Attachment 4: Efficient delivery of services to consumers

Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement

Submission to the Australian Energy Regulator

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4 Efficient delivery of services to consumers

Key points

- ActewAGL Distribution's founding principle of synergy flows through its corporate structure and service delivery model ensuring the efficient delivery of services to consumers.
- The ActewAGL Distribution partnership structure ensures ActewAGL Distribution's consumers receive gas network services at the lowest sustainable cost, benefiting from local experience combined with economies of scale and economies of scope in the delivery of services.
- The Distribution Asset Management Services (DAMS) Agreement outlines the interface between Jemena Asset Management (JAM) (previously Agility) and ActewAGL Distribution. Within the 2010-16 access arrangement period, the initial DAMS Agreement was refreshed to maintain the synergies and achieve efficiencies by consolidating the set of agreements, improving transparency, applying new service standards and key performance indicators (KPI) and resetting the unit rates for capital works which had diverged from costs over 10 years.
- ActewAGL Distribution's governance of the gas network comprises three layers (ActewAGL Distribution governance, the DAMS Agreement and JAM governance systems) dovetailing together to provide a reinforced and robust governance process.

ActewAGL Distribution has a long and proud history of owning and operating a gas network that delivers safe, reliable and affordable gas network services to over 130,000 homes and businesses across the Australian Capital Territory (ACT), Queanbeyan and Palerang region. Customers, stakeholders and the community depend on a high level of service every day to enhance their lifestyle and support their businesses.

This attachment explains how ActewAGL Distribution's corporate structure, service model and internal governance processes support the effective and efficient delivery of services to its customers both now and in the future. These frameworks and agreements underpin the delivery of capital and operating programs at the lowest sustainable cost. As such, this attachment should be read before attachment 5 and attachment 6 to enable a full understanding of ActewAGL Distribution's operating and capital expenditure (capex) proposals.

A fundamental element of the approach to service delivery is that consumers of ActewAGL Distribution's gas pipeline services benefit from its owners—Icon Water (formerly ACTEW Corporation) and Jemena Networks (ACT) (formerly part of the Australian Gas Light Company (AGL))— bringing over 250 years of combined experience and expertise in the ownership and management of essential infrastructure across Australia. The partnership, established in 2000, realised synergies of ACTEW Corporation's management of electricity, water and sewerage assets in the ACT with AGL's ownership of gas assets in New South Wales (NSW) and elsewhere.

JAM provides gas network service delivery and management services to ActewAGL Distribution. This arrangement has and will continue to allow ActewAGL Distribution to pass on the benefits of JAM's expertise and economies of scale in service provision to its consumers. The model allows ActewAGL Distribution to provide its consumers with services below the cost of those which could be provided by a standalone operator the network.

The agreement between ActewAGL Distribution and JAM sets out the manner in which services are provided, the roles and responsibilities of various parties and the fees payable by ActewAGL Distribution. Importantly, the agreement ensures the prudent and efficient management of the gas network to the benefit of ActewAGL Distribution's consumers. In many ways, these arrangements are the same as those Jemena Gas Networks (JGN) has established for the management of its gas network.

This attachment is structured as a chronological account of the development of the ActewAGL Distribution partnership and the evolution of the subcontracting model and services agreements.

The first section (4.1) sets out the rationale behind the establishment of the partnership and how this structure promotes the long-term interests of consumers. In addition, it chronicles the ownership changes that have occurred since the establishment of the partnership in 2000.

The second section (4.2) discusses explains the DAMS Agreement. The DAMS Agreement is the services agreement governing asset management and service delivery by JAM to ActewAGL Distribution. This section sets out the roles and responsibilities of the two parties, and the efficient basis for the fees payable by ActewAGL Distribution. This section also describes the evolution of the DAMS Agreement since the formation of the partnership in 2000.

The last section (4.3) describes the key elements of ActewAGL Distribution's governance framework which ensures that the full benefits of the DAMS Agreement are achieved for the long-term interests of gas customers.

This attachment focuses on the ongoing prudence and efficiency of the subcontracting arrangements over the period from 2000 to 2021. Details on operating expenditure (opex) and capex during the 2010-16 access arrangement period and the forecast for the 2016-21 access arrangement period are provided in attachments 5 and 6.

4.1 The ActewAGL Distribution partnership

The natural gas network first became available in the ACT in 1982 and has expanded progressively since this time. The initial development of the network was undertaken by AGL which owned and operated the gas networks in Canberra and the surrounding region. Electricity services were provided by ACTEW Corporation, an ACT Government-owned corporation.

In October 2000, ACTEW Corporation and AGL entered into a multi-utility joint venture comprised of two partnerships:

- ActewAGL Retail owned equally by ACTEW Corporation and AGL, via subsidiary companies with responsibility for retailing; and
- ActewAGL Distribution owned equally by ACTEW Corporation and AGL via subsidiary companies with responsibility for the distribution networks.

The agreement between ACTEW Corporation and AGL partners focused on realising the synergies of ACTEW Corporation's management of electricity, water and sewerage assets in the ACT with AGL's ownership of gas assets in NSW and elsewhere. The principles of synergy and economies of scale and scope were formalised in the agreement to the benefit of customers. This agreement states:

> *During the term of this agreement, the parties will work together to identify and realise synergies between the Partnerships' gas, electricity and water and sewerage operations and maintenance businesses and to agree on appropriate structures for the management of the businesses of the Partnerships.*

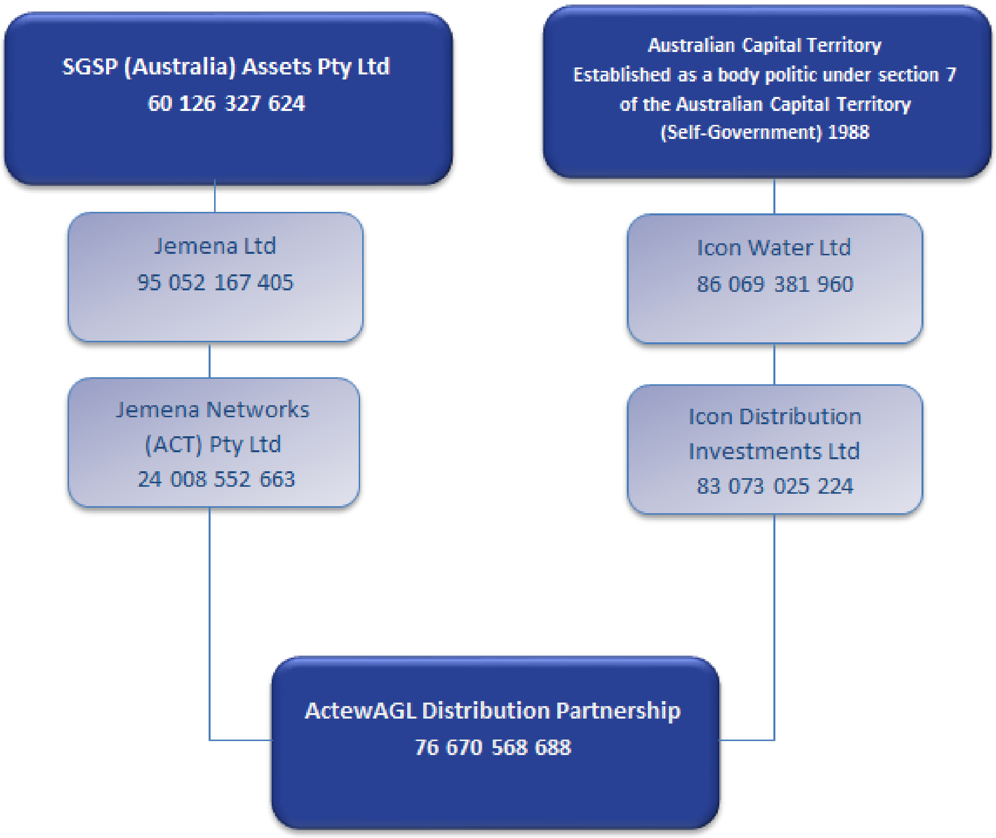
The benefits of the joint venture arrangement to ActewAGL Distribution were twofold. Firstly, the partnership achieved economies of scope through the multi-utility nature of its operations and its focus on and understanding of the ACT and surrounding regions. At the time of entering into the partnership, ActewAGL Distribution's activities included gas, electricity, water and wastewater operations and maintenance. While water and sewerage operations are no longer undertaken by ActewAGL Distribution, corporate services are still provided to ACTEW Corporation, now called Icon Water.

While ActewAGL Distribution was (and remains) responsible for the strategic direction of the two distribution networks, the foundation of the partnership was that the electricity and gas networks were operated and managed by ActewAGL Distribution and AGL respectively. Economies of scale were able to be accessed through AGL, a highly experienced gas network asset manager and operator.

The allocation of responsibilities for the gas network between the partners was enacted through the DAMS Agreement and the ActewAGL Distribution Asset Management Services Supplementary Agreement for Routine Mains and Customer Service Connections (the Supplementary Agreement). The DAMS Agreement was established upon inception of the partnership between the joint venture and Agility Management Pty Limited (Agility) with the Supplementary Agreement established shortly thereafter. Agility was a wholly-owned subsidiary of AGL and provided asset and management services and delivery of capital and operating projects for AGL's gas networks.

Since the establishment of the ActewAGL Distribution partnership the ownership of one of the partners has changed and both entities have changed names. While there have been ownership and name changes, the fundamental principle that gas network services are provided by the partner with this expertise has remained. For simplicity, this attachment refers to ACTEW Corporation, AGL and Agility during the discussion on the initial DAMS Agreement and Icon Water, Jemena, JAM, Zinfra and ZNX(2) Pty Ltd for the new DAMS Agreement. The current ownership structure of ActewAGL Distribution is shown in Figure 4.1.

Figure 4.1 Current ActewAGL Distribution partnership ownership



4.2 *The Distribution Asset Management Services Agreement*

The DAMS Agreement has its origins in a DAMS Agreement that commenced in October 2000, and a Supplementary Agreement that commenced in 2002 (together the 'initial DAMS'). These initial Agreements were renegotiated from 2010 to 2013, with the current consolidated Agreement (the 'new DAMS Agreement') coming into effect on 1 July 2013. This section outlines the key features of both agreements, how the initial DAMS Agreement was refreshed, and the efficiency incentives within the agreements.

4.2.1 The initial DAMS Agreement

The initial DAMS Agreement was established with the formation of the joint venture between ActewAGL Distribution and Agility Pty Ltd (a wholly-owned subsidiary of AGL) for gas network operations and maintenance services in the ACT and Queanbeyan.

The agreement defined the commercial and operational relationship between ActewAGL Distribution and Agility, and included the scope of services, responsibilities, performance measures and penalties.

A summary table of the key elements of the initial DAMS Agreement is provided in Figure 4.2 at the end of this section.

The initial DAMS Agreement structured costs into the following categories:

- management services and asset services;
- other opex charges;
- routine capital works; and
- non-routine capital works.

Each of these is discussed below along with a summary of the incentives in place.

4.2.1.1 Management services and asset services

The fee for management services in the first year of operation (i.e. 2000) was based on historical costs incurred for the relevant activities prior to the establishment of the partnership. In addition, a margin was included to account for risk in providing a fixed price service. Agility was subject to key performance indicators (KPI) contained in the DAMS Agreement. The total management services fee (inclusive of the management services margin) was escalated annually.

4.2.1.2 Other opex charges

In addition to the management services and asset services, during the 2010-16 access arrangement period, fees were sought, and approved by AER, with respect to a utilisation fee, a contestability fee and a marketing fee.[1] These fees were for additional services not included in the original management services or asset services fees.

4.2.1.3 Routine capital works

In an additional agreement to the DAMS Agreement, Agility also provided capital works under the Supplementary Agreement. The Supplementary Agreement was signed on 17 July 2002 and related to the provision of capex services.

For routine works, the Supplementary Agreement contained a schedule of unit rates for conducting the majority of routine capital works associated with network expansion and customer connections. The rates were escalated on an annual basis from 2002 until 2013.

In 2004, ActewAGL Distribution engaged Parsons Brinckerhoff to assess the capital works unit rates and capital project costs. The review concluded that the unit rates and capital project costs of ActewAGL Distribution were efficient and reasonable.[2]

Similarly, the AER investigated the capex unit rates as part of the 2010 access arrangement review process. The AER's consultants Wilson Cook reviewed ActewAGL Distribution's proposed capex unit rates, with the AER making the following conclusion in its draft decision:

[1] As part of the new DAMS Agreement from 2013, the contestability fee and marketing fee were incorporated into the Management Fee and the Utilisation Fee into the Asset Services Fee.

[2] Parsons Brinckerhoff, 2004, *Review of ActewAGL Gas Network Capital and Operating Expenditure*, pp. 30-31.

To provide an independent assessment of the rates underlying the forecast capital expenditure ActewAGL engaged Parson Brinckerhoff (PB), who found the rates to be acceptable. Wilson Cook reviews the PB's report and considers that the PB's methodology and findings can be relied on without the need for Wilson Cook to recalculate or reassess them.[3]

4.2.1.4 Non-routine capital works

Non-routine works were reviewed and approved by ActewAGL Distribution on a case-by-case basis via a separate business case assessment process. All business cases under the old DAMs were charged at a fixed price with JAM bearing the risk. Two forms of business case were used—an Additional Services Request (ASR) for low complexity projects and a capital works Authorisation (CWA) for more complex projects such as multi-year construction projects. The business cases were endorsed by JAM and passed to ActewAGL Distribution for review and approval. Where appropriate, ActewAGL Distribution sought external expertise to assess the prudence and efficiency of the capital project.

Specific business cases were also required for all routine capital projects over $100,000 and any project that had a non-routine capital component regardless of the value. Any significant scope changes or variations required ActewAGL Distribution approval as part of the Client Acceptance Report (CAR) process. The CAR process provided a close-out loop that ensured ActewAGL Distribution only approved payment for scope and variations (if any) it had approved. The CAR process applied to both ASR and CWA business cases.

There is an established processes for agreements between a single partner of ActewAGL Distribution and ActewAGL Distribution. Before an agreement is entered into the other distribution partner must be notified if the value exceeds a set threshold. If the value exceeds a higher threshold, then approval must be sought from the other distribution partner.

4.2.1.5 Incentives within the initial DAMS

The DAMS Agreement and Supplementary Agreement contained a suite of incentives to ensure continual improvement in service delivery and therefore reduced cost to customers.

Notwithstanding that cost efficiencies were expected to flow primarily from the economies of scale and scope of the service provider, the agreements contained provisions for Agility and ActewAGL Distribution to work together to improve efficiencies and realise synergies. Where such synergies were identified, the services could be removed from the scope of services covered by the DAMS Agreement and instead be provided in-house by ActewAGL Distribution. Examples of where ActewAGL Distribution identified synergies and removed services from the scope of the DAMS Agreement included:

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[3] AER, 2009, *Draft Decision, ActewAGL, Access arrangement proposal, ACT, Queanbeyan and Palerang gas distribution network 1 July 2010-30 June 2015*, p. 23.

- digital mapping services for new assets and 'dial-before-you-dig' membership and response; and
- meter reading (undertaken by a direct contract between ActewAGL Distribution and Fieldforce Services to realise cost savings from readings across water, gas and electricity).

The fees in the initial DAMS Agreement were fixed, effectively transferring service delivery risk to Agility. The agreements also set out a number of KPI, measures and targets that Agility was required to meet, such as customer service, supply failure, timing and budget of capital works. Agility faced financial penalties, primarily in the form of reductions to the margin if these targets were not met.[4]

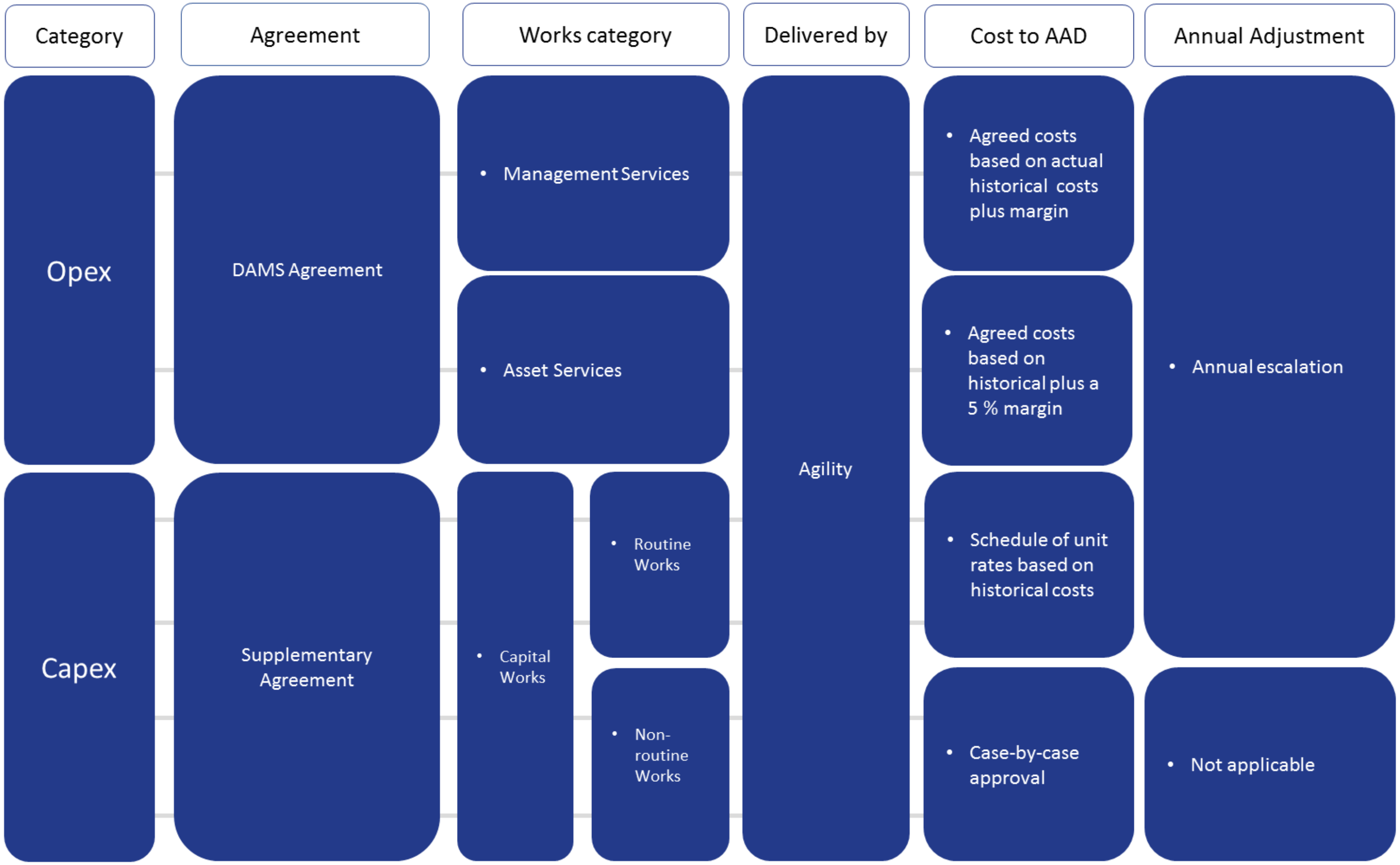
The incentives contained in the DAMS Agreement are summarised in Table 4.1.

Table 4.1 Efficiency mechanisms, including incentive provisions, in the 2000-2013 DAMS Agreement and Supplementary Agreement

Cost category	Incentive
Management services	• Annual review of costs by ActewAGL Distribution and approval of Services Plan, including approval by ACTEW Corporation. • Financial penalties if KPI not achieved
Asset services	• Annual review of costs by ActewAGL Distribution and approval of Services Plan • Financial penalties if KPI not achieved
Routine capital works	• Annual review of costs by ActewAGL Distribution and approval of Services Plan, including approval of ACTEW Corporation
Non-routine capital works	• Annual review of costs by ActewAGL Distribution and approval of Services Plan, including approval of ACTEW Corporation • Market analysis, external quantity surveyor reports, benchmarking, or similar, as required

[4] DAMS Agreement Schedule 2.

Figure 4.2 The initial DAMS Agreement



4.2.2 The DAMS refresh

ActewAGL Distribution, JAM[5] and ACTEW Corporation[6] agreed to refresh the DAMS Agreement, with this process commencing in 2010. The rationale for refreshment of the agreement was to retain the synergies of the arrangement while:

- achieving operational efficiencies from consolidating the DAMS Agreement and the Supplementary Agreement;
- improving transparency;
- applying new service standards and KPI for management services on JAM, which had clearer corrective and material breach levels; and
- addressing a growing divergence which had emerged over the life of the Supplementary Agreement between capex routine unit rates and the underlying cost of service provision, with some unit rates below and some above the cost of provision.

Negotiations took place throughout 2010 to 2013 with the revised DAMS Agreement taking effect from 1 July 2013 (the commencement date of the new contract year for 2013/14). As Singapore Power International Pty Ltd owned 50 per cent of ActewAGL Distribution (through Jemena), as well as 100 per cent of JAM, the renegotiation was undertaken between Jemena, ActewAGL Distribution and ACTEW Corporation.

4.2.3 The new DAMS Agreement

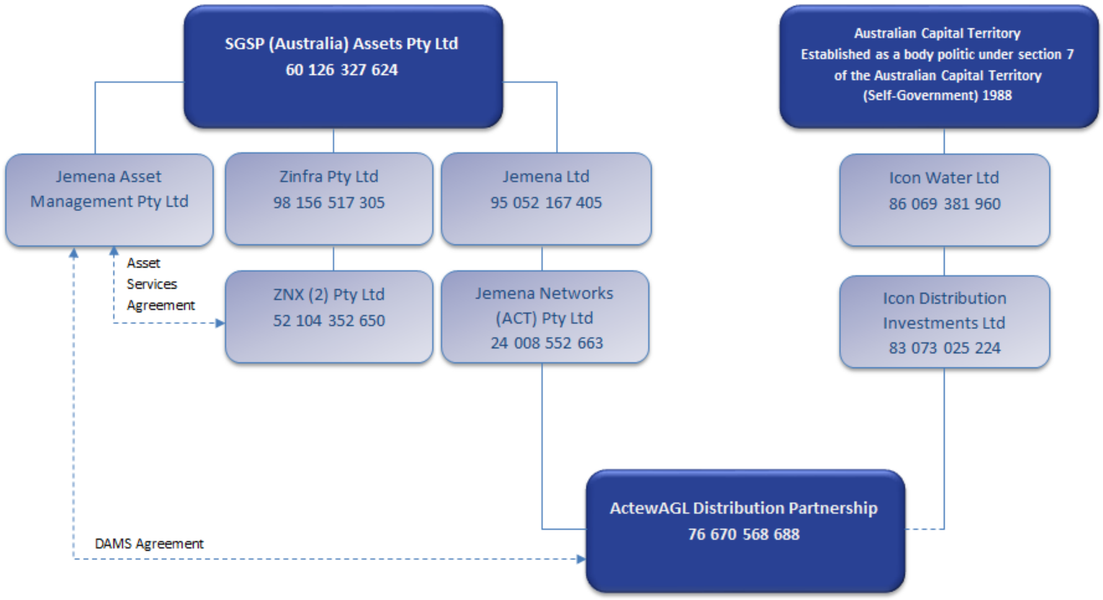
The outcome of the refresh was a streamlined agreement which addressed the rationale for the renegotiation including increased transparency, alignment of costs and fees and updated service standards and KPI. A summary table of the new DAMS Agreement is provided in Figure 4.4 at the end of this section.

The DAMS Agreement established between ActewAGL Distribution and JAM was supported by an agreement between JAM and ZNX(2) known as the Asset Services Agreement (ASA). Under the ASA, JAM subcontracts to ZNX (2) for one opex service (asset services) and all of the capital services except non-routine capital works with a value greater than $500,000. The current organisational structure of the partnership and the associated agreements is shown in Figure 4.3.

[5] Agility was renamed Jemena Asset Management in 2008.

[6] Renamed Icon Water in 2014.

Figure 4.3 Partnership structure and agreements



The charges within the new DAMS Agreement are summarised in the sub sections below, along with the incentives within the new DAMS Agreement.

4.2.3.1 Management services

Management services relate to management and planning of the operations and maintenance of ActewAGL Distribution's gas network, including oversight of ZNX(2). This arrangement benefits consumers as ActewAGL Distribution is able to take advantage of JAM's scale and expertise. An example of this is a single control centre operated by JAM for both the JGN NSW networks and the ActewAGL Distribution gas networks.

The annual budgeted costs of management service is based on prior year costs which are adjusted annually for changes in CPI, along with any annual scope changes to the services contract approved by ActewAGL Distribution. Each year, any discrepancy between forecast and actual costs incurred is trued up with an annual reconciliation. As this annual 'true-up' mechanism applies, effectively no margin is earned by JAM.

4.2.3.2 Asset services

Asset services relate to delivery of the operations and maintenance services of ActewAGL Distribution's gas network. These services are provided to ActewAGL Distribution by JAM who engage ZNX(2) under the ASA. The cost of providing services is based on ZNX(2)'s costs. A margin is included on the basis that ZNX(2) is exposed to risk associated with being responsible for the operation and maintenance of the network against contractual KPI for service performance and is subject to reductions in the margin earned for non-performance.

The margin charged by ZNX(2) for all routine services is [cic [redacted]] which is consistent with five and ten-year EBIT margin benchmarks (5.1-7.3 per cent and 5.4-7.2 per cent), found by an independent expert for JGN. [7] The margin is therefore consistent with the margins earned by other contractors providing asset management services in Australia.

The Asset services fee is adjusted annually for changes in CPI. An annual 'true-up' mechanism exists for any discrepancies via the asset services adjustment quantity which realigns JAM's asset services target cost estimate with actual allocated costs. However, should ZNX(2) realise efficiencies in the provision of asset services, it is able to keep 100 per cent of these savings for that one contract year, with costs rebased to the lower actual costs in the following contract year. In some years ZNX(2) may earn above (or below) the ex-ante [cic [redacted]] margin, which creates an incentive to find efficiencies, thereby lowering costs for consumers in the long term.[8]

4.2.3.3 Capital charges

JAM subcontracts all routine capital works and projects below $500,000 to ZNX(2). For routine capital works, the charges are made up of two components which reflect the underlying cost structure—a fixed construction management fee (CMF) and a series of unit rates.

The CMF includes costs related to the management of the resources to deliver the capital plan, project management of routine capital works and minor and medium non-routine capital works, construction field supervision and quality assurance of capital works. The unit rates include the marginal cost in undertaking the work.

Both the unit rates and the CMF have been benchmarked and found to be efficient. The benchmarking was made possible by JAM's decision to split its NSW network into Northern and Southern regions. JAM conducted an open competitive tender in the Northern Region to appoint subcontractors in four sub-regions to carry out construction, repair and maintenance services from 1 July 2013 and to establish market-tested prices for the provision of these services. JAM then undertook arms-length negotiations with Zinfra, for the provision of an equivalent scope of services in the Southern Region, with pricing to match or better the Northern Region tender outcomes for similar risk activities. Further details on Jemena's splitting of the Northern and Southern regions is provided in appendix 4.3.

As part of the JGN access arrangement process, the AER reviewed the change in arrangements and concluded that:

> *We reviewed the tender documents, the tender assessment and the decision to award the four contracts* [for each of the 4 Northern sub-regions]. *We are satisfied that this was a competitive tender process. As it was a competitive tender price, we are satisfied that the*

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[7] K Lowe Consulting 2014, *Contractor Profit Margins (Benchmark Study: 2004-2013)*, p. 3.

[8] ZNX opex margins for 2012/13, 2013/14 and 2014/15 are [cic [redacted] respectively. Note that during 2012/13 interim arrangements applied during the transition from the initial to new DAMS Agreement, and entry of ZNX(2). Additionally, significant changes to Jemena's financial systems occurred. Jemena considers the estimates to be reasonable.

> *unit rates established in the contracts reflect competitive unit rates prevailing in the market. On this basis we are satisfied that the unit rates drawn from these contracts which form the basis of estimates used in JGN's proposed capex are efficient.*[9]

The market information generated from the process was also used to test ZNX(2)'s proposed unit rates in respect of the ACT, Queanbeyan and Palerang gas network. JAM matched the proposed price for activities against those from the preferred tender in the central coast sub-region. The central coast region, the region with the lowest cost of all sub regions, was selected due to similar characteristics. The market rates were benchmarked against ZNX(2)'s proposed gas main and service connection costs, which represent about 54.5 per cent of routine construction works. Other prices could not be compared on an equal basis. However, ZNX(2)'s proposed metering prices (44.6 per cent of the remaining program of works) were instead benchmarked against JAM's internal costs for materials and labour. Overall, 99 per cent of routine construction works were benchmarked. In aggregate, ZNX(2)'s proposed prices were marginally (approximately one per cent) lower than the benchmark.

Evans and Peck reviewed the JAM pricing methodology including the regional matching methodology and Northern Region tender process. Evans and Peck found the difference between the ZNX(2) unit rates and ZNX(2) CMF, and the benchmark within an acceptable range. Based on this independent verification, ActewAGL Distribution accepted these costs and executed the refreshed DAMS Agreements. The Evans and Peck report is provided in appendix 4.2.

As with the asset services fee for opex, included in the benchmarked unit rates and the CMF is a [cic [redacted]] margin in return for the exposure to risk faced by ZNX(2) in delivering these services. ZNX(2) is able to achieve a higher margin if it can lower costs relative to the fixed unit rates.[10] The unit rates are scheduled to be reset and benchmarked every five years against market prices.

ActewAGL Distribution also notes that the CMF is not a new fee but represents the costs included in other fees in the initial DAMS Agreement. These costs have been reclassified as a capital cost to better reflect the nature of the works undertaken.

Non-routine works are those not substantially covered by the unit rates, for example, 'one-off' or unique works. Non-routine works with a value of less than $500,000 are sub-contracted by JAM to ZNX(2). In these cases ZNX(2) provides a cost estimate which JAM reviews in accordance with its governance processes. If JAM endorses the project, the business case is then taken to ActewAGL Distribution to review and approve.

[9] AER 2014, *Jemena Gas Networks (NSW) Ltd Access arrangement 2015-20 Attachment 6: Capital expenditure, Draft decision,* p.6-47.

[10] ZNX capex margins for 2012/13, 2013/14 and 2014/15 are [cic [redacted])]respectively. Note that during 2012/13, interim arrangements applied during the transition from the initial to new DAMS Agreement, and entry of ZNX(2). Additionally, significant changes to Jemena's financial systems occurred. Jemena considers the estimates to be reasonable.

4.2.3.4 Non-routine works >$500,000

The service provider for non-routine works in excess of $500,000 is determined through a procurement process endorsed by JAM and then approved by ActewAGL Distribution. The procurement process depends on the nature, complexity and technical expertise required. ZNX(2) and Zinfra are able, like any other supplier, to bid for this work.

The business case is prepared by JAM and endorsed by ActewAGL Distribution. For large or complex projects in excess of [redacted] ActewAGL Distribution typically seeks external review, such as an independent party to perform a cost build-up and technical review to ensure scope and costs are efficient and market comparable.

Prior to entering into an agreement with ZNX(2) or Zinfra, Icon Water's approval is required, consistent with the governance process outlined in section 4.3.

4.2.3.5 Efficiency incentive mechanisms in the new DAMS

The incentives and efficiencies across each of the categories of the DAMS Agreement are shown in Table 4.2.

Table 4.2 Efficiency mechanisms including incentive provisions in the DAMS Agreement

Cost category	Incentive
All	• Transparency principle • Commitment for both parties to identify synergies and cost savings • JAM and ActewAGL Distribution both able to propose fee variations (which could come into effect for changes in cost)
Management services	• Annual review of actual JAM costs by ActewAGL Distribution and approval of Services Plan
Asset services	• Annual review and confirmation of costs and approval of Services Plan • ZNX(2) retain any underspend relative to forecast with cost set at the lower actual cost (plus margin) for the following year • Penalty payments for failing to meet KPI
Construction management services	• Part of the Capital Plan annual review of budget by ActewAGL Distribution and approval of Services Plan • Penalty payments for failing to meet KPI
Routine capital works (RCW)	• Part of the Capital Plan Annual Review of RCW programme budgets by ActewAGL Distribution and approval of Services Plan • Market benchmarked rates reset five yearly • Additional Services Requests for routine capital works that include a non-routine component (i.e. no unit rate)
Non-routine capital works (NRCW) <$500k	• Part of the Capital Plan annual review of NRCW programme budgets by ActewAGL Distribution and approval of Services Plan • JAM review and confirmation on project costs submitted by ZNX(2) • Review and approval of project costs by ActewAGL Distribution • Additional Services Requests for unexpected works
NRCW >$500k	• Part of the Capital Plan annual review of NRCW programme budgets by ActewAGL Distribution and approval of Services Plan • JAM project management (cost pass through and based on CWA approval) • Quantity surveyor cost and time reviews on large projects > [redacted] (as required by ActewAGL Distribution) • Competitive tender of (non-standard) engineering design and construction works or using ActewAGL Distribution agreed procurement method • ActewAGL Distribution control of budget and release of funds (via a CWA process) for material known project contingencies or use of any contingency that will exceed allowed project budget

Figure 4.4 The new DAMS Agreement

Category	Sub-category		Delivered by	Cost to AAD	Efficiency test
Opex	Management services		JAM	• JAM costs no margin	• Services Plans approved annually. True up between actual and forecast costs • Proposed step changes reviewed for prudency and efficiency
	Asset services		JAM (sub-contracted to ZNX via ASA)	• ZNX costs with margin	• ZNX keeps efficiency gains for one year. Costs reset to cost plus margin in following years
Capex	Construction Management Services			• Cost reflect cost structure with a fixed fee for fixed costs (Construction Management Fee) and marginal cost of units of work through unit rates	• 5 yearly benchmarking of Construction Management Fee and unit rates • Services plan approved by AAD
	Routine Capital Projects				
	Non-Routine Capital Projects	< $500k		• ZNX cost plus margin	• JAM endorsement and AAD approval of projects above 100,000
		> $500k	• PM by JAM • Construction by tender	• Cost identified through procurement method (e.g. open tender, panel) • JAM costs incurred	• AAD approves procurement methodology • AAD (and Icon Water) approve project. • External cost estimators advice sought where appropriate

4.3 ActewAGL Distribution's governance framework

ActewAGL Distribution's governance of the gas network comprises three layers.

- ActewAGL Distribution's governance from the joint ownership between Icon Water and Jemena, through the corporate and management structures and the processes employed.
- The DAMS Agreement which specifies the roles and accountabilities between ActewAGL Distribution (who retains responsibility for determining the strategic direction) and JAM. The agreement also specifies the day to day processes and procedures between ActewAGL Distribution and JAM.
- JAM's governance systems built on the knowledge and expertise in operating both the ActewAGL Distribution and JGN gas networks.

These layers neatly dovetail to provide a reinforced and robust governance process that ensures that the gas network is managed and operated in the long-term interests of consumers. How each layer of ActewAGL Distribution's governance processes works and interlocks with the other layers is discussed below.

4.3.1 ActewAGL Distribution's governance systems

As outlined earlier, ActewAGL Distribution is a partnership between Icon Water and Jemena. The partnership nature of the business has implications from the ownership level, the Board and throughout ActewAGL Distribution's corporate and management structures.

At the ownership level, neither partner can independently determine the partnership's financial and operating policies and neither partner has control of the gas networks business. Only acting together do the partners have control. This applies in respect of legal rights, practical influence and in respect of practice and patterns of behaviour.

All Board members are required to sign an undertaking that they will act in the interests of the Joint Venture, rather than their individual companies. The ActewAGL Distribution Joint Venture Board is currently comprised of three Icon Water representatives, two Jemena representatives and one AGL representative. The Icon Water Board Chairman is currently the Chairman of the ActewAGL Board.

Below the board level, there are established processes for agreements between a single ActewAGL Distribution partner and ActewAGL Distribution. Before an agreement is entered into the other distribution partner must be notified if the value exceeds a set threshold. If the value exceeds a higher threshold, then approval must be sought from the other distribution partner. As JAM provides the bulk of gas network services, Icon Water approves the agreement between ActewAGL Distribution and JAM. Generally, Icon Water is required to approve:

- the unit rates which apply for routine unit rates over a five-year period (unless a variation is made for uncontrollable circumstances);

- large non-routine capital works; ActewAGL Distribution also seeks the approval of Icon Water when the project is unusual, for instance due to the complexity of the project;
- annual services plans which include both the opex and capex budgets; and
- other aspects as needed.

Icon Water has no incentive to enter into a non-commercial arrangement. These approvals at each stage (rather than when the DAMS Agreement was entered into) ensure that arrangements reflect a commercial, arms-length outcome.

ActewAGL Distribution also has a series of processes that support the governance process including:

- the Strategic Outlook 2012-2022;
- the annual planning and expenditure cycle processes;
- the committee structure, including the Safety and Environment Committee and the Audit and Risk Management Committee which have executive management oversight and monitor the effectiveness of the safety, environment, risk and audits systems and processes;
- procurement management, including contractor management manual and plans;
- the annual reporting process, including audited annual report and financial statements, performance reporting and Regulatory Information Notice responses;
- ISO certification audits to ISO 9001, ISO 14,001 and AS 4801; and
- internal and external compliance and assurance audits.

4.3.2 The DAMS Agreement governance

As detailed in section 4.2, the DAMS Agreement provides a clear allocation of responsibilities and structure to the JAM-ActewAGL Distribution relationship for delivering gas network services for consumers.

The DAMS Agreement establishes ActewAGL Distribution's oversight of JAM's delivery of services. This oversight is implemented through the following processes.

- *Pre-financial year approval of service plans* – The services plans form the basis of the opex and capex program. The DAMS Agreement specifies the timeframes for submission and approval.
- *Monthly and quarterly reporting* – Monthly reports against the activities forecast in the services plan form the basis for monthly invoicing. Quarterly reports provide additional detail, including cost breakdowns of significant projects. ActewAGL Distribution also identifies any additional items that require further monitoring and, if necessary, actions these.

- *Post-financial year annual reporting* – JAM prepares an annual report which sets out the performance against the Services Plans and provides an explanation of differences and a comparison with previous years.

Underpinning JAM's performance are the processes and systems JAM employs for both ActewAGL Distribution and JGN's gas networks.

4.3.3 JAM processes

In providing services to ActewAGL Distribution, JAM applies the same governance systems and policies as it does for the JGN gas network. This has two key advantages.

- Achieving synergies – a consistent set of policies and procedures across the ActewAGL Distribution and JGN network avoid duplication and lowers administrative costs. However, where appropriate ActewAGL Distribution is able, as outlined in the DAMS Agreement, to set operating polices as required.
- Leveraging JAM expertise – by applying JAM's polices and systems, ActewAGL distribution is able to take advantage of the expertise and knowledge within JAM of managing the gas business. JAM is able to apply lessons learnt and experience across both networks.

The governance systems and polices neatly fit into the DAMS Agreement. An example of this is the capital governance process employed by JAM. In managing the capital program, JAM provides the same level of governance as it does for JGN. JAM reports through the DAMS Agreement to ActewAGL Distribution and provides endorsement of business cases which are then provided to ActewAGL Distribution for review and approval.

Abbreviations used in this document

Abbreviation	Full term
ACT	Australian Capital Territory
Agility	Agility Management Pty Limited
ASA	Asset Services Agreement
ASR	Additional Services Request
CAR	Client Acceptance Report
CMF	construction management fee
CPI	Consumer Price Index
CWA	capital works Authorisation
DAMS	Distribution Asset Management Services Agreement
EBIT	earnings before interest and tax
JAM	Jemena Asset Management Pty Ltd
JGN	Jemena Gas Networks (NSW) Ltd
KPI	key performance indicators
NRCW	Non-routine capital works
NSW	New South Wales
opex	operating and maintenance expenditure
RCW	Routine capital works
ZNX(2)	ZNX (2) Pty Ltd