

**Minutes of the Public Forum on Jemena Gas Networks (NSW) access
arrangement proposal (1 July 2010 to 30 June 2015)**

- Location:** The Menzies, Sydney
Level 2 Sydney Room, 14 Carrington Street, Sydney
- Date:** Wednesday, 23 September 2009 (10.00 am to 12.00 pm)
- Forum Chair:** Gwenda Gleeson, Australian Energy Regulator
- Attendees:** See appendix 1.

Summary of forum

A summary of the discussions from the forum is set out below.

1. Opening remarks by the Chair

Gwenda Gleeson (Chair) opened the forum and made introductions. She outlined:

- Steve Edwell, was not able to attend due to adverse weather conditions
- in Steve Edwell's absence, the presentation would be limited to an outline of the review process and not include initial observations of the AER
- the agenda, and noted that a record of the meeting will be made available following the forum
- that the purpose of this forum is for Jemena to outline its proposal and that she would limit questions to the AER's review process
- attendees were instructed that all questions will be taken after AER's and Jemena's presentation.

2. AER presentation – Gwenda Gleeson, Director, AER

This is the first time the AER has reviewed access arrangements for a gas distribution network. Previously, the access arrangement for Jemena Gas Networks (NSW) Ltd (Jemena)'s NSW gas network was approved by the IPART.

The AER received Jemena's access arrangement proposal on 25 August 2009. After undertaking a preliminary examination, Jemena's proposal was published on the AER website. The AER is also conducting access arrangement reviews for two other gas distribution networks.

The AER welcomes submissions in relation to Jemena's proposal. The closing date for submissions is 10 November 2009. While the AER values input from stakeholders, including users of Jemena's network; staff noted that there is only

limited ability to consider late submissions. Attendees were directed to the indicative time line of key dates on the AER's website.

The AER will be engaging consultants to provide expert advice during the review process. Wilson Cook will be assessing forecast capex and opex and ACIL Tasman will be reviewing demand forecasts. The AER will also be referring to labour cost growth forecasts prepared by Access Economics for the electricity, gas, and water (EGW) sector. The consultants' reports will be made available at the time the AER publishes its draft decision. Interested parties are able to provide submissions on these reports in context of the draft decision.

The AER's presentation slides are available on the AER website.

3. Presentation by Jemena

Background and historical context - Sandra Gamble

The Jemena Group builds, owns and manages many major Australian electricity, gas and water assets. Jemena was formed when Alinta Ltd was taken over by a consortium comprising of Singapore Power International (SPI) and Babcock & Brown.

The corporate structure of the Jemena Group consists of many separate entities for each of the separate assets. The entities are ultimately owned by Singapore Power International Limited. The entity which owns the NSW gas network is Jemena Gas Networks (NSW) Ltd. The management of the network is outsourced to the related entity, Jemena Asset Management Ltd (JAM).

Jemena's NSW gas network consists of over 24,000km of pipes supplying gas to 1,050,000 customers in Newcastle, Sydney, Wollongong, and 32 country centres in NSW. In 2010, the capital base will be \$2.37 billion. Annual revenues are \$370 million.

Demand in the earlier access arrangement period was lower than the IPART's forecasts which resulted in Jemena not recovering its expected revenue. Small growth in the housing market was attributed to customer numbers being 6 per cent lower than forecast. Reverse cycle air conditioners, and increased efficiency of gas appliances also contribute to the decrease in demand.

Opex over the earlier access arrangement period is expected to be 7.34 per cent lower than that allowed by the IPART. Jemena outlined this is because economies of scale, scope, and synergies.

Capex over the earlier access arrangement period is in line with the IPART forecasts (1.21 per cent lower), showing that Jemena is meeting its commitment to invest in its network.

This is the third access arrangement revision for Jemena's NSW gas network since 1997. This is the first access arrangement revision proposal under the new National Gas Rules (NGR) and builds on regulatory decisions from previous access arrangements.

Overview of the access arrangement proposal – Sandra Gamble

In developing its access arrangement proposal, Jemena has considered the following:

- New market dynamics such as the short term trading market (STTM) and carbon pollution reduction scheme (CPRS).
- Input cost pressures such as labour and materials cost growth, secondary carbon pricing affects, and trends in global markets
- The introduction of the NGL and NGR
- Rapidly changing national energy market

The National Institute of Economic and Industrial Research (NIEIR) developed Jemena's forecast demand. This forecast is for a continued 1 per cent annual reduction in residential demand with a 2.5 per cent annual growth in customers. Jemena outlined that it considers that this forecast is reasonable.

Jemena and JAM have assessed opex and capex to ensure they achieve the right balance to deliver the best value to Jemena and its customers. Growth in opex is steady over the period; a key component of opex is the carbon costs for UAG (fugitive emissions). Capital works over the access arrangement period include system reinforcement and asset replacement.

Jemena outlined that it proposes a Fama–French three factor model to calculate the cost of equity to overcome a number of shortcomings with the traditional Sharpe–Lintner CAPM model for calculating weighted average cost of capital (WACC). It outlined that this approach also reflects prevailing market conditions.

Jemena has simplified its reference services to two key reference services: a haulage service and meter data service. Pricing arrangements have also been changed to better reflect the characteristics of the STTM. Jemena has also restructured its tariffs for demand or large customers.

Jemena's investment plans for the NSW network – Alf Rapisarda

Jemena has delivered three key projects over the period including:

- the Sydney primary loop
- capacity reinforcement works
- rehabilitation of poor performing assets.

Forecast investment for the next access arrangement period is \$885 million for:

- market expansion (cost of connecting new customers)—40 per cent
- capacity—stay in business (SIB)—40 per cent
- non—system asset (support)—20 per cent.

These forecasts are supported by the Asset Management Plan, Life Cycle Management Plan, and Capacity Planning Framework. Jemena also considered a number of factors when developing these plans including changes in technical standards and government policy (such as state building programs and federal support for gas in building developments), demand growth, asset utilisation, asset condition and ageing, and unit rate changes.

Jemena has used consultants to provide expert advice and review. Parsons Brickerhoff reviewed the forecast capex program (excluding IT) and KPMG reviewed the forecast IT capex.

Distribution capex includes market expansion for new/existing markets, capacity maintenance/development, and system renewal/replacement.

Market expansion for new and existing markets peaks at slightly higher than \$80 million in 2012–13. This incorporates the impact of the economic downturn and government policy initiatives.

Jemena has used a ‘just in time’ approach to capacity maintenance and development. Expenditure is highest in year one with drivers including optimising asset life, capacity enhancement to support fringe growth, and organic growth within existing markets. This will also correct issues such as extra peak load on the system as consumers switch to instantaneous gas water heating systems.

System renewal and replacement capex is being driven by ageing assets, with the need to maintain a safe and reliable system. Much of the infrastructure was built 30–35 years ago and no longer meets OHS standards or noise requirements, and is suffering from metal loss. Certain gate stations that were initially built cheaply are now also proving a constraint on increasing pipe pressure in the network.

Non distribution capex includes expenditure on motor vehicle, fixed plant and equipment, and IT. The key IT programs for the next access arrangement period are:

- Replacement of the core metering, billing, and works management system
- Introduction of a Geographic Information System
- Rollout of a security camera program (particularly to protect unmanned sites)
- Upgrading network design systems and introducing design and drawing document management systems.

Jemena are also proposing a market expansion mechanism to encourage expansion of the network into areas that are currently unreticulated.

Pricing and service offerings – Alf Rapisarda

Jemena has simplified the service offerings by reducing the number of reference services from eleven in the earlier access arrangement to just two in the proposed access arrangement. Trunk and local network services for the Wilton Network section will be combined, and haulage service will become a hub to point service as a result of the STTM. The tariff class for a haulage service will consist to tariff classes -

volume and demand. The outcome of this rationalisation will significantly reduce the administration costs and provide a simplified means to manage the network.

In addition to the changes to reference haulage services for demand customers, there will be no minimum contract terms (compared with current one or two year terms), no overrun charges. Prudent/first response discounts will apply for certain customers with the largest sites that are prepared to shed load. The minimum bill arrangement removes the incentive at certain volumes to demand more gas to move into different tariff classes.

New reference service agreements will be in place from July 2010 and consistent with the new STTM arrangements. Legacy agreements will need to be revised as they will be inconsistent with the new market arrangements. There are transitional arrangements in place. The new terms and conditions for the reference services agreement will form part of approved access arrangement.

Pricing outcomes are as follows:

- Change in volume tariffs in 2010–11—CPI plus 34.3 per cent
- No material change in total revenue from demand services. There is a minimum bill of \$20,000 per annum in year one, increasing to \$60,000 per annum in year five.
- Change in meter data service tariffs in 2010–11—CPI plus 49 per cent

After this initial P_0 adjustment in 2010–11, a CPI-X price control will apply to the tariff basket. The value of X will be set at -1.96 per cent, which means that the average price movement will be CPI plus 1.96 per cent each year. A fixed schedule approach will be retained for ancillary fees and meter data service charges. The tariff variation mechanism also allows for the adjustment of UAG costs within a tolerance band, and includes an adjustment variable for weather effects (since these cannot be reasonably forecast).

The tariff variation mechanism also includes pass through events such as tax changes, declared retailer of last resort, and a business continuity event.

Jemena's presentation slides are available on the AER website.

4. Questions

Bob Lim asked whether the AER's preliminary views (that were not presented at the forum in Steve Edwell's absence) will be posted on the AER website so interested parties can get a clearer view of the AER's initial observations.

Gwenda Gleeson stated that this can be raised with the AER Board. It was also noted that the GEMS notice seeking submissions on the proposal lists several issues on which interested parties may want to comment.

Bob Lim asked whether the AER's consultants' reports could be made available prior to release of the AER's draft decision especially reports on the use of the Fama French model.

Gwenda Gleeson stated that past practice has been that they are released at the same time as the draft decision is published. Ms Gleeson noted that this can be raised with the AER Board.

Phillip Watts stated that in regards to pricing principles, Boral wants efficient pricing and reliable supply, and accepts that Jemena has a pot of money that needs to be collected from customers. Mr Watts questioned how Jemena decides tariffs, and whether there is any comment on costs reflectivity of tariff allocation (i.e. how does Jemena allocate costs to customers).

Alf Rapisarda noted that cost allocation is in accordance with the NGR. In regards to demand customers, the IPART was concerned about the revenue pool for those customers and concluded the pool was cost reflective. Mr Rapisarda stated that the revenue pool for demand customers is not increasing in real terms.

Ariel Liebman supported Bob Lim's earlier comments in relation to posting Steve's presentation on the website and obtaining copies of the consultants' reports before the draft decision. Dr Liebman noted that Jemena in its presentation claims it is acting efficiently and questioned if the AER intends to benchmark this business.

Gwenda Gleeson commented that this will be addressed by the AER Board in its draft decision.

Ariel Liebman asked Jemena how they see the next five years noting that energy users expect efficient costs but capex is increasing. Dr Liebman also questioned whether this expenditure is efficient.

Sandra Gamble explained that capex increases are due to projects which are required to respond to market demand and ageing assets. In regards to opex, the carbon costs of UAG do represent an increase however other opex is forecast from efficiencies already made.

Andrew Phelps noted there are policies regarding capex to connect customers and stated that Jemena required a payment to connect his site (which needed 3.5km of pipe). Mr Phelps then noted that considerable capex is allocated towards connecting new users in the access arrangement proposal and questioned whether under the new arrangement Jemena will connect large users without charge.

Alf Rapisarda explained that Jemena's connection policy is consistent with the NGL and NGR. Jemena wants to grow its asset base and does not actively seek capital contributions because they do not provide a return to Jemena. However, if the incremental revenue from a connection is not sufficient to cover the incremental costs, a capital contribution is required.

Andrew Phelps then commented that other states provide incentives to connect to the gas network.

Alf Rapisarda noted that Jemena must work within the NGR and the NGR cannot cater for every individual circumstance.

Jules Knight stated that in recent AER electricity decisions, large increases were approved. As a large user this means that OneSteel is paying considerably more for

electricity. Mr Knight then asked if major users of gas will experience similar increases in NSW.

Gwenda Gleeson noted that the AER will assess Jemena's proposal on its merits.

Alf Rapisarda said there will be ups and downs in prices for individual customers, but total revenue for demand customers will not change. The proposal sets out how the prices will be determined.

Phil Randall asked whether the presentations given today will be made available on the AER's website.

Gwenda Gleeson commented that it is the intention of the AER to make the presentations available on the AER's website.

Phil Randall stated that Jemena has indicated that total revenue from large customers will not change, but there is a 50 per cent discount for first response (interruptible) supply. Mr Randall asked if Jemena assumed that the discount of 50 per cent will be taken up.

Scott Martin responded noting that Jemena looked at existing data regarding the capability of some customers to shed load and has assumed some businesses will take up the 50 per cent discount.

Phil Randall asked whether, in regards to the MDQ element, there is a reset of MDQ limiting a user's ability to take as much gas as they would like. Mr Randall also asked about seasonal increases, in particular, the previous 'summer tranche' reference service.

Scott Martin stated those features are not part of the access arrangement proposal. Jemena wants to move away from administrative hassles, so the concept of short term capacity will no longer exist. There are no more overrun charges. MDQ will ratchet up automatically to be the ninth highest usage day each year, so effectively everyone gets eight free days a year. There is more flexibility in general.

Ariel Liebman asked if tariff increases are applying to large users. Dr. Liebman also expressed concerns regarding whether the final tariff amounts will be provided in time for users to incorporate the new figures into their budgets. In the electricity decision there was not enough time before 1 July.

Gwenda Gleeson stated that unlike the electricity pricing proposals that are submitted after the revenue determination is made, Jemena's access arrangement proposal sets out the proposed tariffs.

Alf Rapisarda commented that high level information was provided in the presentation. Price increases for volume customers are determined by criteria including location. Mr Rapisarda then stated that prices can be worked out from the access arrangement proposal.

Bob Lim commented that looking forward there is a flat demand but substantial increases in opex and capex. Mr Lim asked Jemena if the WACC model is the only thing that accounts for this.

Alf Rapisarda responded by noting that the flat profile for overall consumption increases is not a cost driver. Costs are driven by items such as peak usage patterns, new connections, and ageing of system assets. Costs are likely to increase even with a flat demand curve.

Bob Lim asked whether Jemena could explain the cost allocation for the STTM, and how UAG costs are allocated.

Alf Rapisarda explained that the IT system changes are required to support the STTM. Jemena has proposed a large IT allowance that will cover most of the changes required and therefore it is not a major cost driver. Mr Rapisarda also noted that the UAG costs are included in the total cost of service. There is also a large increase in costs for the introduction of the CPRS.

Bob Lim questioned what state taxes will be levied and if the AER will show more transparency rather than just passing them straight through. Mr Lim commented that in the recent electricity process, the NSW climate change levy may have had a large impact on pricing, and there was a lack of transparency on how these costs are passed through.

Gwenda Gleeson noted that she was not able to comment on the pricing outcomes in the recent electricity process. Ms Gleeson noted that the AER is not responsible for approving all prices in the supply chain for gas, just the network charges and government levies that applied to network businesses.

5. Concluding comments

Gwenda Gleeson expressed her appreciation to the presenters and attendees for their participation and encouraged submissions to be made by the 10 November 2009, then closed the meeting.

Appendix 1: List of attendees

Organisation	Attendees
Jemena	Sandra Gamble, Alf Rapisarda, Mark Allen, Danielle Beinart, Peter Bowden, Jane Duquemin, Peter Marcus, John Kingsley-Jones, Scott Martin.
AGL Energy Limited	Carlos Aliage, Maralyn Aroutsidis, Derek Chapman, Danni Colla, Steve Costar, Craig Dickonson, Jenny Hart, Carol Lydford, Anne-Marie Mazza, Gonzalo Melchor, Josephine Peralta, Irene Tanty, Cassandra Taylor, Stephen Young.
APA Group	Stuart Ronan
Babcock & Brown Infrastructure	Adrian van Jaarsveldt
BlueScope Steel	Phillip Plat
Boral	Phillip Watts
Caltex Refineries	Louise Warner
Climate Friendly Fertiliser	Andrew Phelps
Country Energy	Glenn Balderston, Maree Richards, Garry Williams
CSR Building Products Ltd	Franz Schlechta
Delta Electricity	Justin Flood, Sonia Kolar, Dat Vvong
Energy Markets Forum	Bob Lim
Energy Strategic Sourcing	Jules Knight
Energy Users Association of Australia	Ariel Liebman
EnergyAdvice	Adam Firmstone, Phil Randall
EnergyAustralia	Marc Flynn, Gary Foo, Catherine Marshall
Hunter Gas Users Group	Garbis Simonian
Infrastructure and Regulation Services	Scott Young
IPART	Stephanie Biesaga, Aaron Murray
National Ceramic Industries	Chris Schneider

Origin	David Grove
Qenos Pty Ltd	Andrew Cheah
Solvay Inerox	Davide Papavero
Australian Energy Regulator (AER)	Gwenda Gleeson (Chair), Sonja Eibl, Shane Adams, Tracey Ji, Trevor Johnston, Matthew Le Cornu, Brett McCarthy, Sajjad Minhas, Iftekhar Omar, Shalini Prasad, Henryk Smyczynski, Caleb Stewart, Ben Stonehouse.