

10 November 2009



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

Dear Mike,

Jemena Gas Networks Access Arrangement proposal 2010/11-2014/15

Thank you for the opportunity to provide a submission on Jemena Gas Networks' Access Arrangement proposal for the period 2010/11-2014/15. Our submission is attached.

Yours sincerely

Roman Domanski
Executive Director



**Submission to the AER on Jemena Gas Networks' Access
Arrangement proposal 2010/11-2014/15**

10 November 2009

Executive Summary

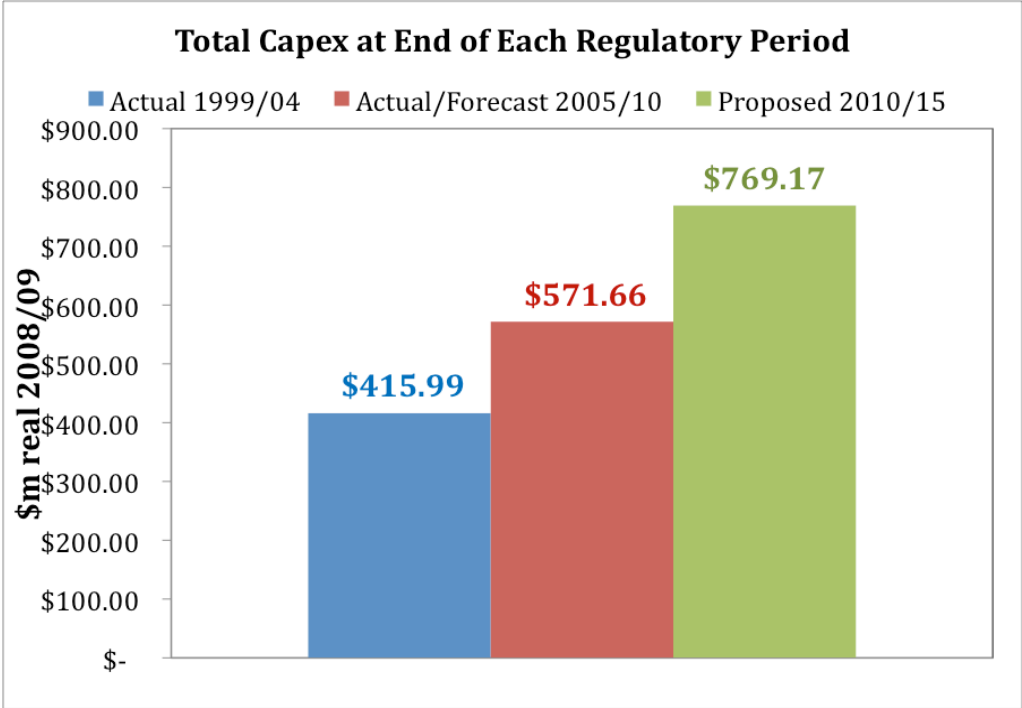
This document is the Energy Users Association of Australia (EUAA) submission to the AER on Jemena Gas Networks (JGN) access arrangement (AA) proposal for the period 2010/11 to 2014/15.

The EUAA has around 100 members throughout Australia. Our members' energy usage accounts for a significant proportion of Australia's industrial consumption of electricity and gas, and energy costs make up a significant part of their operating costs. The EUAA has been involved in the energy sector since its inception in 1996 and has represented its members' interests in energy policy and regulatory issues, energy reform, network pricing reviews and climate change issues. The EUAA has direct experience in over 30 network pricing reviews covering both gas and electricity.

The proposal by JGN shows a significant increase in revenue required for the access arrangement period in question of 18% driven mostly by an increase in forecast of capital expenditure of 34.6%. These are significant increases and of major concern to gas users in New South Wales. The proposal noted that these increases would result in average price increases of 14.5% in the first year and a compounded increase of 32% over the 5-year period.

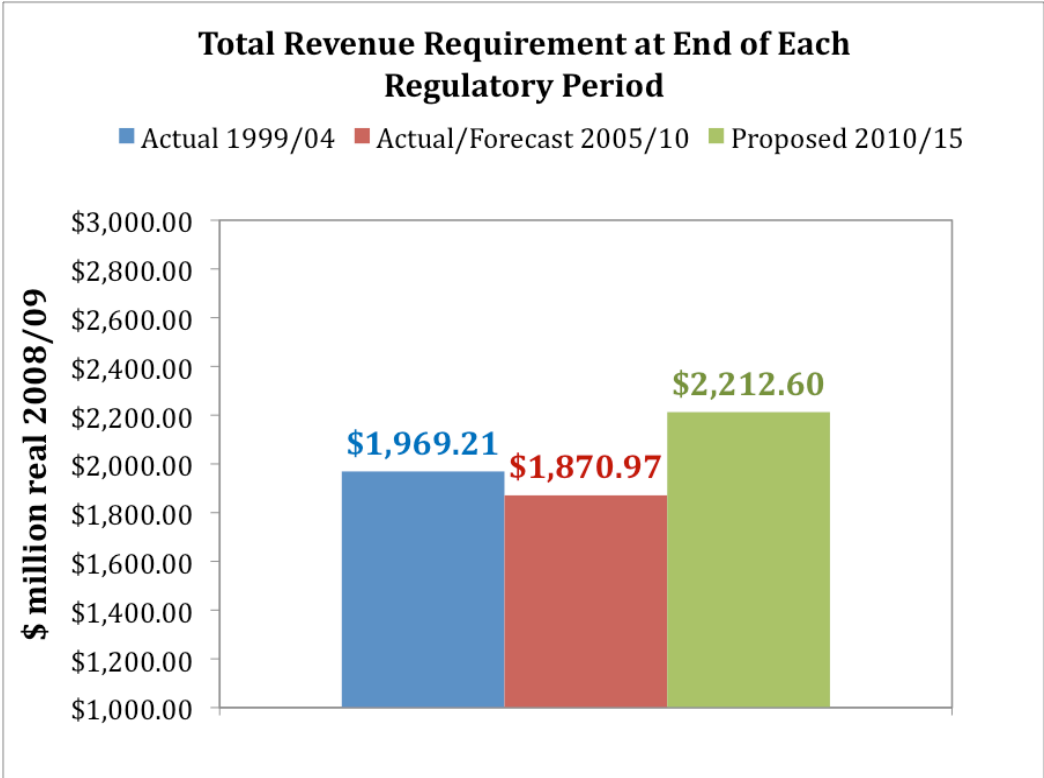
The increase in capital expenditure is shown in figure E1 and the resulting increase in revenue requirements is shown in figure E2.

Figure E1: Total capex across the three arrangement periods



Jemena Gas Networks has cited customer number growth and asset renewal and replacement as the primary drivers for capital expenditure. The customer numbers are forecast to grow 17% over the period of the proposal but this comes entirely from the residential and small business section. The number of Demand Tariff users is actually forecast to go down slightly.

Figure E2: Total Revenue in each of the three AA periods assessed



In this submission we ask the Australian Energy Regulator to investigate the need for these large increases and alert them again to the need for good regulatory oversight in general and we urge them to perform benchmarking specifically. We believe that without benchmarking, users face a significant information asymmetry and cannot assess efficient investment and management of these monopoly businesses.

We also address several specific issues raised by Jemena. These include the proposed new methodology for determining the regulatory rate of return and the allowed weighted average cost of capital which they would like increased from 10% in the current AA period to 12.63%. The AER needs to investigate both of these and determine whether they are efficient. We also alert the AER to the fact that the National Gas Rules require that the rate of return set be commensurate with a benchmark efficient network provider, again illustrating the importance of benchmarking.

Jemena also proposes a major change to the tariff structure which is much simpler than the existing one. While we welcome simplification of tariff structures as this can reduce administrative overheads, we are concerned that the new tariff structure is not sufficiently cost reflective as large users who not contributing in any way for the need to expand the network appear to be set to bear significant cost increases of at least 32% on average.

In addition to this, and even more concerning, is the fact that some users in the Sydney area, are facing cost increases of over 50% in the first year alone, due to the changes in tariffs. This indicates that there is something amiss with the new tariff framework. These large increases imposed on users who are not contributing to the

need for network expansion, do not appear to reflect Jemena's costs as the revenue requirements are forecast to increase by 18% over the entire 5-year period.

We urge the AER to investigate these matters thoroughly and ensure that they only allow benchmark efficient costs.

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1. Introduction

1.1. Overview of the EUAA

This document is the Energy Users Association of Australia's (EUAA) submission to the AER on the Access Arrangement proposal for the 2010/11 to 2014/15 regulatory period submitted by Jemena Gas Networks.

The EUAA has around 100 members throughout Australia. Our members' energy usage accounts for a significant proportion of Australia's industrial consumption of electricity and gas, and energy costs make up a significant part of their operating costs. The EUAA has been involved in the energy sector since its inception in 1996 and has represented its members' interests in energy policy and regulatory issues, energy reform, network pricing reviews and climate change issues. The EUAA has direct experience in over 30 network pricing reviews covering both gas and electricity.

Many of our members are major gas users in New South Wales. They rely on good regulatory practice to maintain a reliable gas supply at efficient price levels. These members will be significantly affected by the expenditure and price increases proposed by Jemena gas Network.

This is the AER's first review major gas distribution review and it is critically important that it sets a strong precedent for good economic regulation in the gas distribution area.

1.2. Overview of Jemena Gas Networks Proposal

Jemena Gas Networks (JGN) has put in a proposal for the access arrangements for the period 2010/11 to 2014/15. This proposal includes both proposed operating expenditures and capital expenditures for this period. The EUAA recognizes the significant effort that went into this proposal and acknowledges that cooperation we received from JGN when enquiring about aspects of the proposal. Based on these forecasts and using the standard regulatory building block approach and methodologies for its application provided by the AER, JGN has derived their revenue requirements for the period in question. The revenue requirements are based on return on capital, return of capital (depreciation) and operating expenditure, which are driven by the weighted average cost of capital determined by the AER, the economic life of the assets, and the age and topology of the networks. In its proposal JGN has requested a real 18% increase in revenues over its current allowance for the period 2005/10. This is a significant increase and translates into increased costs for gas users.

The primary drivers for this increased expenditure has been stated by Jemena to be an increase in customer numbers, requiring new connections, and various other increased costs included asset renewal/replacement and non-system assets, such as vehicles and IT infrastructure.

In order to recover these revenues, Jemena proposes a Tariff regime, which, in contrast to its current one, will allow for variation of tariffs on an annual basis using a Tariff Basket form of Price Control. This will bring JGN's approach into line with other gas distribution businesses in Australia. The EUAA agrees that, if implemented

appropriately and scrutinized annually by the AER, this approach can serve users interests and should allow for a more efficient management of the gas network. We stress, however, the need for Jemena to communicate potential changes in tariffs well in advance of the beginning of the financial year, in order to allow users to factor changes into their budget processes. Similar issues have arisen in the case of electricity distribution tariff setting processes, where inadequate notice has left large electricity users in NSW scrambling to manage unexpected cost increases as little as 2 weeks before the start of the 2009/10 financial year. We trust that the AER and Jemena understand this issue and the importance of liaising closely with customers.

1.3. The National Gas Rules, Efficiency and Benchmarking

The recently established National Gas Law and National Gas Rules have a critical role to play in the efficient management of operation and investment in Australia's gas infrastructure as stated in the National Gas Objective:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

This objective is particularly important at the current time where energy users face multiple cost pressures from various components of the energy supply chain. Australia relies on competitively priced energy to maintain its international competitiveness in the industrial and resources sectors. As network costs, both in gas and electricity supply, are a significant component of the delivered cost of energy, network regulation is critical and has impacts across the whole Australian economy, as seen in the September 2009 quarterly CPI result where electricity was the major driver of inflation.

1.4. Benchmarking

The National Gas Law, as does the National Electricity Law, requires the AER to respond to proposals from the network businesses. We recognise that this can place some limits on the flexibility that the AER has. This makes it doubly critical that in reviewing these proposals the AER remain focused on the key issues. The AER must do everything in its power to ensure that the costs incurred by operators such as JGN are truly efficient and that network companies are only allowed revenues to compensate them for efficiently incurred costs. Energy users are unable to conduct a forensic evaluation of these proposals and therefore rely on the AER to protect them against inefficient expenditure. One of the most powerful and effective tools available for economic regulation is the use of Benchmarking. We have discussed the use of Benchmarking in past submissions to the AER and strongly believe that it should be given priority over other methods of analysis even in situations where it is not explicitly called for, such as under the current National Gas Rules. Robust benchmarking provides one of the most powerful checks that a regulator can provide against inefficient or excessive costs by network businesses. Properly applied, it therefore provides end use customers with a level of comfort that they are not paying for excessive costs. We refer the AER to our previous submissions on the Energex, Ergon Energy and ETSA Utilities Revenue Determinations for further explanations of Benchmarking

1.5. Operating Expenditure

This section outlines JGN's proposed operating expenditures and compare these with the proposed, allowed and incurred opex during the current and previous Access Arrangement periods. This is done in order to assess the efficiency of JGN's opex and draw conclusions regarding its current proposal and its merit. The current proposal totals \$735 million over the 5-year period and compares favourably with the current period's expenditure, in fact, a 2% decrease in real terms. This demonstrates JGN's ability to extract efficiencies from its operations.

The opex proposed is made up in roughly equal parts of operation and maintenance costs which are outsourced to Jemena Asset Management (JAM), JGN's sister company, and non-O&M costs including administrative overheads and other costs, including the significant and growing impacts of carbon costs due to fugitive emissions.

1.6. Opex past and future

We have analysed the current proposal in the context of the past two determinations by the NSW Independent Pricing and Regulatory Tribunal (IPART). We have recast the opex data from the current and past period in real 2009 dollars and displayed them in Figures 1,2, and 3 below.

Figure 1 shows the Actual spend in the first period (1999-2004), the Actual expenditure to date from 2005/06 – 2008/09 added to the forecast expenditure in the current financial year together comprising the current access arrangement period (2005-2010), and the proposed opex. This graph clearly shows a steady downward trend show that JGN and JAM have been able to control the businesses' opex.

In analyzing both the opex and capex in the first two periods, we have noted that Jemena tends to initially be conservative in their estimates of their efficiency. This can be seen in the case of opex in figures 2, and 3, which show proposed, allowed and actual expenditures side by side. The AER should take this pattern into account and be as rigorous as IPART was in setting their allowances.

Figure 1: Opex across the three access arrangement periods 1999-2015

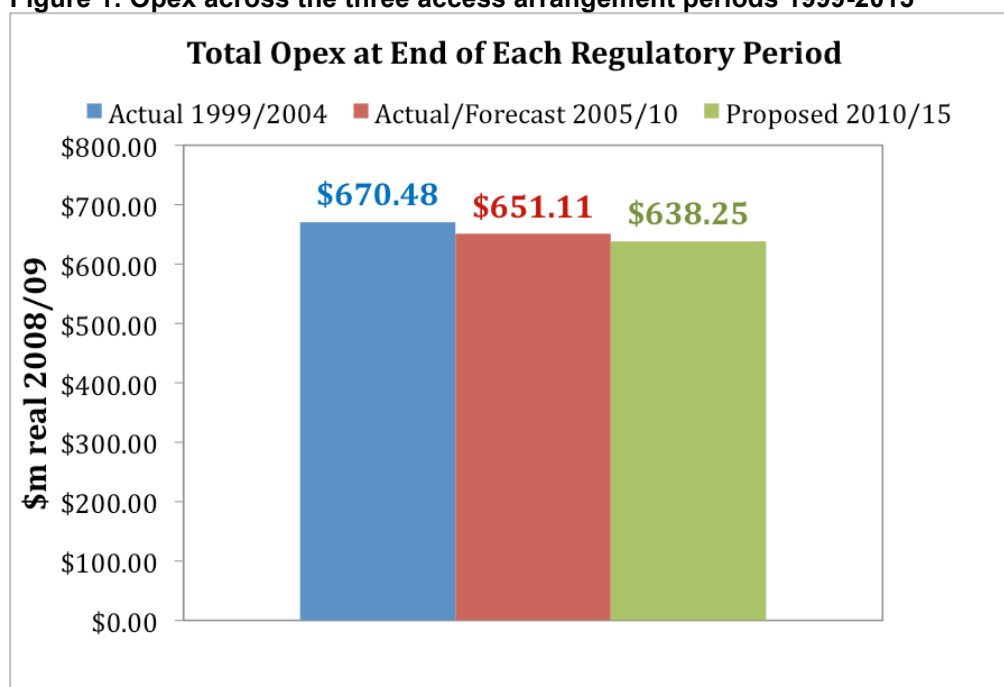


Figure 2: Proposed, allowed and actual opex during the 1999/04 AA period

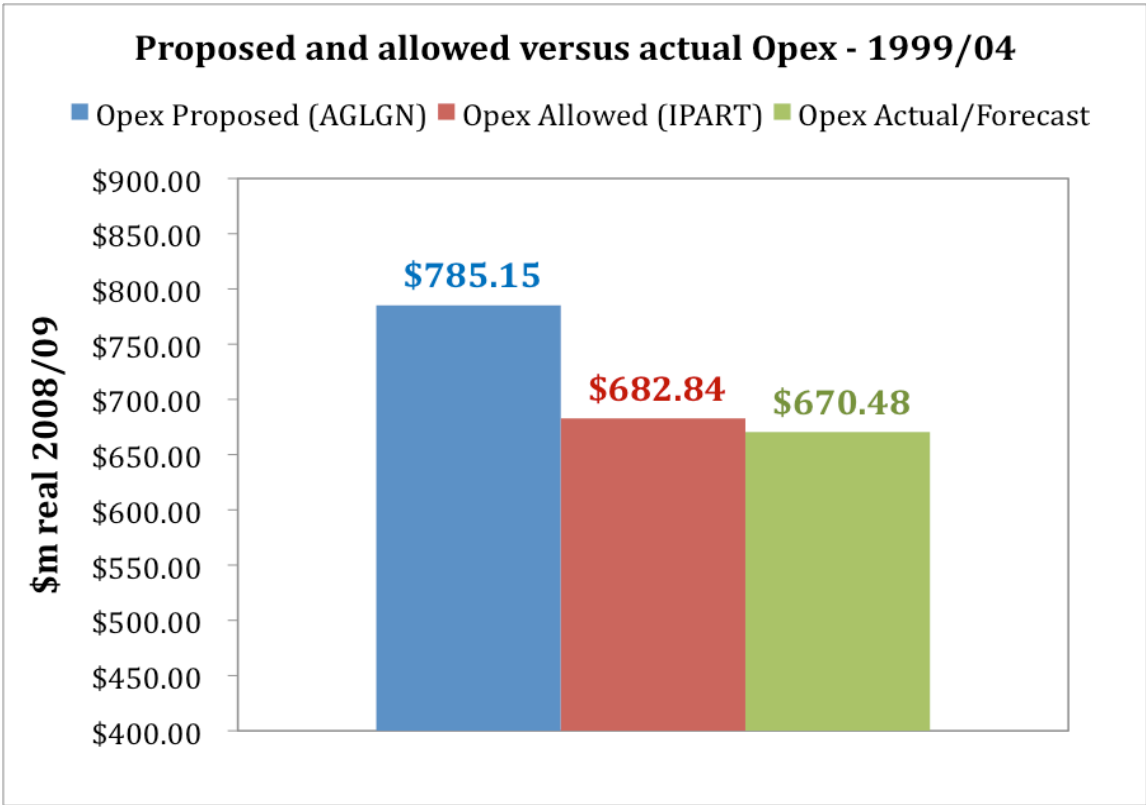
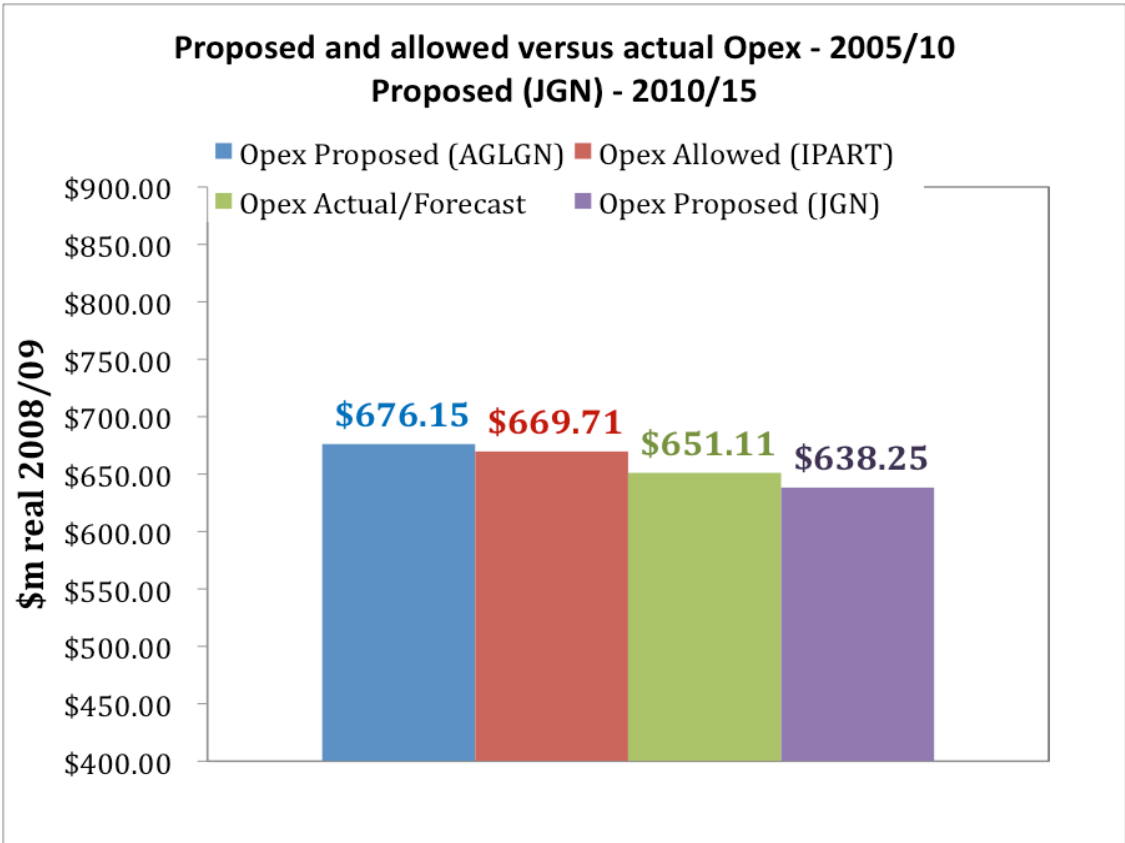


Figure 3: Proposed, allowed and actual opex in the last and current AA periods



1.6.1. UAG and Carbon costs

One significant aspect of gas network operations is unaccounted for gas (UAG). Jemena estimates this at between 2.1 and 2.7 percent of throughput. This is a significant amount and incurs a large costs which to date has been paid for by users. The cost of procurement of the gas alone is forecast to be \$57m over the 5 years in question and if one includes the \$40m Jemena claims for the cost of permits for the fugitive emissions, this amounts to nearly \$100m, a significant amount. This is clearly an ongoing issue for JGN and we acknowledge that some of the costs of managing and procuring additional gas are valid. There is a new factor at play now with the possible advent of a national emission trading scheme (the CPRS) which will impose a cost on fugitive emissions, which according to Jemena, make up roughly half of UAG, i.e. around 1 percent.

In the past, IPART has allowed JGN to charge users for managing this shortfall up to 2.1%. Jemena has proposed that should effectively be increase to 2.7% and suggested an incentive mechanism. It is not clear to us why this is should be allowed by the AER and we ask that the AER investigate this as, in combination with permit procurement costs, would be a significant component of opex. In the proposal it makes up 15% of opex by 2015, or 4% of revenue. The management of UAG is part of gas network operation and the AER should ensure the business should be striving to reduce the cost of this.

Jemena has also proposed that the costs of carbon be passed-through based a permit price forecast they provided. We do not agree with this approach and note that traded market price forecasts are at best, educated guesses, and a different approach needs to be taken. We also believe that procurement of carbon permits will become a part of ongoing business practice for Jemena and other such distribution companies and should not be a straight passthrough once the scheme is bedded down. Gas users would expect JGN to efficiently manage this cost and pass on these efficiencies to end users.

1.7. Incentive Mechanisms

The national gas rules provided two major opportunities for JGN to benefit from more efficiently managing their operation. Firstly, through the allowance of fixed opex and the potential for Jemena to profit by reducing their costs within the 5 year arrangement period. There is also potential for increased revenues due to higher demand and better network utilization as this regulatory regime provides the opportunity to fix the prices for the 5-year period. We note that JGN has already taken advantage of the first in past periods, but that by proposing to move to a tariff basket approach and changing prices every year to account of under/over recovery, the opportunity for taking advantage of the second opportunity may be lost.

1.8. Benchmarking

The principles of benchmarking apply to both operating and capital expenditures. While doing a historical comparison is very useful and our analysis appears to show that Jemena is operating efficiently, we can only make relative statements in time rather than across the entire population of similar gas distribution businesses, both within Australia and around the world.

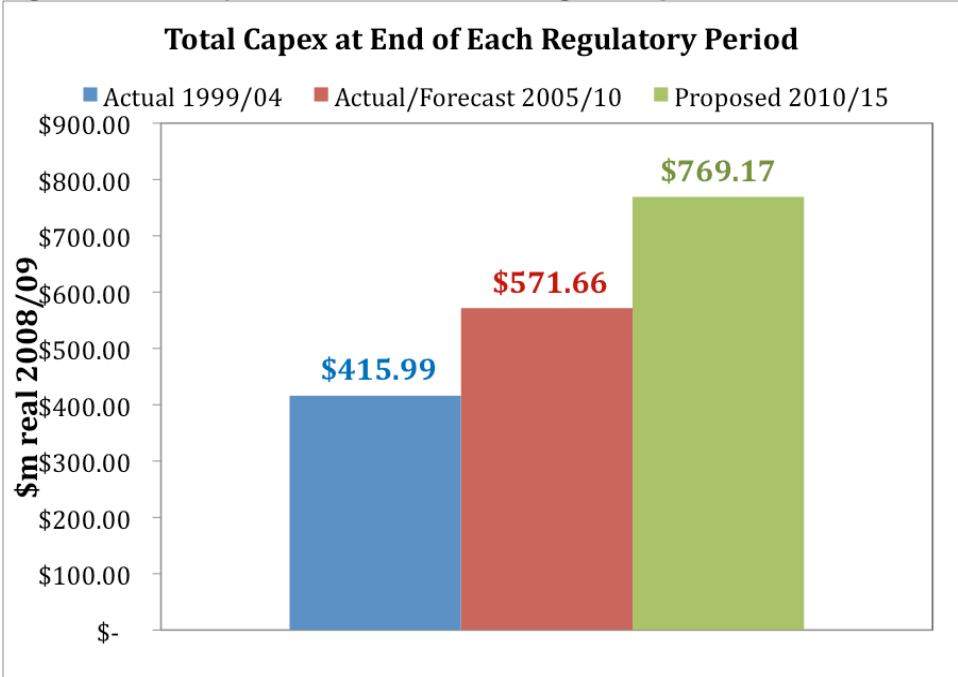
2. Depreciation

The proposal outlines a depreciation approach and forecast in a similar way to the previous two periods. We do note, however, that the depreciation allowance and significantly decreased relative to the previous arrangement period. This could possibly be due to the fact the JGN has re-evaluated the economic life of their assets and concluded that they could operate for longer than previously assumed. If that is the case, however, then it is not clear why the increase in capital expenditure is so large, as we would presume that a longer economic life of the assets would mean they require less renewal or replacement. We outline the changes in capex in the next section but, in the meantime, strongly urge the AER to investigate this issue further.

3. Capital Expenditure

In this section we cover the capital expenditure proposal from Jemena and compare them with the current and previous access arrangement periods. As in the case of opex, we have normalized to 2008/09 dollars and aggregated the expenditures across the 5 years of each access arrangement period. Figure 4 shows the expenditure of the 3 periods with the first two showing actuals and the third the current proposal. Contrary to the case of opex, these capex figures show a concerning trend upwards. In fact, the current proposal shows a 35% increase on the current period's capex and a 65% increase compared to the 1999/04 period. This is a fundamental issue that the AER needs to take seriously. As noted previously, the depreciation figures appear to show that the economic life of the assets has been extended and it is not apparent therefore, why so much capital expenditure should be required.

Figure 4: Total capex across the three arrangement periods



In order to try to determine whether this proposed capex is justified, we compared the previous proposal of AGL Gas Network (AGLGN – the previous owners of the assets

and associated businesses), with the final determinations by IPART and then actual expenditures that result . This is showd in figures 5 and 6.

The purpose of these graphs is to show a pattern of bullish proposals followed by significant reduction in the allowed amounts by IPART which AGLGN and Jemena were able to comply with. The AER should take this into account as it shows the regulator can, and should be able to ascertain the efficient costs.

Figure 5: Proposed, allowed and actual capex in the 1999/04 AA period

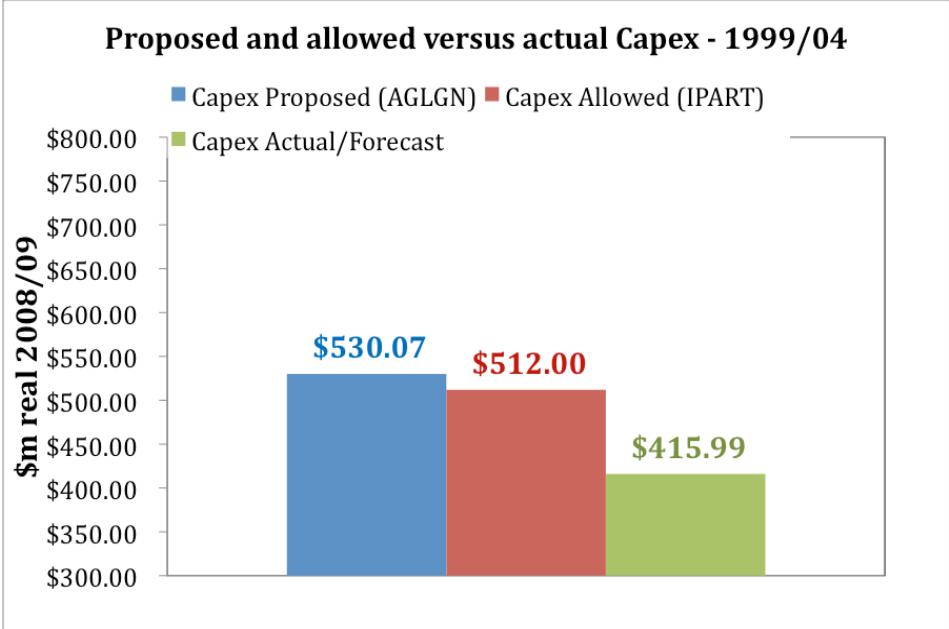
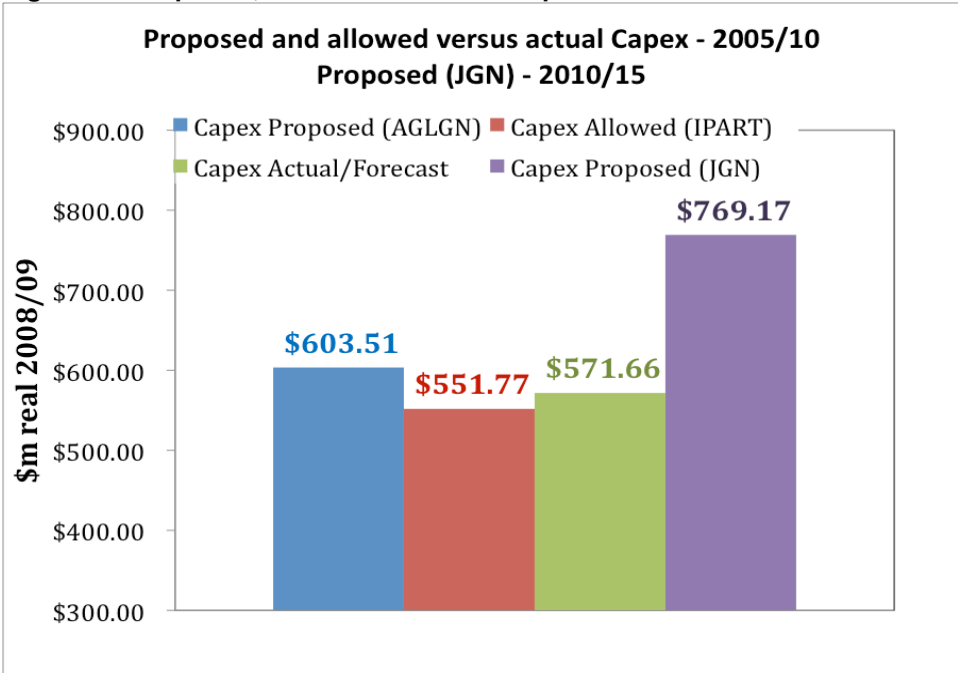


Figure 6: Proposed, allowed and actual capex in the 2000/05 and 2005/10 AA periods



Our calculations show that Jemena are expecting the incurred capex by 2010 to be \$556.6m which they report as an underspend of 1.2% against an allowed \$563.4m. We believe this may be an error as the \$556.6m, when converted to 2005 dollars, is \$506.1m based on our CPI forecast, which is an overspend relative to the \$488.4m

(\$'2005) allowed by IPART. This overspend of 3.6% may be an error on JGN's part or an artifact of differences between forecasts of CPI used by JGN and ourselves. It is important that the AER determine what the actual underspend or overspend would be, as accurate reporting of these numbers is incentive mechanisms is one of the cornerstones of the economic regulation regime.

3.1. Capex drivers

In their proposal, Jemena cited new customer connections as well as aging assets as the key drivers of capital expenditure.

3.1.1. Demand and customer growth

We have compared the increases over the first two periods and cast them as capex increase per additional customer as is shown in Figure 7. There is a large increase in the capex per customer proposed by JGN as compared with the current period and the one before it. We contrast this with the same comparison for opex in Figure 8, which is showing a steady decline. We therefore question whether the customer growth projected justifies the proposed expenditures.

Figure 7: Total Capex in arrangement period per additional customer

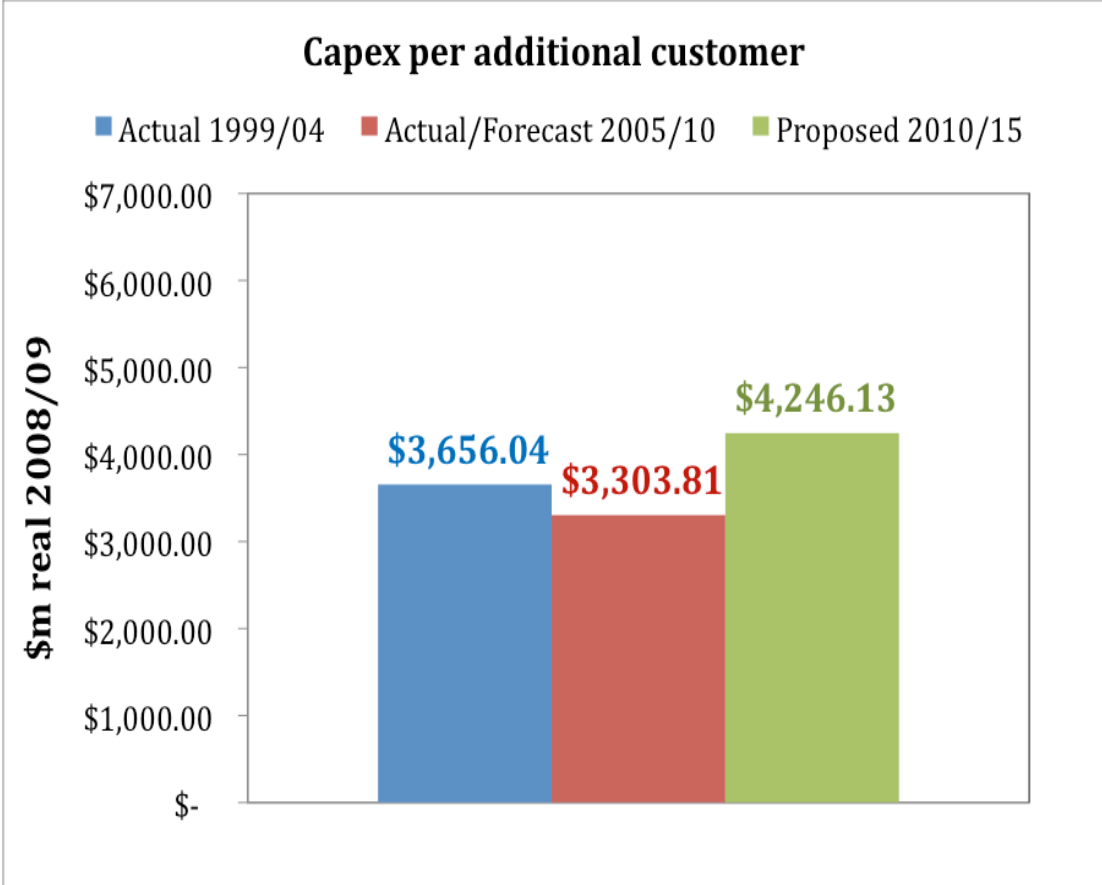
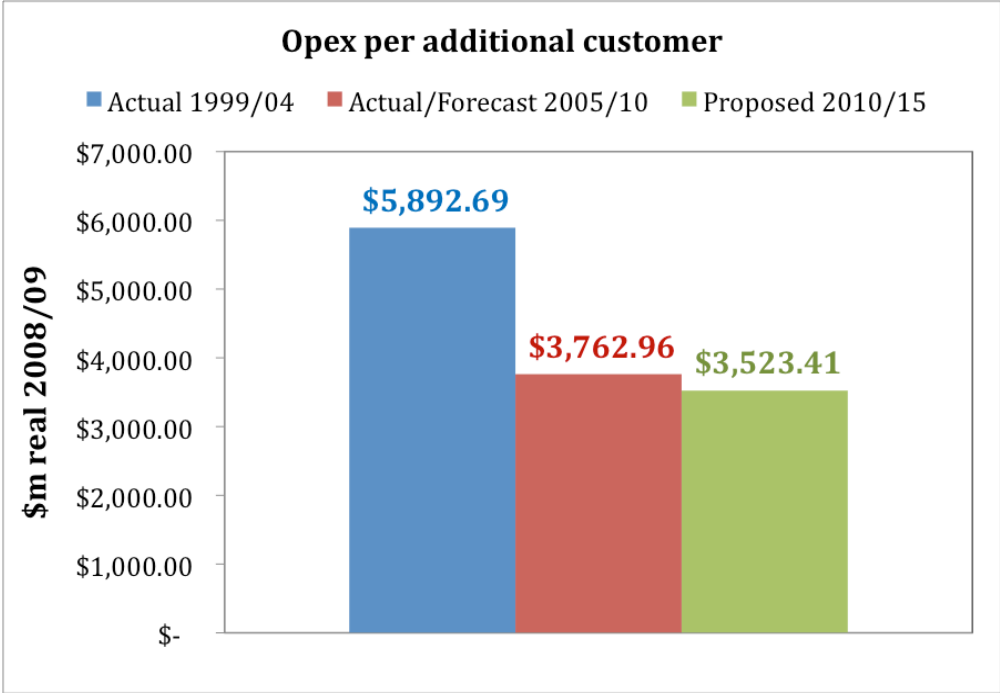


Figure 8: Total opex in arrangement period per additional customer



3.1.2. Asset renewal and replacement

Jemena has claimed a significant proportion of the capital expenditure (43%) is required for replacing or refurbishing existing assets. Given that the system assets have very long economic lives, namely, 50-80 years, and the depreciation claimed is very low, it seems counter-intuitive. The AER needs to investigate this thoroughly.

3.2. Speculative Investment

Jemena Gas Networks has proposed an incentive mechanism to allow them to earn sufficient returns to enable them to proactively expand their network. The AER needs to thoroughly assess this proposal both against the National Gas Rules and on its own economic efficiency merits. User would only support it if it results in more efficient investment in the network and is consistent with cost reflective tariff pricing principles.

3.3. Incentive Mechanisms

The regulatory framework provides an incentive to the network business to maximize their capital investment efficiency since they get a fixed return on assets for the 5 year period and if the expenditure is below their allowed levels, the costs of this investment will also be lower meaning they can keep a certain amount of value during this period. The EUAA generally supports this incentive mechanism and is encouraged to see that Jemena has underspent their allowance in the first period as shown in Figure 5, and underspent at least their initially proposed capex in the current period as shown in Figure 6. However, the EUAA is mindful that this incentive mechanism is also open to some abuse if businesses inflate their expenditure proposals and the regulator is not mindful of this. We are also mindful that this may create a process where expenditures leapfrog from one regulatory period to the next, a consequence of which is that end users never actually see the gains from the efficiency carry-over mechanism. This again points to the importance of the

regulators putting maximum effort into ensure that only efficient costs are approved and they use benchmarking to help determine this.

3.4. Benchmarking

As mentioned above, the principles of benchmarking apply to both operating and capital expenditures separately. Benchmarking is particularly critical in the case of capex in this particular proposal since the increase in capital expenditure proposed is so large. In the past, IPART performed quite comprehensive benchmarking and was thereby better able to ascertain efficient capex as well as opex. The AER should repeat this exercise.

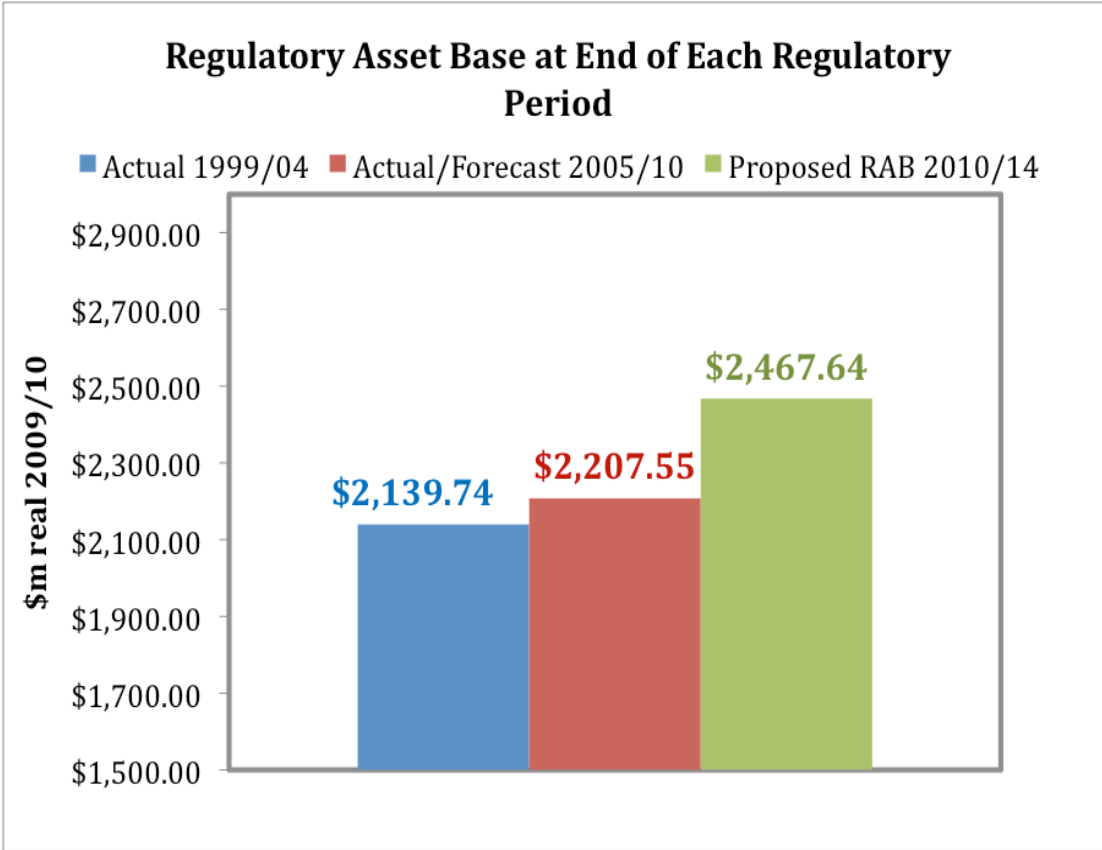
4. Revenue Requirements

The operating expenditures and capital expenditures translate into revenue requirements via the building block approach. We have already discussed operating expenditure, depreciation, and capital expenditure in previous sections. In this section we briefly outline the impact these have on the regulatory asset base and the impact this has on revenue requirements via the allowed rate of return.

4.1. Regulatory Asset Base

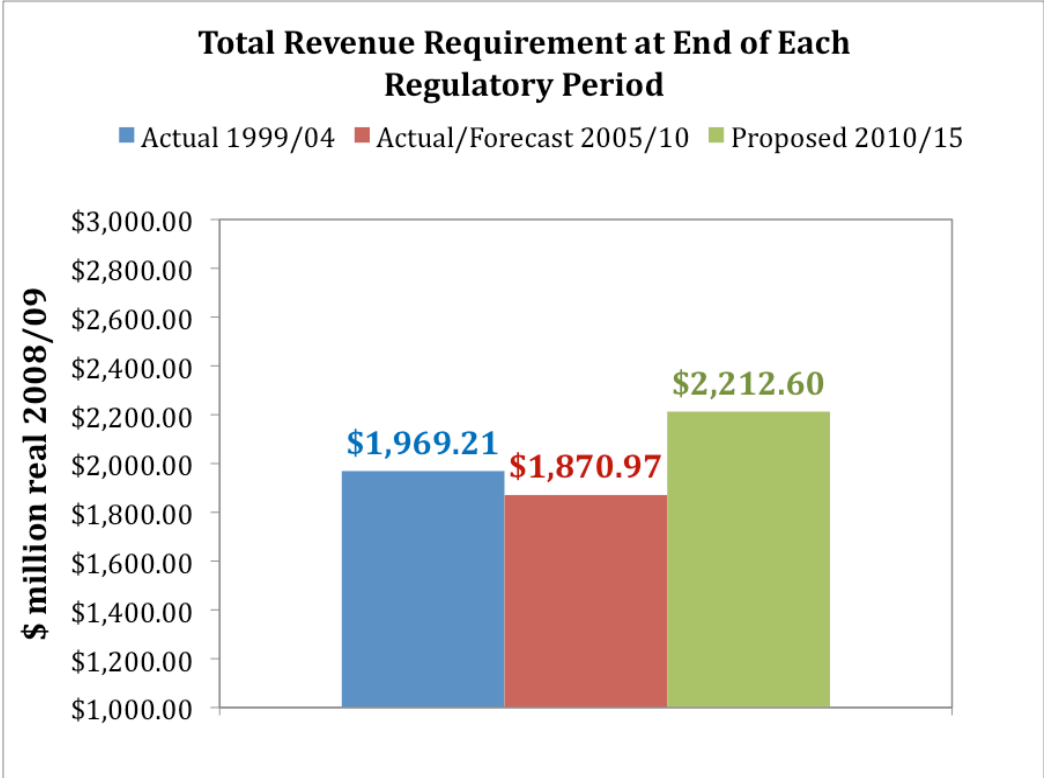
Figure 9 shows the growth in the regulatory asset base (RAB) during the three arrangement periods we have analysed. It shows an increase in the RAB presented in 2008/09 dollars, especially pronounced for the next regulatory period.

Figure 9: RAB at the end of each of the three arrangement periods



Based on this RAB and the opex and depreciation allowances, the regulator calculates the revenue requirements (shown in Figure 10).

Figure 10: Revenue at the end of each of the three arrangement periods



In this graph we see that the revenue requirements dropped by 5%, in real terms, from the first to the second regulatory periods, but have are now proposed to be increased by 18% in real terms. It is noteworthy that the pattern in the proposed versus actual/allowed revenue requirements is the same as in the case of capex and opex. That is, JGN/AGLGN was initially bullish in their ask and were in the end allowed a lower revenue.

4.2. Demand forecasts and revenue recovery

There is an important issue that Jemena raised in their submission and that is the issue of the difficulty in recovering revenues in the price controlled regime if demand is lower than expected in the forecasts. This is a standard issue in price control regimes and a risk that network companies need to themselves manage through appropriate forecasting as they have the best information to do so. The EUAA acknowledges that AGL Gas Networks and JGN would have recovered less of their revenues in the current arrangement period due to the forecast required by IPART in its April 2005 determination, which was higher than that originally provided by AGLGN and higher than the demand that subsequently eventuated. We do not agree that such forecasting issues should be managed as pass-through's. We address this issue of pass-through as proposed by JGN in the section 6 of our submission.

4.3. Cost of Capital Methodology

This section discusses the allowed weighted average cost of capital (WACC). A full discussion of this issue is outside the scope of our submission but given its criticality and Jemena's proposal to change the methodology used, we will comment here briefly on several aspects of the issue.

There are two main issues regarding the WACC we see in this proposal. The first is the proposal to change the methodology from the industry standard capital asset pricing model (CAPM) that JGN refers to as the Sharpe-Lintner CAPM, to a more novel method called the 'Fama-French three factor model'.

4.4. Cost of capital model

The proposed Fama-French model is not a standard model and JGN themselves admit that no economic regulators around the world use this model. While the National Gas Rules allow the AER some leeway in determining the methodology, they do state that an accepted methodology such as the CAPM should be used. We strongly believe that given the criticality of this issue, it cannot and should not, be changed without careful consideration, without reference to other regulators and not on a case-by-case basis. Even if there is merit in investigating new methodologies, as the CAPM is known to have its critics, a change should be only considered as part of an industry wide review of the WACC. We therefore strongly urge the AER to stick to the use of the existing CAPM methodology.

4.5. Requested rate of return

Given that Jemena had used the Fama-French model in their proposal to derive their required rate of return, we can only comment on this rate of return in comparison with the rate allowed in the previous determination. The rate proposed in this case is a pre-tax WACC of 12.63% versus a 10% WACC in the current access arrangement. Since Jemena has used a different methodology it is hard to determine exactly what lead to the 2.6% increase, which is a significant increase and explains some of the increase in revenue requirements we noted. This will lead to a more than 25% increase in return on assets since the RAB has increased as well. This is a serious issue and the AER should investigate this and also require JGN to re-compute a WACC using the existing approach to CAPM.

4.6. The NGR and rate of return for a benchmark efficient business

The National Gas Rules required the AER to determine a rate of return in Rule 87 (2)(a)(i), assuming "the provider meets benchmark levels of efficiency". While this is the only place in the NGR where benchmarking is mentioned, the implications are profound. The rate of return determined assumes that the provider is as efficient as possible. If it is not known whether the business benchmark is efficient, this may imply a lower rate of return must be used. This demonstrates that benchmarking is integral to the National Gas Rules and needs to be done in order to give users confidence that the prices that they are being charged are based on efficient costs.

5. Tariff formulation

As mentioned previously, Jemena proposes a Tariff regime, which, in contrast to its current one, will allow for variation of tariffs on an annual basis using a Tariff Basket form of Price Control. This will bring JGN's approach into line with other gas distribution businesses in Australia.

5.1. Efficient Pricing

The EUAA agrees that if implemented appropriately and scrutinized annually by the AER, this approach can serve users well and should allow for a more efficient pricing of the haulage services. We stress again, however, the need for Jemena to communicate potential changes in tariffs well in advance of the beginning of the financial year, in order to allow users to factor changes into their budget processes. Similar issues have arisen in the case of electricity distribution tariff setting processes, where inadequate notice has left large electricity users scrambling to manage unexpected cost increases as little as 2 weeks before the start of the 2009/10 financial year. We trust that Jemena and the AER agree about the importance of this issue and the importance of liaising closely with their customers.

However, for the sake of clarity to all, we would urge the AER to formally raise it with Jemena and ensure there is a process in place to avoid the problems that beset the recent NSW and Tasmanian regulatory determinations. We are aware that the Chairman of the AER has written to some of the businesses concerned with current electricity price reviews about the matter and asked them to improve the level of communication and notice on tariff changes. EUAA members strongly support his efforts in this regard.

5.2. Price Control Formulae

In proposing the new regime, Jemena has proposed a set of Price Control Formulae while at the same time proposing to greatly simplify their tariff structure. In fact, they propose to have only two types of tariffs for two customer types; Volume and Demand customers. In the current arrangement these are known as Tariff Customers, and Contract Customers. These are respectively customers using less than 10TJ of gas per annum and those using more than 10TJ.

5.3. Tariff Classes and indicative increases in costs

Within both Volume, and Demand customer categories, there are several difference classes based on location, and within the Demand customer category there are also 3 tariff categories:

1. Capacity – The standard tariff for very large customers where the tariffs are based on Maximum Daily Quantity (MDQ) and Maximum Hourly Quantity (MHQ)
2. Capacity First Response – A highly discounted tariff for large customers willing to be called upon to shed load
3. Throughput – more suitable to smaller customers with volume metering only.

These new tariffs are expected to recover the increased revenue by a first year average increase in \$/GJ cost of 14.3% and a total compounded 5 year price increase of 32%.

Although these are indicative costs, they are very large increases and users are concerned that the AER determine the level of efficiency of the proposed expenditures.

5.4. Drivers for revenue and cost reflective revenue allocation

While some investment in network expansion may be needed as customer numbers grow and we note that growth is forecast, this needs to be carefully assessed by the AER in terms of the robustness of the growth forecasts, their composition and the

impacts on JGN costs. Moreover, customer growth appears to be occurring strictly in the volume customer category and in fact, in the residential and small business segments and cost reflective pricing principles suggest that these should bear the brunt of capex recovery related revenue increases. While we acknowledge that the majority of the revenue may already be recovered from this customer segment, nevertheless, we would like to see more reflective cost allocation between different customer segments. It may be that a single volume customer reference tariff category is not sufficient for the purposes of efficient pricing. Given that Jemena is proposing very significant changes to the tariff structure, users would need a comprehensive review of the indicative proposed tariffs to be performed to assess whether the proposed tariff structure is appropriately cost reflective.

We have also note several other aspects of the proposed Tariffs and Tariff structure that give us pause, and cause for concern. These are:

- **Large increases across several zones in the Sydney area.** Some demand users are calculating cost increases as high as 50% in the first year of the new arrangements, while others, such as those in the Newcastle area, are expecting to see much lower increases, or no increases at all. This is not at all acceptable as it is clear that the bulk of the expenditure increases are related to capital investment due to growth in the residential end of the volume tariff category. It is difficult to understand how some users could be charged an increase of 50% when the entire revenue requirement increase is 18% over the 5-year period and is driven primarily by small volume users.
- **Minimum bill requirements for demand users:** Jemena Gas Networks has proposed the inclusion of minimum bill requirements, which they argue are needed to eliminate perverse incentives at the volume-demand customer boundary. We believe any such changes need to be scrutinized carefully by the AER before they are approved to determine if they are in fact efficient and fair. They should not lead to cost increases for existing demand customers.
- **MDQ Setting:** The arrangements propose a negotiated approach to MDQ setting. Users are concerned that this may not be the most appropriate method and the AER needs to assess the merits of this versus other more transparent approaches which may be of more benefit to users.

6. Pass Through Events

Jemena has listed a large range of pass through events which is of concern to users.. The EUAA's position in general is that we do not support pass-through as a matter of principal and believe that they will always be asymmetric in favour of the network businesses given their information advantages. Consequently, any cost reductions that emerge during a regulatory control period will almost certainly never be passed through. It is also important to the that the NGR do not address

We choose three of these to comment on in more detail as they are rather unusual and merit a more focussed discussion.

1. **Unaccounted for Gas:** This is a standard issue for gas networks and they are well placed to manage this. It is not clear why JGN is requesting the benchmark to move for a UAG rate of 2.1% to 2.7%. There may be some merit in this if

benchmark efficient gas distribution businesses face the same level. However we consider this a last resort.

2. Carbon price impacts: We agree that purchasing carbon permits will be an additional impost on the business and while there is both timing and price uncertainty during the initial phase of the scheme, there may be a case to share these risks with users while Jemena and other businesses learn to operate in this new market. However this should rapidly become part of standard business and users should not be required to face carbon price risk, which they are ill positioned to manage. We suggest that the AER to work with JGN and other businesses of a similar type to determine an appropriate costing methodology for carbon impacts on UAG management costs.
3. Regarding the weather events pass through proposal, network businesses consistently have to manage this type of risk both in gas and electricity. We see no reason why they should be protected from this and the AER can address Jemena's other concerns about sufficient revenue recovery through appropriate demand forecasting methodologies.