefore for which actuarial estimation is presented for verification of costs and can be included as self insured risks.

The estimation of a self insurance premium is precisely the means by which the impact of significant possible yet irregular events is determined, as accurately as possible, on a reasonable basis. In other cases (that is, events of known regularity) costs are directly estimated in operating and maintenance outside self insurance. ActewAGL Distribution therefore believes that the AER has incorrectly excluded self insurance premiums calculated on this basis.

5.7.1.2 Liability for expenses

Under several proposed self insurance events, the AER maintains that JAM retains liability for the occurrence of events. The DAMS Agreement which governs the relationship between ActewAGL Distribution and JAM operates on the usual basis that JAM employees and officers acting in good faith and without negligence are not liable for subsequent claims arising from the operation of the network. ActewAGL Distribution as network owner bears full responsibility for these events. Similarly, the AER has inferred that ActewAGL Distribution may be able to receive compensation from transmission operators for business interruption. However, there is no contract between ActewAGL Distribution and the transmission pipeline service providers in this regard and thus no basis to assume or expect compensation in these circumstances. ActewAGL Distribution also bears any reputation and legacy costs.

5.7.2 ActewAGL Distribution response

On the basis of the detailed analysis in confidential attachment D, ActewAGL Distribution proposes to reinstate into operating and maintenance expenditure a number self insurance premiums to the value of $403,500 per annum which replaces the values presented in

[100] AER 2009, *Draft Decision*, confidential attachment C, p 227

Table 9.22 in the original proposal in June 2009. Details of the items included are set out in attachment D.

5.8 Statement of costs

5.8.1 AER Draft Decision

The AER's draft decision includes a requirement for ActewAGL Distribution to amend its access arrangement proposal to include a new section laying down requirements for a "statement of costs" (AER amendment 9.3). The new section of the access arrangement would impose a requirement on ActewAGL Distribution to maintain records of specified fees and costs for each financial year of the access arrangement period in a form indicated in a new attachment required to the access arrangement (amendment 9.4). The information collated would be provided to the AER as part of the proposed revisions to the access arrangement on or before 30 June 2014.

The AER states as its reasons for requiring the access arrangement to include a statement of costs a need for it to have a better understanding of the costs incurred by ActewAGL Distribution, to effectively assess the application of ActewAGL Distribution's incentive mechanism over the access arrangement period, in particular, any reclassification of expenditure from operating to capital expenditure, and to verify that the cost associated with any non-reference services that may later be introduced are identified and maintained separately from the costs related to reference services.[101]

The AER notes also that the statement of costs includes indicative information relating to JAM's management of the network and its ability to meet key performance indicators (KPIs) set out in its annual services plan.[102]

5.8.2 ActewAGL Distribution response

Access arrangement is defined in the NGL as:

> an arrangement setting out terms and conditions about access to pipeline services provided or to be provided by means of a pipeline [103]

In effect, an access arrangement is the form of a default contract between the service provider and users of a covered network. ActewAGL Distribution does not consider that an access arrangement should be used as a means for the regulator to impose obligations to perform actions not relevant to the purpose of the access arrangement in setting out the terms and conditions of access to reference services. Where the NGL (Chapter 2) provides the AER with broad and effective information gathering powers, these have a framework which includes provision for their measured and reasonable application.

Apart from these objections in principle, the required amendments also present practical difficulties in implementation. These arise from the indicative status of the attachment and

[101] AER, Draft Decision, p110
[102] AER, Draft Decision, p111
[103] NGL, section 2—Definitions

the nature of the obligation being placed on ActewAGL Distribution to collate this information.

ActewAGL Distribution interprets the table developed by the AER as being indicative of the level of detail for information that the AER expects to be provided. Therefore, to be sure that it can comply with the obligation imposed by the formulation of the table in the access arrangement, ActewAGL Distribution must be sure that it:

- understands the scope and intent of each piece on information required in the columns of the table; and
- can provide information to the level of detail indicated by the breakdown in the category column.

In both of these respects ActewAGL Distribution has serious concerns.

For example, in respect of the table related to JAM fees, ActewAGL Distribution is unclear as to the intent in requiring information on actual and target activity levels for individual projects. If the AER is referring to Key Target Outcomes included in the annual Services Plan for different activities, then it is difficult to see how these measures can be applied to individual projects, when they are expressed, and calculated as network values. ActewAGL Distribution therefore does not consider that it can provide the kind of information that the AER appears to require under its indicative table.

In addition, ActewAGL Distribution has some concerns with the level of detail required for the breakdown of categories. In respect of ActewAGL Distribution controllable costs for example, the AER requires a breakdown of IT costs into “Labour”, “Software”, “Hardware by Type” and “IT Lease Costs”. ActewAGL Distribution does not consider this to be an appropriate breakdown of these costs, as it potentially double counts leasing and hardware costs, or at least forces an inappropriate division between leasing and hardware costs, which are largely leased.

As the amendments currently stand, ActewAGL would be placed in a situation where it is uncertain whether it is complying, or even can comply, with the indicative requirements of the attachment required by amendment 9.4.

5.8.3 Amendments to the access arrangement proposal and information

As a result of these practical concerns, ActewAGL Distribution proposes changes to the AER’s amendment 9.3 which result in it accepting in principle the requirement to maintain statement of costs included in access arrangement, but with the mechanism changed to support agreement on the precise form of the information template after the final decision. ActewAGL’s proposed revision to the amendment includes in the access arrangement a negotiating framework for this process.

As a consequence of this approach, ActewAGL Distribution rejects amendment 9.4 in favour of the information collection framework to be determined under the revised proposal for amendment 9.3.

5.9 Summary of ActewAGL Distribution's revised operating expenditure proposal

Table 5.8 below replaces Table 9.25 in the original submission in June 2009 and AER amendment 9.1.

Table 5.8 Forecast total operating expenditure for the access arrangement period

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Controllable costs						
Operating and maintenance	9.47	11.31	11.62	10.44	10.75	53.59
APA Security of supply	0.00	5.47	5.47	5.47	5.47	21.88
Corporate overheads	3.25	3.33	3.41	3.49	3.55	17.03
Non-system asset charge	0.52	0.52	0.52	0.52	0.52	2.61
Marketing	1.33	1.33	1.35	1.36	1.38	6.75
Other controllable costs	0.23	0.23	0.23	1.02	0.83	2.54
Total controllable costs	**14.81**	**22.20**	**22.60**	**22.30**	**22.50**	**104.40**
Other allowable costs						
Government levies	0.65	0.65	0.65	0.65	0.65	3.23
UNFT	3.38	3.43	3.48	3.53	3.59	17.42
Contestability costs	0.56	0.57	0.58	0.60	0.62	2.93
Unaccounted for gas	0.71	0.70	0.70	0.72	0.73	3.55
Ancillary services	0.15	0.16	0.16	0.17	0.17	0.80
Other costs	0.26	0.26	0.26	0.27	0.27	1.32
Total other non-capital costs	**5.71**	**5.76**	**5.84**	**5.93**	**6.01**	**29.25**
Self insurance costs	0.40	0.40	0.40	0.40	0.40	2.02
Debt raising costs	0.17	0.18	0.19	0.19	0.19	0.94
Total operating expenditure	**21.09**	**28.55**	**29.04**	**28.82**	**29.11**	**136.61**

6 Derivation of total revenue

This chapter supplements ActewAGL Distribution's Derivation of total revenue chapter (chapter 10 of the June 2009 Access Arrangement Information) and addresses the AER's draft decision on taxation, and proposed amendments to the incentive mechanism and total revenue set out in chapters 6, 7 and 10 of the draft decision.

6.1 Summary of required amendments

The AER accepted ActewAGL Distribution's taxation and establishment of a taxation asset base, however, noted that the standard life was wrong in one of the tables, though correct in the models. The AER also required some changes to ActewAGL Distribution's proposed incentive mechanism as further described in section 6.5.1 below.

Due to the changes in the building block components discussed in Part A of the draft decision, the AER did not approve ActewAGL Distribution's total revenue figure of $370.7 million. Instead, the AER arrived at total revenues of $301.4 million. The main reason for the difference was that the AER did not approve ActewAGL Distribution's proposed capital base, particularly the HFL and the proposed WACC.

6.2 Depreciation

6.2.1 AER Draft Decision

The AER considered that ActewAGL Distribution's depreciation schedules were consistent with Rule 88 and 89 of the NGR and approved ActewAGL Distribution's depreciation schedules subject to amendment 3.6

6.2.2 ActewAGL Distribution response

ActewAGL Distribution has updated the forecast depreciation consistent with the same methodology applied in the original proposal in June 2009 using the PTRM at attachment F. Table 6.1 below replaces Table 10.2 of the original proposal.

Table 6.1 Economic depreciation 2010/11 to 2014/15

$000 nominal	2010/11	2011/12	2012/13	2013/14	2014/15
Straight line depreciation	9.5	11.7	12.9	13.8	14.3
Inflation adjustment	-6.9	-7.7	-8.3	-8.5	-8.7
Economic depreciation	2.6	4.0	4.6	5.2	5.6

6.3 Corporate income tax

6.3.1 AER Draft Decision

As ActewAGL Distribution previously has used a pre-taxation framework, the proposed post-taxation framework required the establishment of a taxation asset base at the start of the access arrangement period. Consistent with the AER's taxation guidelines, ActewAGL Distribution established a tax asset base at the date on which it first came under the national taxation equivalent regime on 1 July 2001. The tax asset base was then rolled forward to 30 June 2010, using actual and forecast capital expenditure, capital contributions, disposals and taxation depreciation, applying a straight line depreciation method.

The AER accepted ActewAGL Distribution's tax asset base, but changed the standard lives of high pressure services in one table of the access arrangement information, noting that the correct value had been applied in the models.

6.3.2 ActewAGL Distribution response

ActewAGL Distribution has corrected the value in the table highlighted by the AER in amendment 6.1 as set out in depreciation schedule Table 6.2 below which replaces Table 10.6 of the June 2009 of the June 2009 proposal.

Table 6.2 Adopted standard tax lives of assets

Asset class	Standard life (years)
TRS & DRS - Valves & Regulators	40.0
HP Mains	50.0
MP Mains	50.0
Meters - Tariff	15.0
Meters - Contract	15.0
MP Services	30.0
HP Services	50.0
IT Systems	5.0
Regulatory Costs	5.0

Due to the actual capital expenditure outcome in 2008/09, ActewAGL Distribution has also amended the opening tax asset base at 1 July 2010 to $196.88 million. The amended roll forward of the TAB is set out in Table 6.3 below and replaces Table 10.8 of the June 2009 proposal.

Table 6.3 Roll forward of the TAB from 2001/02 to 2009/10

$ million (nominal)	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10
Opening TAB	168.58	174.09	177.74	179.41	182.85	183.26	187.31	188.56	189.44
Capital expenditure	10.91	9.33	7.59	9.84	7.28	11.23	8.75	8.75	15.53
Straight-line depreciation	-5.40	-5.67	-5.93	-6.40	-6.87	-7.18	-7.50	-7.87	-8.10
Closing TAB	174.09	177.74	179.41	182.85	183.26	187.31	188.56	189.44	196.88
Opening TAB at 1 July 2010									196.88

Source: Tax Asset Roll Forward Model

The updated opening value as at 1 July 2010 and updates to the capital expenditure program for 2010-2015 requires amendments to the roll forward of the TAB from 2010/11 to 2014/15. Consistent with the revised capital expenditure program described in section 3.2 and applying the depreciation schedule as described above, the roll forward of the TAB from 2010/11 to 2014/15 is set out in Table 6.4 below and replaces Table 10.9 of the June 2009 proposal.

Table 6.4 Roll forward of the TAB from 2010/11 to 2005/15

$ million (nominal)	2010/11	2011/12	2012/13	2013/14	2014/15
Opening TAB	196.88	223.10	241.78	245.85	248.55
Forecast capital expenditure	33.73	27.27	13.44	12.37	13.34
Straight-line depreciation	-7.51	-8.59	-9.37	-9.67	-10.14
Closing TAB	223.10	241.78	245.85	248.55	251.75

Source: PTRM

Based on the tax asset base in Table 6.4, ActewAGL Distribution has calculated the tax depreciation concessions available to the business in the access arrangement period. These can be found in Table 6.5 below and replaces Table 10.10 of the June 2009 proposal.

Table 6.5 Tax depreciation concessions 2010/11 to 2014/15

$ million (nominal)	2010/11	2011/12	2012/13	2013/14	2014/15
Tax Depreciation Concessions	1.13	1.36	1.49	1.59	1.62

Source: PTRM

Consistent with rule 76 (c), ActewAGL Distribution proposes a corporate income tax building block as set out in Table 6.6 below and replaces Table 10.11 of the June 2009 proposal.

Table 6.6 Corporate income tax building block 2010/11 to 2014/15

$ million (nominal)	2010/11	2011/12	2012/13	2013/14	2014/15
Tax Payable	3.2	3.9	4.3	4.5	4.6
Value of Imputation Credits	-2.1	-2.5	-2.8	-3.0	-3.0
Tax Allowance	1.13	1.36	1.49	1.59	1.62

Source: PTRM

6.4 Revenue requirement and X factors

6.4.1 AER Draft Decision

Due to changes in Part A of the draft decision, the AER did not accept ActewAGL Distribution's total revenue requirement over the next access arrangement period of $370.7 million. The AER's draft decision revenue requirement was determined at $301.4 million.

6.4.2 ActewAGL Distribution response

After adjusting the revenue building block components as described in chapters 3 to 6, ActewAGL Distribution has, in accordance with Rule 72, calculated the revised revenue requirement using the PTRM. The populated PTRM is provided at attachment F. The methodology used to determine reference tariffs for the access arrangement period is that used in the June 2009 proposal.

The reference tariff and its calculation are shown in Table 6.7 below and replace Table 10.1 and Table 10.12 in the original proposal. It also replaces the AER's draft decision amendments 10.1 and 10.2.

Table 6.7 Calculation of revenue allowance the reference tariff

$ Nominal	2010/11	2011/12	2012/13	2013/14	2014/15
Regulatory depreciation (million)	2.60	3.99	4.59	5.25	5.62
Return on capital (million)	30.79	34.38	37.08	38.11	38.95
Tax allowance (million)	1.13	1.36	1.49	1.59	1.62
Operating expenditure (million)	21.61	29.98	31.25	31.79	32.90
Incentive mechanism payments (decrements) (million)	Na	Na	Na	Na	Na
Unsmoothed revenue requirement (million)	**56.13**	**69.71**	**74.41**	**76.74**	**79.09**
Energy forecasts (TJ)	6,545	6,525	6,565	6,642	6,736
Revenue yield (tariff /TJ)	7,973	9,064	10,304	11,714	13,316
Smoothed revenue requirement (million)	**54.37**	**61.86**	**70.55**	**80.79**	**92.78**
of which tariff revenue (million)	*52.19*	*59.14*	*67.65*	*77.80*	*89.70*
of which contract revenue (million)	*2.19*	*2.72*	*2.90*	*2.99*	*3.08*
X factor tariff revenue (%)*	10.93	10.93	10.93	10.93	10.93

na – not applicable
*The X-factors in the table above are indicative only.

The allocation of revenues to tariff and contract services is provided in section 7.3 of this Access Arrangement Information Addendum.

6.5 Incentive mechanism

6.5.1 AER Draft Decision

The AER's draft decision requires ActewAGL to amend its access arrangement proposal to:

- Exclude capital expenditure from the operation of the carryover incentive mechanism (AER amendment 7.1);
- Adjust the operation of the mechanism for the first and final year of the access arrangement period (AER amendments 7.2 and 7.3);
- Define the carryover amounts for the second, third and fourth years of the access arrangement period using the AER's terminology (AER amendment 7.4)
- Define the year 6 carryover amount to ensure there is no double counting (AER amendment 7.5);
- Ensure that the carryover mechanism does not include uncontrollable operating expenditure over the access arrangement period (AER amendments 9.3 and 9.4); and
- Appropriately classify costs to account for capital expenditure that is reclassified as operating expenditure (AER amendments 9.3 and 9.4).[104]

[104] AER 2009, *Draft Decision*, pp 82-83

6.5.2 ActewAGL Distribution response

6.5.2.1 Application to capital expenditure

ActewAGL Distribution's proposed carryover incentive mechanism, as set out in the June 2009 proposal, applied to both operating and capital expenditure. This ensured that there was no imbalance in the incentives applying to different types of expenditure, which might lead to the inefficient substitution of one form of expenditure for another. In addition, a mechanism applying to both capital and operating expenditure is consistent with the schemes operating for the gas networks in Victoria and South Australia.

In the draft decision, the AER did not accept the proposal to include capital expenditure in the carryover mechanism. The AER required ActewAGL Distribution to remove the relevant clauses (4.6 to 4.10) from the proposed access arrangement.[105]

ActewAGL Distribution does not accept the required amendment.

The AER acknowledges the rationale for including capital expenditure to provide balanced incentives, yet it concludes that it should not be included:

> The AER considers an incentive mechanism should provide balanced incentives to encourage efficiency across both capital and operating expenditure. However, given the scope to defer capital expenditure because of forecasting errors, this may not be achievable in practice for capital expenditure.[106]

Furthermore, the AER concludes that including capital expenditure in the mechanism:

> …would deliver inappropriate incentives to defer capital expenditure rather than to improve the cost effective delivery of capital expenditures. Capital expenditures are largely related to specific projects and the timing of these projects can be discretionary. By comparison operational expenditures have a recurring nature to them which means that efficiency improvements will be ongoing.[107]

The AER does not provide supporting analysis for its conclusion regarding incentives to defer capital expenditure. ActewAGL Distribution notes that the AER did consider the matter of incentives to defer capital expenditure in its development of the efficiency benefit sharing scheme (EBSS) for electricity distribution networks. The AER concluded that an EBSS which included capital expenditure would deliver inefficient incentives to defer capital expenditure, if deferred capital expenditure was not excluded from capital expenditure allowances for the next period.[108] In its explanatory statement on the proposed electricity EBSS the AER also identified other concerns with including capital expenditure:

> The issues paper noted the 'lumpiness' associated with capex which tends to make it difficult to forecast. To the extent that forecasting errors result in windfall gains and losses for DNSPs, the application of an EBSS to capex would magnify the size of these windfall gains or losses. Furthermore, the variance between actual and forecast capex

[105] AER 2009, *Draft Decision*, p 82
[106] AER 2009, *Draft Decision*, p 78
[107] AER 2009, *Draft Decision*, pp 79-81
[108] AER 2008, *Electricity Distribution Network Service Providers Efficiency Benefit Sharing Scheme Final Decision*, June 2008, p 10

may be significantly larger than that for opex, increasing regulatory uncertainty for DNSPs.[109]

However, the AER's conclusions regarding the nature of capital expenditure, forecasting errors and the incentives to defer capital expenditure in the context of electricity networks should not be automatically applied to gas networks. As ActewAGL Distribution explained in its June 2009 access arrangement information, the need to take account of the different characteristics of gas networks was recognised by the Essential Services Commission of Victoria (ESCV), when it decided to include capital expenditure in the gas networks carryover mechanism for 2008-12, but not the electricity networks carryover mechanism. The ESCV noted:

- the widespread capital expenditure deferrals observed in the electricity industry do not appear to have occurred in the gas industry;
- the nature of capital expenditure in the gas industry and the Commission's ability to monitor units and unit rates better than in the electricity industry provides the Commission with the ability to adjust benchmarks to reflect the actual amount of capital works undertaken;
- removing capital expenditure from the efficiency carryover mechanism may create an imbalance in the regime's incentives.[110]

ActewAGL Distribution further notes that it has included a comprehensive list of Key Performance Indicators (KPIs) in its access arrangement information which relate to both capital and operating expenditure.[111] The pressure to achieve the targets for these KPIs (as set out in table 13.2 of the June 2009 access arrangement information) will ensure that there will be no incentive to defer capital expenditure to the detriment of service standards.

In the absence of conclusive analysis which demonstrates that the conclusions regarding capital expenditure in the electricity EBSS apply equally to efficiency carryover mechanisms for gas networks, ActewAGL Distribution maintains its position that capital expenditure should be included in the carryover incentive mechanism, and has adjusted its proposed access arrangement accordingly. The relevant clauses from the proposed access arrangement have been retained but amended to ensure consistency with the amendments for operating expenditure, as discussed below.

6.5.3 Calculating efficiency gains and losses

6.5.3.1 First year of the access arrangement period

In clause 4.11 of the June 2009 access arrangement ActewAGL Distribution defines the operating expenditure efficiency gain in year i (E_i) as the underspend in year i (ie forecast less actual expenditure) less the underspend in the previous year (i-1). This can be expressed as:

$$E_i = (F_i - A_i) - (F_{i-1} - A_{i-1})$$

[109] AER 2008, *Proposed Electricity Distribution Network Service Providers Efficiency Benefit Sharing Scheme, Explanatory Statement,* April, p 9
[110] ESCV 2008, *Gas Access Arrangement Review 2008-2012, Final Decision*, 2008, p 584
[111] ActewAGL Distribution 2009, Access arrangement information, June, p 273

The AER considers that this equation is not correct for the first year of the regulatory period. The AER requires this clause to be amended to state that the efficiency gain in year 1 of the first access arrangement period (ie 2010/11) will be calculated as the forecast in year 1 less the actual in year 1. This can be expressed as:

$$E_1 = (F_1 - A_1)$$

ActewAGL Distribution accepts this amendment.

ActewAGL Distribution also notes that if the carryover mechanism is to apply to capital expenditure, as proposed, then a similar amendment must be made to the calculation of the year 1 capital expenditure efficiency gain, in clause 4.6 of the revised access arrangement.

6.5.3.2 Treatment of year 5 expenditure

Recognising that year 5 expenditure will not be known when carryover amounts are calculated for the 2015-19 regulatory period, ActewAGL Distribution proposed that no carryover amount should apply in year 5. Clause 4.14A of the June 2009 access arrangement explains that if an efficiency gain is made in year 5, then ActewAGL Distribution would be rewarded by higher benchmark operating expenditure in the first year of the next period (ie year 6):

> For operating expenditure, it will be assumed that ActewAGL does not achieve more than the forecast productivity gain between the penultimate and last years of the current Access Arrangement Period. As a result, if ActewAGL makes an efficiency gain in the last year of the current Access Arrangement Period, there would be no carryover in respect of that year. However, the operating expenditure benchmark for the next Access Arrangement Period will then be higher than otherwise for the next Access Arrangement Period by the amount of the efficiency gain. This would provide ActewAGL with precisely the same reward had the expenditure level in the last year been known.[112]

The AER requires that an adjustment be made to the calculation of the carryover amount in year 6 (and the first year of subsequent access arrangement periods), to ensure there is no double counting. That is, the implicit carryover reward, in the form of higher than otherwise forecast operating expenditure, must be removed from the calculation of the year 6 efficiency gain.

ActewAGL Distribution accepts this required amendment.

ActewAGL Distribution notes that the AER's required amendment to the treatment of final year expenditure (AER amendment 7.5), refers to clause 4.11 of the June 2009 access arrangement (now clause 4.12). However, in the June 2009 access arrangement the treatment of final year expenditure is covered in clause 4.14A (now clause 4.16). This clause also needs to be amended to recognise that the carryover formula in clause 4.12 ensures that there is no double counting. ActewAGL Distribution has made this additional amendment in its revised access arrangement proposal.

[112] ActewAGL Distribution *Access Arrangement Proposal*, paragraph clause 4.14.4A

ActewAGL Distribution also notes that if the mechanism is applied to capital expenditure, as proposed, then amendments are also required to clause 4.6 of the June 2009 access arrangement. ActewAGL Distribution has amended clause 4.6 to ensure that consistent terminology is used for capital and operating expenditure. In addition, the need to treat the year 5 carryover separately is addressed (new clause 4.7). ActewAGL Distribution notes that while the year 1 carryover amount needs to be separately defined for operating expenditure (as in clause 4.12), this is not required for year 1 capital expenditure as there is no lagged term in the definition of the capital expenditure efficiency gain.

6.5.4 Adjustments

The AER accepts that ActewAGL Distribution's proposed adjustments are reasonable.[113] However, it concludes that if capital expenditure is removed from the mechanism, there may be an incentive to shift costs from operating expenditure to capital expenditure. To address this concern, the AER requires an amendment under which ActewAGL Distribution must adjust its forecast and actual operating expenditure to take account of any change in capitalisation policy.

ActewAGL Distribution accepts that it is reasonable to require an explanation and quantification of the impact of a change in capitalisation policy.

ActewAGL Distribution also notes that while the amendments listed on section 7.6 of the draft decision only refer to changes in capitalisation policy, the discussion in section 7.4 refers to an additional requirement regarding controllable and uncontrollable costs:

> In addition, ActewAGL is required to maintain a statement of operating expenditure costs which provides detailed information about the operating expenditure (controllable and uncontrollable) as provided for in the draft decision on operating expenditure.

As discussed above in relation to the Statement of Costs, ActewAGL Distribution considers that the precise information requirements to be included in the Statement of Costs are more appropriately determined following the approval of the access arrangement. This approach would ensure that ActewAGL Distribution can understand and clarify the AER's expectations in respect to information provision, in order to comply with the information requirement.

6.5.5 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended its access arrangement to adopt the AER's amendments to the formulae for calculating efficiency gains and losses across all years of the access arrangement (AER amendments 7.2 to 7.5).

ActewAGL Distribution has also amended the access arrangement to say that changes to the classification of capital and operating costs will be notified and capital and operating expenditures will be adjusted accordingly (AER amendments 7.6 and 7.7).

ActewAGL Distribution has retained its rolling carryover mechanism for capital expenditure in the access arrangement (clauses 4.6-4.11). ActewAGL Distribution does not accept that

[113] AER *Draft Decision*, p. 81

capital expenditure should be removed from the operation of the incentive scheme. However, some changes have been made to the capital efficiency mechanism to ensure consistency with the amendments to the operating expenditure component of the scheme.

7 Services, cost allocation and pricing

This chapter supplements ActewAGL Distribution's services, cost allocation and pricing proposal (chapter 11 of the June 2009 Access Arrangement) and addresses the AER's proposed amendments to pipeline and reference services and reference tariffs set out in chapters 2, 12, 13 and 14 of the draft decision.

7.1 Treatment of ancillary services

7.1.1 AER Draft Decision

The AER's draft decision requires ActewAGL Distribution to include its ancillary service as a pipeline service (AER amendments 2.1 to 2.3), and as a reference service (AER amendments 2.4 to 2.6).

The AER notes in the draft decision that the inclusion of the ancillary service as a pipeline service requires that a revenue allocation be made to the ancillary service (AER amendment 13.1).[114]

The classification of the ancillary service as a reference service requires specification of the terms and conditions applying to those services. As a result, consequential amendments to the structure and content of the access arrangement are required, involving the removal of the ancillary service from the attachments to the access arrangement specifying terms and conditions for other reference services (where the ancillary service is listed as available at the corresponding tariff) and the inclusion of an attachment incorporating the tariff and terms and conditions specific to the ancillary service (AER amendments 14.1 and 14.3).

The AER also requires the access arrangement information submitted to the AER on 30 June 2009 to reflect changes to the treatment of the ancillary service (AER amendment 14.2).

7.1.2 ActewAGL Distribution response

ActewAGL Distribution had set out in its access arrangement proposal to achieve maximum continuity from the earlier access arrangement period and had sought not to change its reference services. Treatment of the ancillary service in the proposed access arrangement therefore closely followed that in the earlier access arrangement period.

At the time of submitting its proposal ActewAGL Distribution had formed a view that the ancillary service was, as implied by the name and consistent with the approved treatment in the earlier access arrangement, to be considered secondary to the pipeline services "provided by means of a pipeline"[115]. This was read in conjunction with the requirement of Rule 48(1)(b) that an access arrangement "describe the pipeline services the service

[114] AER 2009, *Draft Decision*, p 156
[115] NGL, section 2 – definition of *Pipeline Service*. The definition appears to distinguish between pipeline services provided by means of a pipeline and ancillary services

provider proposes to offer to provide *by means of the pipeline"* [emphasis added]. While ActewAGL Distribution considers that its earlier treatment of ancillary services was reasonable, it accepts that an implication of the broad definition of pipeline in the NGL can lead to a different interpretation of the ancillary service as a pipeline service.

As a result, ActewAGL Distribution accepts that the ancillary service offered is intended to be included as a *pipeline service* under the NGL, and as such subject to the requirements of Rule 48(1)(b) for description and capable as being qualified as a reference service by virtue of their being "sought by a significant part of the market".[116]

ActewAGL Distribution therefore amends its access arrangement proposal to include the ancillary service as a reference service, and changes to the access arrangement consequential to this change.

ActewAGL Distribution has included terms and conditions for the provision of the ancillary service in a separate attachment in the access arrangement (attachment 3I). The terms and conditions are largely derived from other parts of the access arrangement (for example former clauses 3.54-3.57) and ActewAGL Distribution's Transport Services Agreement.

ActewAGL Distribution notes, however, that as a consequence of both the treatment of the ancillary service in the earlier access arrangement and ActewAGL Distribution's interpretation that the ancillary service did not qualify as a pipeline service, both costs and revenues associated with providing the ancillary service were not included in the revenue building blocks. ActewAGL Distribution has therefore amended its access arrangement to include costs associated with the provision of the ancillary service in the revenue building blocks.

7.1.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended its access arrangement to:

- Incorporate a description of the Ancillary service, made up of (i) requests for services; (ii) special meter reads; (iii) reconnection; and (iv) disconnection, in clause 2.3 (response to AER amendment 2.1);
    - Amended clauses 2.1, 2.5, 2.7(d), 3.2, 3.4, 5.7, 5.8, 5.11 and Attachment 3 as consequential amendments to AER amendment 2.1;
- Revise the definition of Reference Service in attachment 1 to include Ancillary Service (AER amendment 2.4);
- Include a definition of Ancillary Service in attachment 1 (AER amendment 2.5);
- Include terms and conditions for the provision of the Ancillary service, including tariffs, in attachment 3I (AER amendment 14.3);
    - As a consequential amendment, relocate former clauses 3.54-3.57 of the access arrangement to attachment 3I;

[116] Rule 101

- Amend attachments 3A, 3B, 3C and 3E as per AER amendment 14.1, and amendments consequential to this amendment.

ActewAGL Distribution has amended its access arrangement information to:

- Include costs associated with providing the Ancillary service as set out in chapter 5 above;
- Include revenue associated with providing the Ancillary service as set out in chapter 6 above;
- Update relevant tables to reflect inclusion of operating costs and revenue associated with ancillary services (AER amendment 2.3 and 2.6) in chapters 5, 6, and attachments A and H;
- Replace text in chapter 11 of its June 2009 access arrangement information as set out in Box H.1 in attachment H (response to AER amendments 2.2, 2.3 and 2.6); and

Amend chapter 12 of its June 2009 access arrangement information as set out in Box H.2 in attachment H (response to AER amendments 14.2 and 14.3).[117]

7.2 Reference tariffs

7.2.1 AER Draft Decision

The AER assessed ActewAGL Distribution's proposed tariffs against the requirements of Rules 92-94 of the NGR.

On the basis of this assessment, the AER found that ActewAGL Distribution's allocation of total revenue and costs between reference and non-reference services, the division of customers into tariff classes, and comparison of stand alone and avoidable costs, were consistent with the NGR, and required no amendments.[118]

In respect of charging parameters, the AER described ActewAGL Distribution's proposal as follows:

> ActewAGL proposes a step charging parameter structure for throughput charge [sic] where the cost per GJ is set for a block size of volumes, where the cost for each successive block size between 1.25 GJ per annum [sic] and 75 GJ per annum [sic] decreases as volumes increase. Although ActewAGL proposes six different charging parameters (or steps) for throughput charges, the three block sizes between 1.25 GJ per month and 75 GJ per month have identical prices.[119]

In respect of this tariff structure, the AER stated:

> The AER considers that this has the effect of collapsing the tariff structure into four block sizes rather than six block sizes. While this is consistent with r. 94(4)(b)(i) of the NGR, the AER considers that transaction costs will be reduced by considering the

[117] These amendments to chapter 12 are in addition to the other changes to the access arrangement set out in chapters 8 and 9 of this access arrangement information addendum document.

[118] AER 2009, *Draft Decision*, pp 148-9

[119] AER 2009, *Draft Decision*, p 149. Excepting that the AER has made a transcription error in describing block sizes on a per annum rather than a per month basis in part of this excerpt, this description accurately reflects aspects of ActewAGL Distribution's tariff structure.

identically priced steps as a single step. This will have the effect of providing customers with a more transparent tariff structure increasing the ability of customers to respond to price signals.[120]

The AER accordingly requires ActewAGL Distribution to amend the tariff structure so that identical priced steps are considered as one pricing step in the tariff schedule. This change (amongst others) was included in AER's amendment 13.1.

7.2.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER's amendment collapsing the tariff structure from six charge blocks to four, in addition to the fixed charge.

7.2.3 CPI adjustment in the first year of the access arrangement period

7.2.3.1 AER Draft Decision

The AER notes that ActewAGL Distribution's proposed tariff schedule is expressed in 2008-09 dollars and a CPI base year of 2008, requiring a tariff variation for the first year of the access arrangement on 1 July 2010.[121] The AER does not approve this approach, and requires ActewAGL Distribution to amend its annual reference tariff adjustment formula mechanism so that the first tariff adjustment is made for the year commencing 1 July 2011. Consequential amendments resulting from this amendment are:

- The service schedule in attachment 3 of the access arrangement must be indexed in real 2010-11 dollars and quote tariffs for the 1 July 2010 to 30 June 2015 period (AER amendment 13.1); and
- Subscripts for the CPI denominator in the tariff variation mechanism are 2009 rather than 2008 (AER amendment 13.3).

The AER also requires that tariffs be expressed as GST exclusive (AER amendment 13.1).[122]

7.2.3.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER 's amendment requiring it to present its tariffs in the access arrangement in real 2010-11 dollars, and changes consequential to that amendment. ActewAGL Distribution notes that further amendments to clauses 5.1 and 5.2 of the access arrangement are required to ensure consistency throughout the document.

ActewAGL Distribution accepts the AER amendment requiring it to express all tariffs as GST exclusive in its access arrangement. ActewAGL Distribution notes that its June 2009 access arrangement proposal presented tariffs that were *inclusive* of GST.

7.2.4 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended the presentation of tariffs included in the access arrangement as follows:

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[120] AER 2009, *Draft Decision*, pp 149-50
[121] AER 2009, *Draft Decision*, p 159
[122] AER 2009, *Draft Decision*, p 160

- Collapsed its tariff structure as required by AER amendment 13.1;
- Indexed the service schedule in attachment 3 of the access arrangement in real 2010-11 dollars (AER amendment 13.1);
- Quoted tariffs over 1 July 2010 to 30 June 2015 period (AER amendment 13.1);
- Changed the subscripts for the CPI denominator in the tariff variation mechanism to 2009 (AER amendment 13.3); and
- Expressed all tariffs as GST exclusive (AER amendment 13.1).

ActewAGL Distribution has further amended clauses 5.1 and 5.2 of the access arrangement to ensure consistent referencing to tariffs as being exclusive of GST and expressed in 2010/11 dollars.

7.3 Allocation of adjusted revenue to tariffs

7.3.1 AER Draft Decision

The AER's draft decisions discussed earlier in this access arrangement information in relation to the opening capital base, forecast capital expenditure, forecast operating expenditure and the cost of capital, impact on the amount of forecast revenue to be allocated to reference tariffs. In determining new tariffs to reflect this adjusted revenue, the AER states that it has applied the following methodology:

> The new tariff schedule is adjusted on the basis that every tariff within a category is adjusted by a given percentage so that for each category in present value terms the total revenue allocated to reference services is equal to the new forecast revenue over the access arrangement period.[123]

The AER also included revenue associated with the Ancillary service under ActewAGL Distribution's total revenue allowance.[124]

7.3.2 ActewAGL Distribution response

As noted above, the AER required no amendments to ActewAGL Distribution's methodology of allocation of revenue to reference services and associated tariffs (with the exception of the change to the tariff structure described in section 7.2.1 above that has no impact on the effective tariffs offered). In addition, the AER concluded that ActewAGL Distribution's access arrangement proposal complies with Rule 92(2), which relates to the equalisation in net present value terms of forecast revenue from reference services to the portion of total revenue allocated to reference services.[125] ActewAGL Distribution therefore considers that the AER has accepted its methodology for the allocation of revenue to tariffs and the relationship between revenue and charging parameters included in that methodology. ActewAGL Distribution's methodology includes managing the transition of prices between access arrangement periods to ensure a smooth price path that minimises price shocks to users.

[123] AER 2009, *Draft Decision*, p 156
[124] AER 2009, *Draft Decision*, p 156
[125] AER 2009, *Draft Decision*, p 156

In applying the methodology described above to reflect the adjusted forecast revenue, the AER has effectively changed the pricing methodology that ActewAGL Distribution applied so as to change the relationship between existing and proposed charges. This approach increases price volatility experienced by users between access arrangement periods.

ActewAGL Distribution's considers that it must manage the transition of prices between access arrangement periods as well as within an access arrangement period. It is therefore important that ActewAGL Distribution is given the opportunity to convert the final revenue requirement determined by the AER in its final decision into prices, to ensure that the same methodology is applied to tariffs in the final decision.

In this revised proposal, ActewAGL Distribution has applied the same methodology to allocate revenue to tariffs as that approved by the AER in its draft decision. Due to the updated revenue building blocks and inclusion of the Ancillary service in reference services, however, ActewAGL Distribution has updated section 11.2 of its June 2009 access arrangement information to include updated input data for the operating and capital cost allocation, and information on the allocation of costs for the new Ancillary Service.

7.3.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended tariffs included in the access arrangement to reflect the updated revenue requirement in this revised proposal, and to apply ActewAGL Distribution's methodology in determining tariffs.

ActewAGL Distribution also amends section 11.2 of its June 2009 access arrangement information to include updated input data as described in chapters 3-6, and information on the allocation of costs for the new Ancillary Service, as set out in Attachment H.

8 Reference tariff variation mechanism

This chapter supplements ActewAGL Distribution's services, cost allocation and pricing proposal chapter (chapter 11 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to the reference tariff variation mechanism set out in chapter13 of the draft decision.

8.1 Annual reference tariff adjustment formula mechanism

8.1.1 Adjustment factor

8.1.1.1 AER Draft Decision

The AER did not accept ActewAGL Distribution's proposal to include an Adjustment factor in its annual reference tariff adjustment formula mechanism to adjust for actual costs in relation to the Utilities (Network Facilities) Tax (UNFT), AEMO fees, the Energy Industry Levy, and the difference between the forecast cost of UAG and the efficient tendered market price of UAG as a percentage of actual gas receipts.[126] In rejecting this proposal, the AER stated that more appropriate methods exist to adjust for the difference between actual and forecast costs, such as the cost pass through tariff variation mechanism.[127] The AER also rejected ActewAGL Distribution's proposal on the basis that it only adjusts for actual costs which are higher than approved costs, and states that "the AER does not consider that the proposed asymmetric adjustment mechanism applied by ActewAGL is consistent with the purpose of determining efficient tariffs".[128]

On these bases, the AER requires ActewAGL Distribution to amend the annual reference tariff adjustment formula mechanism in both the access arrangement and access arrangement information to remove the adjustment factor, and include a symmetrical adjustment to costs for CPI. These changes (amongst others) are set out in AER amendments 13.2 and 13.11.

8.1.1.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER's decision to replace its proposed Adjustment factor in the annual reference tariff adjustment formula mechanism with a low administrative cost pass through event and amends its access arrangement and access arrangement information accordingly.

With the removal of the adjustment factor, the annual reference tariff adjustment formula mechanism now applies equally to all reference tariffs. ActewAGL Distribution has therefore simplified this mechanism in the access arrangement formula by removing references to specific tariffs to be amended in clause 6.3, as well as the former clause 6.5.

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[126] AER 2009, *Draft Decision*, p 157
[127] AER 2009, *Draft Decision*, p 157
[128] AER 2009, *Draft Decision*, p 157

ActewAGL Distribution notes that its CPI adjustment formula included in the access arrangement is symmetrical, and therefore made no further amendment to the formula.

8.1.2 Adjustment for time value of money

8.1.2.1 AER Draft Decision

The AER requires ActewAGL Distribution to amend its access arrangement to remove the adjustment of costs in the Adjustment factor by the weighted average cost of capital to take account of the time value of money. In requiring this amendment the AER states:

> [ActewAGL Distribution's proposal] means a cost of capital adjustment is embedded in the annual tariff variation mechanism. Costs such as UAG, taxes and regulatory costs are not relevant capital costs to be adjusted using the weighted average cost of capital approach under the NGR.[129]

This amendment is a component of AER's amendment 13.2.

8.1.2.2 ActewAGL Distribution response

ActewAGL Distribution notes that the removal of the adjustment factor from the annual reference tariff adjustment formula mechanism removes the need to include an "r" parameter in the reference tariff adjustment formula mechanism to take account of the time value of money. ActewAGL Distribution accepts the AER's amendment to remove this parameter from the reference tariff adjustment formula mechanism.

Neutralising the revenue impact of delays in tariff variations is, however, an important element in an efficient reference tariff variation mechanism. Recognition of the time value of money as a revenue component balances two considerations for both users and the regulated business:

- The desirability for relevant increases and decreases in costs to be reflected in tariffs as soon as possible; and
- The need for an orderly tariff variation process that limits the number of tariff variations that occur in a given year, thereby lowering administrative costs.

These considerations have been a driving force behind ActewAGL Distribution's design of the reference tariff variation mechanism, to ensure that it and users are essentially neutral to delays in recovering or returning changes in costs through tariffs.

ActewAGL Distribution notes that including symmetrical recovery of the time value of money is equally likely to compensate users or the regulated business in the reference tariff variation mechanism. For example, a material reduction in costs arising from a cost pass through event (such as the removal of a tax) during the access arrangement period is likely to be reflected in tariffs in the following year and/or the year after that. Noting that customers are effectively "lending" the distribution business money in relation to the removed tax for the remainder of the year before tariffs change, customers are then able to recover that money, plus the time value of that money, at a later stage. Similarly, where there is a delay in the distribution business recovering an increase in costs, customers

[129] AER 2009, *Draft Decision*, p 157

compensate the distributor for the time value of money spent before it could be recovered through tariffs.

A further advantage of including recovery of the time value of money relates to ensuring that customers, where possible, do not face price shocks. For example, a terrorist event may impose very high costs on ActewAGL Distribution over a short period of time. It may, however, be in the interest of users for costs to be recovered over a longer period of time to avoid fluctuations in tariffs and price shocks. In this example, it is very important for the regulated business to be able to recover the time value of money so that it is neutral to the cost recovery approach that also benefits users.

The WACC is generally used as a proxy for the time value of money, relevant to both capital and operating expenditure.[130] In this context the WACC is not a return on expenditure recovered over a number of years, as the time value amount is not added to the capital base. It instead represents the value of money that could be put to a different purpose.

ActewAGL Distribution therefore does not consider that using this value is equivalent to allowing a return on capital associated with operating expenditure, as suggested by the AER. In this respect, ActewAGL Distribution observes that its proposed approach to recovery (or return) of the time value of money is consistent with AER policy for other revenue adjustments that may be subject to delay. For example, the AER, in Appendix E of the AER's Final Decision related to electricity network prices for ActewAGL Distribution[131] requires that "the post-tax nominal rate of return as approved by the AER in its distribution determination" be applied to opening balance of the Transmission Use of System (TUOS) overs and unders account. ActewAGL Distribution has therefore included the time value of money as a relevant consideration for the AER under the cost pass through tariff variation mechanism, as discussed in section 8.3.4 below.

8.1.3 CPI formula

8.1.3.1 AER Draft Decision

In addition to the amendment discussed above related to the indexation of tariffs in the access arrangement, the AER requires amendment to the CPI_t formulae included in the annual reference tariff adjustment formula mechanism in two respects. First, the CPI_t formulae are required to be amended to reflect the availability of CPI inputs at the time the annual tariff variation process is undertaken.[132] The AER has also deleted "-1" from the CPI_t formulae. These changes are included in the AER's amendment 13.3, to give a CPI_t formula of:

$$CPI_t = \left(\frac{CPI_{Mar\,t-2} + CPI_{Jun\,t-2} + CPI_{Sep\,t-2} + CPI_{Dec\,t-2}}{CPI_{Mar\,2009} + CPI_{Jun\,2009} + CPI_{Sep\,2009} + CPI_{Dec\,2009}} \right)$$

[130] For example, the Essential Service's Commission of Victoria's S-bank, applying, until recently, to electricity distributors

[131] AER, Final Decision, Australian Capital Territory Distribution Determination 2009-10 to 2013-14, April 2009, p182

[132] AER 2009, *Draft Decision*, p 158

Secondly, the AER considers that the "*t*" subscript should be defined in the access arrangement as "the year ended 30 June each year of the access arrangement period", as required in AER amendment 13.4.[133]

8.1.3.2 ActewAGL Distribution response

ActewAGL Distribution accepts that if the tariff schedule is to be expressed in terms of 2009-10 dollars[134], then the relevant price indices for the denominator on the CPI_t formula would be 2009. ActewAGL Distribution has amended its CPI_t formula in its access arrangement accordingly.

ActewAGL Distribution does not, however, accept the AER's amendments to the subscripts for the numerators in the CPI_t formula.

The AER states that the because "the tariffs for year t …are assessed in year 't-1' …the latest entire year CPI data available is in year 't-2'".[135] The AER therefore requires the indices for CPI_{Sep} and CPI_{Dec} to be changed from "t-1" to "t-2".

ActewAGL Distribution does not consider that the AER is correct in its conclusion as to the availability of data.

The parameters represented by the terms $CPI_{Sep\ t-1}$ and $CPI_{Dec\ t-1}$ are indices. For example the index for September 2009 is "168.6". The CPI indices for the December quarter are usually available by the end of the following February. Thus, the indices for SEP_{t-1} and DEC_{t-1} would be available in time to be used in preparing prices for the year "t" which starts in the following July.

ActewAGL Distribution also does not consider that the AER's amendment to the formula to determine CPI_t delivers an accurate CPI adjustment in the second year of the period.

ActewAGL Distribution's CPI_t adjustment formula works to adjust tariffs, which are set on a financial year basis, by a CPI_t value which is determined on a calendar year basis. This means that for each annual tariff adjustment, the relevant CPI values will be derived from two financial years. The following demonstrates how this will operate for the first tariff adjustment that will occur in 2011/12.

$$CPI_t = \left(\frac{CPI_{Mar\ t-2} + CPI_{Jun\ t-2} + CPI_{Sep\ t-1} + CPI_{Dec\ t-1}}{CPI_{Mar\,2009} + CPI_{Jun\,2009} + CPI_{Sep\,2009} + CPI_{Dec\,2009}} \right) - 1$$

Where "*t*" is the financial year for which Reference Tariffs are being varied, in this case, the year ending June 2012, which consists of four quarters, namely Sept 2011, Dec 2011, Mar 2012 and Jun 2012. The following examples show how these values are inserted in the formula:

$CPI_{Mar\ t-2}$ is $CPI_{Mar2012-2} = CPI_{Mar2010}$

[133] AER 2009, *Draft Decision*, p 159
[134] AER 2009, *Draft Decision*, p 159
[135] AER 2009, *Draft Decision*, p 158

$CPI_{Sep\ t-1}$ is $CPI_{Sep2011-1}$ = $CPI_{Sep2010}$

This leads to a formula for adjusting tariffs for the financial year ending June 2012 as follows:

$$CPI_{2012} = \left(\frac{CPI_{Mar\ 2010} + CPI_{Jun\ 2010} + CPI_{Sep\ 2010} + CPI_{Dec\ 2010}}{CPI_{Mar\,2009} + CPI_{Jun\,2009} + CPI_{Sep\,2009} + CPI_{Dec\,2009}} \right) - 1$$

In contrast, the AER's amendment to this formula, changing the subscripts for the numerator from SEP_{t-1} and DEC_{t-1} to SEP_{t-2} and DEC_{t-2}, would mean that the same CPI indices for September and December are used in the numerator and the denominator. For example, in the second year, 2011/12, the CPI for SEP_{t-2} and DEC_{t-2} would be for the year 2009/10 and so SEP_{t-2} and DEC_{t-2} would be SEP_{2009} and DEC_{2009}, the same CPI indices for September and December used in the denominator. This outcome would produce an inappropriate factor to inflate prices, increasing prices by the CPI for half a year, rather than a full year. Hence ActewAGL Distribution proposes that the subscripts for the numerator remain as SEP_{t-1} and DEC_{t-1}.

ActewAGL Distribution has included the above example in the access arrangement to demonstrate the operation of the CPI_t formula. ActewAGL Distribution has also deleted the CPI formula for the first year of the access arrangement period from its access arrangement as this is no longer needed as tariffs are indexed in 2010/11 dollars.[136]

The outcome of the CPI_t formula should be a small number significantly less than one. This number is then used in the following application:

$$P_t = P_t^* (1 + CPI_t)$$

ActewAGL Distribution's formula included in its access arrangement proposal of 30 June 2009 deducted one from the ratio of the new price indices over the base year price indices to present the CPI adjustment as positive number if prices increased and a negative number if prices decreased. This form was compatible with the use to which it was to be put in the formula above. If one is not deducted from the tariff formula, then the application of the CPI to prices is likely to double prices. Therefore, ActewAGL Distribution proposes that the formula for the CPI_t be:

$$CPI_t = \left(\frac{CPI_{Mar\ t-2} + CPI_{Jun\ t-2} + CPI_{Sep\ t-1} + CPI_{Dec\ t-1}}{CPI_{Mar\,2009} + CPI_{Jun\,2009} + CPI_{Sep\,2009} + CPI_{Dec\,2009}} \right) - 1$$

The AER proposes that the definition of "*t*" be "the year ended 30 June in the access arrangement period."[137] ActewAGL Distribution finds this definition to lack precision as there are five years in the access arrangement period and this definition does not identify which is the relevant year. Hence, ActewAGL Distribution proposes to amend the definition of "*t*" to be "the financial year for which Reference Tariffs are being varied." ActewAGL

[136] AER 2009, *Draft Decision*, p 159
[137] AER 2009, *Draft Decision*, pp xxvi & 159

Distribution has amended the definition of "*t*"in both the tariff and CPI formula for consistency (clauses 6.3 and 6.4 of the revised access arrangement proposal).

ActewAGL Distribution has also amended the definitions of some parameters in the tariff adjustment and CPI_t formulae to provide greater clarity. These amendments do not change the operation of the formulae from that submitted to the AER in ActewAGL Distribution's June 2009 access arrangement proposal, and amended by the AER.

8.1.4 Inclusion of a rounding convention in the access arrangement

8.1.4.1 AER Draft Decision

The AER requires ActewAGL Distribution to include a rounding convention in its access arrangement to ensure that the reference tariff variation mechanism is calculated consistently each year. This requirement is included in AER amendment 13.5.

8.1.4.2 ActewAGL Distribution response

ActewAGL Distribution has included a rounding convention for CPI_t in the access arrangement, stating that CPI_t will be rounded to four decimal places. ActewAGL Distribution considers that rounding at this stage provides transparency as to the CPI_t value used to adjust tariffs, and to assist users and prospective users to understand and replicate tariffs included in the tariff adjustment notification.

In addition, ActewAGL Distribution proposes that when CPI_t is applied to real prices, the subsequent nominal prices generated be rounded to the same number of decimal places as shown for the relevant reference tariff in attachment 3 of the access arrangement.

8.1.5 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended the reference tariff variation mechanism in its access arrangement as follows:

- Deleted the Adjustment factor from the annual reference tariff adjustment formula mechanism (AER amendment 13.2);
- Removed lists of relevant tariffs in former clauses 6.3 and 6.5 of the access arrangement proposal submitted to the AER on 30 June 2009;
- Amended the tariff adjustment formula to:
    - Define "*t*" in the tariff adjustment formula as "the financial year for which Reference Tariffs are being varied" (response to AER amendment 13.4);
    - Provide further clarity to the definition of some parameters in the formula.
- Amended the CPI_t formula to:
    - Change the CPI denominator to 2009 (AER amendment 13.3);
    - Reinstate the CPI numerator values for CPI_{Sep} and CPI_{Dec} to $CPI_{Sep\ t-1}$ and $CPI_{Dec\ t-1}$;

- Define “*t*” as the financial year for which Reference Tariffs are being varied” (response to AER amendment 13.4);
- Provide further clarity to the definition of some parameters in the formula;
- Reinstate the “-1” to the CPI_t formula to ensure consistency with the Tariff variation formula;
- Delete the formula for adjusting tariffs for the first year of the access arrangement period from its access arrangement; and
- Include an example for the calculation of CPI_t.

- Indexed the service schedule in attachment 3 of the access arrangement in real 2010-11 dollars and quoted tariffs for the 1 July 2010 to 30 June 2015 period (AER amendment 13.1);
- Made other consequential amendments arising from the removal of a tariff variation in for first year of the access arrangement period; and
- Included a rounding convention in the access arrangement (AER amendment 13.5).

Section 11.3.1 of the access arrangement information is replaced with the text in Box H.4 in Attachment H (AER amendments 13.2, 13.3 and 13.4).

8.2 Cost pass through tariff variation mechanism

8.2.1 Definition of pass through events

8.2.1.1 AER Draft decision

The AER approved ActewAGL Distribution’s proposed defined events in its cost pass through tariff variation mechanism subject to the following changes:

- Replace ActewAGL Distribution’s drafting of the Short Term Trading Market (STTM) event with the AER’s drafting (AER amendment 13.9);
- Amend the proposed Change in tax event to remove the reference to the annual reference tariff adjustment formula mechanism (AER amendment 13.10);
- Remove references to ‘material’ in definitions of the General pass-through event and the Regulatory change event (AER amendment 13.11); and
- Include in the definition of a Service standard event scope for higher or lower costs in providing services to be passed through, as well as a change in the definition of a Change in Cost, reflecting the AER’s decision that pass through events should be symmetrical (AER amendment 13.11).

These changes require amendments to both the access arrangement and access arrangement information.

8.2.1.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER’s amendment to replace its proposed definition of an STTM event.

As discussed in section 8.2.2 below, ActewAGL Distribution accepts the AER's amendment to its cost pass through tariff variation mechanism to include a new low administrative cost event, to replace ActewAGL Distribution's proposed Adjustment factor for uncontrollable costs.[138] As a consequence of these amendments, ActewAGL Distribution accepts that the definition of a Change in tax event should be amended as required by the AER.

ActewAGL Distribution accepts the AER's amendment requiring removal of references to "material" and "materially" from the definitions of a General cost pass through event and a Regulatory change event. ActewAGL Distribution notes that there is a further reference to material costs in the Service standard event definition. For consistency, ActewAGL Distribution has amended this definition to remove "materially" from the definition of a Service standard event.

ActewAGL Distribution accepts the AER's amendment to require cost pass through events to allow for revenue to be adjusted to take account of both increases and decreases in costs. ActewAGL Distribution therefore accepts the AER's amendments[139] to the Service standard event and the Change in Cost definition to allow for higher or lower costs to be addressed through the cost pass through tariff variation mechanism.

8.2.2 Low Administrative Cost Event

8.2.2.1 AER Draft Decision

The AER requires the inclusion of a low administrative cost pass through event to account for the difference between actual and forecast costs in relation to the AEMO fee, UNFT, Energy Industry Levy and UAG as part of amendment 13.10.[140] This new pass through event replaces the Adjustment factor, and is subject to a low materiality threshold.[141]

8.2.2.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER's amendment to include a new event in its cost pass through tariff variation mechanism to account for the difference between actual and forecast costs in relation to the AEMO fee, UNFT, Energy Industry Levy and UAG.

While the AER amendments in some instances require this event to be called a Low Administrative Cost event, ActewAGL Distribution has encountered practical drafting issues in giving effect to this aspect of the amendments. This particularly relates to the relationship between the new Low Administrative Cost event, which replaces the Adjustment factor described above, and the Change in tax event, which the AER also intends to be a Low Administrative Cost event for the purposes of the Administrative Cost Impact threshold.[142] ActewAGL Distribution has therefore amended its access arrangement to deliver the same substantive effect as this aspect of the AER's amendment 13.10, while also overcoming

[138] AER 2009, *Draft Decision*, p 161, AER amendment 13.10
[139] AER 2009, *Draft Decision*, p 163, AER amendment 13.11
[140] AER 2009, *Draft Decision*, p 161, AER amendment 13.10
[141] AER 2009, *Draft Decision*, p 161
[142] Further drafting difficulty arises with the conditions placed on whether an event is a low administrative cost event relating to the provision of verifiable documentation with the cost pass through claim. To incorporate this AER decision in drafting, ActewAGL Distribution has had to separate the concept of materiality from the definition or name of the event.

drafting complexities described here. ActewAGL Distribution has included a new Specified Uncontrollable Cost event in its access arrangement, as set out in Table 8.1 below.

ActewAGL Distribution proposes to pass through the difference between the forecast cost (defined in the access arrangement) and the costs for that year (which will be a combination of actual cost incurred to date and forecast cost for the remainder of the year). In the following year ActewAGL Distribution proposes to correct for any difference between the forecast and actual costs in the previous year, by passing through any variation between the forecast made at the time of the last cost pass through notification and the actual cost for the full year. This procedure is very similar to that used for ActewAGL Distribution's TUOS unders and overs account adjustments for the electricity network, and ensures that the pass through is made as close as possible to the pass through event.

8.2.3 Supply Curtailment Event

8.2.3.1 AER Draft decision

ActewAGL Distribution included self insurance operating expenditure to take account of the identified risk that an upstream event, such as a failure in a gas production facility or transmission pipeline, interrupts supply. This is in addition to two "step changes" for the costs associated with managing for market shortfall events.[143] The AER did not accept ActewAGL Distribution's operating expenditure for these costs, but noted in its draft decision that "in the circumstances of an adverse event occurring ActewAGL can vary its access arrangement or in some cases seek a cost pass through in order to recover the cost of the adverse event".[144]

8.2.3.2 ActewAGL Distribution response

ActewAGL Distribution accepts that business interruption costs be treated as a cost pass through event. As set out in its June 2009 access arrangement information, ActewAGL Distribution's preferred approach to addressing the risk of complete business interruption, or supply curtailment as a result of an upstream interruption, is through a cost pass through event:

> ActewAGL Distribution remains of the view that a supply curtailment pass through event is the most appropriate way to manage the risk of a widespread shortfall in gas supply that leads to a sustained disruption of customers.[145]

ActewAGL Distribution further stated that should the AER reject its proposal for self insurance operating expenditure for business interruption risk, it would seek to propose a supply curtailment cost pass through event to address this risk.[146] As the AER rejected ActewAGL Distribution's self insurance proposal, ActewAGL Distribution proposes a Supply curtailment event to address this risk, in accordance with Rule 60(1) of the NGR. As discussed in section 5.2.2.4 above, ActewAGL Distribution also proposes that costs associated with market shortfall events be covered by the Supply curtailment event.

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[143] ActewAGL Distribution 2009, *Access Arrangement Information*, Attachment C and pp 166-7
[144] AER 2009, *Draft Decision*, p 123
[145] ActewAGL Distribution 2009, *Access Arrangement Information*, p 254
[146] ActewAGL Distribution 2009, *Access Arrangement Information*, p 254

A Supply curtailment event is an external event that impacts on ActewAGL Distribution's revenues and costs. As noted in its June 2009 access arrangement information, the ACT Government has in place regulations under the *Utilities Act 2000* (ACT) to allow the responsible minister to approve a scheme to restrict the use of gas in the ACT in a shortage.[147] In the event of a disruption that led to the need to shed domestic load, it could take weeks or months to reinstate network operations and customer supply.[148]

Ministerially-directed supply curtailment, or the widespread domestic load shedding, gas rationing or curtailment as a result of a supply shortfall for the network with or without a ministerial direction, would have a significant adverse financial impact on ActewAGL Distribution which would limit its ability to recover its efficient costs. In this way, it is analogous to other cost pass through events, and ActewAGL Distribution considers that it is consistent with Rule 97(3).

ActewAGL Distribution also considers that inclusion of this event is consistent with the NGL Revenue and Pricing Principles set out in section 24 of the *National Gas Law*, by ensuring that ActewAGL Distribution is provided with a reasonable opportunity to recover at least the efficient costs it incurs in providing reference services and complying with regulatory obligations. It would not be consistent with the revenue and pricing principles for ActewAGL Distribution to be subject to an external event over which it has no control, which meant that it had no opportunity to recover its efficient costs. The risk to ActewAGL Distribution's revenue stream is not compensated elsewhere in the access arrangement.

ActewAGL Distribution therefore proposes the following cost pass through event to address the risk of a ministerially-directed supply curtailment event, or the widespread domestic load shedding, gas rationing or curtailment as a result of a supply shortfall for the network with or without a ministerial direction:

> **Supply Curtailment Event** means a period when insufficient gas is delivered to ActewAGL's gas network due to reasons beyond ActewAGL's control, and cannot be supplied to meet demand requirements as represented by ActewAGL's forecasts used to derive the Reference Tariffs in this Access Arrangement, resulting in:
>
> (a) supply restrictions directed under the *Utilities (Gas Restrictions) Regulation 2005* (ACT); and/or
>
> (b) widespread domestic load shedding, gas rationing or curtailment within ActewAGL's Network.
>
> For the avoidance of doubt, the cost of preparing for, arranging and managing domestic load shedding, gas rationing or curtailment are part of the expenditure incurred by ActewAGL when determining the relevant Change in Cost of a Supply Curtailment Event.

This event has been defined quite narrowly to ensure that ActewAGL Distribution can only seek pass through of foregone revenue and associated costs under this event where there is ministerially-directed supply rationing, or where there is widespread domestic load shedding, gas rationing or curtailment in response to an external event, such as an upstream disruption. It would not be triggered where constraints *within* the network led to

[147] *Utilities (Gas Restrictions) Regulation 2005*
[148] ActewAGL Distribution 2009, *Access Arrangement Information*, p 121

supply shortage for some or all customers, or where commercial load shedding, curtailment or rationing addressed constraints. ActewAGL Distribution also notes that it would be subject to a higher materiality threshold, meaning that short term or local load shedding would be unlikely to trigger the event.

ActewAGL Distribution considers it unlikely that a Supply curtailment event would satisfy other cost pass through events already approved as part of the access arrangement (with the possible exception of the General pass through event), as these events are defined in terms of costs imposed on the service provider, as opposed to an inability to recover revenue.

The amount of foregone revenue should be determined by reference to the revenue earnings of the business relative to what would have been earned had gas been supplied as forecast. Therefore, as a consequential amendment to this proposal, ActewAGL Distribution amends the definition of a Change in Cost to include, for the purposes of the Supply curtailment event, foregone revenue calculated as a function of the difference between actual and forecast demand.

In addition, costs associated with the Supply curtailment event, such as customer claims and the increased costs imposed on ActewAGL Distribution for needing to meet priority demand and restoring supply after load shedding should be able to be claimed under this event.

8.2.4 Amendments to the access arrangement proposal and information

ActewAGL has amended the definitions cost pass through events in both the access arrangement and access arrangement information document in accordance with Table 8.1 below. Table 8.1 therefore replaces table 11.13 of ActewAGL Distribution's June 2009 access arrangement information document.

Table 8.1 Definitions of cost pass through events

Event name	AER required amendments
Change in tax event	Change in Tax Event means: (a) a change in the amount of a Relevant Tax, or the way or rate at which a Relevant Tax is calculated (including a change in the application or official interpretation of a Relevant Tax); or (b) the removal of a Relevant Tax or imposition of a new Relevant Tax. which, in each case, occurs after the Commencement Date of the Access Arrangement.

Service standard event	Service Standard Event means any decision made by the Relevant Regulator or any other Authority, or any introduction of or amendment to applicable law or Gas Law, which: (a) has the effect of: (i) imposing or varying standards (including Network Design and operational standards) on ActewAGL relevant to any one or more of the Services, that are more onerous than the standards imposed at the Commencement Date; or (ii) altering the nature or scope of services that comprise any one or more of the Services; or (iii) substantially altering the manner in which ActewAGL is required to undertake any activity forming part of, or ancillary to, any one or more of the Services (including through rules for the operation of competitive gas markets); and (b) results in ActewAGL incurring or being likely to incur higher or lower costs in providing any one or more of the Services than it would have incurred but for that event.
Regulatory change event	Regulatory Change Event means a change in a regulatory obligation or requirement that: (a) substantially affects the manner in which ActewAGL provides the Services (or any one of them) or otherwise operates its gas business (or any part of it); (b) increases or decreases the costs of providing those Services or operating its business; and (c) does not fall within any other category of Cost Pass Through Event under this clause.
CPRS event	Carbon Pollution Reduction Scheme Event means an event which results in the imposition of legal obligations on ActewAGL or a third party arising from the introduction or operation of a carbon emissions trading scheme imposed by the Commonwealth, a State or Territory or an Authority and results in ActewAGL incurring costs directly or indirectly (including under statute or contract) and includes: (a) the cost of acquiring emissions allowances, permits or units (howsoever called); (b) costs incurred in order to reduce liability for carbon emissions associated with the production, transport or supply of gas, or otherwise in connection with ActewAGL's gas distribution business or the Services; and (c) administrative and compliance costs associated with the introduction or operation of such a scheme, including reporting costs.
An NECF or NGCF event	National Energy Customer Framework/ National Energy Connections Framework Event means the introduction of new laws (including through proposed National Energy Retail Law and Rules, or by additions or changes to the National Gas Law or Rules) or additions or changes to the existing Gas Law, to implement either or both of the proposed National Energy Customer Framework or National Energy Connections Framework, which results in the imposition of legal obligations on ActewAGL or a third party and results in ActewAGL incurring costs directly or indirectly (including under statute or contract) from the operation of those frameworks.
An STTM event	Short Term Trading Market Event occurs if ActewAGL participates in the Short Term Trading Market, resulting in: (a) changes in costs that ActewAGL incurs directly or indirectly (including under statute or contract); or (b) the need to change services provided to accommodate the market, leading to additional costs.
General pass through event	General Pass-Through Event occurs in the following circumstances: (a) an uncontrollable and unforeseeable event that falls outside of the normal operations of a business such that prudent operational risk management could not have prevented or mitigated the effect of the event; (b) which results in a change in the cost of providing the Services (or any of them) or the operation of its gas business (or any part of it); and (c) does not fall within any other category of Cost Pass Through Event under this clause.

Specified uncontrollable cost event	Specified Uncontrollable Cost Event means: (a) the difference between actual and forecast costs in the relevant year for the following costs: (i) the AEMO Fee; (ii) the Utilities (Network Facilities) Tax; and (iii) the Energy Industry Levy; where the forecast costs for each of the charges are those included in the revenue allowance for the relevant year as per the table below, and actual costs are those costs incurred in the relevant year for each of the charges; and (b) the difference between UAG forecast as 1.7 per cent of actual gas network receipts at the relevant forecast cost per GJ in $2009/10 as follows: (i) in FY11: $5.31 (ii) in FY12: $5.23 (iii) in FY13: $5.25 (iv) in FY14: $5.27 (v) in FY15: $5.29, and 1.7 per cent of actual network gas receipts at the efficient tendered market price per GJ for the relevant year.
Supply curtailment event	Supply Curtailment Event means a period when insufficient gas is delivered to ActewAGL's gas network due to reasons beyond ActewAGL's control, and cannot be supplied to meet demand requirements as represented by ActewAGL's forecasts used to derive the Reference Tariffs in this Access Arrangement, resulting in: (a) supply restrictions directed under the Utilities (Gas Restrictions) Regulation 2005 (ACT); and/or (b) widespread domestic load shedding, gas rationing or curtailment within ActewAGL's Network. For the avoidance of doubt, the cost of preparing for, arranging and managing domestic load shedding, gas rationing or curtailment are part of the expenditure incurred by ActewAGL when determining the relevant Change in Cost of a Supply Curtailment Event.

ActewAGL Distribution has also included the following table in its access arrangement in respect of the new Specified uncontrollable cost event.

Table 8.2 Forecast costs of specified uncontrollable charges ($2009/10)

Year	2010-11	2011-12	2012-13	2013-14	2014-15
Australian Energy Market Operator	$42,410	$ 42,400	$ 42,390	$ 42,380	$ 42,371
Utilities Network Facilities Tax	$3,382,620	$3,432,121	$3,482,347	$3,533,309	$3,585,016
Energy Industry Levy	$527,000	$527,000	$527,000	$527,000	$527,000

ActewAGL Distribution has amended its definition of a Change in Cost in the access arrangement as per the drafting in AER's amendment 13.11, subject to the discussion in section 8.4.2 below in relation to the calculation of the Administrative Cost Impact, and to include, for the purposes of the Supply curtailment event, foregone revenue calculated as a function of forecast demand.

8.3 Oversight of reference tariff variation mechanism

8.3.1 AER consideration of tariff variation notifications

8.3.1.1 AER Draft Decision

ActewAGL Distribution's proposal allowed the AER 30 business days to consider and approve tariff variations in relation to the application of the annual reference tariff adjustment formula mechanism, and for the cost pass through tariff variation mechanism.[149] The AER's draft decision states that it requires amendment to this provision to include scope to extend the decision-making timetable to a maximum of 90 days to allow it to obtain expert advice or further information from ActewAGL Distribution, or to consult on the application.[150] This is included in AER amendment 13.6.

8.3.1.2 ActewAGL Distribution response

ActewAGL Distribution developed its reference tariff variation mechanism process to satisfy the requirements of the NGR to:

- Deliver efficient tariff structures (Rule 97(3)), by providing for tariffs to vary;
- Give the AER adequate oversight or powers of approval over variations to the reference tariff (Rule 97(4)) through the notification and approval process; and
- Minimise administrative and other costs on the AER, users, prospective users and itself, as required under Rule 97(3)(c) by placing time limits on the lodgement of tariff variations for the variation of tariffs on 1 July each year.[151]

ActewAGL Distribution is concerned that the AER's required amendments to include scope for extension of time for the AER to make a decision on a cost pass through tariff variation notification until after 1 July will impose additional administrative costs on users and potential users, as well as on ActewAGL Distribution. This is because it will potentially impose the costs of more than one tariff variation in an access arrangement year on users, potential users and ActewAGL Distribution, through the operation of the CPI tariff variation, which must happen on 1 July, and a cost pass through event, where the cost pass through event is subject to extension.

The AER's required amendments are also out of step with the annual gas *retail* tariff variation cycle applying in NSW, and which is generally adopted in the ACT, which adjusts for CPI, amongst other things, on 1 July each year.[152] ActewAGL Distribution took this retail process into consideration when designing its reference tariff variation mechanism to ensure that, to the extent reasonably possible, both users of the network and end users of gas would be subject to only one tariff adjustment each year, thereby imposing the lowest possible administrative costs on users.

As a result of these concerns, ActewAGL does not accept the AER's required amendments to its access arrangement (amendment 13.6), to include a power for it to extend its decision-making time for cost pass through applications to 90 business days.

ActewAGL Distribution does note, however, that the AER seeks greater oversight or powers of approval over variations to reference tariffs. As an alternative to the AER's

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[149] ActewAGL Distribution 2009, *Access arrangement information,* pp 259-261; ActewAGL Distribution 2009 *Access arrangement,* clauses 6.13 and 6.14
[150] AER 2009, *Draft Decision*, pp 159 and 165, AER amendment 13.6
[151] ActewAGL Distribution 2009, *Access Arrangement Information*, pp 257-8
[152] Independent Pricing and Regulatory Tribunal 2007, Promoting retail competition and investment in the NSW gas industry: Regulated gas retail tariffs and charges for small customers 2007 to 2010, June, pp 12, 17, 22 and 26. All retailer proposed arrangements for 2010-13 also include 1 July tariff adjustments, see IPART 2009, Review of regulated retail tariffs and changes for gas 2010-2013: Gas – Issues Paper, November

amendment 13.6, ActewAGL proposes to change its access arrangement to extend the decision making time available to the AER to consider notifications made in respect of both the annual reference tariff adjustment formula mechanism, and for the cost pass through tariff variation mechanism.

ActewAGL Distribution has amended its access arrangement proposal to require it to submit to the AER its notification for the annual reference tariff adjustment formula mechanism and, where relevant, cost pass through tariff variation mechanism, 65 business days, or more than 3 months, prior to 1 July, where it intends tariffs to change on 1 July. Upon receiving a notification, the AER must make its decision within 45 business days. This period is considerably longer than the time allowed under ActewAGL Distribution's earlier access arrangement.[153] It is also longer than the recommended decision making time for cost pass through notifications included in the AER's access arrangement guideline.[154] This timetable would allow the AER to conduct a consultation process in line with the expedited consultation procedures set out under Rule 9 of the NGR, if it chose to do so.

ActewAGL Distribution considered whether it should vary its access arrangement to require it to submit its proposed tariffs 90 business days prior to 1 July, as opposed to proposed 65 business days. This date would mean, however, that the preceding December quarter CPI figures would not be available at the time of the notification. ActewAGL Distribution did not consider that adopting this date would provide an adequate balance between the need for efficient tariffs taking account of relevant changes to CPI, and AER powers for oversight for tariff variations that are most likely to be limited to the application of the CPI formula and the Specified uncontrollable cost event.[155]

ActewAGL Distribution also notes that this notification must be accompanied by detailed information and assurances as required by the AER in amendments 13.7 and 13.12, as discussed in section 8.3.3 below. This information will assist the AER in assessing the application of the reference tariff variation mechanism, and the appropriateness of claims, ensuring that decisions can be made in the available time.

8.3.2 ActewAGL Distribution notification of pass through events

8.3.2.1 AER Draft Decision

The AER requires ActewAGL Distribution to amend its access arrangement to require it to notify the AER within 3 months of incurring costs under a defined cost pass through event, other than a low administrative cost event or a Change in tax event.[156] The AER states:

> This is to remove discretion about if, and when, ActewAGL needs to notify the AER that a material administrative threshold event occurs.[157]

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[153] ActewAGL Distribution 2004, *Access Arrangement for ActewAGL gas distribution system in ACT and Greater Queanbeyan*, clause 6.6

[154] AER 2009, *Access Arrangement Guideline*, p 78

[155] ActewAGL Distribution submitted only one cost pass through application to the ICRC during the earlier access arrangement period in relation to the UNFT, which was supported by detailed, externally verifiable information on ActewAGL Distribution's liability under the new tax.

[156] AER 2009, *Draft Decision*, p 165, AER amendment 13.15.

[157] AER 2009, *Draft Decision*, p 165

The AER goes on to note:

> This requirement is not intended in any way to prevent ActewAGL submitting an application for a cost pass through event at any time consistent with the approved notification procedures.[158]

The AER therefore requires through amendment 13.15 that ActewAGL Distribution inform the AER that a cost pass through event, other than low cost or taxation events has occurred "no later than 3 months after the costs of a cost pass through event have been incurred".[159]

8.3.2.2 ActewAGL Distribution response

ActewAGL Distribution has identified a number of concerns with the formulation of the AER's amendment 13.15 to require ActewAGL Distribution to inform it when it has incurred costs under a cost pass through event.

A cost pass through notification is made under clause 6.10 of the access arrangement and must include all information required under clause 6.14 for the AER to assess the pass through claim.[160] ActewAGL Distribution included flexibility in the notification process included in the access arrangement, in particular in relation to the timing of pass through event notifications, to ensure that a pass through notification, when made, was supported by the best available information and allowed the AER adequate time to consider the claim. This flexibility was considered necessary as:

- It is often difficult to calculate the costs associated with an event until either after an event has occurred, or until sufficient experience has been gained to accurately forecast future costs for an ongoing event. A notification time-limit that required ActewAGL Distribution to provide the AER with its forecast costs within a period of an "event" occurring may mean that cost claims cannot be adequately supported, and therefore not approved by the AER;
- It is not always clear that an event will lead to a material impact on costs at the time the event occurs. A notification time-limit that required ActewAGL Distribution to notify the AER of material events within a period of an "event" occurring, or costs being incurred, may inadvertently limit potential claims that otherwise satisfy the operation and intent of an approved cost pass through tariff variation mechanism; and
- It is not always clear the date from which a pass through event has occurred. For example, increases in material input costs as a result of a market mechanism such as the Carbon Pollution Reduction Scheme are likely to be reflected in prices over time. A notification time-limit that limited potential cost pass through claims to those made within a period of an "event" occurring, or costs being incurred, may inadvertently limit

158 AER 2009, *Draft Decision*, p 165

159 AER amendment 13.15

160 Clause numbers set out in this chapter are, unless specifically stated as otherwise, as per the access arrangement proposal submitted on 6 January 2010 with this access arrangement information addendum (Revised Access arrangement 2010), and may be different to the clause numbers in the original proposal submitted to the AER on 30 June 2009, and the clause numbering following the AER amendments to this Part of the access arrangement arising from its Draft Decision.

potential claims that otherwise satisfy the operation and intent of an approved cost pass through tariff variation mechanism.

ActewAGL Distribution considers that a limitation on its ability to recover its efficient costs as a result of any of these circumstances would be arbitrary, and not related to the prudency of the costs. This outcome would be contrary to the revenue and pricing principles which state that the service provider must be given reasonable opportunity to recover its efficient costs.[161]

ActewAGL Distribution also has concerns as to its ability to comply with an obligation to notify the AER of all occurrences of either positive or negative pass through events within three months of incurring costs under an event. This is because the regulatory framework within which ActewAGL Distribution operates is under regular review and change. For example, workplace safety obligations change on a regular basis as new information on risks and hazards come to light. Not all of these changes lead to a material change in costs, and most are simply absorbed by the business as normal practice. Further, ActewAGL Distribution does not see merit in submitting a cost pass through notification to the AER for changes in costs that do not meet the materiality threshold and therefore will not vary tariffs.

ActewAGL Distribution also queries the interaction of this clause with clause 6.12[162], which allows ActewAGL Distribution to notify the AER of a cost pass through event outside of the annual tariff variation cycle.[163] As the AER's amendment removes ActewAGL Distribution's discretion on when it provides the AER with a cost pass through event notification, the AER's amendment does not appear to be consistent with this clause.

As a result of these concerns, ActewAGL Distribution has not amended its tariff variation mechanism as required under AER amendment 13.15.

Alternative proposal

ActewAGL Distribution does note the AER's concern that ActewAGL Distribution has a degree of discretion on whether it notifies the AER that a pass through event has occurred. To address this concern, ActewAGL Distribution proposes to amend the tariff variation mechanism in its access arrangement to require it to advise the AER within 90 business days if, at any time during the access arrangement period, it becomes aware that:

- A cost pass through event has occurred (other than a Specified uncontrollable cost event or a Change in tax event); and
- The change in cost associated with that event has, or is likely to have, an Administrative Cost Impact as defined in the access arrangement.

[161] National Gas Law, section 24
[162] Clause 6.10 of the access arrangement submitted to the AER on 30 June 2009, of which the AER did not require amendment.
[163] This provision is intended to operate to allow more frequent notifications and potentially tariff variations in the circumstance that an event occurred in the final year of the access arrangement period, or in the exceptional circumstance that an event occurred that required tariffs to change outside the annual tariff variation cycle to ensure that ActewAGL Distribution could continue to be able to offer reference services.

This is included in clause 6.22 of the revised access arrangement proposal.

ActewAGL Distribution may then submit a notification under clause 6.10 or 6.12 of the access arrangement at a later date, triggering the AER's consideration of ActewAGL Distribution's application for the variation of tariffs.

ActewAGL Distribution also notes that the access arrangement currently includes provision for the AER to initiate a reference tariff variation where it considers that a cost pass through event has occurred.[164] The requirement that ActewAGL Distribution inform the AER of all material events (positive or negative) within a period of time of that event ensures that the AER is aware of all events that may impact prices, and can initiate a variation to reference tariffs where ActewAGL Distribution has not done so itself.

This approach separates the advice provided to the AER than an event has occurred and the notification process. This leads to the least possible number of changes in tariffs during the access arrangement period by allowing most cost pass through events to be addressed through the annual tariff variation process. This approach also appears consistent with the AER intent not to prevent ActewAGL submitting an application for a cost pass through event at any time consistent with the approved notification procedures.[165]

ActewAGL Distribution's obligation to advise on the occurrence of a pass through event to the AER is limited to those events that have had, or are likely to have, an Administrative Cost Impact as defined under the access arrangement, and those that are not a Specified uncontrollable cost event or a Change in tax event. This limits the obligation to those events that would otherwise be considered under sections 6.10 and 6.12, and remains in line with the AER's original notification requirement. This places a reasonable limit on administrative costs in complying with the reference tariff variation mechanism.

ActewAGL Distribution has also amended clause 6.23 to provide more clarity as to how the AER can initiate a reference tariff variation, and ActewAGL Distribution's obligations under this clause.

8.3.3 Information provided to the AER in tariff variation notifications

8.3.3.1 AER Draft Decision

The AER requires ActewAGL Distribution to amend its access arrangement to include more detail on the information it will provide to the AER as part of notifications under the annual reference tariff adjustment formula mechanism and the cost pass through tariff variation mechanism. Required drafting is included in AER amendments 13.7, 13.12 and 13.14.

8.3.3.2 ActewAGL Distribution response

ActewAGL Distribution accepts the AER's amendment 13.7 to include more detail in the access arrangement on the information the AER will receive as part of a tariff variation notification. Minor amendments have been made to the AER's drafting of amendment 13.7

[164] Revised Access arrangement 2010, clause 6.23
[165] AER 2009, *Draft Decision*, p 165

to correct a typographical error and achieve consistency in language in the access arrangement.

ActewAGL Distribution accepts the AER's amendment 13.12 requiring a cost pass through notification to address how the relevant pass through event meets the relevant Administrative Cost Impact threshold, and the AER to consider this when approving a cost pass through amount. ActewAGL Distribution has therefore amended its access arrangement as follows:

- a notification under clause 6.14 to the AER must specify:
  - the incurred and/or forecast Change in Cost of the relevant cost pass through event on ActewAGL Distribution and the basis on which this has been calculated;
  - whether the cost pass through event has, or is forecast to have, an Administrative Cost Impact, which must be substantiated to the AER's reasonable satisfaction;
- the AER, upon receiving a notification must decide whether the Cost Pass-Through Event has, or is forecast to have, an Administrative Cost Impact (clause 6.16(b))

ActewAGL Distribution considers that these amendments to the cost pass through tariff variation mechanism address the AER's intent in AER amendment 13.12[166], while also reflecting the separate roles of ActewAGL Distribution and the AER respectively in submitting and considering a reference tariff variation notification.

ActewAGL Distribution also notes that a Change in cost can relate to incurred and/or forecast costs. ActewAGL Distribution has therefore amended its access arrangement to ensure that cost pass through amounts can encompass both incurred and forecast costs.

ActewAGL Distribution accepts the intent behind the AER's amendment 13.14 requiring ActewAGL Distribution to ensure that any cost pass through amount is net of any third party payments.[167] ActewAGL Distribution is unsure, however, as to what is required of ActewAGL Distribution when providing a "verification statement by an officer of the service provider". This requirement is not discussed in the AER's draft decision and it is unclear why this aspect of a pass through claim requires a verification statement.

ActewAGL Distribution notes that its entire cost pass through notification submitted to the AER under clause 6.14 is effectively a statement by an officer of the service provider. ActewAGL Distribution has therefore amended its access arrangement to require a notification to specify that, where relevant, the cost pass through amount notified is net of third party payments.[168]

ActewAGL Distribution further notes that for it to be able to ensure that a cost pass through claim is net of any third party payment, it must be allowed sufficient time to seek those payments before it must lodge a notification statement with the AER. There is therefore a relationship between the AER requirement that ActewAGL Distribution lodge a tariff variation notification with the AER within three months of incurring costs under an event,

[166] AER 2009, *Draft Decision*, p 163
[167] AER 2009, *Draft Decision*, p 164
[168] Revised Access arrangement 2010, clause 6.14(l)

and the requirement that cost pass through claims are net of third party payments. ActewAGL Distribution considers that it has addressed this concern through its amendments discussed above requiring ActewAGL Distribution to inform the AER that a material cost pass through event has occurred, while maintaining discretion over when a pass through event notification is submitted to the AER.[169]

ActewAGL Distribution has also included in its access arrangement a clause that allows costs that may not be ascertainable at the time of submitting a cost pass through notification to be recovered or returned to users at a later date through a subsequent notification (clause 6.15). This is particularly important where third party or insurance payments may be recovered some time after an event occurs, where it has been appropriate to adjust tariffs in the meantime to ensure the efficient recovery of costs known at the time. This later correction is limited to those costs that are noted as unascertainable costs in the tariff variation notification.

ActewAGL Distribution accepts the AER's amendment 13.14 requiring that a notification in relation to a low administrative cost event be supported by information about the financial impact of the event from the relevant taxation or regulatory authority.[170] In addition, as the low administrative cost event also includes adjustments in relation to UAG that are not attributable to decisions or notices from taxation or regulatory authorities, ActewAGL Distribution has further amended this provision to specify which information this requirement relates to (clause 6.14(l)).

ActewAGL Distribution considers that the second part of this clause, related to the other cost pass through events, is adequately covered by clauses 6.14(d) and (e), and has therefore deleted this part of the clause.

8.3.4 Considerations in approving a tariff variation notification

8.3.4.1 AER Draft Decision

The AER requires ActewAGL Distribution to delete its proposed factors that the AER must take into consideration when assessing a cost pass through notification and replace them with the text included in the AER amendment 13.13. To support this decision the AER stated:

> The AER considers that the proposed factors of assessment go beyond the matters that the AER must have regard to under the NGR in determining whether a cost is appropriate to be passed through.[171]

8.3.4.2 ActewAGL Distribution response

A comparison between ActewAGL Distribution's text included in its access arrangement proposal of 30 June 2009 and the AER's replacement text is set out in Table 8.3 below.

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[169] Revised Access arrangement 2010, clause 6.22

[170] The specific drafting in the access arrangement to achieve the AER's requirement to include a Low Administrative Cost event, and impose a different (lower) materiality threshold (administrative cost threshold) for the Low Administrative Cost event and the Change in tax event, differs from that provided by the AER, while delivering the same outcome, as discussed in section 8.2.2 above.

[171] AER 2009, *Draft Decision*, p 163

Table 8.3 Comparison between ActewAGL Distribution and AER proposed factors

ActewAGL Distribution proposed text	AER replacement text
6.16 In making the decisions referred to in clause 6.12, the Relevant Regulator must at all times act reasonably and must ensure that the financial effect on ActewAGL associated with the Cost Pass-Through Event concerned is economically neutral taking into account: (a) the relative amounts of Reference Services supplied to each User; (b) the time cost of money for the period over which the Pass-Through Amount is to apply, including any delay in the recovery of a pass through amount associated with the recovery of costs in line with the annual tariff variation cycle; (c) the manner in which and period over which the Cost Pass-Through Amount or change in Reference Tariffs is to apply; (d) the financial effect on ActewAGL associated with the provision of Reference Services directly attributable to the Cost Pass-Through Event concerned, and the time at which the financial effect arises; (e) if the Cost Pass-Through Event is a Change in Tax Event, the amount of any change in another tax which, in the Relevant Regulator's opinion, may have been introduced as complementary to or may substitute for the Change in Tax Event concerned; (f) the effect of any other previous Cost Pass-Through Event since the last decision made in respect of a Cost Pass-Through Event under clause 6.12; (g) any pass through amount applied under clause 6.12 relating to a previous Cost Pass-Through Event which resulted in ActewAGL recovering an amount either more or less than the estimated financial effect on ActewAGL of that previous Cost Pass-Through Event; and (h) any other factors the Relevant Regulator considers reasonably relevant.	6.16 In making the decisions referred to in clause 6.12, the Relevant Regulator must take into account the following: (a) The costs to be passed through are for the delivery of pipeline services; (b) The costs to be passed through are building block components of total revenue; (c) The costs to be passed through meet the relevant NGR criteria for determining the building block for total revenue in determining reference services; (d) 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 (e) Any other factors the Relevant Regulator considers is relevant and consistent with the National Gas Law and National Gas Rules.

ActewAGL Distribution accepts the AER's considerations as included in its amendment 13.13 as being relevant to the assessment of whether a cost should be approved under the cost pass through tariff variation mechanism. These considerations have been incorporated into the revised access arrangement in clauses 6.20(a) and (b). ActewAGL Distribution considers, however, that a broader view of the relevant rules is required for assessing ActewAGL Distribution's proposed considerations.

As discussed above in section 8.1.2, recovery of the time value of money is an important element in an efficient reference tariff variation mechanism, to balance the drive of regulated businesses and users to have relevant increases and decreases in costs reflected in tariffs as soon as possible, and the need for an orderly tariff variation process that limits the number of tariff variation that occur in a given year. ActewAGL Distribution considers that this inclusion is consistent with the revenue and pricing principles in the NGL as an element of the efficient costs of delivering reference services.[172] Consistent with this approach, ActewAGL Distribution considers that its original clause 6.16(b) is appropriate and has retained this in clause 6.20(c) in the revised access arrangement.

The AER appears to have focused on the consideration of allowable revenue to be recovered through a cost pass through claim, without also considering the appropriate allocation of that revenue to tariffs, and the timing of that allocation, to deliver efficient tariffs. These matters are important in assessing a cost pass through notification, and are specifically included as a consideration for the AER in approving a reference tariff variation mechanism, and more generally in respect of the allocation of revenue to tariffs under the NGR.[173]

ActewAGL Distribution therefore considers that it is consistent with the NGR for the reference tariff variation mechanism to include guidance in relation to the specific tariff effects of a cost pass through amount to ensure that it is allocated to tariffs efficiently. Consistent with this approach, ActewAGL Distribution considers that its original clauses 6.16(a) and (c) in Table 8.3 above are consistent with the NGR and has retained these in the revised access arrangement in clauses 6.20(d) and (e) respectively.

ActewAGL Distribution's original clause 6.16(d) requires the AER to consider ActewAGL Distribution's ability to deliver reference services as a result of a cost pass through event in determining how an approved cost pass through amount will be reflected in tariffs. For example, costs arising from a terrorism event may mean that ActewAGL Distribution does not have sufficient capital to continue to provide reference services unless costs are recovered quickly from users. This situation may necessitate rapid implementation of a reference tariff variation with high up-front recovery of revenue. ActewAGL Distribution considers that this is consistent with the revenue and pricing principles which require that a regulated business be given a reasonable opportunity to recover at least its efficient costs in providing reference services.[174]

This clause also notes that a cost pass through claim may relate to future costs, and therefore the recovery of costs through tariffs should reflect the timing that the costs are incurred, subject to the need to ensure that users are not subject to price shocks in applying this principle. This is a similar process to the revenue smoothing process that

[172] National Gas Law section 24
[173] Rule 97(3)(a) and Division 8 of the NGR.
[174] National Gas Law section 24

applies to total revenue within an access arrangement period. ActewAGL Distribution therefore considers that its original clause 6.16(d) is consistent with the NGR and has retained this in the access arrangement at clause 6.20(f).

ActewAGL Distribution considers that the considerations expressed in its original clauses 6.16(e), (f) and (g) are adequately addressed in the AER's consideration 6.16(c), and therefore accepts the deletion of these clauses and replacement with AER consideration 6.16(c).

ActewAGL Distribution considers that the AER's formulation of its 6.16(e) is superior to its own equivalent clause 6.16(h) and therefore accepts the AER's substitution of this clause in its access arrangement (clause 6.20(g)).

ActewAGL Distribution has therefore amended clause 6.20 of its access arrangement to include a mix of the AER's and ActewAGL Distribution's considerations as described above. Small drafting changes to ensure consistency of style across the considerations have also been made. ActewAGL Distribution does not consider these changes affect the intent of the provisions.

8.3.5 Timing of operation of reference tariff variation mechanism

8.3.5.1 AER Draft Decision

Amendment 13.8 of the AER's draft decision requires ActewAGL Distribution to amend clause 6.2(a) of the reference tariff variation mechanism to remove the word 'automatically' from the description of the operation of the annual reference tariff adjustment formula mechanism. This change is required as:

> The AER considers that an automatic tariff adjustment is inappropriate as this does not provide the AER with any oversight or powers of approval for the annual tariff variation…[175]

The AER also requires amendment to clause 6.9 of the access arrangement (now clause 6.10) such that tariffs will only change once a year on 1 July as a result of cost pass through events subject to a low materiality threshold.[176]

This amendment (amongst others) was required to:

> … [streamline] the assessment of the low administrative threshold events to further reduce administrative costs by considering costs to be pass [sic] through once a year at the same time as the annual tariff variations…[177]

8.3.5.2 ActewAGL Distribution response

Annual reference tariff adjustment formula mechanism

ActewAGL Distribution accepts the AER's amendment 13.8.

[175] AER 2009, *Draft Decision*, p 160
[176] These events are the Change in tax event and the Specified Uncontrollable Cost event, where the incurred costs can be readily verified by documentation.
[177] AER 2009, *Draft Decision*, p 165

ActewAGL Distribution has also detected an oversight in its drafting of the annual reference tariff adjustment formula mechanism included in its access arrangement proposal submitted to the AER on 30 June 2009 that requires amendment. As drafted in that proposal, only 2 of 3 relevant clauses relating to the timing of an AER decision in response to a notification were applied to the annual reference tariff adjustment formula mechanism.

ActewAGL Distribution has amended this oversight in its revised access arrangement to include relevant provisions in clauses 6.7, 6.8 and 6.9 related to the AER's decision in relation to the operation of the annual reference tariff adjustment formula mechanism. These amendments do not in any way change ActewAGL Distribution's intended operation of this mechanism with respect to approval of variations to reference tariffs as described in the June 2009 access arrangement information, nor do they conflict with any of the AER's amendments to the reference tariff variation mechanism.

Cost pass through tariff variation mechanism

ActewAGL Distribution notes that its former proposal to include an Adjustment factor in the annual reference tariff adjustment formula mechanism to take account of costs now defined under the Specified uncontrollable cost event ensured that tariffs were adjusted once a year at the same time as the scheduled annual CPI adjustment. This aspect of the AER's amendment 13.8 therefore restores the nature of ActewAGL Distribution's original proposal, and is accepted by ActewAGL Distribution.

ActewAGL Distribution notes, however, that the AER amendment discussed in section 8.3.1 above allowing the AER to extend its decision making time with respect to the cost pass through tariff variation mechanism, make the operation of this clause potentially inconsistent with the AER amended clause 6.10 of ActewAGL Distribution's original access arrangement proposal. This is because these clauses, as amended by the AER variously provide for:

- In clause 6.17: scope for the AER to extend the decision making timetable to 90 business days for cost pass through claims, making it possible that the AER's decision on a cost pass through claim associated with an event subject to a low materiality threshold will be made after 1 July; and
- In clause 6.10: a requirement for reference tariffs only to change once a year on 1 July as a result of cost pass through events that have a low materiality threshold.

The AER has not addressed in its discussion in the draft decision or though specific amendments how approved tariff changes as a result of a Change in tax event or a low administrative cost event that have been subject to a decision making period that extends beyond 1 July will be reflected in tariffs. Under the AER amendments, there does not appear to be a mechanism for tariffs to change in this circumstance.

ActewAGL Distribution considers that these concerns can be addressed through its proposed changes to the notification timetable, and other features of its tariff variation mechanism that achieve the AER's intent, such that:

- ActewAGL Distribution can only submit a tariff variation notification to the AER in respect of the pass through events subject to a low materiality threshold once a year (clauses 6.11 and 6.12);
- The notification must be made at least 65 business days before 1 July in the relevant year that the tariff variation is to apply; and
- If sufficient information is not available to ActewAGL Distribution to make a full claim at the time required, differences in pass through claims can be recovered in the subsequent year (clause 6.13).

Further, this approach requires that ActewAGL Distribution and users be compensated for the time value of money related to any increase or decrease in tariffs that is delayed through the operation of these principles (clause 6.20(c)).

8.3.6 Pass though claims in the final year of the access arrangement

8.3.6.1 AER Draft Decision

In its draft decision the AER rejected a proposal by ActewAGL Distribution to include a fixed principle that allowed ActewAGL Distribution to recover costs associated with a cost pass through event that extended beyond the revisions commencement date.[178]

8.3.6.2 ActewAGL Distribution response

ActewAGL Distribution proposed the above fixed principle in it access arrangement to address limitations in the access arrangement revision process and reference tariff variation mechanism whereby cost pass through events occurring in the final year of the access arrangement period (after the review submission date) did not have a clear mechanism for cost recovery.

The operation of the fixed principle was intended to remove the potential perverse outcome whereby the timing of a pass through event limits ActewAGL Distribution's recovery of costs even where those costs relate to an approved cost pass through event and are otherwise conforming expenditure. This can occur in the following circumstances:

- the operation of the reference tariff variation mechanism limits recovery, such as where the AER does not allow an application under clause 6.12 to revise tariffs outside of the annual tariff variation cycle to allow recovery of costs within the access arrangement period;
- an event occurs after a review submission date and the AER does not approve an application by ActewAGL Distribution to revise its access arrangement proposal under Rule 58(3) relating to costs in the next access arrangement period; or
- the event occurs after the AER's final decision on an access arrangement proposal, which is likely to occur some months before the commencement of the next access arrangement period, meaning that costs associated with an event that are incurred in the next access arrangement period cannot be reflected in tariffs for that period.

[178] AER 2009, *Draft Decision*, pp 87-9

A combination of these events can mean that ActewAGL Distribution cannot recover (or return) changes in prudent and efficient costs associated with an approved cost pass through event in an existing access arrangement period, or in the next access arrangement period. This is particularly a concern in relation to operating expenditure arising from a pass through event. This is because, unlike capital expenditure, operating expenditure cannot be added to allowable revenue at a later date once it is judged to be conforming capital expenditure. Therefore, a shortfall in recovery of operating expenditure arising from a cost pass through event as a result of the circumstances described above would not be compensated at a later date.

ActewAGL Distribution does not consider that this outcome would be consistent with the NGL revenue and pricing principles.[179]

The fixed principle was therefore intended to operate to ensure that events that occurred within the access arrangement period could be assessed in accordance with the tariff variation mechanism in place for that period, but that cost recovery (or return) deemed appropriate within that period could occur in a manner that was appropriate to ensure that ActewAGL Distribution was given opportunity to recover at least its efficient costs[180], as well as to deliver efficient tariff structures (including avoiding price shocks)[181] and lower administrative costs associated with multiple tariff change events in a year[182]. This would remove any incentive on the AER not to allow ActewAGL Distribution to propose a tariff variation under clause 6.12 of the access arrangement.

As an alternative to using a fixed principle to address this concern, ActewAGL Distribution has amended its cost pass through tariff variation mechanism to provide scope for the AER to approve the recovery of efficient costs arising from a cost pass through event over a number of years, which can span into the next period.

ActewAGL Distribution considers this proposal to be consistent with the revenue and pricing principles by ensuring that costs associated with an approved pass through event in an access arrangement period are able to be recovered. Where the event relates to costs in the next period, the principle is intended to ensure that those costs are able to be recovered in that period.

ActewAGL Distribution notes that costs recovered under cost pass through events must satisfy the requirements under the NGR relating to capital and operating expenditure. Therefore, approved pass through amounts are amounts that would otherwise be recovered in the normal access arrangement revision process, but for the timing or unpredictable occurrence of the event.

ActewAGL Distribution has therefore included a requirement that its notification to the AER under clauses 6.10 and 6.12 of the revised access arrangement must specify:

[179] National Gas Law, section 24
[180] National Gas Law, section 24
[181] Rule 97(3)(1)
[182] Rule 97(3)(b)

The date from and period over which ActewAGL proposes to charge the pass through amount or change the Reference Tariffs**, which may occur over a number of financial years to smooth the cost impact for customers, including financial years in the next Access Arrangement Period**.[183]

ActewAGL Distribution also proposes the following amendments in bolded text to clause 6.12 of the cost pass through tariff variation mechanism.

> With the consent of the Relevant Regulator (which will not be unreasonably withheld), ActewAGL may notify the Relevant Regulator **at any other time during a financial year that a Cost Pass-Through Event has occurred (or ActewAGL reasonably expects one will occur), and that ActewAGL is seeking to vary Reference Tariffs with effect from a date specified by ActewAGL in its notice to the Relevant Regulator.**
>
> …
>
> **Where an application made under this clause 6.12 is made after 30 June 2014, the Relevant Regulator may not withhold its consent to making an application under this clause 6.12, as there is no opportunity for ActewAGL to make an application for a cost pass through under clause 6.10 at the end of the last financial year of the Access Arrangement Period.**

ActewAGL Distribution has also amended the definitions of a Change in Cost, Cost Pass through Event, and a General Pass through event to remove references to events or costs occurring in the access arrangement period. This amendment means that ActewAGL Distribution can submit a reference tariff variation notification in the access arrangement period associated with an event occurring in the earlier access arrangement period. This will mean that if a pass through event occurs in the final months of the current access arrangement period, then ActewAGL Distribution can submit to the AER a notification in relation to costs associated with that event that occur in the access arrangement period to which the access arrangement applies. ActewAGL Distribution considers that this is consistent with the NGR as it means that costs incurred in the access arrangement period can be recovered by way of the reference tariff variation mechanism, even where they arise from an event that has occurred in a different period.

8.3.7 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended the reference tariff variation mechanism notification and approval process included in its access arrangement as follows:

- ActewAGL Distribution will notify the AER at least 65 business days prior to each 1 July during the access arrangement period of the reference tariffs to apply from 1 July in the next financial year. This notification will include reference tariffs varied in accordance with the annual reference tariff adjustment formula mechanism and, as relevant, the cost pass through tariff variation mechanism (response to AER amendment 13.6);
- The AER must make its decision in respect of a notification under the annual reference tariff adjustment formula mechanism and the cost pass through tariff variation

[183] Revised Access arrangement 2010, clause 6.14(i). Bolded text denotes additions to this clause compared with the original access arrangement proposal submitted to the AER on 30 June 2009

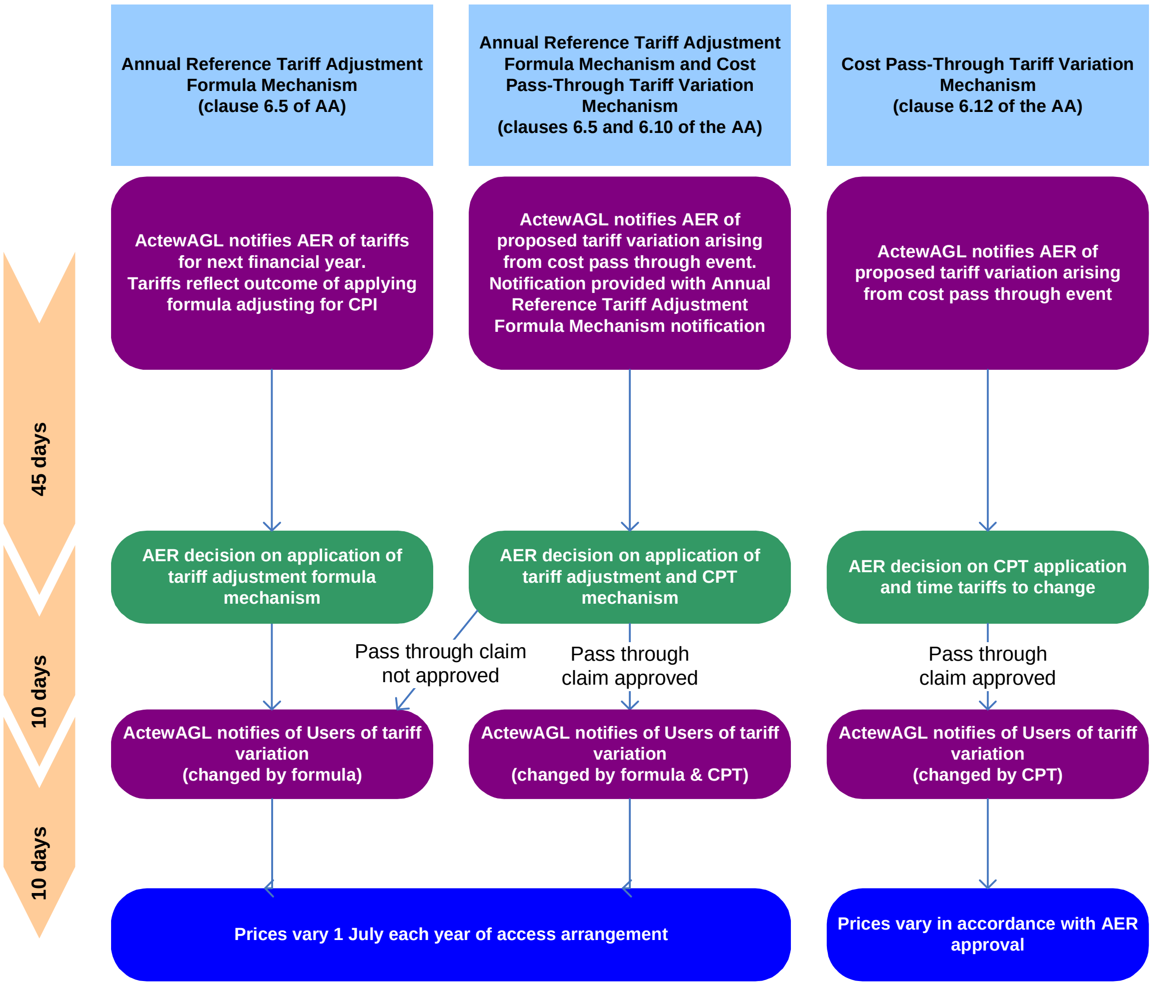
mechanism within 45 business days of receiving a notification (response to AER amendment 13.6);

- ActewAGL Distribution will advise the AER within 90 business days if, at any time during the access arrangement period it becomes aware that:
  - A cost pass through event has occurred (other than a Specified uncontrollable cost event or a Change in tax event); and
  - The Change in Cost associated with that event has, or is likely to have, an Administrative Cost Impact as defined in the access arrangement (clause 6.22) (response to AER amendment 13.15);
- Amended clause 6.23 to provide more clarity as to how the AER can initiate a reference tariff variation, and ActewAGL Distribution's obligations under this clause (response to AER amendment 13.15).
- Included a requirement under clause 6.5(b) of the access arrangement as required under AER amendment 13.7 that ActewAGL Distribution provide the AER with its workings showing how the varied reference tariffs have been calculated using the relevant reference tariffs in Attachment 3 of the access arrangement as a reference;
- Included the following in clause 6.14 of the reference tariff variation mechanism:
  - A requirement that a cost pass through notification specify the incurred and/or forecast Change in Cost of the relevant cost pass through event, and the basis on which this has been calculated (response to AER amendment 13.12);
  - Whether the cost pass through event has, or is forecast to have, an Administrative Cost Impact, which must be substantiated to the AER's reasonable satisfaction (response to AER amendment 13.12);
  - A requirement that, where relevant, ActewAGL Distribution must ensure and specify that a cost pass through amount notified to the AER is net of any third party payments (AER amendment 13.14);
  - Scope for a cost pass through notification to specify the recovery of a cost pass through amount over a number of financial years including financial years in the next access arrangement period (response to AER amendment 8.2); and
  - Other amendments required under AER amendment 13.14, varied to also recognise that information requirements associated with UAG are not currently addressed under the AER amended provision, and other additions in 6.14(d) and 6.14(e) (clause 6.14(l));
- Included scope in the cost pass through variation mechanism for ActewAGL Distribution to make a notification to the AER on the basis that unascertainable costs be either included or excluded from the cost pass through amount and addressed in a subsequent notification once these costs are able to be verified or forecast (clause 6.15) (response to AER amendment 13.14);

- Included an additional factor in clause 6.16 requiring the AER to decide, upon receiving a cost pass through notification, whether the Cost pass through event has, or is forecast to have, an Administrative Cost Impact (response to AER amendment 13.12);
- Clarified that a Change in Cost and a Cost Pass Through Amount can relate to incurred and/or forecast costs, and removed limitation that the event must occur in the access arrangement period (response to AER amendment 8.2);
- Included revised drafting of clause 6.20 in the access arrangement (response to AER amendment 13.13);
- Removed the reference to automatic variation of reference tariffs in accordance with the annual reference tariff adjustment formula mechanism in clause 6.2(a) (AER amendment 13.8);
- Corrected an oversight in ActewAGL Distribution's original proposal and included the process for approval of Reference Tariffs adjusted user the annual reference tariff adjustment formula mechanism (clauses 6.7-6.9)
- Included a requirement that ActewAGL Distribution can only submit a tariff variation notification to the AER in respect of the pass through events subject to a low materiality threshold once a year for a 1 July tariff change (clauses 6.10, 6.11 and 6.12) (response to AER amendment 13.15);
- Clarified that notifications made under clause 6.10 relate to the variation of reference tariffs on 1 July of the next financial year (clause 6.10), and can only be made once each financial year (clause 6.11);
- Clarified that notifications made under clause 6.12 relate to the variation of reference tariffs on a day other than 1 July (clause 6.12);
- Included a new provision that if insufficient information is available for ActewAGL Distribution or the AER to make or assess a full claim in respect of a cost pass through event in the year that the event occurs, ActewAGL Distribution can notify the AER in a later year of the access arrangement period (clause 6.13); and
- Included provisions to address cost pass through claims in the last year of the access arrangement period as follows:
    - Limited the AER's ability not to consider a Cost Pass Through Application made in the final year of the access arrangement period (clause 6.12); and
    - Clarified that cost pass through amounts may be recovered over a number of years, including years in the next access arrangement period (response to AER amendment 8.2).

ActewAGL Distribution also amends Figure 11.1 of its access arrangement information to reflect the increase to the reference tariff variation notification time period, as set out in Figure 8.1 below.

Figure 8.1 Replacement to Figure 11.1 of ActewAGL Distribution's 30 June 2009 access arrangement



8.4 Materiality threshold

8.4.1 AER Draft Decision

The AER requires amendments to ActewAGL Distribution's access arrangement to vary its proposed materiality threshold for the cost pass through tariff variation mechanism as follows:

- Rename the definition of a 'Material impact" to refer to an "Administrative Cost Impact" (AER amendment 13.11);
- Include a low administrative cost event in the cost pass through tariff variation mechanism, to which a lower Administrative Cost Impact threshold would apply (AER amendment 13.10);
- Define the Change in tax event as a low administrative cost event (AER amendment 13.10);

- Require that tariffs are only varied once each year on 1 July for the low administrative cost event and Change in tax events to further reduce administrative costs (AER amendment 13.15);
- Include a Administrative Cost Impact threshold for events other than a low administrative cost event and a Change in tax event that is expressed as a percentage of ActewAGL Distribution's revenue allowance as follows:

  > …at least one per cent of total revenue approved in the relevant year that a cost pass through cost is incurred.[184]

- Include a Administrative Cost Impact threshold for the low administrative cost event and the Change in tax event defined in relation to the administrative costs of the service provider, users and the AER, for claims under these events that can be readily verified by documentation such as invoices or independently audited information as follows:

  > …where the change in cost incurred is greater in magnitude than the administrative costs of the service provider, users and the relevant regulator in making a notification, and that the incurred cost of these event [sic] can be readily verified by documentation such as invoices or independently audited information.[185]

- For low administrative cost events and Change in tax events where the costs cannot be readily verified by documentation such as invoices or independently audited information, the higher Administrative Cost Impact threshold will apply (AER amendment 13.11);
- Replace ActewAGL Distribution's definition of a "Change in Cost" with AER's drafting (AER amendment 13.11); and
- Include a requirement in the access arrangement for a notification to specify how each individual pass through event takes into consideration the administrative cost impact (AER amendment 13.12).

The AER also requires ActewAGL Distribution to amend its access arrangement information to reflect its required amendments to the materiality threshold (AER amendment 13.10).

8.4.2 ActewAGL Distribution response

8.4.2.1 Pass through events subject to a low administrative cost impact threshold

ActewAGL Distribution accepts the AER's amendment 13.11 to rename the definition of a "Material impact" to refer to an "Administrative Cost Impact".

As discussed in sections 8.1.1 and 8.2.2 above, ActewAGL Distribution accepts the AER's amendment to replace its proposed Adjustment factor with a low administrative cost pass through event. For practical drafting purposes this event has been called a Specified uncontrollable cost event, however, ActewAGL Distribution considers that the drafting that is has included in the access arrangement in respect of this event delivers an identical outcome to that intended by the AER.

[184] AER amendment 13.11
[185] AER amendment 13.11

ActewAGL Distribution further accepts that the Specified uncontrollable cost event should be subject to a lower Administrative Cost Impact threshold than other cost pass through events due to the fact that claims under this event can be readily verified by documentation, significantly reducing the administrative costs associated with approval. As the same arguments can be made in respect of most Change in tax events, ActewAGL Distribution also accepts the AER amendment 13.10 that Change in tax cost pass through claims, where documentation is readily available to verify claims, will be subject to the lower Administrative Cost Impact threshold.

ActewAGL Distribution has therefore included separate tiers in its Administrative Cost Impact threshold definition in the reference tariff variation mechanism reflecting pass through claims that are expected to have low administrative costs for approval, and those expected to have higher administrative costs for approval.

8.4.2.2 Low administrative cost impact threshold

ActewAGL Distribution accepts the principle behind the AER definition of a low administrative cost impact threshold, however it considers that it could give rise to uncertainty in relation to cost pass through claims, by providing the AER considerable discretion in defining the relevant Administrative Cost Impact threshold. For example, while ActewAGL Distribution may be able to estimate its own administrative costs in preparing a cost pass through claim and varying prices, it would be very difficult for it to estimate the costs likely to be incurred by the AER or users in relation to a cost pass through claim. This limitation, in part, was why ActewAGL Distribution proposed that the materiality threshold for some events with low administrative costs should be set at zero. ActewAGL Distribution is concerned that the Administrative Cost Impact threshold for these events, as defined by the AER, could be applied somewhat arbitrarily to pass through claims in the absence of information about the administrative costs that are likely to be incurred.

Events subject to a low administrative cost impact threshold are readily verifiable by documents. They therefore operate more like a “true-up” mechanism similar to the mechanism that applies to Transmission Use of System charges for electricity network businesses.[186] Under or over recovery under this mechanism is not subject to materiality limits. Similarly, the Australian Energy Market Commission’s rule determination in relation to the Easement Land Tax applying to SP AusNet concluded that it was inappropriate for recovery (or return) of costs for the tax to be subject to a materiality threshold.[187]

ActewAGL Distribution notes that there is a minimum amount of change in costs that can be meaningfully reflected in tariffs. For example, a very small change in costs, when allocated to tariffs, is likely to lead to such a small change in tariffs that rounding means that no change can be effectively made. ActewAGL Distribution therefore considers that the Administrative Cost Impact threshold for low administrative cost events should be set in relation to the level of change in costs that can be reflected in tariffs, applying the rounding convention included by ActewAGL Distribution in its access arrangement in response to

[186] AER, Final Decision 2009*, Australian Capital Territory Distribution Determination 2009-10 to 2013-14*, April, p 182
[187] Australian Energy Market Commission Australian Energy Market Commission, National Electricity Amendment (Easement Land Tax Pass Through) Rule 2008: Rule Determination, 28 November 2008.

AER amendment 13.5. This threshold is likely to be different depending of the tariffs that require adjustment in relation to a cost pass through event. For example, a Regulatory Change Event that solely impacts metering costs (and is therefore allocated to metering costs) would require a smaller cost pass through amount to affect tariffs than a Regulatory Change event that affected all tariffs.

8.4.2.3 Administrative Cost Impact threshold applying to other cost pass through events

The AER did not approve ActewAGL Distribution's proposal to retain the same materiality threshold for pass through claims made outside the annual tariff variation cycle as applied in the earlier access arrangement period. ActewAGL Distribution proposed threshold was $0.5 million (2009-10 dollars) above the costs approved in the access arrangement.

The AER rejected both ActewAGL Distribution's proposed threshold, and proposal as to which events this threshold should apply.

In respect of the specification of the Administrative Cost Impact threshold, ActewAGL Distribution accepts the AER's argument that cost pass through event notifications that impose higher administrative costs on the service provider, the AER, and users should be subject to a higher Administrative Cost Impact threshold. This is consistent with the requirements under Rule 97(3)(b).

ActewAGL Distribution does not consider, however, that an Administrative Cost Impact threshold defined in relation to the regulated business' revenue allowance has any relevance to the administrative costs that the service provider, the AER and users incur as a result of the operation of a tariff variation mechanism, as is required under Rule 97(3)(b). The administrative costs associated with a pass through claim are unlikely to change significantly as the regulated business' revenue allowance increases or decreases.

Despite this, ActewAGL Distribution notes the requirement under Rule 97(3)(d) that the AER must also have regard to the desirability of consistency between regulatory arrangements. The materiality threshold for some cost pass through events applying to ActewAGL Distribution's electricity network is defined in terms of a percentage of the revenue allowance. In light of this, ActewAGL Distribution accepts the AER's amendment that the Administrative Cost Impact threshold for events other than those subject to the low administrative cost impact threshold should be set as a percentage of approved revenue in the relevant year.[188]

In relation to which cost pass through claims this higher Administrative Cost Impact threshold should apply to, the AER did not address in its draft decision ActewAGL Distribution's proposal that, as administrative costs are lower on the service provider, the regulator and users when assessing a cost pass through claim as part of the annual tariff variation process, a lower threshold should apply to these claims. The AER therefore gives no reasons in its draft decision for why it has rejected ActewAGL Distribution's proposal in

[188] Australian Energy Regulator *Australian Capital Territory distribution determination 2009-10 to 2013-14: Final Decision*, 28 April 2009, p 130

favour of a general threshold applying to all pass through claims, regardless of when those claims are made, with the exception of Change in tax and low administrative cost events.

The AER does acknowledge within its draft decision that administrative costs are lower where claims are made at the same time as the annual tariff variation process, and has used this as a reason to constrain ActewAGL Distribution in making pass through claims for Change in tax events and low administrative cost events other than during the annual tariff variation process.[189]

In light of this, ActewAGL Distribution maintains its initial proposal, on which the AER did not comment, that cost pass through claims made at the same time as the annual tariff variation process should have a different, and lower, Administrative Cost Impact threshold apply to them compared to pass through claims made at other times.[190] This would recognise the lower costs for ActewAGL Distribution, the AER and users in assessing claims within the annual tariff variation cycle compared with outside that cycle. These lower costs relate to the avoided costs of assessing multiple claims throughout the year, leading to multiple tariff variations.

ActewAGL Distribution accepts, however, the AER's argument that the administrative costs of assessing cost pass through claims made as part of the annual tariff variation cycle would be greater than zero[191], as they would require some level of analysis and consideration by the AER, in some cases including a public consultation process. Therefore, ActewAGL Distribution proposes the following Administrative Cost Impact thresholds to apply to cost pass through claims other than claims related to Change in tax events and Specified uncontrollable cost events to which the low administrative cost impact threshold applies:

- For cost pass through event claims made as part of the annual tariff variation cycle (clause 6.10 of the access arrangement):
  - the Change in Cost arising from the pass through event must exceed 0.5 per cent of the revenue approved in the year the costs are first incurred.
- For cost pass through event claims made outside of the annual tariff variation cycle (clause 6.12 of the access arrangement):
  - the Change in Cost arising from the pass through event to exceed one per cent of the revenue approved in the year the costs are first incurred.

In formulating these Administrative Cost Impact thresholds, ActewAGL Distribution has amended the AER's drafting of the threshold in its amendment 13.11 to provide greater clarity over which year's revenue should be used in assessing satisfaction of the Administrative Cost Impact threshold. This is relevant for events that impose costs over multiple years of the access arrangement period. To address this, ActewAGL Distribution considers that the definition should refer to revenue in the year that a cost pass through cost is *first* incurred.

[189] AER 2009, *Draft Decision*, p 165
[190] ActewAGL Distribution *Access arrangement information*, 30 June 2009, p 256-7
[191] AER 2009, *Draft Decision*, p 161

ActewAGL Distribution considers that this approach satisfies the requirements under Rule 97(3) of the NGR.

8.4.2.4 Definition of Change in Cost

The AER's amendment 13.11 requires ActewAGL Distribution to replace its definition of a Change in cost with the AER's definition.

ActewAGL Distribution accepts the AER's amendment to its definition, however it appears that the definition includes a clerical error in defining a Change in cost associated with a pass through event by reference to an increase or decrease of capital *or* operating expenditure.[192] Pass through claims can include a combination of capital and operating costs associated with a single event, and therefore ActewAGL Distribution considers that it is appropriate for this definition to refer to the total combined costs of an event. ActewAGL Distribution therefore has amended the definition included in the access arrangement accordingly.

ActewAGL Distribution has also amended the definition of a Change in Cost to reflect the revenue effects for the Supply curtailment event, as discussed in section 8.2.3 above.

8.4.2.5 Treatment of cost pass through claims under separate events but linked to a single happening

ActewAGL Distribution accepts the AER's reasoning that individual pass through events should be separately subject to the relevant materiality threshold. This principle notes that there is little overlap in analyses associated with two unconnected events, even when the analysis occurs contemporaneously.

ActewAGL Distribution is concerned, however, that this reasoning may unreasonably limit ActewAGL Distribution's ability to recover costs associated with a single happening, but for which claims are appropriately made under separate pass through events. For example, an event such as a terrorist attack could impose significant costs on ActewAGL Distribution in relation to repair and reinstatement of the network, and could also lead to the imposition of new regulatory requirements on ActewAGL Distribution to mitigate future risks of the event. The AER's consideration of these claims is likely to have significant synergies, for example as part of the assessment of the existence of an applicable cost pass though event, the date or period over which the pass through claim should be recovered, and the allocation of the cost pass through amount to reference tariffs. ActewAGL Distribution therefore considers that cost pass through claims made under separate events that are linked to a single happening should be, as a group, subject to the relevant materiality threshold. Where the separate events are subject to different thresholds (for example the combination of a regulatory change event and a new tax), the higher materiality threshold should apply to the combined costs of the event. This approach would limit the use of this provision to those events that are reasonably linked to a single happening.

[192] AER amendment 13.11

8.4.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended the reference tariff variation mechanism included in its access arrangement as follows:

- Included a Specified uncontrollable cost event in its cost pass through tariff variation mechanism (AER amendment 13.10);
- Amended the definition of Material impact to:
  - Change its name to Administrative Cost Impact (AER amendment 13.11);
  - Apply a low administrative cost threshold to Specified uncontrollable cost events and Change in tax events where the incurred costs of the event can be readily verified by documentation such as invoices or independently audited information (AER amendments 13.10 and 13.11);
  - Apply an Administrative Cost Impact threshold for the Change in Cost of 0.5 per cent of the revenue requirement for the relevant year that the Cost Pass through Amount is first incurred to all other cost pass through event claims that are made as part of the annual tariff variation cycle (response to AER amendment 13.11); and
  - Apply an Administrative Cost Impact threshold for the Change in Cost of 1 per cent of the revenue requirement for the relevant year that the Cost Pass through Amount is first incurred for all cost pass through event claims made outside the annual tariff variation cycle (response to AER amendment 13.11);
- Amended the definition of a Change in Cost to:
  - Adopt the AER's amendment 13.11;
  - Clarify that the Change in Cost calculation relates to the net Change in Costs:
  - Refer to the combined operating and capital expenditure associated with an event, rather than capital or operating expenditure (response to AER amendment 13.11); and
  - To include revenue impacts under the Supply curtailment event (response to AER amendments 9.1 and 9.2);
- Included a requirement that a cost pass through notification address how the relevant Change in Cost meets the Administrative Cost Impact threshold (AER amendment 13.12);
  - An exception to this requirement is where multiple pass through events relate to a single happening, in which case the events in aggregate must meet the highest relevant materiality threshold (clause 6.16).

ActewAGL Distribution also amends section 11.3.2.2 of its access arrangement information submitted on 30 June 2009 to replace the proposed Administrative Cost Impact thresholds detailed in that section with those discussed in this section 8.4.

8.5 Other amendments to the reference tariff variation mechanism

There a number of changes that ActewAGL Distribution has made to the reference tariff variation mechanism included in the access arrangement to reflect requirements consequential to the AER's amendments, or to correct reference, definitional or other issues identified since submission of the proposal on 30 June 2009, or arising from the AER's amendments to that proposal.

These changes are limited to the following:

- Included a definition of a Cost Pass Through Amount and Cost Pass-Through Event in the access arrangement;
- More accurately referring to Reference Tariffs set out in Attachment 3 of the Access Arrangement; and
- Changing reference to the "service provider" in AER amendment 13.14 to references to "ActewAGL".

9 Changes to the access arrangement

This chapter supplements ActewAGL Distribution's Changes to the access arrangement chapter (chapter 12 of the June 2009 Access Arrangement Information) and addresses the AER's proposed amendments to access arrangement drafting and non-tariff components of the access arrangement in chapters 2, 3, 5, 8, 10, 12 and 14 of the draft decision.

When referring to its June 2009 access arrangement proposal ActewAGL Distribution uses clause references relevant to that proposal. Clause references relevant to the revised access arrangement proposal that accompanies this Access Arrangement Information Addendum are noted as referring to the revised access arrangement.

9.1 Reference tariff policy

9.1.1 AER Draft Decision

The AER requires amendment to clauses 4.1-4.4 as per AER amendments 12.1 (to clauses 4.1 and 4.4), 10.3 (to clause 4.2) and 5.1 (to clause 4.3). These amendments are largely required to more accurately reflect the operation of the NGR.

9.1.2 ActewAGL Distribution response

ActewAGL Distribution's proposed access arrangement included a Reference Tariff Policy that was essentially unchanged from the earlier access arrangement, with the exception of changes to references from the former Gas Code to the National Gas Law. The inclusion of the Reference Tariff Policy reflected the inclusion in the former Gas Code of Reference Tariff Policy Principles.

In reviewing the "Reference Tariff Policy" (Part 4) in the proposed access arrangement, ActewAGL Distribution considers that it is more appropriate to name this part "Determination of total revenue". This change reflects the actual content of the part, which sets out the principles for determining total revenue, the operation of incentive mechanisms, the calculation of new capital expenditure, etc, which are relevant to the calculation of revenue, as opposed to the subsequent setting of tariffs, which is addressed in Part 5 of the access arrangement. ActewAGL Distribution considers the name of this part to be a remnant of the language of the former Gas Code and should have been revised in its initial proposal to the AER. This has been updated in the revised access arrangement.

ActewAGL Distribution considers that the corollary of the reference tariff policy principles in the current access framework is the Revenue and Pricing Principles set out in section 24 of the *National Gas Law*. The *National Gas Law* principles, like those in the former Gas Code, set out the principles for determining the total revenue which is then allocated to and subsequently recovered through tariffs, and as such provide the underpinning for the calculation of those tariffs. In contrast, Rule 94 provides more detailed guidance on the division of customers into tariff classes, the allocation of revenue to those tariff classes, and boundaries for charging parameters.

ActewAGL Distribution considers that the AER's amendment to clause 4.1 to refer to Rule 94 is not consistent with the intention of this clause to set out how revenue has been calculated. ActewAGL Distribution therefore does not accept the AER proposed change to clause 4.1 to include a reference to Rule 94. ActewAGL Distribution has also made subsequent changes to this clause (as well as clauses 4.3 and 4.4) to more closely reflect the language in the NGL and NGR.

ActewAGL Distribution also notes that the AER's amendment to clause 4.1 requires inclusion of a reference to the Reference Tariff Variation Mechanism that is consistent with rule 92(2) of the NGR. ActewAGL Distribution accepts that it is appropriate to refer to the reference tariff variation mechanism as the operation of the mechanism potentially varies revenues within the period. ActewAGL Distribution does not, however, accept the specific drafting of this inclusion as set out in the AER's amendment 12.1.

ActewAGL Distribution considers that, since the access arrangement includes the reference tariff variation mechanism that will apply to tariffs in the period, it is more useful and transparent for users and potential users for the access arrangement to refer to the relevant part of the access arrangement (Part 6), rather than the underpinning rules that were used to develop and approve the mechanism. This approach is consistent with the role of the access arrangement as a complete document that sets out relevant provisions to apply to users and potential users when seeking access, and limits the perceived need for users or potential users to refer to the NGR to understand the underpinning of tariffs included in the access arrangement. ActewAGL Distribution has, however, included this reference to Part 6 of the access arrangement in clause 4.2. ActewAGL Distribution accepts other AER amendments to clause 4.2.

While the AER has not given any reasons in its draft decision for its amendments to clause 4.3, ActewAGL Distribution notes that the amendments make no substantive change to the clause and are therefore accepted. ActewAGL Distribution notes, however, that the AER's changes to this clause do not retain capitalisation of defined terms, which is the standard adopted through ActewAGL Distribution's access arrangement.

ActewAGL Distribution has therefore amended clause 4.3 as per the AER's amendment, while also capitalising defined terms, and changing the reference to "Price Paths" to "Reference Tariffs" (which it considers is more consistent with the language used in the NGR). ActewAGL Distribution has also included a definition of "Weighted Average Cost of Capital" in Attachment 1 of the access arrangement.

ActewAGL Distribution accepts in principle the AER's amendments to Clause 4.4 to refer to Rule 94 as the basis for the allocation of revenue to market segments. ActewAGL Distribution has made a slight amendment to the AER's drafting of this clause, however, to update the language and to reflect that Rule 94 does not "determine" the revenue for each market segment, only the allocation of revenue to each market segment.

9.1.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended clauses 4.1 to 4.4 of its access arrangement as follows:

- Changed name of Part 4 to "Determination of total revenue"
- Amended clause 4.1 to reference to the Revenue and Pricing principles set out in section 24 of the National Gas Law;
- Referred to the Reference Tariff Variation Mechanism set out in Part 6 of the access arrangement (response to AER amendment 12.1);
- Accepted the AER's amendment to clause 4.3 (AER amendment 5.1), subject to the following changes:
  - Capitalising defined terms; and
  - Referring to "Reference Tariffs" rather than Price Paths";
- Accepted the AER's amendments to clause 4.4 (AER amendment 12.1); and
- Changed drafting in the provisions as necessary to more closely mirror language of NGL and NGR, and to correct references to "section" to refer to "Rule".

ActewAGL Distribution has also included a definition of "Weighted Average Cost of Capital" in Attachment 1 of the access arrangement.

9.2 New capital expenditure

9.2.1 AER Draft Decision

The AER requires a series of amendments (AER amendments 3.9, 3.10, 3.11, 3.12 and 3.13) to clauses 4.17 to 4.21 of ActewAGL Distribution's access arrangement, as it does not consider that these clauses accurately reflect or reference the NGR.[193]

9.2.2 ActewAGL Distribution response

In respect of clause 4.17(b), the AER 's draft decision notes an incorrect reference to Rule 83, which should be a reference to Rule 79. ActewAGL Distribution agrees with the AER that the reference should be to Rule 79, and has included this change in its revised access arrangement.

Further AER amendment 3.9 requires the addition of the following bolded text to be included in clause 4.17(a):

> 4.17 Reference tariffs have been determined on the basis of:
>
> (a) the Capital Base **(excluding any capital contributions made under Rule 82)**; and
>
> …

The AER states the following in respect of this amendment:

> Clause 4.17 of the access arrangement proposal states that reference tariffs have been determined on the basis of the capital base for forecast capital expenditure that is reasonably expected to satisfy the requirements of r. 83 of the NGR. However, this does not take into consideration that not all amounts that may be included in the capital

[193] AER 2009, *Draft Decision*, p 44

> base (namely capital contributions under r. 82 of the NGR) will determine reference tariffs…[194]

For similar reasons the AER requires amendment to clause 4.19 to also note scope for capital contributions to be added to the capital base.[195]

ActewAGL Distribution is concerned that the AER amendments 3.9 and 3.10 do not take into consideration the specific circumstances of ActewAGL Distribution's access arrangement, and create unnecessary complexity and uncertainty for users and prospective users in understanding the basis of ActewAGL Distribution's reference tariffs.

While the AER is correct in identifying that capital contributions rolled into the capital base are excluded from the calculation of reference tariffs, the AER has not taken into account the specific limitations in the rules which would prevent ActewAGL Distribution from rolling capital contributions into its capital base under its access arrangement. Rule 82(3) governs the conditions on which a service provider can roll capital contributions into its capital base as follows:

> The AER may approve the rolling of capital expenditure (including a capital contribution made by a user, or part of such a capital contribution) into the capital base for a pipeline on condition that the access arrangement contain a mechanism to prevent the service provider from benefitting, through increased revenue, from the user's contribution to the capital base.[196]

The AER notes that ActewAGL Distribution states in its June 2009 access arrangement information that it does not intend to include any capital contributions in its capital base.[197] ActewAGL Distribution is further limited in its ability to include capital contributions in its capital base by the absence of a mechanism in its access arrangement as required under Rule 82(3), and the need for AER approval for such a mechanism to be included in the access arrangement. This makes it impossible for ActewAGL Distribution to include capital contributions in the capital base during the access arrangement period without amendment to the access arrangement. Despite these limitations, the AER states in support of its amendment:

> …nevertheless the AER requires an amendment to clause 4.17 of the access arrangement proposal to the effect that reference tariffs will not be calculated in accordance with any capital contributions in the event they are included in the capital base.[198]

ActewAGL Distribution considers that the AER's inclusions to clauses 4.17(a) and 4.19 create uncertainty around a circumstance that could not arise under the access arrangement. ActewAGL Distribution therefore does not accept the specific amendments required by the AER to these clauses.

As an alternative, ActewAGL Distribution proposes to amend clause 4.19 to include a footnote as follows:

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[194] AER 2009, *Draft Decision*, p 44
[195] AER amendment 3.10
[196] Rule 82(3)
[197] AER 2009, *Draft Decision*, p 44
[198] AER 2009, *Draft Decision*, p 44

> Rule 82(3) only permits capital expenditure to be rolled into the capital base if this Access Arrangement contains a mechanism which prevents ActewAGL from benefiting, through increased revenue, from the User's contribution to the capital base. As of the Commencement Date, ActewAGL does not have such a mechanism. Accordingly, ActewAGL cannot increase the Capital Base for capital contributions pursuant to rule 82.

ActewAGL Distribution considers that this approach addresses the AER's intent to note that capital contributions can be included as part of the capital base, without creating uncertainty for users as to the basis of the determination of total revenue in the case of ActewAGL Distribution's access arrangement.

ActewAGL Distribution accepts AER amendments 3.11, 3.12 and 3.13 to clauses 4.18, 4.20 and 4.21 of the access arrangement.

9.2.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended clause 4.19 of its access arrangement to note that it cannot add capital contributions to its capital base (response to AER amendments 3.9 and 3.10).

ActewAGL Distribution has incorporated the AER's amendments 3.11, 3.12 and 3.13 into its access arrangement.

9.3 Provision of meter data services

9.3.1 AER Draft Decision

The AER requires insertion of the following statement in attachments 3A, 3B, 3C and 3E of ActewAGL Distribution's access arrangement:

> Users shall be free to acquire such services from parties unrelated to ActewAGL on the date that meter reading or on-site data and communications becomes contestable.[199]

The AER also requires insertion of the following statement in attached 3F of ActewAGL Distribution's access arrangement:

> At this time all Users shall be free to acquire such services from third parties unrelated to ActewAGL.[200]

9.3.2 Amendments to the access arrangement proposal and information

ActewAGL Distribution accepts the AER's amendments 2.7 and 2.8 and has incorporated the required text into the access arrangement.

[199] AER amendment 2.7
[200] AER amendment 2.8

9.4 Fixed Principles

9.4.1 AER Draft Decision

ActewAGL Distribution proposed three fixed principles in clause 4.27 of its June 2009 access arrangement.

The AER approved the fixed principle in clause 4.27(a) subject to an amendment consequential to its draft decision not to approve ActewAGL Distribution's proposed rolling carryover mechanism for capital expenditure (AER amendment 8.1) [201].

The AER approved ActewAGL Distribution's fixed principle 4.27(b), subject to its required amendments to clauses 4.18-4.21 (AER amendments 3.10, 3.11, 3.12 and 3.13).[202]

The AER did not approve ActewAGL Distribution's proposed fixed principle 4.27(c), and required its deletion in accordance with AER amendment 8.2. The AER rejected this proposed fixed principle as it considered that several rules in the NGR made this principle inoperable and inconsistent with the NGR, in particular Rule 99(4)(b), which it considered operated to exclude the fixed principle.[203]

9.4.2 ActewAGL Distribution response

As discussed in section 6.5 above, ActewAGL Distribution does not accept the AER's amendments to its access arrangement to remove its proposed rolling carry over mechanism for capital expenditure. ActewAGL Distribution has therefore reinstated this mechanism into its access arrangement. As a result, ActewAGL Distribution also does not accept the AER's amendment 8.1, and has reinstated the references to the rolling carry over mechanism for capital expenditure in clause 4.27(a).

As a result of changes to the formulae for calculating carry over amounts for both the operating and capital expenditure carry over mechanisms arising from AER amendments 7.2, 7.3, 7.4 and 7.5, ActewAGL Distribution has also updated the clause references in clause 4.27(a).

As discussed above in relation to the reference tariff variation mechanism, ActewAGL Distribution proposed the fixed principle in 4.27(c) to address limitation in the access arrangement revision process and reference tariff variation mechanism whereby cost pass through events occurring in the final year of the access arrangement period (after the review submission date) did not have a clear mechanism for cost recovery.

ActewAGL Distribution accepts the AER's amendment 8.2 requiring deletion of fixed principle 4.27(c). As an alternative to this fixed principle, ActewAGL Distribution has proposed a number of changes to its reference tariff variation mechanism to give effect to some parts of this fixed principle through alternative means. These are discussed in section 8.3.6 above.

[201] AER 2009, *Draft Decision*, p 78
[202] AER 2009, *Draft Decision*, p 87
[203] AER 2009, *Draft Decision*, pp 87-8

9.4.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended its access arrangement to:

- Reinstate reference to the rolling carry over mechanism for capital expenditure in clause 4.27(a) and update clause references to the capital and operating expenditure rolling carry over mechanisms (response to AER amendments 7.2, 7.3, 7.4 and 7.5);
- Delete clause 4.27(c) (AER amendment 8.2); and
- Include alternative provisions in Part 6 of the access arrangement to address issues previously addressed in clause 4.27(c) (response to AER amendment 8.2).

9.5 Extensions and expansions policy

9.5.1 AER Draft Decision

The AER did not approve ActewAGL Distribution's extensions and expansions policy and required a series of amendments (AER amendments 14.11, 14.12, 14.13, 14.14 and 14.15) replacing the majority of ActewAGL Distribution's proposal with the AER's preferred approach. In requiring these amendments the AER states:

> The AER has reviewed ActewAGL's extension and expansion requirements and considers that this complies with r.104 of the NGR but that preferable alternatives that comply with the NGL and are consistent with applicable criteria in accordance with r. 40(3) of the NGR exist.[204]

To support its decision in relation to ActewAGL Distribution's extensions and expansions policy, the AER states:

> The AER considers that whether a particular extension should be covered by default under the access arrangement will depend on whether the extension relates to a high pressure pipeline or a medium or low pressure pipeline.[205]

In line with this, the AER states 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".[206] In determining whether an extension should be covered, the reasons for the extension and the degree of integration into the existing network will be considered.[207] ActewAGL Distribution is therefore required to apply to the AER in relation to a proposed high pressure pipeline extension of the coverage pipeline so that the AER can decide whether the proposed extension will be taken to form part of the covered pipeline.[208]

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[204] AER 2009, *Draft Decision*, p 184. ActewAGL Distribution notes that Rule 104 sets out the extension and expansion requirements for inclusion in an access arrangement, and Rule 40(3) relates to the AER's discretion in making certain decisions, noting that the AER has full discretion in relation to a decision in relation to extension and expansions requirements to withhold its approval of a proposal if, in the AER's opinion, a more preferable alternative exists that complies with applicable requirements of the NGL and is consistent with applicable criteria prescribed in the NGL.
[205] AER 2009, *Draft Decision*, p 185
[206] AER 2009, *Draft Decision*, p 185
[207] AER 2009, *Draft Decision*, p 185
[208] AER requirement text for clause 7.1 of the access arrangement, as required by AER amendment 14.11

The AER has imposed detailed annual reporting requirements on ActewAGL Distribution in respect of medium and low pressure pipeline extensions and expansions[209], except where the cost of the extension or expansion has been included in the calculation of Reference Tariffs[210].

The AER also requires ActewAGL Distribution to amend clause 7.6 of its access arrangement (AER amendment 14.14) to more closely reflect the wording of Rule 83(2) of the NGR in relation to the recovery of non-conforming capital expenditure through a surcharge.

AER amendment 14.15 requires ActewAGL Distribution to reflect these changes to the access arrangement in its access arrangement information.

9.5.2 ActewAGL Distribution response

9.5.2.1 Extensions to high pressure pipelines

ActewAGL Distribution notes that the AER has raised concerns with its proposed extensions and expansions policy, stating that it wanted to look at the costs and benefits associated with expenditure being added to the capital base and additional costs being imposed upon existing users.[211]

ActewAGL Distribution notes that new capital expenditure is only added to ActewAGL Distribution's capital base through the operation of relevant provisions relating to conforming capital expenditure under the NGR, which are largely determined during each access arrangement revision process, with the exception of investments subject to an AER advance determination under Rule 80, or approved cost pass through amounts. Coverage has no bearing on these decisions except to the extent that the extensions and expansions policy states that the relevant reference tariffs will be applied (and therefore they are relevant for determining conforming capital expenditure under Rule 79(2)(b)).

Further, ActewAGL Distribution is unclear as to the AER's concern in relation to additional costs being imposed on existing users, as its extensions and expansion policy states that extensions and expansions will not impact existing users through tariffs.[212]

Despite this, ActewAGL Distribution notes the AER's desire to have greater discretion over whether high pressure pipeline extensions are covered under the access arrangement. As currently drafted, however, the AER's amendments to clause 7.1 requiring ActewAGL Distribution to seek its approval, applies to all high pressure pipeline extensions, including:

- those approved under the access arrangement and included in Reference Tariffs; and
- high pressure extensions to the network required for individual customer connections such as bakeries, restaurants/cafes and apartment blocks which are only serviced

[209] AER 2009, *Draft Decision*, pp 185-6, AER amendments 4.11 and 4.2
[210] AER amendment 4.13
[211] AER 2009, Forum on the AER's draft decision for ActewAGL's ACT, Palerang and Queanbeyan gas distribution network, p 8
[212] ActewAGL Distribution proposed access arrangement, 30 June 2009 clause 7.5

within high pressure precincts where no medium pressure mains exist (such as parts of Canberra city centre and Fyshwick).

ActewAGL Distribution does not consider that requiring AER approval of coverage of these extensions is in the long term interest of consumers.

In respect of the first instance, extensions included in reference tariffs have already been assessed by the AER in approving the access arrangement as being appropriate under the access arrangement. In the second instance, ActewAGL Distribution, like many other gas network businesses, is subject to legislative obligations to connect customers to the network where relevant capital contributions are paid.[213] Therefore, ActewAGL Distribution does not have discretion as to whether, and in many cases how, it extends its network to connect new customers in these circumstances.

ActewAGL Distribution notes the AER's comments at the Public Forum on its draft decision held in Canberra on 17 November 2009 that clarified the AER's intent to capture in its approval requirements high pressure extensions to new developments, rather than extensions to service individual customers.[214] Therefore, as an alternative to the AER's amendment to clause 7.1 of the access arrangement, ActewAGL Distribution proposes that its access arrangement be amended to require it to advise the AER if it proposes an extension to ActewAGL's Covered Pipeline with a direct connection to a transmission pipeline that serves end-use customers outside the boundaries of the ACT and Queanbeyan, or outside ActewAGL's existing market in Palerang.

ActewAGL Distribution considers that this approach addresses the AER's concern that ActewAGL Distribution may extend its network into another market to which the existing access arrangement provisions, including reference tariffs, may not be appropriate. The drafting also excludes extensions that would otherwise be required under applicable law (that is, those to connect individual customers in the existing network). ActewAGL Distribution further proposes that this requirement be limited to high pressure extensions that are not included in the calculation of Reference tariffs (new clause 7.3).

ActewAGL Distribution also has concerns with the drafting of the AER's requirement to seek approval the coverage approach for high pressure pipeline extensions, as it does not specify the requirement on ActewAGL Distribution in advising the AER, or what considerations and processes the AER will apply in making its decision. ActewAGL Distribution therefore proposes the following clauses be included in the access arrangement:

> 7.2. A notification given by ActewAGL under clause 7.1 must:
>
> (a) be in writing;
>
> (b) state whether ActewAGL intends for the proposed extension to be covered by the Access Arrangement;

[213] Utilities Act 2000 (ACT) section 31.

[214] AER 2009, Forum on the AER's draft decision for ActewAGL's ACT, Palerang and Queanbeyan gas distribution network, p 9

(c) describe the high pressure pipeline extension and describe why the extension is being undertaken; and

(d) be given to the Relevant Regulator before the proposed high pressure pipeline extension comes into service.

7.4. Within 20 Business Days of receiving a notification under clause 7.1, the Relevant Regulator must notify ActewAGL:

(a) of its decision on ActewAGL's proposed coverage approach for the high pressure pipeline extension; or

(b) whether the Relevant Regulator requires further consultation with ActewAGL before making a decision.

ActewAGL Distribution considers that these provisions provide improved clarity and certainty as to ActewAGL Distribution's obligations in informing the AER of a proposed high pressure pipeline extension, and how the AER will assess that proposed extension.

9.5.2.2 Coverage of other pipeline extensions and expansions

ActewAGL Distribution accepts that there should be a presumption of coverage for all other pipeline extensions and expansions to ActewAGL Distribution's ACT, Queanbeyan and Palerang gas distribution network. ActewAGL Distribution considers however, that there should be scope for some pipeline extensions and expansions not to be covered by the access arrangement, where this is considered to be in the long term interests of consumers.

The extensions and expansions policy included in ActewAGL Distribution's original proposal was essentially unchanged from that included in its earlier access arrangement.[215] A key feature of ActewAGL Distribution's proposed policy was that it had scope to apply to the AER for any pipeline extension or expansion not to be covered under the access arrangement. The AER's amendments to ActewAGL Distribution's extensions and expansions policy remove this discretion.

ActewAGL Distribution considers that the flexibility provided by these clauses in its original access arrangement proposal is very important to ensure that ActewAGL Distribution is not unduly limited by the access arrangement in servicing new customers through medium and low pressure extensions and expansions. Without this flexibility, the access arrangement may mean that ActewAGL Distribution may not be able to extend or expand its network on terms that would otherwise be acceptable to users, but which are not consistent with the access arrangement. ActewAGL Distribution does not consider that this outcome would be in the long term interests of consumers as it has the potential to limit the ability for ActewAGL Distribution to undertake extensions to its network on commercial terms.

ActewAGL Distribution therefore proposes to reinstate the former provisions in the extensions and expansions policy that allow it to apply to the AER for an extension or expansion of the network not to be part of the covered pipeline. This ability would be limited to pipeline extensions and expansions not considered under clause 7.1 and those not

[215] The only change to the policy relates to providing further clarification that an extension or expansion made under the policy will not lead to a change in reference tariffs. ActewAGL Distribution 2009, *Access Arrangement proposal with amendments marked*, June, p 41

included in reference tariffs under the access arrangement. These amendments are set out in clauses 7.5 and 7.6 of ActewAGL Distribution's revised access arrangement.

9.5.2.3 Information requirements

The AER requires ActewAGL Distribution to inform the AER within 20 business days of the end of the financial year of all low and medium pressure pipeline extensions including all extensions commenced, in progress and completed during that financial year.[216] The notice must also describe each extension and set out why the extension was necessary.[217] The AER's draft decision also states that default coverage of these extensions will be subject to this notice[218], however ActewAGL Distribution cannot identify a clause in the AER's revised text for the access arrangement that gives effect to this intent.

Similar to the approach for pipeline extensions, the AER requires ActewAGL Distribution to inform the AER within 20 business days of the end of the financial year of all expansions of the capacity of the network during that year, including all expansions commenced, in progress and completed, including a description of why the expansion was necessary.[219]

An exception to the requirements for extensions and expansions (with the exception of the requirements for high pressure pipeline extensions) is where the extension or expansion has been included in the calculation of reference tariffs. An amendment to the access arrangement to this effect is set out in AER amendment 14.13.

ActewAGL Distribution has identified a number of issues relating to the scope of these requirements, and its ability to comply with them.

It is unclear why the AER seeks information in relation to extensions and expansions to the network that are automatically covered by the access arrangement. The AER does not give reasons for these information requirements or indicate how it intends to use this information. The AER noted in its public forum on its draft decision that the information requirements for low pressure pipelines:

> … allows [the AER] to obtain information on capital expenditure during the access arrangement period, and therefore stop these low pressure additions ('infill developments') being a black box.[220]

Given that ActewAGL Distribution operates under applicable law in undertaking market expansions and extensions, ActewAGL Distribution does not perceive the benefit accrued to itself, the AER or users from the AER's annual reporting requirement.

ActewAGL Distribution notes that the AER's requirements for ActewAGL Distribution to provide it with detailed reasons for additional pipeline expansions and individual additional low and medium pressure extensions go beyond those in the NGR, or those required by

[216] AER 2009, *Draft Decision*, p 185; AER required text for clause 7.2 of the access arrangement, set out in AER amendment 14.11

[217] AER required text for clause 7.2 of the access arrangement, as set out in AER amendment 14.11

[218] AER 2009, *Draft Decision*, p 185

[219] AER 2009, *Draft Decision*, p 186; AER required text for clause 7.3 of the access arrangement, set out in AER amendment 14.12

[220] Australian Energy Regulator, Forum on the AER's draft decision for ActewAGL's ACT, Palerang and Queanbeyan gas distribution network, p 9

the AER under its Regulatory Information Notice to assess the prudency of investment as part of the current access arrangement revision process. ActewAGL Distribution must provide the AER with sufficient information as part of its access arrangement revision proposal to allow the AER to approve its opening capital base, which will include information required to support market extensions and expansions expenditure undertaken during the period. If it fails to do so, it runs the risk that the AER will not approve that expenditure for inclusion in its capital base at the start of the next access arrangement period.

For example, ActewAGL Distribution provided the AER with a detailed description of the process it undertakes in assessing market extensions in its access arrangement information submitted in June 2009, which it considered met the requirements under the NGR to show that market extensions satisfied the requirements under 79(2)(b) for conforming capital expenditure. This process, applied to all market extensions, shows how new connections are assessed on net present value terms to ensure they are prudent. The AER subsequently accepted ActewAGL Distribution's market expansion expenditure in the earlier access arrangement period, and that proposed for the access arrangement period.[221] A similar level of information was provided to the AER in support of capacity development (market expansion) expenditure, which was also accepted in the draft decision.[222]

ActewAGL Distribution therefore does not consider that the AER's amendment to its extensions and expansions policy imposing annual information requirements relating to low and medium pressure extensions provide any additional benefits to users by providing additional oversight of the extension and expansion expenditure assessment process. ActewAGL Distribution therefore does not consider that the AER's requirements are reasonable and in the long term interests of consumers.

In addition, ActewAGL Distribution does not consider that it can comply with the AER's information reporting requirements as currently drafted, as the limitation to extensions and expansions not included in the access arrangement will be difficult to comply with in practice (clause 7.4 in the access arrangement as amended by the AER), given the nature of ActewAGL Distribution's market expansion forecast. ActewAGL Distribution includes a forecast of the number of new connections, which forms one part of its market expansion capital expenditure forecast. These connections are not necessarily attributed to particular areas, but are based on the extrapolation historical trends and expected new developments.[223] ActewAGL Distribution therefore cannot readily differentiate on a year-on-year basis those extensions included in the calculation of reference tariffs in the access arrangement, and those not included.

As an alternative, ActewAGL Distribution proposes to maintain records throughout the access arrangement period on extensions activity undertaken in each year of the access arrangement period. This information will be provided to the AER in respect of the next access arrangement revision process. Relevant information to be maintained in respect of

[221] AER 2009, *Draft Decision*, p 30
[222] AER 2009, *Draft Decision*, p 31
[223] ActewAGL Distribution 2009, *Access Arrangement Information*, p 110-2

each year of the access arrangement period and provided to the AER is set out in clauses 7.8 and 7.9 of the access arrangement as follows:

7.8. ActewAGL will maintain records of all pipeline extensions (including all material extensions of the Capacity of the Network) that occur during the Access Arrangement Period. Such records will form part of the records to be provided to the Relevant Regulator as part of the next access arrangement revision proposal.

7.9. The records maintained by ActewAGL in accordance with clause 7.8 of this Access Arrangement must include:

(a) the total number of customers added to the Network each year;

(b) the total length of the Network each year, categorised as low, medium or high pressure pipelines; and

(c) the predominant areas of extension activity (by suburb or region as appropriate).

For the purposes of this clause 7.9, a "predominant area of extension activity" is an extension to the Network to include new greenfield developments or where a pipeline is extended to an existing locality to which such service was not formerly available.

This information requirement will relate to all pipeline extensions, including those approved under the access arrangement for inclusion in reference tariffs. ActewAGL Distribution considers that this addresses the AER's desire to receive detailed information in respect of pipeline extensions carried out during the access arrangement period.

Should the AER not approve ActewAGL Distribution's proposal that this information for provided to the AER as part of its access arrangement revision proposal for the next access arrangement period, ActewAGL Distribution considers that the AER should amend its proposed annual time limit for providing information to be in line with other ActewAGL Distribution reporting requirements. Much of the information to be maintained by ActewAGL Distribution as part of this obligation (as amended) is also prepared and provided to the ICRC as part of annual reporting requirements under the *Utilities Act 2000* (ACT). This information is submitted to the ICRC on 31 October each year.

In order to limit the compliance costs associated with this requirement (where the AER retains its former position and requires this information on an annual basis), ActewAGL Distribution considers that it should be required to submit the information to the AER on or before 31 October 2011 and each subsequent 31 October of the access arrangement period.

9.5.2.4 Other AER amendments

In relation to AER amendment 14.13, requiring ActewAGL Distribution to delete its clause 7.4 and replace it with the AER's drafting of the clause, ActewAGL Distribution can discern no difference between its clause and the AER's preferred drafting.

ActewAGL Distribution has amended this clause to deliver the outcomes described above, such that the approval process for pipeline extensions and expansions only relates to extensions and expansions where the cost has not been included in the calculation of Reference Tariffs.

ActewAGL Distribution further notes that the AER's amendment 14.14 reflects the requirements under the NGR and therefore accepts this amendment.

9.5.3 Amendments to the access arrangement proposal and information

ActewAGL Distribution has amended its extensions and expansions policy included in its access arrangement as follows:

- Include a requirement for ActewAGL Distribution to notify the AER of any high pressure pipeline extensions (as defined in the access arrangement) before that extension comes into effect (response to AER amendment 14.11);
    - The notification must include information as specified in the access arrangement;
    - Requirement is limited to high pressure pipeline extensions that are not included in the calculation of reference tariffs;
    - The AER must make a decision on the notification application, or advise that it requires further consultation, within 20 business days.
- Provide that all other extensions and expansions to the network are to be treated as part of the covered network (AER amendments 14.11 and 14.12);
- Include scope for ActewAGL Distribution to apply to the AER for a low or medium pressure pipeline extension or expansion not to be included as part of the covered network (response to AER amendment 14.11);
    - Provision is limited to pipeline extensions and expansions that are not included in the calculation of reference tariffs;
- Include a requirement for ActewAGL Distribution to maintain records of all pipeline extensions made in respect of each year of the access arrangement, and provide this information to the AER as part of the next access arrangement revision proposal (response to AER amendments 14.11 and 14.12).
    - Details of information to be maintained are set out in the access arrangement; and
- Amended access arrangement as per AER amendment 14.14.

ActewAGL Distribution also amends section 12.7 of the access arrangement information document submitted to the AER on 30 June 2009 as per the discussion in this section 9.5 (AER Amendment 14.15).

9.6 Trading policy

9.6.1 AER Draft Decision

The AER requires ActewAGL Distribution to amend its trading policy included in its access arrangement as follows:

- clarify that matters referred to in chapter 8 of the access arrangement are only subject to the Business Rules insofar as they are not subject to Rule 105 of the NGR (AER amendment 14.6)[224];
- amend the definition of "Business Rules" in attachment 1 of the access arrangement to clarify that if the Business Rules are no longer applicable, any other rules or procedures which govern a gas market that is applicable to ActewAGL Distribution will apply (AER amendment 14.7)[225];
- amend the definition of "Bare Transfer" in attachment 1 of the access arrangement to state that Users must give notice to ActewAGL Distribution of the subcontract and its *likely* duration, to more closely reflect the NGR (AER amendment 14.8)[226];
- include an example of "reasonable commercial terms or technical grounds" where ActewAGL Distribution can withhold its consent to capacity trades other than bare trades (AER amendment 14.9)[227]; and
- replace ActewAGL Distribution's proposal that it will respond to urgent trades within 5 days with a requirement that it will respond within 2 days (AER amendment 14.10)[228].

9.6.2 ActewAGL Distribution response

Rule 105(1) of the NGR states:

> (1) Capacity trading requirements must provide for the transfer of capacity:
>
> (a) In accordance with the rules of a gas market that are applicable to the service provider; or
>
> (b) If there are no such applicable rules governing transfer of capacity – in accordance with this rule.

ActewAGL Distribution considers that this means that the rules of an applicable gas market, where they are in place, apply in preference to the operation of Rule 105. In contrast, the AER's amendment to clause 8.1 of ActewAGL Distribution's trading policy appears to apply a different hierarchy when it requires replacement of ActewAGL Distribution's clauses with the following:

> 8.1 Matters referred to in this clause 8 are subject to the Business Rules insofar as they are not subject to rule 105 or rule 106 of the National Gas Rules.

Therefore, ActewAGL Distribution considers that the AER's amendment is not consistent with the NGR. ActewAGL Distribution has amended this clause of the access arrangement to provide greater clarity as to the applicable rules.

ActewAGL Distribution notes that the Business Rules are now referred to as the Gas Market Procedures. ActewAGL Distribution has therefore amended the access arrangement to reflect this change.

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[224] AER 2009, *Draft Decision*, p 181
[225] AER 2009, *Draft Decision*, pp 181-2
[226] AER 2009, *Draft Decision*, p 182
[227] AER 2009, *Draft Decision*, pp 180-1
[228] AER 2009, *Draft Decision*, pp 181-2

ActewAGL Distribution has also adopted the AER's amendments to the definition of Business Rules, notwithstanding the change in nomenclature discussed here, as well as AER amendments 14.8. 14.9 and 14.10.

9.6.3 Amendments to the access arrangement proposal and information

As an alternative to the AER's amendment 14.6 ActewAGL Distribution has amended clause 8.1 of its Trading policy as follows:

> 8.1 Transfers of contracted Capacity will be undertaken:
>
> (a) where the relevant parties are registered as participants under the Gas Market Procedures - in accordance with the Gas Market Procedures; or
>
> (b) if the relevant parties are not so registered - in accordance with rules 105 and 106 of the NGR and this Part 8.

ActewAGL Distribution has amended the following parts of the access arrangement to replace references to the "Business Rules" with "Gas Market Procedures":

- Part 3;
- Part 8;
- Definition of Business Rules in attachment 1;
- Requests for service in attachment 2; and
- Gas balancing arrangements in attachment 5.

ActewAGL Distribution has adopted AER amendment 14.7, subject to the change in nomenclature from Business Rules to Gas Market Procedures.

ActewAGL Distribution further accepts AER amendments 14.8, 14.9 and 14.10, and has incorporated these into its access arrangement.

9.7 Trigger event

9.7.1 AER Draft Decision

The AER amendment 14.16 requires ActewAGL Distribution to include a trigger event in its access arrangement as follows:

> **Amendment 14.16:** amend the access arrangement proposal to include a new part with the following:
>
> The revisions submission date stated in clause 1.16 of this Access Arrangement will advance on the occurrence of a Trigger Event described below.
>
> For the purposes of the provision able, a "Trigger Event" occurs if:
>
> (a) there is an amendment to the National Gas Law or the National Gas Rules; and
>
> (b) the Relevant Regulator provides ActewAGL with a notice stating that the amendment described in (a) affects this Access Arrangement.

> The new revisions submission date will be the date which is earlier of six Months from the date of the notice provided by the Relevant Regulator under (b) above, and the original revisions submission date stated in clause 1.16 of the Access Arrangement.

In support of this amendment, the AER states in its draft decision:

> The AER notes that the retail 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.[229]

9.7.2 ActewAGL Distribution response

ActewAGL Distribution is concerned that the AER's amendment 14.16 is not consistent with the NGR and introduces significant risk for ActewAGL Distribution. ActewAGL Distribution considers that the impact of events such as the National Customer Energy Framework (NECF) can be adequately dealt with using other measures.

Under the AER's proposed drafting, a trigger event occurs if there has been an "amendment to the National Gas Law or the National Gas Rules" and the AER advises ActewAGL that this amendment "affects" the Access Arrangement.

ActewAGL Distribution submits that the proposed drafting conflicts with Rule 51(2) of the NGR which provides that "a trigger event may consist of any significant circumstance or conjunction of circumstances".[230]

ActewAGL Distribution notes that there is a well established process for amending the NGR through an industry led rule change process.[231] This process can lead to a number of changes to the rules ranging from procedural and drafting amendments to widespread systematic changes to the market. ActewAGL Distribution does not consider that just any amendment to the NGR would satisfy the requirement that a trigger event be a "significant circumstance or conjunction of circumstances".

First, even a minor amendment to the NGR or NGL will satisfy the requirements of paragraph (a) of the AER's proposed clause. There is no requirement that the amendment be substantial or have any impact on ActewAGL Distribution's business. Secondly, using the word "affects" in paragraph (b) has a similarly broad application. Again, there is no requirement that the access arrangement be affected to a significant degree.

Further, in ActewAGL Distribution's view the reference in Rule 51(1) to "significant circumstance or conjunction of circumstances" means an external event rather than one initiated by the regulator or the service provider. ActewAGL Distribution considers that a trigger event that comprises a discretionary decision by the AER does not comply with the requirements of the NGR for a "circumstance or conjunction of circumstances".

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[229] AER 2009, *Draft Decision*, p 190
[230] NGR 51(2)
[231] National Gas Law chapter 9

This interpretation is supported by the examples provided in the NGR which relate to significant events outside the control of the service provider (or the AER) including a re-direction of flow of natural gas along a pipeline, a competing source of natural gas becoming available to customers served by the pipeline, or a significant extension, expansion or interconnection.[232] All of these circumstances would have a significant impact on throughput for a pipeline such as to fundamentally change the underpinning economics of reference tariffs, potentially requiring the resetting of reference tariffs. This is not the case for all amendments to the NGL or NGR.

In any event, ActewAGL Distribution does not consider that changes brought about by the NECF would satisfy the condition that the trigger event relate to a "significant circumstance or conjunction of circumstances". The AER's draft decision refers to the potential for the NECF to change terms and conditions of access for users and potential users, such as the credit support provisions.[233] ActewAGL Distribution does not consider that a change to credit support arrangements, or other aspects that make up the NECF legislative package could be considered a "significant circumstance or conjunction of circumstances" as required under Rule 51 of the NGR.

ActewAGL Distribution notes that the most recent draft of the NECF legislation, released on 27 November 2009, contemplates far less comprehensive changes to services provided by gas distribution businesses than those proposed in the first legislative package.[234] In addition, the MCE SCO has also confirmed that the economic framework for gas connections will operate under the existing access framework:

> SCO has arrived at the view that for covered pipelines, existing practice with respect of connection related capital expenditure should continue – that is, distributors should make capital expenditure that is prudent, and to the extent that customers requesting connection would not otherwise meet the justifiable expenditure test under s. 79(2)(b) of the NGR, they will need to make a capital contribution to the distributor in order to proceed to be connected.[235]

Notwithstanding that other options to capital contributions exist under the NGR for non-conforming capital expenditure (which ActewAGL Distribution expects to be accommodated under the gas connections framework in line with the policy decision that existing practice in this area should continue), ActewAGL Distribution notes that this means that the economic approach to network connections is unlikely to change significantly under the new framework. Where procedural arrangements change, ActewAGL Distribution considers these can be addressed through the cost pass through tariff variation mechanism approved by the AER in its Draft Decision, as this level of procedural detail is not part of the access arrangement as currently drafted.

The AER states that it requires the trigger event to allow it to "review the approved terms and conditions of access for consistency with the arrangements proposed under these new

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[232] Rule 51(2)

[233] AER 2009, *Draft Decision*, p 190

[234] For example, the NECF second exposure draft legislation not longer contains a default retail services contract between distributors and retailers, MCE SCO 2009, *National Energy Customer Framework: Second exposure draft Explanatory Material,* November, p 11

[235] MCE SCO 2009, *National Energy Customer Framework: Second exposure draft Explanatory Material,* November, p 20

frameworks". ActewAGL Distribution submits that the operation of the trigger event initiates a more widespread review and revision of the access arrangement than just providing an opportunity to update terms and conditions of access to reflect a new credit support arrangements.

The requirement that a trigger event be a "significant circumstance or conjunction of circumstances" recognises that bringing forward the revision submission is a significant event that imposes considerable costs and risks on the service provider, the regulator, users and prospective users. This is because the enactment of the trigger event would require ActewAGL Distribution to submit to the AER, within 6 months (or a maximum of 8 months with the AER's approval[236]), a full access arrangement proposal including new forecasts for demand, capital and operating expenditure for a full access arrangement period, as well as new tariffs, and arrangements for the operation of incentive mechanisms.[237]

Alongside the costs associated with an abrupt and premature revision of the access arrangement, the early revision date would undermine the incentive properties of the access arrangement. An early review arising from a change in the NGR would be unprecedented under the access regime and considerably out of step with the interaction of an approved access arrangement and the rules and obligations under the NGL, NGR and the previous National Gas Code.

ActewAGL Distribution also notes that even if provisions related to ActewAGL Distribution's access arrangement were to change as a result of the NECF legislative package, this may not lead to the need to amend the access arrangement during the access arrangement period. Changes to legislation and rules, where they lead to significant changes to obligations and rights, are supported by transitional arrangements. ActewAGL Distribution noted in its June 2009 access arrangement information that the NECF legislative package will include transitional arrangements, but that these arrangements had not yet been established.[238]

The second exposure draft of the NECF, referred to as NECF2, was released on 27 November 2009. Explanatory Material released with the package highlights a further delay in implementing the lead legislation, and notes that the NECF will be implemented through jurisdictional legislation according to a timetable set in that jurisdiction:

> Application Acts in each participating jurisdiction are generally expected to be introduced from 2011 onwards (with SA, as lead legislator, expected to introduce its application Act with the NECF legislation). Each jurisdictional Application Act will set out the specific jurisdictional arrangements for transitioning to the NECF. A new section 103 of the NEL recognises the role of both the Application acts, and other jurisdictional energy legislation in implementing the NECF.[239]

The most recent MCE Communiqué confirms long jurisdictional transitional periods in implementing the national framework:

[236] Rule 52(3)
[237] Rule 52(1) and Part 9
[238] ActewAGL Distribution Access arrangement information p 19
[239] MCE SCO *National Energy Customer Framework: Second exposure draft Explanatory Material,* November 2009 p 6

> To provide greater certainty to stakeholders on the NECF introduction, Ministers agreed that jurisdictions will introduce the NECF progressively between July 2011 and July 2013, noting that some transitional arrangements will be required…. Implementation is still expected to be on an incremental basis with jurisdictions noting it may take longer before they apply the entire Framework. Ministers previously proposed at the 10 July 2009 MCE meeting that the NECF legislative package be introduced into the South Australian Parliament in the Spring Session of 2010.[240]

These recent developments suggest that the AER may be premature in assuming that the NECF package will apply during the access arrangement period, and that suitable transitional arrangement will not be in place as part of the jurisdictional implementation plans.

ActewAGL Distribution considers that it is essential for the NECF legislative package to have adequate transitional arrangements in place to deal with price determinations and access arrangements that are in operation at the time that the new national provisions are introduced. This is because the timing for reviews of current electricity and gas network pricing decisions vary considerably, and no mechanism exists under the National Electricity Rules to bring forward the date on which the electricity distribution business must submit a regulatory proposal to the AER.[241] This means that the transitional arrangements must accommodate existing electricity price determinations.

ActewAGL Distribution notes that there are alternative provisions to deal with the introduction of the NECF during the access arrangement period, if this is needed. ActewAGL Distribution has included a mechanism to deal with costs associated with the introduction of the NECF in its cost pass through tariff variation mechanism. The AER accepted this pass through event in its draft decision.[242]

ActewAGL Distribution also notes that it can seek a variation to its access arrangement during the access arrangement period under Rule 65. Should the effect of the NECF legislation coming into force mean that the access arrangement can no longer remain in place without significant change, ActewAGL Distribution would have a clear incentive to seek to vary its access arrangement to ensure that it remains compliant with its requirements under Law. If the variations required are very significant, this would trigger a full review of the access arrangement through the operation of rule 66(3).

This approach is preferable as it does not expose ActewAGL Distribution to the risk that the AER will enforce a trigger event on the basis of changes to legislation or rules that are not commensurate with the costs and risks associated with undertaking a full access arrangement revision.

For the reasons above, ActewAGL Distribution has not amended its access arrangement to include the trigger event proposed by the AER.

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[240] MCE 2009, *MCE Communiqué, Hobart*, 4 December, p 3
[241] The current ActewAGL Distribution electricity network determination for the ACT is expected to continue in place until 30 June 2014
[242] AER 2009, *Draft Decision*, p 161

9.8 Other minor amendments to the access arrangement

9.8.1 AER Draft Decision

The AER includes two minor amendments to access arrangement drafting as follows:

- include a definition of "OBG" in attachment 1 of the access arrangement (AER amendment 14.4); and
- delete the typological error from footnote 14 to remove the number "19" (AER amendment 14.5).

9.8.2 Amendments to the access arrangement proposal and information

ActewAGL Distribution accepts these amendments and has incorporated the required changes in the access arrangement.

ActewAGL Distribution has amended clause 3.9 of the access arrangement to more accurately reflect the requirement to have a queuing policy in the access arrangement, and its relationship to the content of any Transport Services Agreement entered into with users.

ActewAGL Distribution has also amended the access arrangement to address definitional and referencing issues in the access arrangement. These amendments do not change the operation or intent of the access arrangement as considered by the AER in its draft decision. Amendments are limited to the following:

- replacing references to "section" throughout the access arrangement where these should be references to "rule";
- applying a consistent approach to referring to parts of the access arrangement, for example by referring to Part 6: Variations to Reference Tariffs or Part 7: Trading Policy;
- Capitalising defined terms;
- Ensuring consistency in use of terms;
- Updating clause numbering and cross referencing;
- Correcting minor grammatical errors and removing redundant terms; and
- revising definitions in Attachment 1 as follows:
    - updated definition of AEMO to note the AEMO is now in place;
    - included definition of AEMO Fee;
    - included definition of Energy Industry Levy;
    - updated definition of Gas Law to reflect new national gas legislation and capture forthcoming energy customer legislation;
    - deleted definition of Gas Market Company as now included in AEMO;
    - amended definition of Minister to more accurately reference relevant legislation;
    - included a definition of the Short Term Trading Market;

- Included a definition of a Transport Service; and
- included a definition of the Utilities (Network Facilities) Tax.

Glossary

Term	*Meaning*
AA	access arrangement
ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
ACTEW	ACTEW Corporation Ltd
ACTHERS	ACT House Energy Rating Scheme
ACTPLA	ACT Planning and Land Authority
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AGL	The Australian Gas Light Company
AMP	Asset Management Plan
APT	Australian Pipeline Trust
AS	Australian Standard
ASIC	Australian Securities and Investment Commission
ASR	Additional Services Request
ASX	Australian Stock Exchange
BCA	Building Code of Australia
capex	capital expenditure
CAPM	Capital Asset Pricing Model
CEG	Competition Economics Group
CGS	Commonwealth Government Securities
CM	Corrective Maintenance
CPI	Consumer Price Index
CPRS	Carbon Pollution Reduction Scheme
Cth	Commonwealth
CTS	custody transfer station
DAMS	Distribution Asset Management Services Agreement
DGM	Dividend Growth Market
DWE	NSW Department of Water and Energy
E to G	electricity to gas conversions
EA	Enterprise Agreement
EBA	Enterprise Bargaining Agreement
EBSS	Efficiency Benefit Sharing Scheme
EBT	earnings before tax
EGP	Eastern Gas Pipeline
EGW	electricity, gas and water

Term	Meaning
EPA	NSW Environmental Protection Authority
ESC	Victorian Essential Services Commission
FPSC	fixed price service charge
GDP	Gross Domestic Product
GIS	geographic information system
GJ	Gigajoule(s)
HFL	Hoskinstown to Fyshwick Loop
HP	high pressure
I&C	industrial and commercial
ICRC	Independent Competition and Regulatory Commission
IT	Information Technology
JAM	Jemena Asset Management Pty Ltd
km	kilometre(s)
kPa	kilopascal(s)
LGA	local government area
LP	low pressure
m	metre(s)
MAOP	maximum allowable operating pressure
MDQ	maximum daily quantity
mm	millimetre(s)
MP	medium pressure
MRP	Market Risk Premium
MSP	Moomba to Sydney Pipeline
na	not applicable
NECF	National Energy Customer Framework
NEMMCO	National Energy Market Management Company
NERA	NERA Economic Consulting
NGCF	National Gas Connections Framework
NGERS	National Greenhouse Emissions Reporting Scheme
NGL	National Gas Law
NGR	National Gas Rules
NIEIR	National Institute of Economic and Industry Research (also known as National Economics)
NSW	New South Wales
NTER	National Tax Equivalent Regime
OH&S	Occupational Health and Safety
opex	operating and maintenance expenditure
PM	Preventative Maintenance

Term	*Meaning*
POTS	Package offtake station
PRS	primary regulating station
PTRM	post tax revenue model
RBA	Reserve Bank of Australia
REC	Renewable Energy Certificate
RET	Renewable Energy Target
RFM	roll forward model
RIN	Regulatory Information Notice
RUGS	Request Utility for Gas Service
SA	South Australia
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
SAOP	Safety and Operating Plan
SCADA	supervisory control and data acquisition
scmh	standard cubic metres per hour
SDRS	secondary district regulator set
SRS	secondary regulator set
STTM	Short Term Trading Market
T&C	terms and conditions
TAB	taxation asset base
TJ	Terajoule(s)
TRS	trunk receiving station
TWAW	Think Water Act Water
UAG	unaccounted-for gas
UNFT	Utilities Network Facilities Tax
WACC	weighted average cost of capital
WBH	Water Bath Heater
WELS	Water Efficiency Labelling and Standards
Wilson Cook	Wilson Cook and Co (the AER’s consultant for forecast expenditure)
WTP	willingness to pay

Attachment A: Updated financial tables replacing the original submission in June 2009

ActewAGL Distribution provides all remaining Tables from the original submission in June 2009 that have been affected by the changes in the revised proposal e.g. through updated inflation, escalators and change to projects, that are not already reproduced in the main document.

Table 6.2 in the original proposal is replaced with Table A.1.

Table A.1 Comparison of ICRC final decision and outturn capital expenditure 2004/05 to 2009/10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	Total
ICRC final decision 2004							
Market expansion	7.40	6.38	6.25	6.14	6.17	6.08	38.41
Capacity development	1.98	3.33	2.69	2.05	5.11	0.95	16.10
Stay in business	2.76	1.38	1.47	1.40	1.54	1.17	9.71
Total distribution system capital expenditure	**12.13**	**11.08**	**10.41**	**9.58**	**12.81**	**8.19**	**64.21**
Non-system capital expenditure							
Non system assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Regulatory capitalisation costs	1.85	0.00	0.00	0.00	0.00	0.00	1.85
IT system	0.58	0.00	0.00	0.00	0.00	0.00	0.58
Total non system capital expenditure	**2.43**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**2.43**
Total capital expenditure	**14.56**	**11.08**	**10.41**	**9.58**	**12.81**	**8.19**	**66.64**
Actual and forecast capital expenditure	**Actual**	**Actual**	**Actual**	**Actual**	**Actual**	**Forecast**	
Market expansion	5.65	4.36	7.11	7.91	6.11	7.19	38.33
Capacity development	2.12	2.50	4.21	0.30	1.18	3.52	13.82
Stay in business	1.18	1.23	0.80	1.09	0.71	3.90	8.92
Total distribution system capital expenditure	**8.95**	**8.09**	**12.12**	**9.29**	**8.01**	**14.61**	**61.08**
Non-system capital expenditure							
Non system assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Regulatory capitalisation costs	2.09	0.00	0.00	0.00	0.90	0.54	3.53
IT system	0.34	0.11	0.08	0.00	0.00	0.38	0.90
Total non system capital expenditure	**2.42**	**0.11**	**0.08**	**0.00**	**0.90**	**0.92**	**4.43**
Total capital expenditure	**11.37**	**8.20**	**12.21**	**9.29**	**8.91**	**15.53**	**65.50**
Variance between ICRC final decision and ActewAGL Distribution actual and forecast capital expenditure							
Market expansion	1.75	2.01	(0.9)	(1.8)	0.06	(1.1)	0.1
Capacity development	(0.1)	0.83	(1.5)	1.75	3.93	(2.6)	2.3
Stay in business	1.58	0.15	0.67	0.31	0.82	(2.7)	0.8
Total distribution system capital expenditure	**3.19**	**2.99**	**(1.71)**	**0.29**	**4.80**	**(6.42)**	**3.13**
Non-system capital expenditure							
Non system assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Regulatory capitalisation costs	(0.2)	0.00	0.00	0.00	(0.9)	(0.5)	(1.68)
IT system	0.24	(0.11)	(0.08)	0.00	0.00	(0.38)	(0.32)
Total non system capital expenditure	**0.01**	**(0.11)**	**(0.08)**	**0.00**	**(0.90)**	**(0.92)**	**(2.00)**
Total capital expenditure	**3.19**	**2.89**	**(1.80)**	**0.29**	**3.90**	**(7.34)**	**1.13**

Note: Figures in parentheses denote actual, forecast capital expenditure above that approved by the ICRC in ActewAGL Distribution's 2004 access arrangement. Calculations include capital expenditure in financial year 2004/05, although the earlier access arrangement commenced on 1 January 2005.

Table 6.3 in the original proposal is replaced with Table A.2.

Table A.2 Market expansion capital expenditure program in the earlier access arrangement period

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Mains Extension	2.53	1.30	3.62	4.28	2.59	3.85	18.17
Service Connection	2.13	2.10	2.10	2.50	2.34	2.40	13.57
Meters - residential	0.57	0.58	0.64	0.59	0.51	0.59	3.50
Meters - commercial	0.40	0.39	0.74	0.54	0.67	0.35	3.10
Total market expansion	5.65	4.36	7.11	7.91	6.11	7.19	38.33

Table 6.4 in the original proposal is replaced with Table A.3.

Table A.3 Capacity development capital expenditure program 2005-10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Mains - High Pressure	(0.0)	2.28	1.18	0.03	0.39	2.71	6.54
Mains - Medium Pressure	0.00	0.00	0.00	0.00	0.20	0.71	0.91
Facilities - High Pressure	2.16	0.21	2.88	0.27	0.00	0.10	5.63
Facilities - Medium Pressure	0.00	0.00	0.16	0.00	0.59	0.00	0.75
Total capacity development	2.12	2.50	4.21	0.30	1.18	3.52	13.82

Table 6.5 in the original proposal is replaced with Table A.4.

Table A.4 Stay in business capital expenditure program 2005-10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Facilities Renewal and Upgrade	0.52	0.36	0.00	0.31	0.00	3.21	4.40
Mains & Services Renewal and Upgrade	(0.01)	0.01	0.32	0.23	0.00	0.03	0.58
Residential Meters	0.54	0.40	0.30	0.28	0.41	0.28	2.21
I & C Meters	0.14	0.45	0.19	0.25	0.30	0.37	1.69
Other	0.00	0.00	0.00	0.02	0.00	0.02	0.04
Total stay in business	1.18	1.23	0.80	1.09	0.71	3.90	8.92

Table 6.6 in the original proposal is replaced with Table A.5.

Table A.5 Non system assets capital expenditure program 2005-10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Regulatory Costs	2.09	0.00	0.00	0.00	0.90	0.54	3.53
IT Systems	0.34	0.11	0.08	0.00	0.00	0.38	0.90
Total non system assets capital expenditure	**2.42**	**0.11**	**0.08**	**0.00**	**0.90**	**0.92**	**4.43**

Table 6.7 in the original proposal is replaced with Table A.6.

Table A.6 Capital expenditure by asset class 2004–10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Distribution system							
TRS & DRS - Valves & Regulators	2.68	0.58	3.04	0.58	0.59	3.31	10.78
HP Mains (inc DRS & TRS)	(0.06)	2.29	1.48	0.20	0.39	2.71	7.02
MP Mains	2.53	1.30	3.63	4.36	2.79	4.61	19.22
Meters - Tariff	1.59	1.76	1.84	1.54	1.81	1.32	9.85
Meters - Contract	0.06	0.07	0.03	0.12	0.08	0.28	0.64
MP Services	2.13	2.10	2.10	2.50	2.34	2.40	13.57
HP Services	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total distribution system	**8.95**	**8.09**	**12.12**	**9.29**	**8.01**	**14.61**	**61.08**
Non system							
IT system	0.34	0.11	0.08	0.00	0.00	0.38	0.90
Regulatory costs (capitalised)	2.09	0.00	0.00	0.00	0.90	0.54	3.53
Total non system	**2.42**	**0.11**	**0.08**	**0.00**	**0.90**	**0.92**	**4.43**
Total	**11.37**	**8.20**	**12.21**	**9.29**	**8.91**	**15.53**	**65.50**

Table 6.12 in the original proposal is replaced with Table A.7.

Table A.7 Market expansion capital expenditure program 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Mains Extension	4.99	3.36	3.20	2.45	2.09	16.09
Service Connection	3.15	3.07	3.03	2.82	2.74	14.80
Meters - residential	0.89	0.97	0.96	0.87	0.83	4.51
Meters - Commercial	0.44	0.47	0.49	0.50	0.51	2.41
Total market expansion	9.47	7.88	7.67	6.64	6.16	37.82

Table 6.13 in the original proposal is replaced with Table A.8.

Table A.8 Capacity development capital expenditure program 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Mains - High Pressure	0.98	11.54	0.00	0.00	1.49	14.01
Mains - Medium Pressure	0.21	0.53	0.70	0.33	0.93	2.69
Facilities - High Pressure	4.24	3.47	0.00	0.00	0.00	7.71
Facilities - Medium Pressure	0.00	0.00	0.00	0.00	0.00	0.00
Total capacity development	5.42	15.54	0.70	0.33	2.42	24.40

Table 6.14 in the original proposal is replaced with Table A.9.

Table A.9 Forecast main capacity development projects in 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Tuggeranong Primary Mains Extension	0.1	11.5	0.0	0.0	0.0	11.7
Tuggeranong PRS	0.1	3.5	0.0	0.0	0.0	3.6
Queanbeyan PRS	4.1	0.0	0.0	0.0	0.0	4.1
Griffith/Red Hill Secondary Mains Extension	0.0	0.0	0.0	0.0	1.5	1.5
Total	4.4	15.0	0.0	0.0	1.5	20.9

Table 6.15 in the original proposal is replaced with Table A.10.

Table A.10 Stay in business capital expenditure program 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Facilities Renewal and Upgrade	14.53	0.62	0.42	0.95	0.42	16.94
Mains & Services Renewal and Upgrade	0.03	0.03	0.03	0.05	0.05	0.19
Security of Supply	0.00	0.00	0.00	0.00	0.00	0.00
Meters - Residential	0.61	0.93	1.96	1.78	1.85	7.12
Meters - I & C	0.80	0.65	1.23	1.36	0.88	4.91
Other	1.74	0.02	0.02	0.02	0.02	1.83
Total stay in business	17.71	2.25	3.67	4.15	3.22	31.00

Table 6.16 in the original proposal is replaced with Table A.11.

Table A.11 Forecast main stay in business projects in 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Security of Supply	0.00	0.00	0.00	0.00	0.00	0.00
Fyshwick TRS Upgrade	4.64	0.00	0.00	0.00	0.00	4.64
I&C aged meter replacement	0.63	0.46	1.05	1.08	0.60	3.80
Residential aged gas meter replacement populations	0.08	0.38	0.67	1.70	1.50	4.32
Canberra Primary Scraper Stations	1.79	0.00	0.00	0.00	0.00	1.79
Hoskinstown-Fyshwick Trunk Main Pigging Facilities	1.37	0.00	0.00	0.00	0.00	1.37
Total	8.50	0.84	1.71	2.77	2.10	15.91

Table 6.17 in the original proposal is replaced with Table A.12.

Table A.12 Non system assets capital expenditure program 2011-15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
IT System	0.32	0.31	0.44	0.10	0.00	1.17
Total non system assets capital expenditure	0.32	0.31	0.44	0.10	0.00	1.17

Table 6.18 in the original proposal is replaced with Table A.13.

Table A.13 Capital contributions 2004/05 to 2009/10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
MP Services	0.06	0.08	0.12	0.04	0.11	0.05	0.46
Medium pressure mains	0.00	0.00	0.00	1.10	0.00	0.00	1.10
Meters – Commercial and Industrial	0.00	0.00	0.01	0.06	0.01	0.00	0.08
Total capital contributions	**0.07**	**0.09**	**0.13**	**1.20**	**0.12**	**0.05**	**1.65**

Table 6.19 in the original proposal is replaced with Table A.14.

Table A.14 Capital contributions 2009/10 to 2014/15

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
MP Services	0.06	0.06	0.06	0.06	0.06	0.31
Meters – Commercial and Industrial	0.00	0.00	0.00	0.00	0.00	0.02
Total capital contributions	**0.06**	**0.06**	**0.07**	**0.07**	**0.07**	**0.32**

Table 7.2 in the original proposal is replaced with Table A.15

Table A.15 ActewAGL Distribution capital expenditure and depreciation roll-forward 2005-2010

$'000 nominal	2004/05	2005/06	2006/07	2007/08	2008/09	F2009/10	Total
Actual net capital expenditure	9.8	7.2	11.1	7.6	8.6	15.5	59.8
Depreciation	7.3	8.0	8,6	8.4	8.7	9.2	50.4

Table 9.1 in the original proposal is replaced with Table A.16.

Table A.16 ActewAGL Distribution's gas network operating costs 2004–10

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	Total
	Actual	*Actual*	*Actual*	*Actual*	*Actual*	*Forecast*	
Controllable costs							
Operating and maintenance	8.91	8.17	8.22	8.63	8.36	8.82	51.11
Corporate overheads	2.12	2.21	2.28	2.38	2.62	3.30	14.90
Non-system asset charge	0.28	0.55	0.55	0.55	0.54	0.52	3.00
Marketing	1.18	0.92	1.16	1.23	1.31	1.33	7.12
Other direct costs	(0.00)	0.10	0.02	0.36	0.53	0.23	1.24
Total controllable costs	**12.49**	**11.94**	**12.23**	**13.14**	**13.37**	**14.19**	**77.37**
Other allowable costs							
Government levies	0.42	0.46	0.54	0.56	0.46	0.65	3.08
Utilities Network Facilities Tax	0.00	0.00	2.26	3.79	3.44	3.33	12.82
Contestability costs	0.65	0.53	0.53	0.53	0.52	0.56	3.32
Unaccounted for gas	0.25	0.49	0.63	0.69	1.19	0.74	3.98
Other direct Costs	0.27	0.37	0.27	(0.0)	0.18	0.22	1.30
Total other non-capital costs	**1.58**	**1.84**	**4.22**	**5.57**	**5.79**	**5.49**	**24.50**
Total operating expenditure	**14.07**	**13.79**	**16.46**	**18.71**	**19.16**	**19.69**	**101.87**

Table 9.2 in the original proposal is replaced with Table A.17.

Table A.17 ICRC approved operating expenditure for ActewAGL Distribution's earlier access arrangement

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	Total
Controllable costs							
Operating and maintenance	7.98	8.16	8.54	8.65	8.78	8.90	51.01
Corporate overheads	2.22	2.22	2.22	2.22	2.22	2.22	13.31
Non-system asset charge	0.55	0.55	0.55	0.55	0.55	0.55	3.33
Marketing	1.69	1.69	1.69	1.69	1.69	1.69	10.12
Other controllable costs	0.28	0.28	0.28	0.28	0.28	0.28	1.66
Total controllable costs	**12.72**	**12.90**	**13.28**	**13.39**	**13.52**	**13.63**	**79.44**
Other allowable costs							
Government levies	0.64	0.64	0.64	0.64	0.64	0.64	3.81
Utilities Network Facilities Tax	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Contestability costs	0.52	0.53	0.53	0.53	0.53	0.52	3.17
Unaccounted for gas	0.45	0.46	0.46	0.46	0.47	0.47	2.78
Other costs	0.28	0.28	0.28	0.28	0.29	0.29	1.69
Total other non-capital costs	**1.88**	**1.91**	**1.91**	**1.91**	**1.93**	**1.92**	**11.45**
Total operating expenditure	**14.61**	**14.80**	**15.18**	**15.30**	**15.45**	**15.55**	**90.89**

Table 9.3 in the original proposal is replaced with Table A.18.

Table A.18 Variation between actual and approved operating costs for the earlier access arrangement period

$ million (2009/10)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	Total
	Actual	*Actual*	*Actual*	*Actual*	*Actual*	*Forecast*	
Controllable costs							
Operating and maintenance	(0.93)	(0.01)	0.31	0.02	0.42	0.08	(0.09)
Corporate overheads	0.09	0.01	(0.06)	(0.16)	(0.40)	(1.08)	(1.59)
Non-system asset charge	0.28	0.00	0.01	(0.00)	0.01	0.03	0.33
Marketing	0.51	0.77	0.53	0.46	0.37	0.36	3.00
Other controllable costs	0.28	0.18	0.26	(0.08)	(0.25)	0.05	0.43
Total controllable costs	**0.23**	**0.95**	**1.04**	**0.25**	**0.15**	**(0.56)**	**2.07**
Other allowable costs							
Government levies	0.22	0.18	0.09	0.07	0.18	(0.01)	0.74
Utilities Network Facilities Tax	0.00	0.00	(2.26)	(3.79)	(3.44)	(3.33)	(12.82)
Contestability costs	(0.13)	0.00	0.01	(0.00)	0.01	(0.04)	(0.15)
Unaccounted for gas	0.20	(0.02)	(0.17)	(0.23)	(0.72)	(0.27)	(1.20)
Other allowable costs	0.01	(0.09)	0.01	0.28	0.11	0.06	0.39
Total other non-capital costs	**0.30**	**0.06**	**(2.32)**	**(3.66)**	**(3.86)**	**(3.58)**	**(13.05)**
Total operating expenditure	**0.53**	**1.02**	**(1.28)**	**(3.41)**	**(3.71)**	**(4.13)**	**(10.98)**

Note: Figures in parentheses denote actual, forecast operating expenditure as applicable above that approved by the ICRC in ActewAGL Distribution’s 2004 access arrangement.

Table 9.12 in the original proposal is replaced with Table A.19.

Table A.19 Forecast operating and maintenance costs for the access arrangement period

$ million (2009/10)	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Asset services	5.93	7.77	8.04	6.76	7.02	35.51
Asset Management	3.41	3.47	3.58	3.71	3.82	17.98
Productivity factor	(0.05)	(0.11)	(0.17)	(0.21)	(0.27)	(0.81)
IT Support	0.18	0.18	0.18	0.18	0.18	0.91
Total operating and maintenance costs	9.47	11.31	11.62	10.44	10.75	53.59

Table 9.13 in the original proposal is replaced with Table A.20.

Table A.20 Forecast corporate overheads costs for the access arrangement period

$ million (2009/10)	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Corporate overhead costs	3.30	3.25	3.33	3.41	3.49	3.55	17.03

Table 9.15 in the original proposal is replaced with Table A.21.

Table A.21 Forecast marketing and other controllable costs 2010-15

$ million (2009/10)	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Marketing	1.33	1.33	1.33	1.35	1.36	1.38	6.75
Other controllable costs	0.23	0.23	0.23	0.23	1.02	0.83	2.54
Total	1.56	1.56	1.56	1.58	2.38	2.21	9.29

Table 10.4 in the original proposal is replaced with Table A.22.

Table A.22 Roll forward of the capital base 2010/11 to 2014/15

$ million (nominal)	2010/11	2011/12	2012/13	2013/14	2014/15
Return on equity	14.5	16.1	17.4	17.9	18.3
Return on debt	16.3	18.2	19.7	20.2	20.7
Return on capital	30.8	34.4	37.1	38.1	38.9

Table 10.5 in the original proposal is replaced with Table A.23.

Table A.23 Operating expenditure 2010/11 to 2014/15

$ million (nominal)	2010/11	2011/12	2012/13	2013/14	2014/15
Operating expenditure	21.6	30.0	31.3	31.8	32.9

Attachment B (confidential): Financial risk and preparedness cost

Attachment provided as a separate document.

Attachment C: CIE, Economic value of reducing the risk of gas supply outage

Attachment provided as a separate document.

Attachment D (confidential): Self insurance

Attachment provided as a separate document.

Attachment E: Escalation reports and support

Attachments provided as a separate documents.

E.1 Competition Economists Group (CEG): Escalation factors affecting expenditure forecasts

E.2 KPMG Econtech's Australian National, State and Industry Outlook, August 2009

E.3 Confidential: Excel document providing support for the IT application cost escalator

Attachment F: Models

Attachments provided as a separate documents.

F.1 Roll forward model (RFM), confidential

F.2 Post tax revenue model (PTRM)

F.3 Tax roll forward model, confidential

F.4 Revenue allocation model, confidential

F.5 Allocation of revenue to tariff and contract, confidential

F.6 Final gas networks access arrangement 2005/10 model, confidential

Attachment G (confidential): Step changes

Confidential attachment provided as a separate document.

Attachment H: Replacement text for the June 2009 Access Arrangement Information

Box H.1 Replacement text for section 11.1 of June 2009 access arrangement information

11.1 Services offered

The NGR and the AER's RIN require the access arrangement to describe the pipeline services to be provided and to specify the reference services. A reference service is defined in Rule 101 as "a pipeline service that is likely to be sought by a significant part of the market".

ActewAGL Distribution proposes to offer nine pipeline services, comprising seven reference services and two non-reference services. These services are the same as those offered in the earlier access arrangement, plus the addition of the ancillary service treated as an additional service.

The seven reference services, as set out in part 2 of the access arrangement proposal, are as follows:

Capacity Reservation Service—a transport service from the receipt point to a single non-tariff delivery point. Charges are determined on the basis of capacity reserved. Additional capacity reservation options for this service are:

- **Summer Tranche Option**—provides an option to book capacity between the months of October and April (inclusive);
- **Short Term Capacity Option**—available to end use customers using gas for purposes other than space heating (subject to available capacity). There are two options—one for 30 TJ or less of gas per year, the other for over 30 TJ of gas per year. A short term capacity charge (premium) may be charged for the under 30 TJ option;

Managed Capacity Service—a transport service from receipt point to a single non-tariff delivery point. Charges are determined on the basis of capacity reserved;

Throughput Service—a transport service from the receipt point to a single non-tariff delivery point. Charges are determined on the basis of throughput;

Multiple Delivery Point Service—a transport service from the receipt point to a number of non-tariff delivery points. Charges are based on the relevant service at each delivery point;

Tariff Service—a transport service from the receipt point to one or more tariff delivery points. Charges are determined on the basis of throughput;

Meter Data Service—a service comprising the reading of meters and handling of metering data.

Ancillary service—a service for the provision of: (i) requests for services; (ii) special meter reads; (iii) disconnection; and (iv) reconnection.

The two non-reference services offered by ActewAGL Distribution are:

Interconnection of Embedded Network Service—a service to provide for the establishment of a single delivery point from the network to an embedded network; and,

Negotiated Service—any service negotiated to meet the needs of a user which is not met by the reference services.

ActewAGL Distribution's proposed reference services are those pipeline services which are likely to be sought by a significant part of the market. The non-reference services have not been sought by any customers or potential customers during the earlier access arrangement period, and ActewAGL Distribution considers that they are unlikely to be sought by a significant part of the market during the access arrangement period. The proposed reference and non-reference services therefore remain appropriate.

11.1.1 Allocating costs between services

The NGR set out requirements for allocating costs between reference services and other pipeline services. The portion of total revenue allocated to reference services is determined by the ratio in which costs are allocated between reference and other services (Rule 93(1)). Rule 93(2) requires allocation of directly attributable costs to reference and other services as appropriate, and other costs (such as overheads) to be allocated (consistent with revenue and pricing principles) between these services on a basis determined or approved by the AER.

As outlined above, ActewAGL Distribution offers seven reference services and two non-reference services. While the non-reference services continue to be offered, they are not currently used by any customers and therefore ActewAGL Distribution incurs no costs in relation to them. Further, the cost of maintaining the availability of non-reference services is negligible. Accordingly, ActewAGL Distribution's costs are fully allocated to reference services.

Costs are allocated between customer classes in order to set the tariffs for each reference service, as described in the following sections.

Box H.2 Replacement text for Chapter 12 of June 2009 access arrangement information

12 Changes to the access arrangement

The chapter of the access arrangement information summarises proposed revisions to the access arrangement.

ActewAGL Distribution is proposing to substantially retain its access arrangement from the earlier access arrangement period. Terms and conditions of access to the network remain largely unaltered and changes mostly reflect changed requirements from those of the former Gas Code to those of the NGL and NGR. The reference tariff structure applying in the earlier access arrangement period has been retained, with the addition of the Ancillary Service, which is for the provision of: (i) requests for services; (ii) special meter reads; (iii) disconnection; and (iv) reconnection.

Some changes are proposed to the tariff variation mechanism (in relation to cost pass through and an adjustment mechanism for unaccounted for gas and fees, taxes and levies), to ensure that the impacts of ongoing developments in the regulatory framework and gas market can be appropriately managed.

…

12.2 Revisions to Part 2—Services policy

Part 2 of the access arrangement has been amended to include the new reference service, the Ancillary Service.

12.3 Revisions to Part 3—General terms and conditions for access

Part 3 of the Access Arrangement has been updated to reflect the change from the National Gas Code to the NGL/NGR. For example, the access arrangement now refers to “Access Determinations” in place of “arbitrated access decisions”, reflecting Chapter 6 of the NGL. No other significant amendments have been made.

ActewAGL Distribution has included references to the Ancillary Service, and moved provisions relevant to the Ancillary Service, namely suspension of supply, to a new Attachment 3I.

ActewAGL Distribution has clarified the position with respect to title to gas in clause 3.41, as this is important for some aspects of the proposed CPRS. However, this does not represent a change to the position under the current access arrangement, merely a confirmation of that position.

ActewAGL Distribution submits that these terms and conditions of access are reasonable, and in particular seek to impose a reasonable risk allocation between ActewAGL Distribution and Users. As the result of consultations with Users and the ICRC in the before approval of the access arrangement in the earlier access arrangement period, the terms and conditions were substantially re-written to put them into a plain English style that is more readily understood by Users.

ActewAGL considers that the terms have worked well over the term of the earlier access arrangement, with Users who have negotiated Transport Agreements for access to the network not seeking significant change to the terms.

…

12.11 Revisions to access arrangement attachments

Attachment 1—*Definitions* has been amended to include a new definition of the Ancillary Service, and other definitions have been amendment consequential to this change.

Attachment 2—*Requests for service* has been amended for minor changes in section 112 of the NGR.

A new Attachment 3I has been included setting out the terms and conditions for the provision of the Ancillary Service.

Box H.3 Replacement text for section 11.2 of June 2009 access arrangement information

11.2 Tariffs for reference services

11.2.1 Tariff classes

The NGR specify that, for the purpose of determining reference tariffs, customers must be divided into tariff classes. Tariff classes must be constituted with regard to grouping of customers together on an economically efficient basis and the need to avoid unnecessary transaction costs.

ActewAGL Distribution’s customers are grouped into two classes:

- Tariff customers; and
- Contract customers.

This grouping is appropriate and economically efficient, as required by the NGR. The split is based on the nature and size of the connection and load. Within each group customers have broadly similar load and connection characteristics. The tariffs available for each group reflect the different economic costs of supplying each group. Transactions costs, particularly the costs of metering, are also taken into account in determining the appropriate tariffs to be offered to each group, as discussed further below.

Contract customers are those that consume more than 10 TJ of gas per annum. These customers have different load and connection characteristics to the tariff customers, often requiring multiple connection points, and are generally more responsive to price signals regarding capacity. The relatively large loads consumed by the customers in this group mean that the transactions costs associated with installing more sophisticated metering, to measure maximum daily and hourly consumption, are warranted.

The reference services for the contract customer class comprise:

- Capacity reservation services;
- Managed capacity services;
- Throughput services;
- Multiple delivery point services;
- Meter data services; and
- Ancillary services.

While the contract customers face several service options, the existing contract customers all take the capacity reservation service with meter data services. Within the meter data services, most contract customers take the communications option that allows meters to be read remotely. However, one customer with 97 meters finds it more efficient to have its meters manually read monthly.

The tariff customer class comprises residential and business customers consuming fewer than 10 TJ per annum. The reference services for tariff customers are:

- Tariff services;

- Meter data services; and
- Ancillary services.

The tariff for the tariff service involves a fixed charge and a throughput charge consistent with an efficient two part tariff structure. More complex tariffs, involving capacity charges as for the contract market services, would require more costly metering capability.

11.2.2 Revenue and cost allocation

The NGR require the access arrangement information to include the proposed approach to the setting of reference tariffs including the method used to allocate costs.

ActewAGL Distribution has allocated the total cost of providing reference services between contract and tariff markets using the methodology approved by the ICRC in the earlier access arrangement period and applied since the 2001 access arrangement decision. The methodology uses a series of rules to allocate operating and capital costs to contract and tariff market segments in line with their respective use of network services. It is consistent with the requirements for allocating costs between reference and other services, as set out in Rule 93. Costs that are directly attributable to either market segment (contract or tariff) are allocated to that segment, while other costs which are shared between segments, are allocated on the basis of reasonable cost drivers. The cost allocation model is described below.

11.2.2.1 Allocation of operating costs

Operating costs are allocated between tariff and contract customers using an activity based costing methodology. ActewAGL Distribution has identified eleven operating cost categories which account for approximately 99.9 per cent of total operating expenditure, to allocate costs to contract and tariff cost pools. The remaining 0.1 per cent of the operating expenditure has been allocated in accordance with the average percentage derived from the eleven operating cost categories. Costs for each activity are based on expenditure levels in the 2009/10 base year, apart from ancillary services which are based on the 2010/11 forecast, which represents a normal year (ActewAGL Distribution notes that the ancillary services in 2009/10 were extraordinarily high). Where a cost category is only driven by one market (tariff or contract), all costs have been allocated directly to that market segment. However, where costs are shared, an allocation 'key' provides the rule for attributing costs to either contract or tariff markets. The keys used to allocate costs to operating expenditure categories are the same as those approved in the 2004 Final Decision, with the exception of the UNFT which is added to government levies and ancillary services which have been directly allocated to tariff customers according to relevant activity. The operating cost categories and the allocation keys are provided in Table 11.1.

Table 11.1 Allocation keys used to allocate operating cost categories

Opex category	Allocation key
Asset Services costs	Where the costs have not been allocated directly to tariff and contract customers, they are allocated based on the allocation determined in the earlier access arrangement using relative size of MDQs (actual peak data from 2007/08), customer numbers, new connections and the actual revenue split in 2007/08.
Asset Management costs	Costs allocated by relative size of MDQs.
Corporate overheads	The actual revenue split in 2007/08 has been used as a proxy to distribute corporate overhead costs.

Non System Asset Charge	Costs allocated by relative size of MDQs.
Marketing	Costs allocated entirely to the tariff market.
Ancillary services	Costs directly allocated according to activity
Other direct costs	Costs allocated by relative size of MDQs.
Government levies & UNFT	The actual revenue split in 2007/08 has been used as a proxy to allocated government levies.
Contestability Charge	Costs allocated entirely to the tariff market.
UAG Other Opex	The actual revenue split in 2007/08 has been used as a proxy to distribute UAG and Other Opex.

11.2.2.2 Allocation of capital costs

Capital costs are split in proportion to the market segments' relative shares of the capital base. The methodology requires the regulated asset base (as at 1 July 2010 from the RFM) and capital expenditure over the access arrangement period to first be allocated to asset classes and second, split into contract and tariff markets. Two asset classes—contract meters and tariff meters—have been allocated directly to the relevant market segments. The other asset classes have been allocated via the relative size of contract and tariff MDQs. The capital costs for medium pressure mains—utilised almost entirely by the tariff market—have been allocated using the same allocator as in the earlier access arrangement period. The allocation of the rolled forward capital base is shown in Table 11.2.

Table 11.2 Allocation of the average values of the capital base 2010/11 to 2014/15

$million	Total	Contract	Tariff
HP Mains	75.82	6.33	69.49
HP Services	0.78	0.07	0.72
MP Mains	149.36	0.10	149.25
MP Services	61.85	0.04	61.80
TRS & DRS – Valves & Regulators	30.67	2.56	28.10
Contract meters	1.59	1.59	0.00
Tariff meters	18.96	0.00	18.96
Regulatory Costs	0.34	0.03	0.31
IT System	0.80	0.07	0.73
Total	**340.17**	**10.80**	**329.37**

Table 11.3 shows the allocation of operating and capital costs to the contract and tariff markets.

Table 11.3 Allocation of operating and capital costs

$ million nominal	Total	Contract	Tariff
Operating costs	137.34	6.94	130.30
Capital costs	218.84	6.95	211.90
Total allocation	356.08	13.88	342.20

11.2.2.3 Revenue allocation

For each year of the access arrangement period, ActewAGL Distribution has determined the costs allocated to each of the contract and tariff markets based on the operating expenditure and capital base splits described above. The proportion of total costs allocated to each of these classes over the period is used to allocate revenues.

Revenues for each tariff class are further split into meter provision, meter communication, meter reading and network use in order to allocate costs within contract and tariff customer classes to reference services.

The revenue allocation of operating and capital costs is presented in Table 11.4 in nominal dollars.

Table 11.4 Revenue Allocation

$ million nominal	2010/11	2011/12	2012/13	2013/14	2014/15
Contract	2.60	2.67	2.74	2.83	2.92
Tariff	53.99	67.01	70.93	73.70	76.69
Contract- meter provision	0.45	0.46	0.48	0.49	0.50
Contract - meter communication	0.08	0.08	0.08	0.09	0.09
Contract - meter reading	0.04	0.04	0.04	0.04	0.04
Contract - ancillary	0.00	0.00	0.00	0.00	0.00
Contract – network use	2.02	2.08	2.14	2.21	2.28
Tariff- meter provision	3.75	4.62	4.87	5.12	5.38
Tariff - meter reading (including special meter reads- an ancillary service)	0.69	0.85	0.90	0.95	0.99
Tariff – ancillary disconnection and reconnection	0.03	0.03	0.03	0.03	0.03
Tariff - network use	49.52	61.51	65.13	67.59	70.28

Note: ActewAGL Distribution has projected the earlier access arrangement period split between meter communications and meter provision for the access arrangement period.

11.2.3 Relationships between costs and revenues

In addition to a description of the proposed allocation of costs and revenues, the NGR require information on the relationship between costs and tariffs for tariff classes and reference services. The NGR include requirements regarding costs and expected revenues from tariff classes and reference tariffs.

11.2.3.1 Standalone and avoidable costs

Rule 94 states that for each tariff class, the revenue expected to be recovered must lie between the standalone cost of providing the reference service to customers who belong to that class (upper bound) and the avoidable cost of not providing the reference service to those customers (lower bound).

The standalone cost for a tariff class is the cost that would be incurred if only that customer group were supplied. Any costs that would otherwise be shared with other customer groups would have to be fully attributed to the standalone customers. The standalone cost is effectively the cost of replicating or bypassing the infrastructure. The avoidable cost for each tariff class is the cost that would be avoided if the customers in that class were removed from the network. Avoidable costs are therefore all costs that can be directly attributed to that customer group. Any cost incurred in jointly supplying other customers is not part of the avoidable cost, as it would still be incurred to supply the other customers.

The purpose of the standalone and avoidable cost test is to ensure that there are no cross subsidies between tariff classes. It is also designed to discourage inefficient bypass of the pipeline, which may occur if prices are above the standalone cost. If any tariff class, or group of customers, is paying less than the lower bound of the avoidable cost, or the costs that arise directly from its use of the pipeline, then it is receiving a subsidy. If any tariff class is paying more than the upper bound of the stand alone cost, or the cost if it alone was supplied, then it is subsidising other users. If the revenues from each group lie between the bounds of avoidable cost and stand alone cost, then each group is making some contribution to covering the joint or shared costs of supply. However, no group is receiving or paying an economic subsidy.

In applying this requirement to ActewAGL Distribution, it is important to note the dominance of the tariff market. The tariff segment of ActewAGL Distribution's gas market accounts for approximately 99.6 per cent of customers and 86 per cent of sales. Contract customers represent a very small part of the market and are allocated an appropriately small share of costs.

The standalone cost for ActewAGL Distribution's tariff customers is therefore very close to the total cost of providing the network services. It is equal to total cost less those costs that are directly related to contract customers (and would not be incurred in the absence of the contract customers). The relevant contract customer costs to be deducted are the contract operating, meter and ancillary service costs.

The avoidable cost for the tariff customer class is the cost that would be avoided if tariff customers were not supplied. In principle, if tariff customers were excluded, then it would not be viable at all for ActewAGL Distribution to be supplying gas. In this sense the avoidable cost would be the full cost of the network—that is, without the tariff customers there would be no network and therefore all costs would be avoided. However, if it is assumed that the network would continue to exist, then avoidable costs for tariff customers would be defined as those costs which are directly attributable to tariff customers and hence would be avoided if they were not supplied. These avoidable costs would be the operating and meter costs.

Avoidable and standalone costs tariff classes are shown in Table 11.5

Table 11.5 Avoidable and stand alone costs (2010/11)

$ million nominal	Avoidable Cost	Expected Revenue	Stand-alone Cost
Contract Class	1.35	2.60	32.61
Tariff Class	23.97	53.99	55.23

The expected revenue recovers the total cost of the contract and tariff class reference services. The stand alone cost for contract customers is calculated as the total cost less the avoidable cost of the tariff customers. Similarly, the stand alone cost for tariff customers is calculated as the total cost less the avoidable cost of the contract customers.

The costs and revenues of the contract class are derived from the Capacity Reservation Reference Service, the associated Meter Data Reference Service that relates to that service and associated Ancillary Services. While there are other Reference Services listed, there are no customers taking those services. The costs and revenues of the Tariff Class are derived from the Tariff Reference Service, the

Meter Data Reference Service and the Ancillary Services that relate to the tariff service. The Meter Data Reference Service and the Ancillary Services are an integral part of each of the pipeline services, as discussed above, and do not have their own avoidable or stand alone cost.

11.2.3.2 Long run marginal cost and transactions costs

The NGR also include requirements regarding long run marginal cost and transactions costs. Rule 94 says that each charging parameter for a tariff class must:

- take into account the long run marginal cost for the reference service or the element of the service to which the charging parameter relates; and
- be determined having regard to transaction costs and the ability of customers to respond to price signals.

The purpose of the long run marginal cost requirement is to ensure that prices signal to customers the forward-looking costs of expanding pipeline capacity, where appropriate.

The long run marginal cost is the cost of providing an increment in capacity. It includes the capital costs associated with the increment in capacity as well as the additional operating and maintenance costs. At times when pipeline utilisation is at or near capacity levels, prices should signal the costs of expanding capacity rather than the short run marginal costs which do not include capital related costs.

While the stand alone and avoidable cost requirement involves a specific requirement that revenues are within certain bounds (between stand alone and avoidable costs), the long run marginal cost requirement refers factors that are appropriate and necessary to be *taken into account*.

ActewAGL Distribution has provided indicative long run marginal costs of expanding the pipeline service to provide incremental capacity in the form of new customers. Excluding meter costs, these are estimated as follows:

- $1.24 per GJ to supply a government department;
- $2.28 per GJ to supply a retail market facility; and
- $4.64 per GJ to supply two residential developments estimated to supply 341 households.

These long run marginal costs are calculated as the amount per GJ required to recover the cost of the capital expenditure over a life of 15 years and applying a rate of interest assumed to be the post-tax nominal WACC of 11.08 per cent. They are the incremental cost of linking new customers to an existing pipeline network. They do not include the cost of providing the upstream network which is assumed to have the capacity to take the additional load. ActewAGL Distribution takes account of long run marginal cost, transactions costs and price responsiveness when setting reference tariffs. Reference Tariffs recover the long run marginal cost or the incremental cost of a new customer or group of customers. In addition, they must recover the cost of providing the upstream network. Therefore, Reference Tariffs must be higher than the long run marginal cost.

11.2.3.3 Charging parameters

Contract customers have a choice of two charging parameters, a capacity charge and a throughput contract customers to manage their daily demand. The Throughput Reference Service would suit a customer with a variable load as it has only a throughput charge and does not have a capacity charge. There are no customers in the ACT region that have chosen this service.

Contract customers have separate parameters for meters that reflect the varying cost of meters with different capacities. Meter communications costs and meter reading costs do not vary with the capacity of the meter. However, where a customer has multiple meters and multiple meter sites, meter communications and meter reading charges may apply to each meter, depending upon the location of the meters.

Reference tariffs for tariff customers have fixed, throughput, metering and meter reading parameters. They do not include capacity charges. ActewAGL Distribution has assessed that the transactions costs involved in moving from the relatively simple tariff structure, comprising a throughput charge and a fixed charge, to one with capacity charges would more that offset any potential benefits of signalling the cost of providing capacity, particularly when capacity constraints are not binding. Relevant transactions costs include the costs of more sophisticated metering, the costs of more complex billing and the costs to customers of understanding, and responding to, a more complicated tariff structure.

The fixed charge signals the cost of connecting and maintaining a connection service to the consumer. Where a customer does not require a service, it encourages the customer to disconnect and lower the cost of providing network services.

There are 4 price steps in the throughput charges for the tariff service. The first two price steps are of most relevance to the majority of residential consumers. The first step is the highest and is the marginal price faced by consumers consuming at the rate of up to 15 GJ per annum such as those that may use gas only for cooking. Customers with this level of consumption have a more price inelastic load. About 25 per cent of the residential load is consumed in this price step and 2 per cent of the business load.

The second step is 21 per cent lower than the first step and applies to around 75 per cent of the residential load and 47 per cent of the business load. It is the marginal cost faced by customers consuming at the rate of more than 15 GJ and less than 1 TJ per annum. Residential customers faced with this step are known to be relatively more price sensitive. It is the marginal price that is likely to apply to residential consumers with space heating and hot water appliances. It is also the marginal price that is faced by most small business consumers.

The third step is 9 per cent lower than the second step and applies to 39 per cent of the business load. It is the marginal price faced by larger, primarily business, customers consuming at the rate of more than 1 TJ and less than 5 TJ per annum.

The fourth step is 30 per cent lower than the third step and applies to 13 per cent of the business load. It is the marginal price faced by customers consuming at the rate of more than 5 TJ per annum who do not qualify or have not moved to a contract service. This step is the intermediate rate between tariff services and contract services.

There are two metering charge options for tariff customers. For those with a meter capacity of less than 6 cubic meters per hour, there is a fixed annual charge. For meters with a capacity of more than 6 cubic charge options for tariff class customers depending upon whether the meter is read quarterly or monthly.

There are four Ancillary Services available to both Contract and Tariff customers. However, the Request for Service charge is relevant only to contract customers and the other charges (special meter read, reconnection fee and disconnection fee) are relevant mainly to tariff customers.

11.2.3.4 Revenue equalisation

Rule 92(2) requires that the reference tariff variation mechanism be designed to equalise (in terms of present values) 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.

Capacity reservation service

The revenue requirement for the capacity reservation service customers using the building block approach for contract customers is as shown in Table 11.6.

Table 11.6 Revenue requirement for capacity reservation service customers

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Contract revenue	2.09	2.59	2.77	2.86	2.94

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $9.627 million.

The proposed revenue stream in nominal dollars using the building block approach for contract customers is as per Table 11.7.

Table 11.7 Proposed revenue stream for capacity reservation service customers

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Contract revenue	2.48	2.54	2.62	2.70	2.78

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $9.62 million which is equal to the revenue requirement.

Tariff service

The revenue requirement for the tariff service customers in nominal dollars using the building block approach for contract customers is as per Table 11.8.

Table 11.8 Revenue requirement for the tariff service customers

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Tariff revenue	53.25	66.14	70.60	72.80	75.03

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $245.28 million.

The proposed revenue stream for the tariff service customers in nominal dollars using the building block approach for contract customers is as per Table 11.9.

Table 11.9 Proposed revenue stream for tariff service customers

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Tariff revenue	53.30	66.16	70.03	72.75	75.69

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $245.28 million which is equal to the revenue requirement.

Meter data service

The revenue requirement for the meter data service in nominal dollars using the building block approach for contract customers is as per Table 11.10.

Table 11.10 Revenue requirement for the meter data service

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Meter data revenue	0.790	0.981	1.047	1.079	1.113

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $3.61 million.

The proposed revenue stream for the meter data service in nominal dollars using the building block approach for contract customers is as per Table 11.11.

Table 11.11 Proposed revenue stream for the meter data service

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Meter data revenue	0.808	0.972	1.024	1.075	1.127

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $3.61 million which is equal to the revenue requirement.

Ancillary service

The revenue requirement for ancillary services in nominal dollars using the building block approach is included in the revenue requirements for capacity reservation services, tariff services and meter data services. The proposed revenue stream from ancillary services is included in the respective revenue streams for each service. A separate statement of revenue for ancillary services is provided in Table 11.12.

Table 11.12 Proposed revenue stream for ancillary services

$million nominal	2010-11	2011-12	2012-13	2013-14	2014-15
Ancillary service revenue	0.155	0.163	0.172	0.181	0.190

When discounted at the nominal vanilla WACC of 11.08 per cent, the net present value of these revenues is $0.629 million.

Other reference services

While there are other reference services available, there are no customers taking those services or expected to take them.

Box H.4 Replacement text for section 11.3.1 of June 2009 access arrangement information

11.3.1 Annual reference tariff adjustment formula mechanism

Rule 97(1)(b) states that a reference tariff variation mechanism can provide for the variation of a reference tariff in accordance with a formula set out in the access arrangement. ActewAGL Distribution proposes to include an annual reference tariff adjustment formula mechanism in its reference tariff variation mechanism in the access arrangement.

ActewAGL Distribution's previous access arrangement included an annual tariff variation formula in its tariff variation mechanism to escalate prices by CPI. ActewAGL Distribution proposes to retain this annual tariff variation adjustment.

ActewAGL Distribution considers that this approach is consistent with the NGL Objective, and with Rule 97(3)(a), which requires the AER to have regard to the need for efficient tariff structures in deciding on a reference tariff variation mechanism.

11.3.1.1 Proposed annual tariff variation formula

In accordance with the earlier access arrangement period, ActewAGL Distribution proposes that all Reference Tariffs be varied by CPI each year by the following formula.

$$P_t = P_t^*(1 + CPI_t)$$

Where:

P_t is the varied Reference Tariff for the relevant financial year t, rounded to the same number of decimal places for that Reference Tariff, as provided in Attachment 3 of the Access Arrangement;

P_t^* is the unadjusted Reference Tariff, in 2010/11 dollars, for the relevant financial year t, as set out in Attachment 3 of the Access Arrangement;

CPI_t is the result of the formula in clause 6.4, which is a decimal number, rounded to 4 decimal places;

t is the financial year for which Reference Tariffs are being varied.

CPI_t is calculated in accordance with a formula in the access arrangement as follows:

$$CPI_t = \left(\frac{CPI_{Mar\ t-2} + CPI_{Jun\ t-2} + CPI_{Sep\ t-1} + CPI_{Dec\ t-1}}{CPI_{Mar\ 2009} + CPI_{Jun\ 2009} + CPI_{Sep\ 2009} + CPI_{Dec\ 2009}} \right) - 1$$

Where:

CPI_{Mar} means the Consumer Price Index Number "All Groups, Australia", for the March quarter (and similarly for other quarters), published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Relevant Regulator that is its best estimate of the index.

CPI$_{Dec2009}$ means the CPI for the December quarter for the year 2009 and similarly for other quarters.

Year t is the financial year for which Reference Tariffs are being varied.

Year t-1 is the financial year previous to year t and, where relevant, refers to quarters within that previous financial year.

For example, the CPI_t value to be applied in respect of the year ending 30 June 2012 is calculated as:

$$CPI_{2012} = \left(\frac{CPI_{Mar\ 2010} + CPI_{Jun\ 2010} + CPI_{Sep\ 2010} + CPI_{Dec\ 2010}}{CPI_{Mar\,2009} + CPI_{Jun\,2009} + CPI_{Sep\,2009} + CPI_{Dec\,2009}} \right) - 1$$