

9 November 2012

Andrew Schille
 General Manager Regulation
 United Energy and Multinet Gas
 Pinewood Corporate Centre
 43 - 45 Centreway
 Mount Waverley VIC 3149

Dear Andrew,

Review of Network Operating Expenditure

AECOM was engaged to review Network Operations operating expenditure forecasts for the period 2013 – 2017. The forecasts were prepared by Multinet Gas. The purpose of the review was to determine whether Network Operations operating expenditure forecasts were consistent with National Gas Rules (NGR) 74(1), 74(2) and 91¹.

The purpose of this letter is to outline the findings of that review.

Findings of the review

AECOM is of the view that the forecast of Network Operations, as revised by Multinet Gas since the previous submission, is consistent with NGR 74(1), 74(2), and 91.

Table 1 below outlines the adjustments made to the forecast of Network Operations operating expenditure by Multinet Gas since the original proposal.

Table 1: Adjustments to Network Operations operating expenditure

	Total	Metering	Other	Comments
Original proposal	191.5	13.2	178.3	
Adjustments				
- Transition	(3.6)		(3.6)	Advised to AECOM by Multinet Gas
- Volume error	(5.6)		(5.6)	As a result of AECOM identifying a calculation error
- Revised labour	(4.1)		(4.1)	Advised to AECOM by Multinet Gas
- Minor contracts	0.3	0.3	0.0	Advised to AECOM by Multinet Gas
- Other	9.0		9.0	ESV levy scope change
Revised total	186.9	13.5	173.4	

Network maintenance tender costs

AECOM reviewed the forecast of network maintenance tender costs and, in doing so, found a number of calculation errors. Multinet Gas subsequently corrected those errors and as a result we are of the view that the forecasts of network maintenance tender costs are consistent with NGRs 74(1), 74(2) and NGR 91.

¹ NGR 74(1) – Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate.

NGR 74(2) – A forecast or estimate:

- a) Must be arrived at on a reasonable basis
- b) Must represent the best forecast or estimate possible in the circumstances

NGR 91 – Operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

In the majority of cases the volume of work is consistent with the previous regulatory period and activities undertaken in 2011. However, for a small number of activities included in the forecast of network maintenance tender costs AECOM was unable to establish that those activities had been undertaken in the previous regulatory period. This was due to a handful of errors and oversights in how those activities were recorded in the previous regulatory period. These are not considered material by AECOM.

Of particular note, AECOM found that Multinet Gas has procured network maintenance tender services at relatively lower cost than would otherwise have been the case had the procurement arrangement from the previous regulatory period been replicated in the forecast regulatory period. This outcome resulted from Multinet Gas procuring those services through a competitive tenderer process.

Our review of network maintenance tender costs excluded metering activities.

In-house labour expenses

AECOM is of the view that the forecasts of in-house labour expenses are consistent with NGRs 74(1), 74(2) and NGR 91, subject to the following qualifications.

AECOM is of the view that the proposed organisational structure for the forecasted regulatory period reflects common industry practice. In our experience with like utilities (electricity, water and other gas distribution businesses), the organisational structure is typical and consistent with Multinet Gas acting as a prudent and efficient utility. It is our opinion that the organisational structure developed will provide Multinet Gas with the foundation to take strong ownership of their asset base and develop efficient long-term asset management strategies for the network. Multinet Gas has sought to share functional positions with existing United Energy staff, where appropriate.

AECOM was asked by Multinet Gas to review 12 Network Operations positions that could not be reviewed by a separate consultant. AECOM has received necessary position descriptions to review five of the roles and has had discussions with relevant management in relation to those and the remaining seven positions. It is our opinion that the roles and associated salaries of these positions are reasonable, considering the context of the Multinet Gas business.

Through discussions with Multinet Gas, AECOM is of the opinion that there is no duplication between the tender service provider roles and the in-house labour positions.

Direct Costs

AECOM is of the view that the forecasts of direct costs are consistent with NGRs 74(1), 74(2) and NGR 91, subject to the following qualifications.

Of the Direct Cost items reviewed by AECOM, it was confirmed that the process undertaken by Multinet Gas to arrive at the overall costing forecasting was reasonable.

It is AECOM's understanding that an internal costing model was completed by AT Kearney, which incorporated whole of business Direct Costs. Multinet Gas advised that the AT Kearney team completed an internal cost model for United Energy in 2010, where the team were able to gain insight into the operations of the organisation. When developing the Multinet Gas internal costing model, it is AECOM's understanding that AT Kearney staff consulted with line managers to accurately forecast the organisational costs. In order to proportion the total direct costs into the organisational divisions (such as Network Operational, Legal and I.T), it is AECOM's understanding that Multinet Gas undertook a workshop with key managers from each organisational division in order to decide the best way to segment the operational costs across the business. The proportional split was dependent upon the number of staff in each area, the nature of work and the volume of work. AECOM was able to validate that the proportion of the total business Direct Costs that were attributed to Network Operations were included in the submission calculation spreadsheet.

Through the review undertaken, AECOM was able to confirm that the 'Other Network Costs' item was calculated based on specific invoice categories, which are known to Multinet Gas through their obligations in the previous regulatory period, which were paid by Jemena on their behalf.

The carbon tax administrative costs and the ESV levy scope change costs were not reviewed in the AECOM scope.

Overview of AECOM's approach to this review

Network Operations components

Network Operations operating expenditure consists of four segments:

- Operating Services Agreement (OSA): A single outsourcing agreement that will expire in June 2013
- Network maintenance tender costs: Multinet Gas has split its network into two geographic regions (north and south). Outsource agreements relating to each region have been procured via a competitive tender process. Separate firms have been engaged to provide clearly defined maintenance activities for each region.
- In-house labour: A number of asset management and operational roles will be provided by 'in-house' Multinet Gas staff for the forecast period. A number of these functions were previously provided under the OSA.
- Direct costs: Multinet Gas incurs direct costs related to functions such as staff training, engagement of consultants etc.

Table 2 outlines the forecasted costs estimated by Multinet Gas for Network Operations associated with each segment.

Table 2 - Network Operating Costs - Resubmission

	CY 2103	CY 2104	CY 2105	CY 2106	CY 2107	Total
Labour - Opex	3,028	5,255	5,326	5,399	5,317	24,324
Direct	4,306	6,282	6,282	6,282	6,282	29,432
Tender	12,428	26,216	27,476	26,746	26,331	119,198
OSA	13,971					13,971
TOTALS	33,733	37,752	39,084	38,427	37,929	186,925

AECOM's review of Network Operations operating expenditure does not include the following:

- Operating Services Agreement
- The portion of network maintenance tender costs related to metering

AECOM was provided with data and relevant information by Multinet Gas in order to undertake the review. AECOM was also provided with access to relevant staff at Multinet Gas in order to clarify any matters necessary for AECOM to undertake the review. Notes have been made below highlighting specific line items that were not reviewed, due to information not being available or being outside the scope of works.

Approach to reviewing Network Operations operating expenditure

Network maintenance tender costs

Network maintenance tender costs consist of three distinct sub-segments:

- 1) Tender service provider overheads
- 2) Metering activities
- 3) Non-metering activities

AECOM's review of network maintenance tender costs was restricted to tender service provider overheads and non-metering activities. Metering activities have been reviewed by a separate consultant.

In reviewing tender service provider overheads, AECOM reviewed the process undertaken by the tenders to quantify and cost the number of staff required. To review this item, AECOM was provided with an excerpt from the Operational and Management Service Agreement, dated 10 September 2012, which was entered into by the tender service providers. The agreement outlines the scope of the services, which formed the basis for the tender service provider costing. Multinet Gas advised that the scope of services was defined internally, by considering

the Legislative Requirements and Australian Standards imposed on Multinet Gas as a gas distribution business operating in Australia. AECOM considers the tender service provider overhead costs to be derived through a competitive tender process.

In reviewing non-metering activities AECOM analysed itemised activities for network operations in order to review consistency between the actual operational activities completed in the previous regulatory period and those forecast for the subsequent reporting period. This analysis involved identifying activities that contained potential data inconsistencies or errors, followed by an investigation of the causes of the inconsistencies and errors.

In undertaking the review AECOM identified a handful of calculation errors for the forecast period. As a result of correcting those errors Multinet Gas has arrived at a relatively lower forecast of Network Operations operating expenditure.

In-house labour expenses

AECOM reviewed in-house labour expenses by examining the proposed organisational structure for asset management and operation of Multinet Gas assets, with the purpose of forming an opinion on the extent to which the organisational structure represented common industry practice and the proposed labour expenses (e.g. salaries) were reasonable in the context of current market conditions. A number of specialist positions related to Network Operations were identified by Geoff Nunn for further review. Where relevant position descriptions were provided, AECOM assessed the role in the context of the Multinet Gas business and evaluated whether the salaries specified fell within a reasonable range. Additionally, AECOM aimed to validate that the organisational structure was in-line with the in-house labour costing spreadsheet used to derive the submission forecasted cost.

Direct costs

AECOM's review of direct costs for the forecast period was undertaken by reviewing the process to derive the final cost estimate.

The Direct Costs allocated to Network Operations expenditure consist of four sub-segments:

- 1) Organisational direct costs that were modelled by AT Kearney – In evaluating the calculation process, AECOM investigated the methodology employed by Multinet Gas to proportion the total direct costs into the organisational divisions (such as Network Operational, Legal and I.T). AECOM also aimed to validate that the forecasted costs were retrieved from the AT Kearney internal costing model.
- 2) Other network costs, representing invoiced costs that were not included in the AT Kearney cost model – AECOM investigated the process undertaken to derive the costing forecast associated with this category.
- 3) Carbon tax administrative costs – AECOM has been advised that an alternative consultant has reviewed the carbon tax administrative costs in their entirety and a reduction was suggested to Multinet Gas that has been deducted appropriately.
- 4) ESV levy scope change - AECOM has been advised by Multinet Gas that this levy is imposed by ESV. AECOM has not independently verified this amount.

About AECOM

AECOM is a global provider of professional technical and management support services to a broad range of markets, including transportation, facilities, environmental, energy, water and government. With approximately 45,000 employees around the world, AECOM is a leader in all of the key markets that it serves. AECOM provides a blend of global reach, local knowledge, innovation and technical excellence in delivering solutions that create, enhance and sustain the world's built, natural, and social environments. A Fortune 500 company, AECOM serves clients in more than 130 countries and had revenue of \$8.3 billion during the 12 months ended June 30, 2012.

Yours faithfully



Joel Byrnes

Associate Director - Economics

joel.byrnes@aecom.com

Mobile: +61 409 842 496

Direct Dial: +613 9653 8466

Direct Fax: +61 3 9654 7117

© AECOM Australia Pty Ltd (AECOM). All rights reserved.

AECOM has prepared this document for the sole use of the Client and for a specific purpose, each as expressly stated in the document. No other party should rely on this document without the prior written consent of AECOM. AECOM undertakes no duty, nor accepts any responsibility, to any third party who may rely upon or use this document. This document has been prepared based on the Client's description of its requirements and AECOM's experience, having regard to assumptions that AECOM can reasonably be expected to make in accordance with sound professional principles. AECOM may also have relied upon information provided by the Client and other third parties to prepare this document, some of which may not have been verified. Subject to the above conditions, this document may be transmitted, reproduced or disseminated only in its entirety.