# Jemena Gas Networks (NSW) Ltd – Further response to the draft decision

## Attachment 3

## JGN's response to the AER's 31 March questions (public version) submitted on 9 April 2010

28 April 2010

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**1. Question 1 - The AER notes that JGN's proposed operating expenditure has increased from the original proposal as a result of changes to underlying 'base costs'. The AER also understands that there are two primary causes of this increase in base costs;**

**1(a) Question 1a - errors or omissions in the original proposal as identified in correspondence from JGN in December 2009. Please provide a description of the errors and/or omissions from JGN's original proposal, including an explanation as to why the errors were not identified by quality controls and checking, and to the extent relevant, any changes that have subsequently been made to JGN's processes and procedures. We consider a public version of this material is required to explain the additional costs. (The AER notes that the only information provided by JGN has been provided on a confidential basis in its December 2009 correspondence).**

**PUBLIC**

## *Public explanation of omissions*

JGN provides a public version of the 18 December 2009 submission, *Response to AER 11 December 2009 Question*, in appendix 1 to this response. This is the relevant excerpt from the original submission in response to the AER's 11 December 2009 question number 3a. JGN agrees to disclose this information in the interests of helping stakeholders understand that:

- the omissions arise from the manner in which different cost elements are represented for regulatory reporting and forecasting purposes
- the total value of input costs originally submitted in August 2009 was correct and that the process of cost movements and representations is what gave rise to the omissions.

## *Reasons for additional costs*

The reasons supporting the additional cost are that these costs are part of JGN's revealed efficient base year cost base. This means the same reasons as to why an inference could be made as to the efficiency of JGN's other base year costs as previously consulted on, prior to the 18 December 2009 submission, are equally applicable to the additional costs.

Section 9.3.3 of JGN's Initial Response to the Draft Decision has a section titled 'Why JGN and the AER can infer that JGN's base-year cost base is efficient'. In this section, Table 9-8 summarises the relevant considerations that support JGN's base-year cost base.

## *Actions to avoid future omissions*

JGN administers a detailed input and forecasting sign-off process to support its regulatory proposal. This is necessary to support the statutory declaration terms required by the AER's regulatory information notice (RIN).

JGN's original August 2009 proposal included specific sign-offs on the inputs to the opex forecasts including the various cost elements of the efficient base-year cost base. These inputs were correct as documented in JGN's 25 August 2009 forecast data model and discussed in the 18 December 2009 submission – see excerpt at Appendix 1 to this submission.

The omission arose in the manner these inputs were collated into a forecasting cost base, as detailed in the 18 December 2009 submission and replicated in a public version at appendix 1 to this response.

JGN's revised AA revision proposal now includes a specific accountability and sign-off for the manner in which these cost inputs are used for forecasting purposes.

JGN has also obtained an independent expert forensic accounting opinion from PricewaterhouseCoopers (PWC) on all cost elements of its efficient base-year cost base. This is provided in Appendix 9.2 to JGN's Initial Response to the Draft Decision and in the further submission provided on 9 April 2010.

## *Impact of omissions on review process*

JGN has previously noted that it is disappointed that the AER did not rely on the corrected information for the purposes of the AER's draft decision.

JGN notes that it explained and corrected for these omissions in its 18 December 2009 submission and that the AER did not consider the revised material in its draft decision published some seven weeks later on 9 February 2010.

This decision by the AER to not consider JGN's revised submission in its draft decision contrasts to the AER's practice in other price reviews. Below JGN provides recent examples where the AER has relied upon corrected submission information in its draft decision.

ETSA Utilities made an error in its tax calculation that it corrected and which the AER considered in its draft decision four weeks after receiving the correction. Following its initial proposal on 1 July 2009, on 30 October 2009 ETSA submitted to the AER that it had made an error in its tax calculation. The AER's draft decision on 25 November 2009 relied upon the revised material.[1]

ActewAGL Electricity identified an error in its input cost escalators which it revised and the AER considered in its draft decision five weeks later. Following its initial

[1] AER, *South Australia Draft Distribution Determination*, 25 November 2009, p. 278.

proposal on 2 June 2008, on 1 October 2008 ActewAGL Electricity submitted to the AER that it had identified an error in its input cost escalators. The AER's draft decision on 7 November 2008 relied upon revised forecasts that corrected for the identified error.[2]

## 1(b) Question 1b - actual base year expenditure for 2008-09 becoming available and substantially higher than estimated in JGN's original proposal. There is no detailed analysis or description of these changes in JGN's revised proposal. Please provide an explanation for the variance between JGN's estimate and actual outturn expenditure for 2008-09. The explanation should include an assessment of the cost drivers, whether there were one-off or unusual events, and any other reasons for the differences between the estimate provided in JGN's original proposal. Given the extent of the variance and the impact on proposed operating expenditure, a public version of this analysis should be made available.

**PUBLIC**

JGN considers it is neither helpful nor meaningful to explain variances at a cost driver level by reference to the original proposed opex forecast because of the omissions therein which JGN identified and explained in its 18 December 2009 submission (Appendix 1 to this response). JGN detailed the variances arising from the omissions in its 18 December 2009 submission. The following explains variances between JGN's corrected estimate and the actual data submitted on 19 March 2010.

JGN does not consider that the $2.5 million or 2.0 per cent increase in JGN's base year cost base relative to its corrected 18 December submission constitutes a 'substantially higher' estimate.

Notwithstanding this view, JGN provided a comprehensive expert forensic accounting opinion examining the variances between the estimated 2008-09 base year cost inputs and the actual data for that period.[3] Paragraphs 72 and 73 of Appendix 9.2 to JGN's Initial Response to the Draft Decision detail these variances. These variances occurred largely in the Whole of Business Cost Allocation (**WOBCA**) costs – this includes IT which is reported as a direct cost in Table 9-6 of JGN's Initial Response to the Draft Decision in accordance with the cost reporting summarised in Table 9-5 and discussed in Table 3 of JGN's 18 December 2009 submission.

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[2] AER, *Draft Decision Australian Capital Territory Distribution Determination*, 7 November 2008, pp. 66 and 188.

[3] JGN, *Initial response to the draft decision*, 19 March 2010, appendix 9.2, *PwC review of direct, ESF and overhead costs*.

This report identifies that there were a number of one-off costs driving movement in certain WOBCA cost categories. Cells D360, H360:I360, D368 and H368:I368 of the 'Inputs' sheet of JGN's 19 March 2010 Forecast Data Model (Appendix 9.8) demonstrates that these have been appropriately removed.

Given that appendix 9.2 is confidential, JGN's Initial Response to the Draft Decision provided an overview of the variances by opex category in Table 9-6.

JGN now provides the following more detailed non-confidential variance analysis by augmenting Table 9-6 with a summary for the explanation available in Appendix 9.2. This Table also includes explanation of variances for JGN direct costs associated with UAG, marketing and government levies.

**Table 1-1: JGN current efficient cost base in comparison to earlier submissions with variance summary (2009 $ millions)**

| Cost category | Efficient cost base excluding step changes (A) | Estimated cost base in original AA proposal (B) | Corrected estimated cost base submitted on 18 Dec 09 (C) | Difference between current and estimated cost base (A – C) | Drivers of variances |
|---|---|---|---|---|---|
| **O&M** | | | | | These changes are a combination of ESF cost increases and the categorisation of capitalised costs:<br>• Changed ESF's are primarily driven by inclusion of IT amortisation not previously included in the forecast (see Appendix 9.2 paragraph 73.d). This increases overall ESF costs by $12 million, $3 million of which is allocated to JGN via JAM in the secondary WOBCA allocation. This is partially offset by a $7 million reduction in total information services (IS) direct costs, of which $1.5 million is allocated to JGN (via JAM in the secondary WOBCA allocation), following the identification and transfer of IS capital works in progress previously included within IS opex.<br>• There were further increases in ESF's following additional one-off project costs post Feb 2009, however these costs were identified and removed from the final costs allocated to JGN.<br>• A capitalised cost categorisation issue also exists although this has no net change to total O&M because $4 million of costs originally capitalised from JAM Indirect is now capitalised from JAM Direct. |
| JAM direct | | | | | |
| JAM indirect | | | | | |
| JAM share of ESFs | | | | | |
| Outsourcing margin | | | | | |
| Total O&M | 80.68 | 75.95 | 80.32 | 0.36 | |

| Cost category | Efficient cost base excluding step changes (A) | Estimated cost base in original AA proposal (B) | Corrected estimated cost base submitted on 18 Dec 09 (C) | Difference between current and estimated cost base (A – C) | Drivers of variances |
|---|---|---|---|---|---|
| **A&O** | | | | | This variation is a combination of:<br>• JGN's share of increased ESF costs described above as allocated via the primary WOBCA allocation<br>• JGN directs lower due to elimination of the capitalised AA project legal costs from the direct costs and the use of actuals to June 2009. |
| JGN share of ESFs | 18.54 | 15.14 | 16.24 | 2.30 | |
| JGN other direct | 5.62 | 5.89 | 5.89 | -0.26 | |
| Total A&O | 24.16 | 21.02 | 22.13 | 2.04 | |
| **Marketing** | | | | | • This change is explained in section 9.3.4 of JGN's Initial Response to the Draft Decision |
| JGN direct | 6.04 | 6.30 | 6.30 | -0.26 | |
| **UAG** | | | | | • The change arises from a change in methodology. The revised submission uses actual UAG costs as at 30 June 2009 instead of a forecast calculated as 2.1% of forecast demand multiplied by a forecast gas price. |
| JGN direct | 12.66 | 12.24 | 12.24 | 0.42 | |
| **Govt levies** | | | | | • Licence Fee was estimated for the submission. The June actuals used in the revised submission are slightly higher. |
| JGN direct | 2.99 | 3.05 | 3.05 | -0.06 | |
| **Total** | **126.54** | **118.57** | **124.04** | **2.50** | |

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## 2. Question 2 - Page 80 of JGN's original AAI refers to the removal of an 'implied margin' from forecast operating expenditure as it is to be replaced by an explicit margin under the AMA. Please state the amount of the implied margin and identify where it has been deducted from the base costs in JGN's revised proposal including sheet and cell references to the forecast data model as appropriate.

The implied margin is the difference between the operational asset management fee JGN formerly paid to JAM and the costs JAM incurred to deliver services associated with that fee.[4]

JGN's base year roll-forward forecast for operating and maintenance expenditure (O&M) relies upon the revealed underlying costs of JAM. This means it does not roll forward from the former fee, meaning no deduction is necessary. This is why the deduction is not separately identified in the forecast data model.

Removal of the implied margin occurs by virtue of JGN using JAM's underlying costs instead of taking the former fee and deducting down to get to those costs. JGN notes that either method would get to the same outcome, subject to adjustment for the activities that changes responsibility under the AMA from JAM to JGN as detailed in JGN's 18 December 2009 submission.

[4] Value calculated as the 2008-09 agreed fee less JAM costs . The agreed fee is shown at cell G202 of the 'Inputs' sheet of Appendix 9.8 of JGN's Initial Response to the Draft Decision. Here, JAM costs are net of one-offs and are the sum of direct JAM costs, other direct JAM costs, indirect JAM costs, IT costs, JGN ESF costs (via JAM), JGN ESF costs (direct to JGN) and AO commercial group costs: see cells G138:G139, G141:G142, G144, G148 and G155 of the 'Inputs' sheet of Appendix 9.8.

**3. Question 3 - Pages 13 and 14 of appendix 6.1 to JGN's original AAI contains a table of costs allocated using the WOBCA methodology. While the AER has not yet seen a detailed description of all categories in the table on pages 13-14, certain cost categories within this table do not appear to be relevant to the delivery of pipeline services, including:**

**i) SP management fee (The AER notes that this fee has been excluded from JEN's cost allocation method and its forecast operating expenditure)**
**ii) Investment analysis**
**iii) Finance strategy**
**iv) Energy investments**

**Paragraph 6.9-6.14 of appendix 9.7 to JGN's revised AAI describes a 'Portfolio Management Fee', which is also described as being a 'non-regulatory management fee'**

**To the extent that each of the cost categories listed above (from both the WOBCA report and appendix 9.7) is included in JGN's forecast operating expenditure, please explain how the costs are relevant to the delivery of pipeline services under the NGR. To the extent that these costs are not included in JGN's forecast operating expenditure, please outline how the costs have been excluded including where relevant, sheet and cell references to JGN's forecast data model. Further, please confirm how the non-regulatory portfolio management fee was treated in the WOBCA process.**

*Clarification of appendix numbering*

The above question incorrectly identifies the JGN 18 August 2009 board paper submitted on 19 March as 'appendix 9.7 to JGN's revised AAI'. This paper, as its cover page identifies, is appendix 9.7 to JGN's Initial Response to the Draft Decision, not to the revised AAI.

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## *How JGN incurs these corporate costs in delivering pipelines services*

The Jemena Group[8] incurs the abovementioned costs at a corporate level in order to manage a portfolio of assets. These costs relate to activities that contribute to the Jemena Group providing a range of services to customers across the various businesses, including distribution pipeline services provided by JGN to its customers.

In relation to JGN, the activities in question relate to JAM and Jemena Ltd (JEM) supporting JGN's day-to-day operations and enabling the provision of regulated pipeline services. The costs of undertaking these activities are captured at the group level and, as JGN is a significant asset within the Jemena Group portfolio, an appropriate portion of the costs of these activities is passed onto JGN through the WOBCA methodology.

As the AER's question identifies, JGN has provided an expert report from PWC explaining the WOBCA methodology and assessing its reasonableness.[9]

Below, JGN has provided a detailed description of each of the cost categories queried by the AER. JGN provides these descriptions to give a better understanding of the types of activities that underlie these costs.

### *SP management fee*

In order to conduct its day-to-day operations, as any business, JGN needs to be financed and requires governance, compliance and strategic advice. JGN receives this support from Jemena Group (which in turn receives such support from SP). The SP management fee relates to SP providing strategic support within the Jemena Group enterprise support function streams, including:

- Strategic group finance advice
- Group corporate governance and compliance
- Strategic advice regarding management of regulatory matters

Accordingly, JGN receives an appropriate allocation of part of the costs involved in providing such support to the entire group.

[8] Jemena group here is as defined in Jemena Electricity Networks' approved Cost Allocation Methodology dated 18 February 2010.

[9] JGN, *Access Arrangement Information*, 25 August 2009, Appendix 6.1

This fee is separate to the portfolio management fee (PMF) that JGN pays to JAM. As discussed the PMF is not included in JGN's regulated cost base and is excluded from the forecast expenditure in its revised AA revision proposal.

*Financial strategy*

In order to conduct its day-to-day operations, as any business, JGN needs to ensure it has access to operational and fully supported financial systems. JGN also requires financial analysis support for the projects that the business undertakes. The services provided by the financial strategy unit include the following:

- Finance systems
- Finance projects

Finance systems relate to providing support and integrity around the key finance systems, being SAP, focusing on the general ledger. The general ledger is the primary data source for the finance team as a whole. It underpins many of the finance outputs.

Finance projects relates to providing finance support for key commercial and strategic initiatives of the business.

JGN receives financial systems and financial analysis support from the Jemena Group and, accordingly, receives an appropriate allocation of part of the costs involved in providing such support to the entire group.

*Investment analysis*

In order to conduct its day-to-day operations, as any business, JGN must undertake budgeting, forecasting and financial modelling. The services provided by the investment analysis unit include the following:

- group budgeting & forecasting
- ownership of the corporate model and long term forecast
- financial modelling and project support.

The group budgeting and forecasting process includes providing a framework for the business units to prepare their budgets and forecasts. These are then consolidated to report the group budget and forecasts to the executive leadership team, SPIAA board and SPI. This information is used to make strategic decisions for the business, including decision on the capital structure. The information is also used to update stakeholders, including ratings agencies and lenders about the company.

The corporate model is used by the business and SPI to support strategic decision making as noted above. This includes decisions on the most efficient capital

structure for the business as well as supporting the carrying value of the assets of the group.

Modelling support is also provided for specific projects throughout the business, including development projects and regulatory determinations.

JGN receives support for these functions from the Jemena Group and, accordingly, receives an appropriate allocation of part of the costs involved in providing such support to the entire group.

*Energy investments*

The energy investment unit (also referred to as 'infrastructure investments') serves to maximise the financial returns from Jemena's equity investment in wholly-owned or partially owned assets. It achieves this by:

- protecting and creating incremental value in the asset businesses
- effective management of regulatory matters
- effective asset control
- effective management of government relations.

Figure 3-1 of JGN's 25 August 2009 AAI illustrates the role of energy investments within JGN's management structure.

Taking an asset owner perspective, this unit works together with its service provider (JAM) to deliver safe, reliable and value-adding services to customers, while maintaining a long-term focus on the performance of each asset business in the Jemena Group.

The unit has direct management accountability for the performance of wholly owned assets and acts as shareholder representative in the governance of partially owned assets. It regularly reviews the performance of all assets in its portfolio, and works with its shareholder to identify additional and alternative investments to increase returns.

The unit also monitors changing trends and technologies which may impact on our business and develops plans for the business to adapt to a changing future.

The energy investments unit provides support for JGN's day-to-day operations (including regulatory management), which relate to the full range of services provided by JGN. JGN receives an appropriate allocation of part of the costs involved in providing such support to all assets in the group.

## 4. Question 4 - JGN's response to the AER's questions dated 11 December, at page 4, breaks down the delivery of O&M services between insource, competitive tender and other. The AER understands from this breakdown that the 'other' category represents services delivered by a party other than JAM, but not awarded on the basis of a competitive tender. Is that correct?

This category captures costs that are not necessarily awarded through competitive tender, such as selectively awarded contracts and restoration works that JAM is required to procure from local governments. There are a number of broad items that make up the other sourced O&M expenditure for the JGN financial year 2008-09. The following explains these to elaborate on what this category captures. Figure 4-1 illustrates the materiality of these categories.

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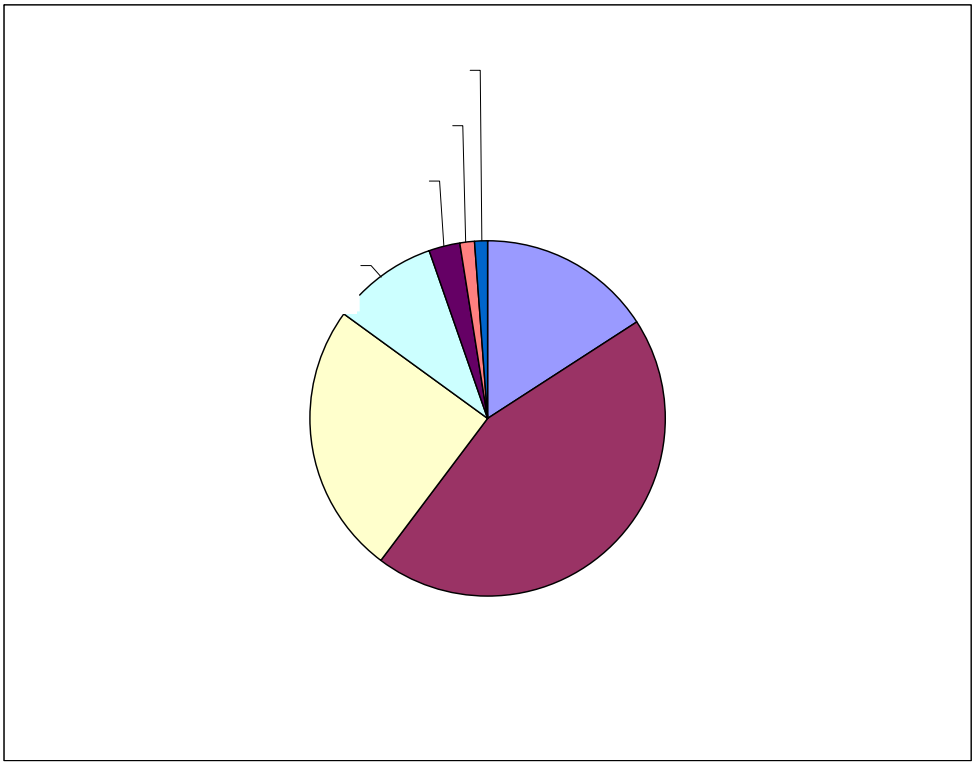

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Consultancy services are also included in the "other" sourced category.

Consultant services are mostly used to provide additional labour resources for asset management activities. The majority of this category is provided under selectively awarded contract to consultant engineering firms.

restoration operating costs. These costs are charges from local councils to restore sites.

The remaining "other" category are a miscellaneous grouping of smaller costs that include utilities, rates, repairs and maintenance associated with network facilities properties. These costs were included in the other category because, given the timeframes for the response to the 11 December 2009 questions, JGN was unable to investigate the source of all minor O&M costs.

These miscellaneous costs are undertaken in accordance with JGN's procurement policy[10] which requires, unless exempted in advance, that purchases costing more than $2,500 obtain a minimum of three quotes.

Table 4-1 sets out the breakdown of expenditure sourced in the "other" category.

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[10] JGN, *Initial Response to the Draft Decision*,19 March 2009, appendix 3b.11.

## 5. Question 5 - JGN states on page 3 of its response to the draft decision that "The benchmarking of JGN continues to show that its costs compare very favourably with its peers." Could JGN please provide the benchmarking analysis that underpins this statement.

**PUBLIC**

JGN is referring to the benchmarking analysis provided in Appendices 6.7, 7.4 and 7.5 of its August 2009 AAI as well as Appendix 7 of its 10 November 2009 submission.

## 6. Question 6 - Please provide a list of projects for which business cases have been prepared. Please indicate those projects that Jemena has approved.

In total JGN has identified 36 projects that have business cases. These projects are set out in Table 6-1.

**Table 6-1: Business Cases with committed cost estimate**

| Project | Approval status |
|---|---|
| Yass POTS Temp heating for coating repairs & upstream metering Upgrade | Approved |
| Prestons SRS CDP | Approved |
| Dapto Koonawarra Capacity Development | Approved |
| Horsley Capacity Development Project - Stage one | Approved |
| Gauging System replacement of obsolete equipment | Approved |
| Loftus / Engadine Capacity Development (Stage two) | Approved |
| Kanahooka CDP | Approved |
| ALBV Minor Aged Upgrade Works - Phase one | Approved |
| Wollongong POTS/ Yahllah TRS / Albion Park | Approved |
| Lane Cove PRS | Approved |
| Installation of Riverwood PRS - Capacity Development Project | Approved |
| Rocky Ponds Mines Subsidence Mitigation | Approved |
| SDRS Upgrades (COCON) | Approved |
| Central West Pipeline Upgrades | Approved |
| Wollongong contingency project | Approved |
| Enfield South / Canterbury CDP (SRS) | Approved |
| Belmore CDP (SRS) | Approved |
| Young Capacity Development Project (Moppity Rd) | Approved |
| Bowral CDP (Old South Rd) | Approved |
| Kelso CDP (Marsden Ln - Part One) | Approved |
| Raby Capacity Development Project | Approved |
| Wollongong North CDP Stage One | Approved |
| Wollongong (Loftus St) CDP | Approved |
| Licence 1 integrity digs & repairs | Approved |
| Licence 2b integrity digs / repairs | Approved |
| Sydney Primary Main Integrity Digs | Approved |
| North Ryde PRS - Regulator/Instrumentation Upgrade | Approved |
| Wakehurst Parkway Secondary Main | Awaiting Approval |
| Woodford Capacity Development Project (RTA One) (interconnection) | Awaiting Approval |
| Newcastle MP1 CDP Part two | Awaiting Approval |

| Project | Approval status |
|---|---|
| Smithfield-Liverpool Programmed Mains and Services Area Renewal | Awaiting Approval |
| Motor Vehicles | Awaiting Approval |
| Distribution Network and Load Management Systems | Awaiting Approval |
| AA Services | Awaiting Approval |
| CABS Technology Upgrade | Awaiting Approval |
| STTM | Awaiting Approval |

## 7. Question 7 - Please provide routine and non-routine capex by the categories 'Competitive tender', 'Insource' and 'Other' as per the attached spreadsheet <<2010 03 28 - GDR 2010 - Jemena capex.xls>> (shaded cells). For capex that has not yet been allocated to routine and non-routine capex, please provide estimates for routine and non-routine capex.

Please see the spreadsheet named “AA10-AO-74802A AER Spreadsheet Requesting Split of JGN CapEx” provided in the same email in which this document was provided on 9 April 2010.

## 8. Question 8 - The depreciation amounts in Table 9-1 (p. 38) and Table 9-4 (p. 40) in the revised access arrangement proposal do not appear to be consistent with the total depreciation amounts reported at Table 7-8 and Table 7-11 of the revised access arrangement proposal. A check of Appendix 10 JGN regulatory model.xls shows that Table 9.1 and Table 9-4 do not appear to be reported correctly in the revised access arrangement proposal. Could you please verify the values of depreciation reported at Tables 9-1 and Table 9-4 of the revised access arrangement information proposal?

**PUBLIC**

The depreciation values in 'Appendix 10 JGN regulatory model.xls' to JGN's Initial Response to the Draft Decision and Table 7-8 of the revised AAI revision are correct. However, Table 7-11, Table 9-1 and Table 9-4 of the revised AAI revision contain pasting errors.

- *Table 7-11*—All values in the four rows headed "Less Depreciation", "Less Capital Contributions", "Less Disposals" and "Add Reused redundant assets" should be raised by one row and all values in the row headed "Add Reused redundant assets" should be zero.

- *Table 9-1 and Table 9-4*—Values in Table 9-1 and in the "Total" row of Table 9-4 should be equal to corresponding values in the "Less Depreciation" row of Table 7-8, and the totals for all years in Tables 9-1 and 9-4 should be 554.1 and 554.09 respectively.

- *Table 9-4*—Values in the "Distribution network" row should equal corresponding corrected values in the "Less Depreciation" row of Table 7-11 and the total for all years should be 537.23.

All these changes are marked in the attached excerpt from the revised AAI revision in Appendix 2 .

## 9. Question 9 - On p. 51 of Jemena's initial response to the draft decision, in referring to the high pressure system assets Jemena states 'a significant proportion of these assets are now reaching, and in some cases have exceeded, the end of their usable lives.' Using the asset register for 2009, could Jemena please indicate for which of the listed assets this statement applies, and the reason and/or supporting assessment that leads to this conclusion.

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The statement that “a significant proportion of these [high pressure system] assets are now reaching, and in some cases have exceeded, the end of their usable lives” applies to significant components and systems associated with the following types of high pressure assets:

- Trunk Receiving Station (TRS)
- Primary Receiving Station (PRS)
- Package Off-Take Station (POTS)
- Automatic Line Break Valve (ALBV).

These assets were for the most part designed and constructed in the 1970s or early 1980s to meet standards and performance requirements applicable at the time. Significant proprietary and non-standard components of the assets must now be replaced for the following reasons:

1. obsolete technology and lack of support from original equipment manufacturers mean that parts are unavailable or difficult to source and maintenance and repairs are difficult and costly as a consequence
2. some components cannot meet current performance standards and requirements
3. it is becoming increasingly difficult to meet modern OHS, technical and environmental compliance requirements e.g. backup control systems result in venting of gas, vibration can lead to fatigue failures, and noise levels can be excessive
4. for some assets, capacity is inadequate to meet forecast demand growth.

JGN plans to upgrade the following high pressure assets of the types referred to above during the next AA period as outlined in Table 9-1 below.

**Table 9-1 High pressure assets to be upgraded during the next AA period**

| Asset | Reference in 2009 Asset Register * | Asset class ** | Principal reason(s) for upgrade (refer to list above) |
|---|---|---|---|
| Appin POTS | 6017458 | FXPL | 2, 3 |
| Gosford TRS | 6017453 | FXPL | 1, 2, 4 |
| Campbelltown TRS | 6017447 | FXPL | 4 |
| Wyong TRS | 6017452 | FXPL | 1, 4 |
| Horsley Park TRS | 6017450 | FXPL | 1, 2, 4 |
| Wyee and Morisset | 6017460 and 6017459 | FXPL | 4 |
| Windsor TRS | 6017456 | FXPL | 1, 2 |
| Goulburn TRS | 6018023 | POTS | 2, 4 |
| Yass POTS | 6018033 | POTS | 2, 4 |
| Riverina HP Facilities | 6018041 Griffith, 6018031 Junee, 6018034 Coolamon, 6018038 Rockdale, 6018039 Leeton, 6018035 Murrami, 6018037 Narrandera | POTS | 2 |
| Central West facilities | 6018047 to 6018050 | POTS | 2 |
| Auburn PRS | 6017388 | FXPL | 1, 2, 3 |
| Mascot PRS | 6017393 | FXPL | 1, 2, 3 |
| Tempe PRS | 6017389 | FXPL | 1, 2, 3 |
| North Ryde PRS | 6017390 | FXPL | 1, 2 |
| Banksmeadow PRS | 6017394 | FXPL | 1, 2, 3 |
| Haberfield PRS | 6017396 | FXPL | 1, 2, 3 |
| ALBVs at Auburn, Flemington, Haberfield, Lidcombe, Wetherill Park, Mascot, Putney, Tempe, Yennora | 6017465 Sydney, 6017466 Wollongong, 6017467 Newcastle | FXPL | 1, 2, 3 |
| ALBVs at Wilton Southern, Mt. Keira, Menangle Park, Catherine Field, Cecil Park, Horsley Park, Plumpton, Pitt Town, Canoelands Road, Gosford, Wyong, Freemans Waterholes, Hexham, Hexham-Maitland line | 6017465 Sydney, 6017466 Wollongong, 6017467 Newcastle | FXPL | 1, 2, 3 |

Notes:

* Base assets only. Any upgrades are part of other asset numbers.

** FXPL denotes fixed plant.

The basic pipework, fittings and equipment that form part of each asset remains serviceable so, in no case will the entire asset be replaced. The proposed expenditure is prudent and will:

- ensure long term asset integrity and extend the life of the assets
- bring assets into compliance with current OHS and environmental requirements
- enhance the performance of the assets
- reduce future repair and maintenance costs.

## 10. Question 10 - The total number of new customer connections in the revised access arrangement information for 2008-09 (25,423) and 2009-10 (30, 979) is 56,402 (table 4.4 pp. 14-15), which is 12 per cent higher than the number of new connections of 50,440 in Jemena's original proposal (table 5-11 p. 69 of the access arrangement information). However, over the same period the level of market expansion capital expenditure is revised downwards from $102.8 million to $98.5 million (table 4.8 p. 49 of the access arrangement information and table 3.5 p. 11 of the revised access arrangement information). What are the reasons for the lower market expansion capex despite the higher number of new connections?

In reviewing the data while preparing this response JGN has identified an error in the method it used to produce the 2009-10 market expansion capital forecast in the 19 March 2010 initial response submission.. The 2009-10 market expansion figure was not derived using the updated NIEIR connection forecast and unit rate driven model used in the original submission, and did not reflect the significant impact the Governments stimulus package identified in the NIEIR forecast.

This error only affected the 2009-10 year market expansion capex forecast not the remainder of the forecast periods 2011-10 to 2014-15.

Table 10-1 below identifies the variance between the original and revised AA revision proposals.

Market expansion cost per new connection can vary as a result of the changing mix of medium and high density connections, however this variation is generally between 10 and 15 per cent. The variation in the 2009-10 is clearly outside the normal range and confirms the error.

**Table 10-1: Identified variance between original and revised submission**

| | 25 August 2009 Submission | | 19 Mar 2010 Submission | |
|---|---|---|---|---|
| | **2008-09** | **2009-10** | **2008-09** | **2009-10** |
| New Connections | 22,967 | 27,473 | 25,423 | 30,979 |
| Market Expansion Capex | $48.9m | $53.9m | $49.7m | $48.8m |
| Cost/New connection | $2,129 | $1,962 | $1,955 | $1,575 |

The table below compares the original and revised submission market expansion capital forecasts and an amended forecast calculated using the updated NIEIR

connection forecast and volume and unit rates model. The amended forecast below is also consistent with the 2008-09 actual average cost per connection and actual unit rates for the period July 2009 to February 2010. JGN proposes to replace the 2009-10 market expansion capital forecast in it's AAI with the amended forecast in Table 10-2 and make the consequential amendments to other documents and models.

**Table 10-2: Comparison of original and revised submission**

| | **25 August 2009 Submission 2009-10** | **19 March 2010 Submission 2009-10** | **Amended forecast 2009-10** |
|---|---|---|---|
| New Connections | 27,473 | 30,979 | 30,979 |
| Market Expansion Capex | $53.9m | $48.8m | $60.1m |
| Cost/New Connection | $1,962 | $1,575 | $1,940 |

## 11. Question 11

### 11(a) Question 11a - From 2009-10 to 2010-11 the number of new connections is forecast to increase by only 2 per cent from 30,979 to 31,651 (table 4.4 pp. 14-15 of the revised access arrangement information), yet market expansion capex is forecast to increase by 25 per cent from $48.8 million to $61.2 million (table 3-5 p. 11 and table 6-1 p. 19 of the revised access arrangement information). What is the explanation for this difference?

As identified above the 2009-10 market expansion capital forecast provided in the 19 March 2010 submission is incorrect. When the 2010-11 market expansion capital expenditure of $61.2 million is compared to the amended 2009-10 forecast of $60.1 million the increase is 2 per cent, consistent with the increase in new connections.

### 11(b) Question 11b - What is the explanation for the steep increase (22 per cent) in new connections from 34,243 in 2012-13 to 41,664 in 2014-15 (table 4.4 pp. 14-15 of the revised access arrangement information)?

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The increase in new connections is driven by the cyclic upturn in NSW new dwelling construction as forecast by NIEIR. Over the past 5 years NSW has constructed significantly fewer new dwellings than the underlying demand for housing, and as a consequence NIEIR have forecast a significant increase in new dwelling construction as access to capital for housing construction improves throughout the economic cycle. Subsequent to the December 2008 forecast, new housing approvals fell to record low levels in NSW, further increasing the gap between underlying demand and actual new dwelling construction. A year on year increase of more than 10,000 new connections is not usual in the NSW market, and reflects the cyclic nature of the housing market.

### 11(c) Question 11c - In the revised access arrangement information the number of new connections is forecast to increase from 34,243 in 2013-13 to 45,937 in 2014-15 (table 4.4 pp. 14-15), whereas in Jemena's original proposal the number of new connections was forecast to decrease from 41,932 to 32,755 over the same period (table 5-11 p. 69 of the access arrangement information). What is the explanation for this change?

The difference in new connection forecast is based on the changed economic conditions and future projections of NSW economic activity between the original forecast developed in December 2008 and the reforecast completed in February 2010. A feature of this forecast update is a much stronger rebound in the housing sector, as despite the financial crisis, population growth in Australia remains at very high levels. As stated above, yearly variations in new dwelling construction can be significant, JGN believes the variation between the two forecasts is reasonable given the significantly different economic conditions and forecasts between December 2008 and February 2010.

## 11(d) Question 11d - On page 63 of Jemena's response to the draft decision Jemena states 'in updating its forecast capex, JGN has updated its system expansion capex to reflect the new forecast connections but has used the same unit rates as were included in its original proposal.' Could Jemena please provide the data and calculations that demonstrate this. Could Jemena please also provide updated information to the tables headed 'Growth volumes' and 'Growth capex' in Appendix 7.6 of the access arrangement information (original proposal).

The underlying unit rates for both the August 2009 proposal and the March 2010 initial response are the same.

Table 11-1 sets out the market expansion unit rates in JGN's original AA revision proposal. The amendments to the calculation of inflation and adjusted escalators that JGN incorporated into its Initial Response in March resulted in changes in the forecast unit rates. The change to forecast unit rates as a result of incorporating changes to inflation are set out in Table 11-2. The change to forecast unit rates as a result of incorporating adjusted escalators are set out in Table 11-3.

The values in Table 11-2 and Table 11-3 are the difference between the original proposal and the 19 March 2010 revised AA revision proposal unit rates. JGN has provided the revised unit rates in Table 11-4. It is on this basis that JGN supports its statement that the same unit rates were used in its 19 March 2010 revised AA revision proposal. All dollars are $2010.

**Table 11-1: Unit Rates in original proposal**

| Description | Unit of unit rate | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|---|---|
| **Mains** | | | | | | | |
| E to G | metre of mains | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| New Estates | metre of mains | | | | | | |
| Medium Density / High Rise | metre of mains | | | | | | |
| I & C Tariff | metre of mains | | | | | | |
| Contract | metre of mains | | | | | | |
| **Services** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |
| **Meters** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |

**Table 11-2: Inflation changes in unit rates**

| Description | Unit of unit rate | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|---|---|
| **Mains** | | | | | | | |
| E to G | metre of mains | | | | | | |
| New Estates | metre of mains | | | | | | |
| Medium Density / High Rise | metre of mains | | | | | | |
| I & C Tariff | metre of mains | | | | | | |
| Contract | metre of mains | | | | | | |
| **Services** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Medium Density / High Rise | Number | 11.47 | 11.47 | 11.47 | 11.47 | 11.47 | 11.47 |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |
| **Meters** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |

**Table 11-3: Escalator changes in unit rates**

| Description | Unit of unit rate | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|---|---|
| **Mains** | | | | | | | |
| E to G | metre of mains | | | | | | |
| New Estates | metre of mains | | | | | | |
| Medium Density / High Rise | metre of mains | | | | | | |
| I & C Tariff | metre of mains | | | | | | |
| Contract | metre of mains | | | | | | |
| **Services** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |
| **Meters** | | | | | | | |
| E to G | Number | | | | | | |
| New | Number | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Estates | | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |

**Table 11-4: Unit rates in revised proposal**

| Description | Unit of unit rate | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|---|---|
| **Mains** | | | | | | | |
| E to G | metre of mains | | | | | | |
| New Estates | metre of mains | | | | | | |
| Medium Density / High Rise | metre of mains | | | | | | |
| I & C Tariff | metre of mains | | | | | | |
| Contract | metre of mains | | | | | | |
| **Services** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |
| **Meters** | | | | | | | |
| E to G | Number | | | | | | |
| New Estates | Number | | | | | | |
| Medium Density / High Rise | Number | | | | | | 92 |
| I & C Tariff | Number | | | | | | |
| Contract | Number | | | | | | |

The market expansion unit rates in the revised proposal of 19 March 2010 underpin the market expansion capex forecast. To assist in understanding the market expansion capex the spreadsheet named AA10-SA-74814A Amended market

expansion unit rates volumes and capex - CONFIDENTIAL.xls has been provided in the 9 April 2010 email. This spreadsheet demonstrates that when the unit rates from Table 11-4 are multiplied by the relevant growth volumes the result is the market expansion capex for JGN.

For the growth volumes and the growth capex as per the AER's request also refer to the fore mentioned spreadsheet.

## 12. Question 12 - Please provide the data and calculations underpinning Table 11-5 of Jemena's initial response to the draft decision.

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The confidential spreadsheet "AA10-SM-70801A Figure 11-5 - Volume market disaggregated extrapolation - CONFIDENTIAL" provided in the email on 9 April 2010 documents the requested calculations. The calculation that underpins Figure 11-5 is set out in the 'Disaggregated extrapolation' sheet. The basis for the disaggregated extrapolation calculation is described on pages 209-10 of JGN's Initial response to the draft decision dated 19 March 2010 as follows:

Even if trend extrapolation was considered an acceptable forecasting methodology, the question must be asked whether ACIL Tasman's gross approach is the best available in the circumstances. In JGN's view it is not.

The volume market has three distinct components:

- existing residential customers
- new residential customers, comprising transfers from electricity to gas (E to G) and new homes
- business customers.

Between them, over one million existing and new residential customers account for approximately two thirds of volume market consumption and the 30,000 business customers account for the remaining one third. The three components each have very different characteristics and drivers.

If the forecast is to be developed by extrapolation then, to be as rigorous as possible, the approach should be applied at the level of the relevant market components and the resulting components aggregated into a total. To illustrate the inadequacy of the ACIL Tasman extrapolation, JGN has developed its own extrapolation at a more disaggregated level. In building up this extrapolation based forecast JGN has extrapolated trends for:

- average consumption per E to G customer
- average consumption per new home customer
- the number of existing (as at 2003) residential customer
- aggregate load for existing (as at 2003) residential customers
- average consumption per business customer

When these extrapolated trends are combined with forecast numbers of customers, the resultant forecast consumption for the volume market is lower than both NIEIR and ACIL Tasman as shown in Table 11-5.

In JGN's view, if extrapolation is to be the basis for forecasting, this result has a much stronger analytical foundation than ACIL Tasman's. ACIL Tasman's gross extrapolation forecast is also shown on the graph along with the JGN/NIEIR forecast which JGN proposes to adopt.

## 13. Question 13 - Could you provide us with a marked-up version of the reference services agreement?

JGN has provided this document in the email sent on Friday 9 April 2010.

## 14. Question 14 - Could you provide us with word versions of the access arrangement proposal, access arrangement information and the reference services agreement, this is to assist us in our final decision processes and in circumstances where the AER may need to make its own access arrangement proposal.

JGN has provided these documents in the email sent on Friday 9 April 2010. In providing the word documents JGN requests that changes made by the AER be tracked to facilitate discussions resulting from any proposed changes.

## Glossary

| | |
|---|---|
| ALBV | automatic line break value |
| AMA | asset management agreement between JGN and JAM |
| AMP | asset management plan |
| CDP | capacity development project |
| FXPL | fixed plant |
| HP | high pressure |
| JAM | Jemena Asset Management Pty Ltd, ACN 086 013 461 |
| JGN | Jemena Gas Networks (NSW) Limited, ACN 003 004 322 |
| POTS | packaged off-take |
| PRS | primary regulating station |
| RIN | regulatory information notice |
| SRS | secondary regulator set |
| STTM | short term trading market |
| TRS | trunk receiving station |
| WOBCA | whole of business cost allocation |

# Jemena Gas Networks (NSW) Limited

## Appendix 1- Excerpt from JGN 18 December 2009 submission

9 April 2010

## 1.4 Question 3a - Can you confirm that all of the WOBCA/ESF costs are charged to operating expenditure as either O&M (JAM contract costs) or Administration and Overhead (JGN direct costs).

JGN confirms that the majority of WOBCA ESF costs are charged to operating expenditure as either O&M through the secondary allocation or Administration and Overhead (A&O) through the primary allocation, however there is also an adjustment to deduct costs that are capital in nature. These costs were backed out of the secondary allocation along with the other adjustments made to these costs identified in Table 3 of JGN's response below.

As discussed in JGN's access arrangement information (AAI), JGN had to make certain adjustments to the WOBCA ESF costs to ensure these reflected:

- recurrent costs through removal of one-off costs
- future asset management agreement conditions through the transfer of certain functions between JGN and JAM.

These adjustments affected the total level of costs reported in the O&M and A&O opex categories.

In addition to these adjustments, JAM also transferred certain WOBCA costs between the costs delineations within the O&M category. JAM moved certain costs from the secondary ESF pool into its direct costs. This was not done to affect the total value of recoverable costs. Instead, it simply ensured these costs were reported in a manner that best reflected their direct attribution.

The WOBCA costs that JAM considered to be directly attributable to the JGN services related to:

- IT
- SOP rents
- telecommunications charges for JGN's remotely read metering equipment.

In addition, JAM transferred certain cost reported as indirects in the PwC report (page 4 and paragraphs 96 to 102) to the unrecovered direct cost category.

Table 3 sets out all the adjustments to the WOBCA cost allocations that are necessary in order to establish the appropriate base year opex and which JGN and JAM applied to reflect the underlying reality as outlined in Access Arrangement Information.

JGN notes that its further investigation following the AER's recent questions has identified some areas where the necessary adjustments were not made or certain adjustment incorrectly applied. These are identified in Table 3 as:

- underlined text for omitted adjustments
- ~~strikethrough text~~ for errors.

The following sections explain each omission and correction. These explanations are based on the data input JGN submitted on 26 August 2009 in its forecast data model and the accompanying PwC report in Appendix 6.1.

These explanations set out the required amendments to the forecast data model calculations (not inputs) and the resulting opex forecasts.

**Table 3 – Adjustments to WOBCA outputs ($ million)**

| | JAM Directs | Unrecovered directs | JGN Directs (not part of O&M) | JAM Indirects | Primary ESFs (not part of O&M) | Secondary ESFs | Reason for adjustment | Source in PWC (where applicable) |
|---|---|---|---|---|---|---|---|---|
| PwC Report | | | | 17.63 | 16.73 | 28.02 | | Page 4. JGN allocation |
| JAM Direct OPEX | 44.16 | | | | | | | |
| Remove one-off costs | | | | | - 1.59 | - 2.65 | Remove to prepare a recurrent base year | Page 13. One off costs |
| Transfer AO commercial group | | | + 1.4 | - 1.4 | | | Reflects the organisation of these activities under the AMA | Part of page 4, 22, JAM Indirect |
| Transfer regulatory | | | | | + 1.10 | - 1.10 | Reflects the organisation of these activities under the AMA | Page 13. Regulatory |
| Transfer SOP rent | | + 1.69 | | - 1.69 | | | Reflects that the cost is a directly attributable cost rather than an overhead | Part of page 4, 22, JAM Indirect |
| Transfer of Telecommunications | | | | | | ~~-3.69~~ | This adjustment was duplicated through the transfer of IT costs below and had been applied as a deduction without a corresponding addition | Part of page 13. Information Systems |
| Transfer residual directs | | + 5.7 | | - 5.7 | | | Reflects that the cost is a directly attributable cost rather than an overhead | Part of page 4,22, JAM Indirect |
| Transfer IT costs | + 15.69 | | | | | - 15.69 | Reflects the removal and re-inclusion of IT costs to adjust for IT growth and that the cost is a directly attributable cost rather than an overhead | Page 13. Information Systems (+105k IT depreciation adjustment) |

| | JAM Directs | Unrecovered directs | JGN Directs (not part of O&M) | JAM Indirects | Primary ESFs (not part of O&M) | Secondary ESFs | Reason for adjustment | Source in PWC (where applicable) |
|---|---|---|---|---|---|---|---|---|
| Remove capitalised overheads | | | | - 4.75 | | - 3.93 | Reflects that JGN recovers the costs through its capitalised overhead recovery | Page 13. Information Systems, Depreciation and Health & Safety.<br>Part of page 4,22 , JAM Indirect |
| **Intended outcome** | **59.85** | **7.39** | **+ 1.4** | **4.09** | **16.24** | **4.64** | | |
| **25 Aug 2009 regulatory submission** | **59.85** | **5.7** | **+ 1.4** | **4.09** | **15.14** | **0.69** | | |

Note.
Residual directs are primarily regional JAM costs which are essentially client specific indirect costs not recovered from the direct charging of labour to capital jobs. This would include regional and operational management and support costs including costs such as unrecovered labour, general training, team meetings and non specific client travel, accommodation, and administration.

### 1.4.1 Commercial (regulatory) team costs

As noted in JGN's response to question 10 of the AER's 20 October 2009 questions sent on 27 November 2009. JGN has identified that whilst the appropriate adjustments were made to remove the regulatory team costs from the secondary allocation, the related adjustment to include the costs with the primary allocation was not made. JGN set out the required corrections for this item in its 27 November 2009 submission.

### 1.4.2 Sydney Olympic Park rent

JGN backed out the cost for SOP rent from the JAM indirects at "Inputs" G384. JGN should have added this back to the value of unrecovered directs at G127 but omitted this step. The correction for this is to add the value of SOP rent as part of the sum for unrecovered direct costs at G127.

### 1.4.3 Telecoms

JGN backed out telecoms from ESF secondary allocation. This can be seen in the submitted forecast data model at "Inputs" G382. JGN should not have made this separate deduction. This is because telecoms is a subcomponent of the information services WOBCA category. This category was transferred in its entirety to JAM direct costs as discussed below. Consequently, JGN had deducted these costs twice whilst only adding them back in a directs once given a net position that was understated by $3.69 million.

The correction for this is to make the value of G382 zero.

### 1.4.4 Result of corrections

As can be seen from the above explanation and the corresponding calculations in the submitted forecast data model, JGN had in effect:

- transferred the telecoms costs once, but had inadvertently deleted them twice
- deleted but not transferred the SOP rents.

This resulted in the base year JAM O&M costs being $5.64 million ($2008) lower than the firm's actual costs. Table 4 sets out the corrected O&M forecast.

**Table 4 – Corrected OPEX Forecast**

| | | | Next AA Period | | | | |
|---|---|---|---|---|---|---|---|
| **Category** | **2008-09 (base yr)** | **2009-10** | **2010-11** | **2011-12** | **2012-13** | **2013-14** | **2014-15** |
| Total Non O&M | 49.43 | 48.62 | 50.70 | 55.41 | 63.20 | 65.38 | 67.51 |
| O&M | 88.10 | 85.60 | 90.98 | 90.79 | 94.00 | 96.92 | 100.51 |
| Total OPEX | 137.53 | 134.22 | 141.67 | 146.20 | 157.21 | 162.30 | 168.03 |

Table 4 is the corrected version of Table 6-1 on page 75 of the Access Arrangement Information.

### 1.4.5 *Impact of correction in context of AA review*

JGN has to date submitted its 2008-09 base year costs on the basis of part actual and part forecast data with the intent to update this information once available. The above errors would have been identified when JGN submits its full year actual costs. However, JGN considers it important to point out this initial omission at this stage of the review process.

JGN is currently working to complete the collation and external validation of its actual base year costs and will have this information available in the first quarter of 2010.

# Jemena Gas Networks (NSW) Limited

## Appendix 2 -
## Corrected Tables 7-11, 9-1, 9-4

9 April 2010

# 7 Regulatory asset base

## 7.1 Summary

JGN has determined that the combined total of its RAB at 1 July 2010 is $2,996million ($nominal) and is forecast to be $3,038 million at 30 June 2015 ($nominal), as shown in Table 7-1.

**Table 7-1: Forecast value of RAB at 30 June 2015 ($nominal)**

| Asset class | Closing RAB at 30 June 2015 |
|---|---|
| Wilton-Wollongong trunk | 12.74 |
| Wilton-Newcastle trunk | 146.56 |
| NSW distribution network | 2,910.07 |
| **Combined total** | **3,069.38** |

In 2005 IPART agreed to JGN's proposal to treat the four pipelines that comprised its NSW network as a single covered pipeline for the purposes of the gas code and AA. In its decision on the 2005 AA, IPART required JGN to maintain separate capital bases for each of the Wilton to Newcastle and Wilton to Wollongong transmission pipelines and the distribution system, in addition to the aggregated capital base.[1] The AER has imposed similar terms in its AA consolidation direction. JGN has prepared its RAB roll forward by these three capital bases.

## 7.2 Opening capital base for the current AA period

**Table 7-2: JGN's closing RAB as at 30 June 2005 ($nominal)**

| Asset class | Closing RAB 30 June 2005 |
|---|---|
| Wilton-Wollongong trunk | 10.6 |
| Wilton-Newcastle trunk | 124.0 |
| NSW distribution network | 1,832.8 |
| **Combined total** | **1,967.4** |

Notes: Closing RAB for Wilton-Wollongong trunk is before 20 per cent reduction require by IPART.

## 7.3 Closing capital base for the current AA period

JGN has adjusted its capital base as follows:

capital base = opening capital base + indexation at CPI + conforming capital expenditure – depreciation – capital contributions + conforming assets from speculative investment account – redundant assets + re-used redundant assets – asset disposals[2]

[1] AER letter to JGN dated 5 June 2009.
[2] NGR rule 77.

**Table 7-3: Increase in consumer price index**

| Financial Year | Annual increase in the consumer price index (per cent) |
|---|---|
| 2006 actual | 3.98% |
| 2007 actual | 2.07% |
| 2008 actual | 4.51% |
| 2009 actual | 1.46% |
| 2010 forecast | 3.00% |

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Notes: Values up to 2009 are year on year CPI inflation for the year to June for 8 capital cities as published by the Australian Bureau of Statistics. The value for 2010 is as forecast by the Reserve Bank of Australia in its May 09 *Monetary Policy Statement*.

Source: Australian Bureau of Statistics and Reserve Bank of Australia.

The closing capital base for the current AA period is set out in Table 7-4, Table 7-5, Notes:Opening RAB for Wilton-Wollongong trunk is after 20 per cent reduction require by IPART.

Table 7-6 and Table 7-7.

**Table 7-4: Roll forward of combined total capital base over current AA period ($nominal)**

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Opening balance (before revaluation) [3] | 1,965.3 | 2,051.4 | 2,131.8 | 2,238.7 | 2,273.7 |
| Add capex (before revaluation) | 86.3 | 118.7 | 99.7 | 93.7 | 100.0 |
| Add revaluation of assets | 79.6 | 43.7 | 98.1 | 33.3 | 69.6 |
| Less depreciation | 67.9 | 73.7 | 81.4 | 82.9 | 83.9 |
| Less capital contributions | 6.2 | 4.3 | 7.8 | 8.6 | 3.8 |
| Less disposals | 5.7 | 3.9 | 1.7 | 0.3 | 2.0 |
| Add reused redundant assets (end year) | 0.0 | 0.0 | 0.0 | 0.0 | 3.5 |
| **Closing balance** | **2,051.4** | **2,131.8** | **2,238.7** | **2,273.7** | **2,357.0** |

Notes: Values for 2009-10 are forecast. JGN has derived historical amounts from the regulatory asset register that it has maintained in accordance with section 9.1 of its current AA. These notes apply to the following three tables also.

**Table 7-5: Roll forward of Wilton to Wollongong trunk pipeline capital base over current AA period ($nominal)**

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Opening balance (before revaluation) | 8.5 | 8.7 | 8.7 | 8.9 | 8.8 |
| Add capex (before revaluation) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Add revaluation of assets | 0.3 | 0.2 | 0.4 | 0.1 | 0.3 |
| Less depreciation | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |

[3] In his and following roll forward tables Opening Balances and half of the real equivalent of capex are in year end $nominal of he preceding year.

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Less capital contributions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Add reused redundant assets (year end) | 0.0 | 0.0 | 0.0 | 0.0 | 3.5 |
| **Closing balance** | **8.7** | **8.7** | **8.9** | **8.8** | **12.3** |

Notes: Opening RAB for Wilton-Wollongong trunk is after 20 per cent reduction require by IPART.

**Table 7-6: Roll forward of Wilton to Newcastle trunk pipeline capital base over current AA period ($nominal)**

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Opening balance (before revaluation) | 124.0 | 126.5 | 126.7 | 129.8 | 129.1 |
| Add capex (before revaluation) | 0.0 | 0.0 | 0.0 | 0.0 | 2.2 |
| Add revaluation of assets | 4.9 | 2.6 | 5.7 | 1.9 | 3.9 |
| Less depreciation | 2.4 | 2.5 | 2.6 | 2.6 | 2.7 |
| Less capital contributions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Add reused redundant assets (year end) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing balance** | **126.5** | **126.7** | **129.8** | **129.1** | **132.5** |

**Table 7-7: Roll forward of NSW distribution system capital base over current AA period ($nominal)**

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Opening balance (before revaluation) | 1,832.8 | 1,916.2 | 1,996.4 | 2,100.0 | 2,135.8 |
| Add capex (before revaluation) | 86.3 | 118.7 | 99.7 | 93.7 | 97.8 |
| Add revaluation of assets | 74.3 | 40.9 | 92.0 | 31.2 | 65.5 |
| Less depreciation | 65.4 | 71.1 | 78.7 | 80.1 | 81.0 |
| Less capital contributions | 6.2 | 4.3 | 7.8 | 8.6 | 3.8 |
| Less disposals | 5.7 | 3.9 | 1.7 | 0.3 | 2.0 |
| Add reused redundant assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing balance** | **1,916.2** | **1,996.4** | **2,100.0** | **2,135.8** | **2,212.2** |

The closing balance values for 2009-10 constitute the opening capital base for the next AA period.

## 7.4 Projected capital base in the next AA period

The projected capital base in the next AA period is set out in Table 7-8, Table 7-9, Table 7-10 and Table 7-11.

**Table 7-8: Roll forward of combined total capital base over next AA period ($nominal)**

| Details | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|
| Opening Balance (before revaluation) [4] | 2,357.0 | 2,495.9 | 2,629.7 | 2,760.1 | 2,909.8 |
| Add Capex (before revaluation) | 171.7 | 176.2 | 176.2 | 204.9 | 225.8 |
| Add Revaluation Of Assets | 61.6 | 65.1 | 68.5 | 72.1 | 76.2 |
| Less Depreciation | 88.1 | 98.8 | 109.3 | 121.7 | 136.2 |
| Less Capital Contributions | 3.9 | 6.9 | 3.1 | 3.6 | 4.0 |
| Less Disposals | 2.5 | 1.8 | 1.9 | 2.0 | 2.1 |
| Add Reused redundant assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing Balance** | **2,495.9** | **2,629.7** | **2,760.1** | **2,909.8** | **3,069.4** |

**Table 7-9: Roll forward of Wilton to Wollongong capital base over next AA period ($nominal)**

| Details | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|
| Opening Balance (before revelation) | 12.3 | 12.4 | 12.5 | 12.6 | 12.7 |
| Add Capex (before revelation) | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 |
| Add Revaluation Of Assets | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Less Depreciation | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Less Capital Contributions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less Disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Add Reused redundant assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing Balance** | **12.4** | **12.5** | **12.6** | **12.7** | **12.7** |

**Table 7-10: Roll forward of Wilton to Newcastle trunk pipeline capital base over next AA period ($nominal)**

| Details | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|
| Opening Balance (before revelation) | 132.5 | 134.6 | 137.2 | 140.0 | 143.1 |
| Add Capex (before revelation) | 1.5 | 2.1 | 2.2 | 2.6 | 3.0 |

[4] In his and following roll forward tables Opening Balances and half of the real equivalent of capex are in year end $nominal of he preceding year.

| Details | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|
| Add Revaluation Of Assets | 3.4 | 3.4 | 3.5 | 3.6 | 3.6 |
| Less Depreciation | 2.8 | 2.9 | 3.0 | 3.1 | 3.2 |
| Less Capital Contributions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less Disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Add Reused redundant assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing Balance** | **134.6** | **137.2** | **140.0** | **143.1** | **146.6** |

**Table 7-11: Roll forward of NSW distribution system capital base over next AA period ($nominal)**

| Details | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---|---|---|---|---|---|
| Opening Balance (before revelation) | 2,212.2 | 2,348.9 | 2,480.0 | 2,607.5 | 2,754.1 |
| Add Capex (before revelation) | 170.0 | 174.0 | 173.8 | 202.1 | 222.5 |
| Add Revaluation Of Assets | 57.9 | 61.3 | 64.7 | 68.3 | 72.2 |
| Less Depreciation | 84.9 | 95.5 | 105.9 | 118.2 | 132.6 |
| Less Capital Contributions | 3.9 | 6.9 | 3.1 | 3.6 | 4.0 |
| Less Disposals | 2.5 | 1.8 | 1.9 | 2.0 | 2.1 |
| Add Reused redundant assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Closing Balance** | **2,348.9** | **2,480.0** | **2,607.5** | **2,754.1** | **2,910.1** |

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## 7.5 Capital contributions

**Table 7-12: Capital contributions over the current AA period ($nominal)**

| Details | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|---|---|
| Total Contributions Received | 7.83 | 5.01 | 8.55 | 6.87 | 4.28 |
| Less Tax Cost Compensation | 0.87 | 0.26 | 0.39 | 0.33 | 0.50 |
| Contribution to Assets | 6.96 | 4.74 | 8.16 | 6.54 | 3.78 |
| Number of Contributions Received | 886 | 724 | 772 | 857 | 1024 |

Notes: Values for 2009-10 are forecast. JGN has derived historical values from the capital contr butions database that it has maintained in accordance with section 9.2 of its AA.

# 9 Depreciation

## 9.1 Summary

Table 9-1 summaries JGN's forecast deprecation over the next AA period by applying the real straight-line depreciation method.

**Table 9-1: Forecast depreciation over next AA period ($nominal)**

| Deprecation | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | Total |
|---|---|---|---|---|---|---|
| Total | 88.1 | 98.8 | 109.3 | 121.7 | 136.2 | 554.1 |

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## 9.2 Assumptions on economic life of assets for regulatory depreciation

**Table 9-2: Economic lives of JGN assets**

| Asset Class | Economic Asset Life (Years) |
|---|---|
| System Assets | |
| Trunk Wilton-Sydney | 80 |
| Trunk Sydney-Newcastle | 80 |
| Trunk Wilton-Wollongong | 80 |
| Contract Meters | 20 |
| Fixed Plant - Distribution | 50 |
| HP Mains | 80 |
| HP Services | 50 |
| MP Mains | 50 |
| MP Services | 50 |
| Meter Reading Devices | 20 |
| Country POTS | 50 |
| Tariff Meters | 20 |
| Building | 48 |
| Computers | 5 |
| Software | 5 |
| Fixed Plant | 10 |
| Furniture | 10 |
| Land | 0 |
| Leasehold Improvements | 10 |
| Low value assets | 10 |
| Mobile Plant | 10 |
| Vehicles | 4 |
| Stock | 1 |

| Asset Class | Economic Asset Life (Years) |
|---|---|
| All assets (including equity raising costs) | 54 |

## 9.3 Depreciation and accumulated depreciation

Remaining asset lives for the capital base at 30 June 2010 are set out in Table 9-3.

**Table 9-3: Remaining asset lives as at 30 June 2010**

| | Remaining Asset Life |
|---|---|
| Trunk pipeline (Wilton-Newcastle) | 45.71 |
| Trunk pipeline (Wilton-Wollongong) | 34.25 |
| **Distribution system:** | |
| Country POTS | 35.04 |
| Contract meters | 9.61 |
| Tariff meters | 10.14 |
| Meter reading devices | 19.35 |
| Fixed plant | 7.08 |
| HP mains | 58.51 |
| MP mains | 28.97 |
| HP services | 26.23 |
| MP services | 35.86 |

Notes: Values based on:

1. actual capex and disposals to June 2009 and forecasts for 2009-10
2. depreciation for the period to June 2010 as set out in IPART's 2005 Final Decision adjusted for actual inflation over the period
3. forecast depreciation for the year ended June 2005.

Forecast regulatory depreciation for the next AA period is provided in Table 9-4.

**Table 9-4: Forecast depreciation over next AA period ($nominal)**

| Asset category | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | Total |
|---|---|---|---|---|---|---|
| Wilton/Wollongong | 0.37 | 0.38 | 0.39 | 0.40 | 0.42 | 1.96 |
| Wilton/ Newcastle | 2.78 | 2.87 | 2.97 | 3.08 | 3.19 | 14.89 |
| Distribution network | 84.93 | 95.52 | 105.94 | 118.23 | 132.60 | 537.23 |
| Total | 88.08 | 98.77 | 109.31 | 121.72 | 136.21 | 554.09 |

JGN intends to use forecast depreciation for the next AA period (adjusted for the difference between forecast and actual CPI) in rolling forward the asset base to the beginning of the next AA period beginning on 1 July 2015 (rule 90(2)).

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