

27 March 2015



Via email

Sebastian Roberts  
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Dear Mr Roberts

### **Submission on JGN 2015-20 access arrangement draft decision**

Jemena Gas Networks (**JGN**) welcomes the opportunity to make a submission on the AER's draft decision on JGN's 2015-20 access arrangement (**AA**) proposal (**draft decision**). As previously discussed, we would like to take this opportunity to provide further information on the rate of return, our proposed price path and to submit data updates since our revised proposal was lodged on 27 February 2015.

#### Rate of return

An inadequate rate of return strains our ability to provide a reasonable return to our shareholders, and puts pressure on our ability to deliver critical capital and operating programs that support the safe and reliable operation of the NSW gas network.

We consider that the AER's draft decision rate of return and gamma do not reflect the requirements of the National Gas Rules. This submission includes the following material that responds to the draft decision rate of return and gamma methods:

- two expert reports from SFG that review:
  - the AER's proposed foundation model approach for estimating the return on equity
  - recent changes in yields on commonwealth government securities, updating the return on equity for the final averaging period (discussed below)
- two expert reports from NERA that:
  - update estimates of the payout ratio and redemption rate from tax statistics that are relevant when estimating gamma
  - review literature in support of using the Sharpe-Lintner CAPM, Black CAPM, Fama-French three factor model, and dividend discount model to estimate the return on equity

- one expert report from CEG that analyses the AER's approach to setting the return on debt, updating an earlier version of this report for the final averaging period (discussed below)
- another expert report from UBS that also analyses the AER's approach to setting the return on debt.

### Price path

We believe that the AER has an opportunity to use its final decision price path to better meet customers' preferences and promote the NGO in a more preferable manner that provided for in its draft decision.

We agree with the AER that we should seek to minimise price shocks. However, where the AER has sought to minimise price shocks at the start of the subsequent 2020-25 AA period, this has focussed on a particular year and our distribution prices *only*. It has not taken into account expectations for end-retail prices across the duration of the period. It is well-accepted that these end-retail prices will be trending upwards due to the expected doubling in the wholesale price of gas from 2016.

Our customer feedback was clear:

- rising gas prices and affordability are a concern, particularly for those customers vulnerable to price shocks, both of which are a function of the end-retail price and not just JGN's distribution prices
- stability of end-retail prices over the next five years should be the key driver, rather than other possible options such as steep price decreases followed by steep or steady increases.

I have attached the draft minutes of the February 2015 JGN customer council meeting. The minutes have been endorsed by one council member, and we expect other members' endorsement before or at the next council meeting in June 2015. As noted in the draft minutes:

*Council unanimously agreed that Jemena's proposed price path ('Orange' option in presentation material) will help consumers minimise price volatility and avoid "bill shock" for the next five years.*

The presentation material was included in appendix 1.7 of our revised proposal.

### Expenditure, revenue and price updates

We have updated our proposed 2015-20 AA period expenditure, revenue and prices to reflect:

- an updated (and lower) nominal vanilla WACC—updated for our final averaging period—now 7.06 per cent<sup>1</sup>

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<sup>1</sup> See JGN, *2015-20 response to the draft decision and revised proposal*, 27 February 2015, table 7-1. Note (1) below that table notes that the rate of return will update for the final averaging period (19 January 2015 to 16 February 2015) determined in the AER draft determination for JGN.

- B2B harmonisation—updated for costing refinements to this project (impacting opex step change as well as capex)<sup>2</sup>
- real cost escalators—updated for an error in labour cost escalators for capex, and material cost escalators for both opex and capex to account for the recent AUD depreciation
- opex partial factor productivity—updated for an inconsistency identified within Economic Insight’s econometric modelling.
- the implementation of our tariff-V block two pricing strategy<sup>3</sup> to the initial tariff schedule in the 2015-20 AA, which we did not reflect (in error) in the version submitted with our revised proposal

Updated expenditure, revenue, and pricing models are attached to this letter. We have also attached a revised 2015-20 AA (the initial tariff schedule) to reflect the final bullet point above.

We are pleased to note that, as a result of these proposals, residential customers can expect bill savings of up to \$575 over the 5 year period, compared with the \$563 resulting from our 27 February 2015 revised proposal.

Please feel free to contact me on (03) 8544 9053 or at robert.mcmillan@jemena.com.au if you would like to discuss any aspect of this submission.

Yours sincerely



**Robert McMillan**  
General Manager Regulation  
Jemena Limited

*Attach: Attachment listing  
Attachments A to Q.*

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<sup>2</sup> See JGN, *2015-20 response to the draft decision and revised proposal*, 27 February 2015, chapter 4 and appendix 5.4.

<sup>3</sup> See JGN, *2015-20 access arrangement information*, 30 June 2014, para 490. This is also consistent with our tariff structures statement.

## **Attachment listing**

### *Price path*

Attachment A: new – JGN Customer Council – draft minutes of the February 2015 meeting (**public**)

### *Rate of return*

Attachment B: updated appendix 7.12 – CEG –return on debt expert report (**public**)

Attachment C1: new – SFG – return on equity (**public**)

Attachment C2: new – Guy Debelle – global and domestic influences on the Australian bond market (**public**)

Attachment D: new – NERA – estimating distribution and redemption rates from taxation statistics (**public**)

Attachment E: new – NERA – literature review of the Sharpe-Lintner CAPM, Black CAPM, and Fama-French three factor model (**public**)

Attachment F: new – SFG – review of the AER return on equity foundation model (**public**)

Attachment G: new – UBS – transaction costs in the hybrid transition (**public**)

Attachment H: updated appendix 5.2 – Economic Insights – updated productivity assessment (**public**)

### *Access arrangement*

Attachment I: updated revised 2015-20 Access Arrangement (**public**)

### *Models*

Attachment J: updated appendix 3.3 - demand forecasts adapted for reference tariffs model (**confidential**)

Attachment K: updated appendix 4.1 – capex forecast model (**confidential**)

Attachment L: updated appendix 5.5 – opex forecast model (**confidential and public versions**)

Attachment M: updated appendix 7.15 – rate of return forecast model (**public**)

Attachments N: updated appendix 10.1 – JGN revenue forecast model (**confidential and public versions**)

Attachment O: updated appendix 10.2 – JGN reference tariffs and customer outcomes model (**public**)

Attachment P: new – attachments J to O model change references **(public)**

*Confidentiality claim*

Attachment Q: confidentiality claim **(public)**