

JEMENA GAS NETWORKS (NSW) LTD

JEMENA'S 5-YEAR PLAN:
2015/16 – 2019/20





An appropriate citation for this paper is:

Customer Overview of JGN's 5-year plan:
2015/16 - 2019/20

Contact Person

Robert McMillan
General Manager Regulation
Ph: (03) 8544 9000
haveyoursay@jemena.com.au

Jemena Gas Networks (NSW) Ltd

ABN 87 003 004 322
321 Ferntree Gully Road
Mount Waverley VIC 3149

Postal Address

Locked Bag 7000
Mount Waverley VIC 3149
Ph: (03) 8544 9000
Fax: (03) 8544 9888

INTRODUCTION

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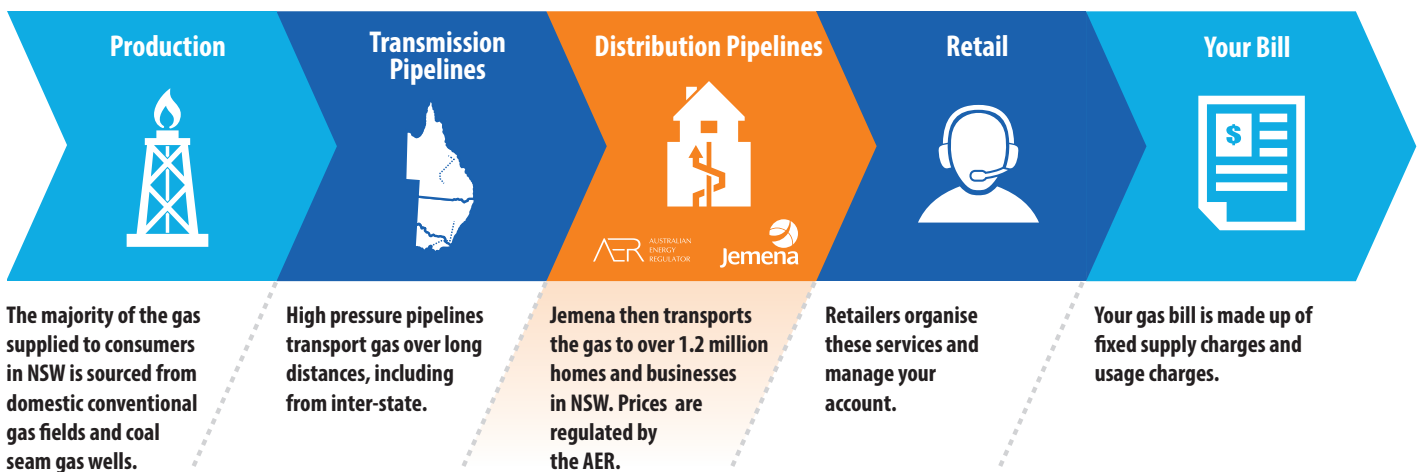
If you're like most people, you rarely think about your natural gas supply – you just expect the water to be hot when you step into the shower, and a flame to appear when you turn on your stove. So you might not be aware of Jemena – the company that delivers the gas to your premises.

We own and manage the 25,000 kilometres of pipelines that distribute natural gas to over 1.2 million homes and businesses across NSW. We also read and maintain the meters which measure how much gas is being used by each customer each day.

Like most businesses, we need to recover the costs of providing our distribution network services from the customers who use them. We do this by charging for these services, and our network charges make up around half of a typical residential customer's gas bill.

We are lowering our network charges by an average of 14.8% over the 5 year period from 1 July 2015, excluding the impact of inflation.

Figure 1: Getting the gas to you



INTRODUCTION

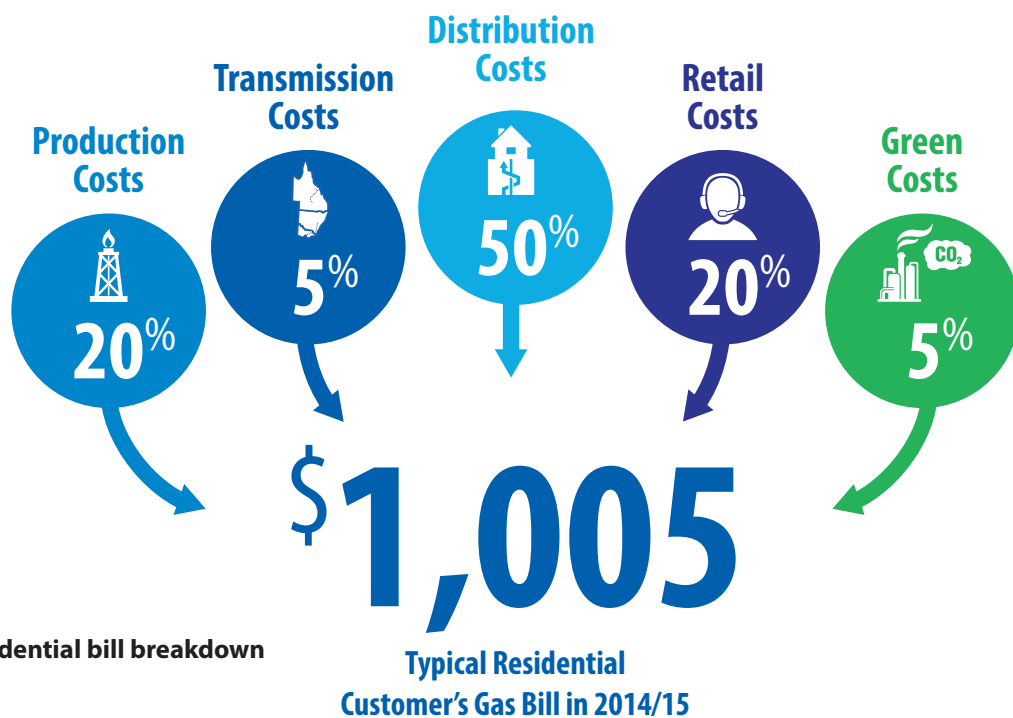


We are currently developing a 5-year plan for the period 1 July 2015 to 30 June 2020 (2015 Plan). Our 2015 Plan sets out how much funding we need - in terms of the costs we need to recover from our customers - to continue to provide safe and reliable services.

As part of this process, we engaged with our customers, stakeholders and the community to better understand what you want and value in your gas supply. We want to make sure

the decisions we make about our services, costs and prices reflect your priorities and long-term interests.

This document explains our proposed 2015 Plan. It focuses on what the plan will mean for you – including how our prices will change so we can provide the services you value. It also discusses how we engaged with you in developing the plan, and how we responded to your feedback.

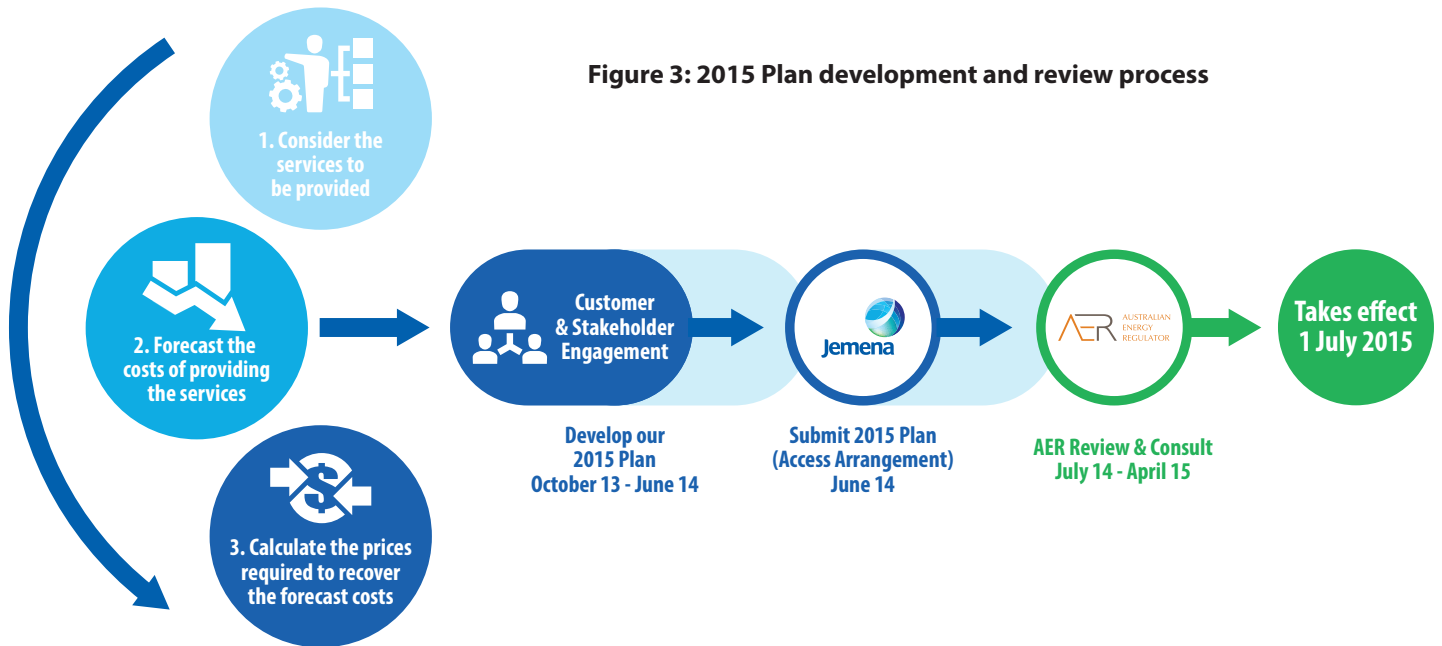


OUR 2015 PLAN

WHAT IS OUR 2015 PLAN?

Like most distribution network businesses in Australia, the prices we charge are regulated. That means every 5 years we submit a plan to the Australian Energy Regulator (AER) that explains the services we will offer, the costs we are likely to incur, and the prices we propose to charge. The National Gas Law requires our plan to promote “the long-term interests of customers”.

The AER reviews our proposed plan to check that it complies with this legislation and meets your long-term interests. It then either approves the plan, or specifies the changes we must make. Once approved, we must set our prices in line with the plan.



DEVELOPING THE 2015 PLAN

To develop our proposed 2015 Plan, we considered:

- The safety and service levels we are expected to provide over the 5-year period from 1 July 2015
- Forecasting the efficient level of costs required over this period and future periods to meet these safety and service levels, and run our business effectively to promote your long-term interests
- Calculating the prices we need to charge to recover these costs

During this process, we engaged with you to help us understand your views and concerns, and to test whether our proposed service levels, costs and prices promote your long-term interests. **[Box 1]** We also took into account expected cost changes in the other parts of the gas supply chain and how they will affect you. **[Box 2]**

OUR 2015 PLAN

BOX 1: How we engaged with you in developing our 2015 Plan

To help ensure our 2015 Plan reflects your views and concerns, and promotes your long-term interests, we engaged with customers, stakeholder and community groups in a range of forums.

We explained the context for our plan, including the role of gas as a competitive fuel in NSW; the different parts of the gas supply chain; the costs associated with each part; and the roles of the AER in regulating our network service prices and IPART in regulating some end-retail prices.

We then explored your views on the decisions we need to make for the coming 5 years by outlining how this will affect services and prices over this period and future periods. This included how we can best balance the prices we charge for our services, the long-term safety of these services, and the service levels our network provides to current and new customers. Some of the specific issues we sought your views on were:

- The current levels of safety and service we provide, and whether we should invest to provide a

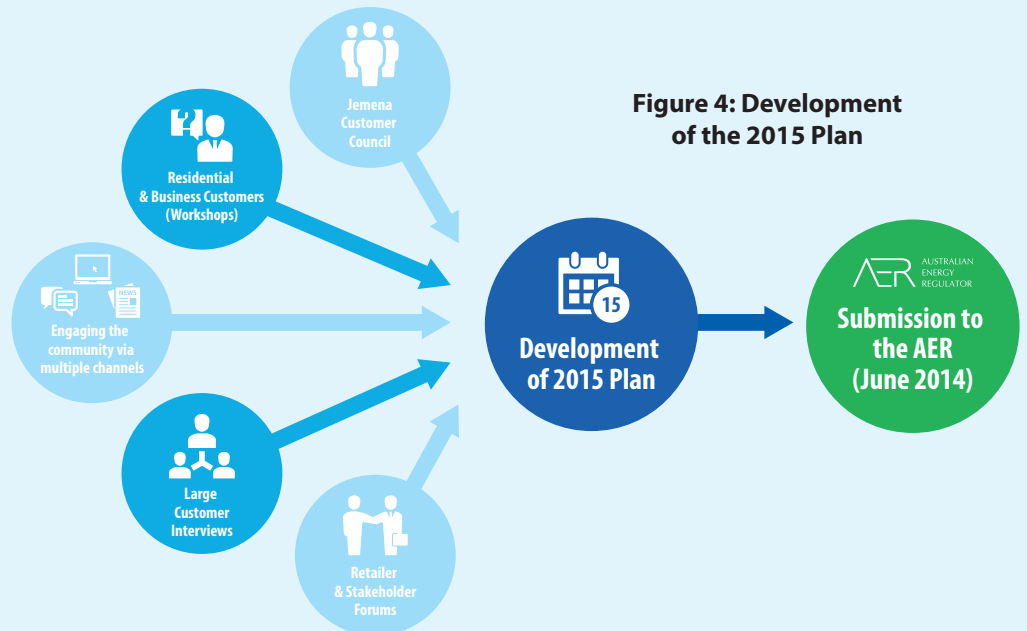


Figure 4: Development of the 2015 Plan

Business As Usual Engagement

universal level of service quality across our network

- Our proposed investments to manage expected changes in Australia's gas markets over the coming years, as new sources of gas become available in NSW
- Whether and to what extent we should focus on attracting new customers – for example by extending our network to new suburbs and areas
- Various options for recovering our costs over the period, including whether we should consider the

movement in end-retail prices when setting our network prices

- Various options for the structure of our prices, including the balance between our fixed charges and usage charges.

We think the approach we used, the background information we provided, and the issues we explored are consistent with the AER's Consumer Engagement Guidelines. We are committed to continuing this best-practice approach to customer engagement as part of our usual business practice.

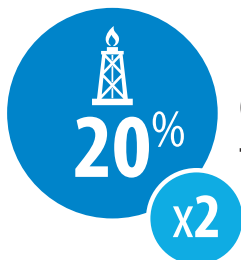
"There should be the same service for everyone"

Residential Customer
Parramatta forum, 9 April 2014

BOX 2: Key changes in the gas market in the coming years

Australia's gas markets are expected to undergo big changes over the next 15 years, with major implications for us and for you. The changes are likely to put upward pressure on gas prices. As most customers in NSW have a range of other options to power their homes and business, rising gas prices will make it more difficult for us to attract new customers and lower our prices.

In the Eastern Australian markets, producers are developing new conventional and coal seam gas fields and establishing Liquefied Natural Gas (LNG) export facilities. This will enable them to access the international market for natural gas, with its strong demand and higher prices. As these facilities come on stream, we expect the domestic wholesale price of gas (or production costs) to rise towards international levels. How fast and how far this price will rise is not certain, as it depends on many factors. However, it is expected to have a significant impact on gas prices over the next 5 years.

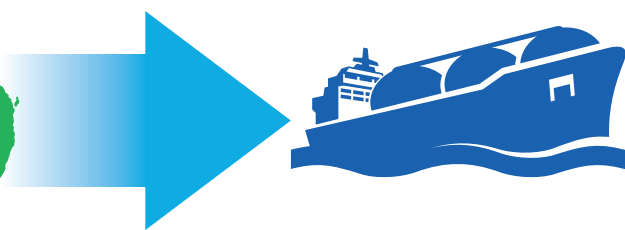


Gas production costs forecast to double by 2020

In NSW, we expect residential and business demand for natural gas will plateau in the coming years (due in part to the increases in gas wholesale prices), while industrial



Figure 5: Changes in the gas market



demand will decline due to the closure of several large industrial facilities. We will need to be proactive in attracting new customers to the network to help spread our fixed costs over a larger customer base and put downward pressure on our prices.

In addition, there are changes in the way that gas will be brought to the NSW market – for example, construction is currently underway to allow gas to enter our network near Newcastle – which will require us to make changes to the way we operate our physical gas network.

At the national level, the National Energy Customer Framework (which was implemented in NSW on 1 July 2013) ensures that all energy customers now have access to consistent, effective consumer protection measures.



Increased production costs mean higher charges to customers

OUR 2015 PLAN

YOU TALKED AND WE LISTENED

Through our various forums, our customers have told us what they want and expect from their gas distributor and we have heard you.

You are concerned about gas prices

Although we can't influence the cost of wholesale gas or your retail charges, by reducing our distribution charges we can do our bit to try to try to keep your bill as low as possible.

Our proposed prices have been developed in response to your concerns about affordability of energy, including the forecast increases in end-retail gas prices over the next 5 years. They also take account our customers' views that we should consider the total cost of gas, not just our own distribution costs, when setting our prices.

We are proposing that our network charges fall by an average of 14.8% over the 5 year period from 2015/16, excluding the impact of inflation. For typical residential customers the network component of their annual gas bill will decrease by \$271 over the period and more than offset the impact of inflation. **[Figure 6]**

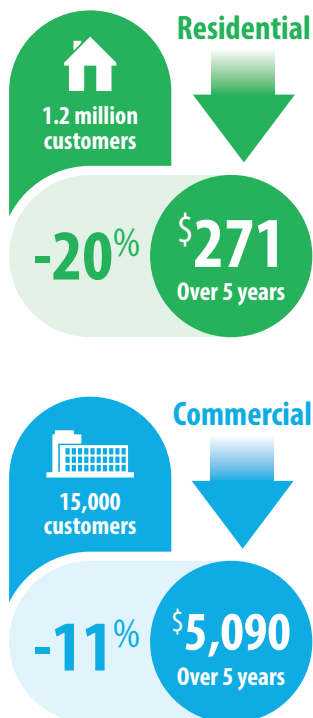
You say you've lowered your prices so why is my bill still going up?

Customers may not see their network tariff itemised on their gas bill, as retailers incorporate our tariffs in their end prices and charges, along with the other costs of producing and supplying gas.

As the network component represents only about half of a typical customer bill, customers won't see their total gas bill fall by this amount. In fact, because the other components of these bills are expected to increase (due to rising wholesale gas costs) most customers will face higher total gas bills. However, our price decreases will offset some of the wholesale gas cost increases, so customers will face lower total gas bills than would otherwise be the case.

We think our plan strikes the right balance between the business and customer outcomes necessary to promote your long-term interests and reflects the feedback you have given us. **[Box 3]** Most importantly, it recognises that you are concerned about the affordability of energy and value our network prices promoting stable end-retail gas prices. It also recognises that NSW energy prices (including gas prices) have increased significantly over the past 5 years, and end-retail gas prices are expected to rise further in coming years, largely because wholesale gas costs are rising.

Figure 6: Changes in our prices over the 5 year period for typical customers (excluding the impact of inflation)



BOX 3: What do we mean by the long-term interests of customers?

To ensure our 2015 Plan promotes the long-term interests of customers, we considered what this means in practical terms. Essentially, we think it means we must strive to run our business as smartly and efficiently as possible, so our:

- Prices reflect the lowest sustainable cost of providing our services and meeting the required safety and service levels (and are not higher than they need to be because of inefficient operations or poor investments).
- Service levels reflect what our customers want and are willing to pay for (no 'gold plating'), and are priced to support efficient use.
- Combination of prices and service levels represents good value for money and encourages new customers to connect to the network and install more gas appliances, which helps reduce prices for all customers.
- Management thinks and plans for the long term, so we can respond to changes in our market and innovate to help ensure gas remains a competitive fuel option over the long term.

Figure 7: Balancing safety, services and prices in the long term interests of customers



You want your gas supply to be safe and reliable

We know that not having gas when you need it is more than an inconvenience, it impacts the entire family or business. We asked you about the current balance between the prices we charge for our services, the long-term safety of these services, and the service levels our network provides to current and new customers. While we found there is some support for modest improvements, your overall satisfaction with our current service levels is strong.

While our service quality is high for most customers, those in certain areas of the network have relatively low gas pressure. This limits the gas appliances they can use effectively. You told us that all our customers should receive the same service levels, regardless of their location. We agree, and propose to improve pressure levels in these underperforming areas. Our 2015 plan includes investing \$22m over the 5-year period (adding around \$1 to a typical customer bill per year) to ensure all customers across our network enjoy the same quality of service and receive the same value for money.

OUR 2015 PLAN

BOX 4: What do we mean by our service levels?

Our service levels have 5 key aspects:

1

Public amenity – minimising gas leaks (which smell bad and can be dangerous) and planning maintenance work to minimise traffic disruptions (from digging up streets, driveways and footpaths)

2

Service quality – providing the gas pressure needed to meet customer expectations, particularly for new more efficient (and more demanding) gas appliances

3

Reliability – making sure gas is available when it is needed and reducing customer frustration due to service disruption

4

Responsiveness – minimising the time it takes to respond to supply disruptions and to reconnect customers

5

Availability – making sure new customers can connect to our network

WHAT DO WE MEAN BY OUR COSTS?

You told us you want to know where your money goes, so we're going to be more transparent in exactly what you are paying for.

Like most businesses, we incur two broad types of costs in providing our network services – operating and capital costs.

Operating costs includes the costs of operating and maintaining our physical assets (e.g. pipes, meters and computer systems) to provide our services and meet our safety and service levels. It also covers the costs of performing related functions like reading meters and providing billing information to retailers, and meeting legal and regulatory requirements. These costs are generally recurrent, much like the costs of running a household (buying groceries, paying bills, general home maintenance). We expect our operating costs to decrease slightly (-0.1% per annum, excluding the impact of inflation).

Some of the things that impact our operating costs include cost pressures from competing for skilled labour with other sectors in the economy, the cost of changing our systems and meeting new regulatory obligations.

You told us that you expect us (and other gas market players) to continually strive to improve our cost efficiency, to help lower our costs. We agree, and our 2015 Plan commits us to

making a 5% efficiency saving in operating costs over the next 5 years and introducing a new mechanism – like the AER has introduced for other network businesses – to further encourage cost savings.

Capital costs include the investments we make to buy and build physical assets that will deliver our required safety and service levels now and into the future. Our capital works range from small standard projects (like installing a small length of pipe and a meter to connect a new customer to the existing network) to large multi-million-dollar projects (like extending the network and installing multiple meters to connect a new town or housing estate). These costs are generally funded through borrowings and paid back over the long term.

We expect our capital costs to increase moderately (3.7% per annum, excluding the impact of inflation), due to higher spending on reinforcing, renewing and replacing assets, such as replacing old gas meters, to maintain service reliability and to accommodate changes in the gas market, including changes to the way gas comes into our network. We also propose to make smart investments in attracting new customers, which will lower our average costs per customer. (See 'What else are we doing in response to customer feedback?' for more detail.)

YOU WANT US TO BE MORE TRANSPARENT ABOUT OUR REVENUE

You told us you want to know how our network prices are determined, to be assured that we aren't recovering more than we need to.

To run our business effectively we need to generate enough revenue to recover:

- Our forecast operating costs over the 5-year period
- Our funding costs over the 5-year period (interest and other costs related to our 'borrowings' for our debt and equity for past and forecast capital costs)
- The depreciation on our assets over the 5-year period (the amount we need to recover over this period so that we will recover our capital costs over the expected life-time of each asset)
- Our tax costs over the 5-year period (to pay our tax liabilities to the Australian Tax Office)

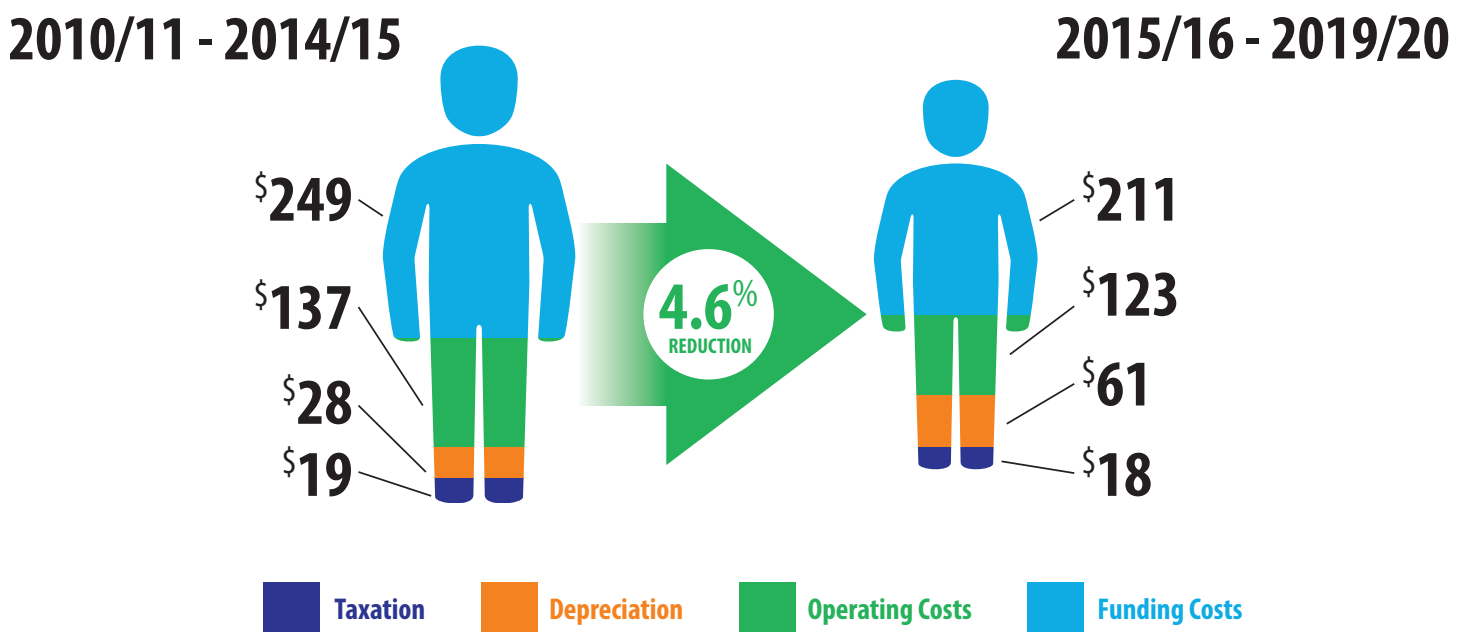
We recover these costs from our customers by adding up our 'building block costs', using an approach specified in the gas regulatory framework. These building block costs form the basis of the revenue approved by the AER. Over the next 5 year period, the required revenue per customer will fall by 4.6% per year and we will pass this saving on to our customers.

There are several key reasons for this.

Firstly, our funding costs will decrease over the period reducing our required revenue per customer by \$37 per year. Like home interest rates, the costs of funding our past and forecast capital costs vary with economic and financial market conditions. When we submitted our current plan 5 years ago, our rates of 'borrowing' were high due to the unusual conditions in financial markets at that time (the global financial crisis). Since then, conditions have improved and our costs have come down.

Secondly, we are continuing to attract new customers to the network. Attracting new customers helps to lower the average costs we must recover from each customer. The forecast increase of over 150,000 new customers over the next 5 years puts downward pressure on our revenue requirement per customer and ultimately our network prices.

Figure 8: Changes in our required revenue per customer per year (\$ 2015)



OUR 2015 PLAN

YOU WANT US TO FIND WAYS TO DRIVE DOWN COSTS

Attracting more customers is beneficial for you and us.

Like most businesses, attracting more customers can be a profitable way of expanding our business. However attracting new customers also helps to lower our prices over time because a large proportion of our costs are 'fixed' – that is, they remain largely the same no matter how many customers we have and how much gas our customers use. Just as sharing a rental property lowers the rental cost per person, increasing the number of customers we serve and the amount of gas we supply lowers the average costs we must recover from each customer. In turn, lower average prices are likely to make gas supply more attractive.

We are committed to attracting new customers to put downward pressure on our prices. We forecast that we will attract over 30,000 new customers per annum, or over 150,000 customers over the period. These new customers will lower our average costs and prices, and will largely offset the fall in gas demand as a result of rising end-retail gas prices.

A key part of this is continued investment in our Natural Gas, The Natural Choice marketing campaign which promotes the benefits of natural gas and encourages home and businesses to connect to the gas network in New South Wales.

"I like the idea of attracting new customers to lower the price"

*Residential Customer,
Parramatta Forum, 9 April 2014*



Figure 9: Cost efficiency benefits of attracting new customers



IMPROVING OUR EFFICIENCY

Improving our efficiency by being smarter and more innovative in how we plan and operate our network also helps lower our prices over time. You told us that you want to see us continually striving to improve our efficiency so our services provide more value for money.

Currently, we are one of the lowest cost and most efficient gas utilities in Australia. For example, our operating costs have been found to be amongst the most efficient of these businesses for the last 15 years. However, as markets change and knowledge and technologies improve, there are always opportunities for further improvements in efficiency.

That is why we are committed to pursuing more efficiency improvements including reducing our operating costs by 5% over the next 5 years and proposing the introduction of a new mechanism that will strengthen our incentives.

RECOVERING OUR COSTS IN A WAY THAT MINIMISES END-RETAIL GAS PRICE SHOCKS

We asked you how we should recover our costs over the next 5 years. You told us that you are concerned about the affordability of gas, which depends on the overall end-retail price of gas, not just our distribution prices, and were concerned about rapid increases in your bills as a result of forecast increases in wholesale gas costs. You also told us that we should consider the end-retail price when setting our distribution prices to promote the stability of end-retail prices over the next 5 years.

With large forecast increases in wholesale gas costs over the next 5 years, we have proposed to recover our costs in a way that provides greater stability in end-retail prices. Our proposed network prices place downward pressure on these end-retail prices and offset some of the expected increases due to rising wholesale gas costs. As a result, the affordability and stability of end-retail gas prices will be greater than would otherwise be the case.

KEEPING OUR FIXED CHARGES LOW FOR RESIDENTIAL AND SMALL BUSINESS CUSTOMERS

Our current price structure for residential and business customers includes fixed charges (\$ per quarter) plus usage charges (\$ per unit of gas used). Given the size and value of our existing assets (valued at over \$3 billion), most of our costs

in supplying gas to you are fixed. However, we set the fixed charges at a low level, so most of the network component of a typical residential or small business gas bill reflects the volume of gas the customer used. We set our prices this way because:

- You told us you value having control over your gas bills and expect to pay less when you use less gas
- We want to create incentives for you to connect to gas supply and install gas appliances, which would lower the average cost per customer, and you have told us that high fixed charges are a barrier to this

As most of our costs in supplying gas to you are fixed, we will also ensure that our usage charges continue to encourage customers to use multiple gas appliances (which puts downward pressure on our prices), by offering 'bulk discounts' to our customers. This means that the price of gas decreases as more gas is used.

SIMPLIFYING OUR PRICING

While our fixed charges are set at a low level that encourages customers to connect to gas and manage their gas bills, there are currently 3 separate fixed charge components for each customer group. You told us that you value network pricing that is simple and easy to understand, particularly as many retail market contracts in NSW include a pass through of our network charges. In response, we propose to simplify our pricing where we can.

Under our 2015 Plan, all residential and small business customers in NSW will pay just one fixed charge and one usage charge. This should make it easier for customers to understand our prices and for retailers to incorporate these prices in their market offers.

We have also simplified our disconnection charges to make it easier for customers and retailers to understand.

PROVIDING CLEARER INFORMATION ON OUR PRICING DECISIONS

You told us that you would like to know more about how your gas prices are set, and how they may change over time. We think we can do more to assist you in understanding how energy pricing decisions are made, including the matters we are required to consider in making these decisions, and how these prices may change over time. For this reason, we have:

- Made clear and accessible information available on our website on how retail gas prices are set, how our network

OUR 2015 PLAN

prices are regulated and how customers can get involved

- Prepared a Tariff Structures Statement that provides clear, accessible guidance on how we decided on our current prices, and how our price structures and levels may change in the future. This statement is available on our website.

PROVIDING MORE ASSISTANCE TO VULNERABLE CUSTOMERS STRUGGLING TO PAY ENERGY BILLS

You told us that vulnerable customers in our community need assistance to manage their energy bills, and that we should play a role. In response, we are committed to taking the following steps:

- Making it easier for customers to manage their gas bills by:
 - providing clear, accessible information for customers to make it easier for them to manage their gas consumption, find a better retail market offer, and take advantage of any rebates that may be available to them
 - advocating for policy and regulatory changes to ensure all customers – including those who rent their property, or live in a caravan park or boarding house – have the choice of individual billing and metering and their choice of retail supplier
- Advocating for additional Government programs to assist vulnerable customers (for example, by providing rebates for larger gas bills, and conducting energy audits to identify steps they can take to use gas more efficiently)
- Assisting vulnerable customers to reduce their energy consumption by using gas more efficiently:
 - working with the NSW Government and other partners organisation to upgrade gas appliances in public housing
 - becoming a partner of NILS NSW, a No Interest Loan Scheme, to help vulnerable customers access funds to replace old their gas appliances with new, more efficient models

HELPING MAKE THE GAS MARKETS WORK MORE EFFECTIVELY FOR ALL CUSTOMERS

You told us that we should help make the state's energy markets "work better" for customers. Our 2015 Plan includes 5

steps towards this goal.

WE WILL MAKE IT EASIER TO SWITCH RETAILERS

We have reduced our charges for special meter reads to reduce barriers to customer switching. This should make it easier for customers to take-up a competitive retail market offer that suits their needs.

WE WILL MAKE INVESTMENTS TO ACCOMMODATE NEW SOURCES OF GAS INTO SYDNEY AND REGIONAL NSW

Australia's gas markets are expected to undergo big changes over the next 15 years, with implications for Jemena Gas Networks and our customers. One of the major changes is the availability of new gas sources across NSW.

To manage these expected changes we will make investments to ensure these new sources of gas become available to our customers. This should put downward pressure on end- retail gas prices by offering retailers alternative sources of gas supply.

WE WILL SCALE UP THE REPLACEMENT OF METERS ACROSS OUR NETWORK

We seek to manage our assets prudently. This means we look to minimise the long term cost of providing our services and meeting the required safety and service levels.

Many of our gas meters are over 20 years old, and require replacing. We plan to invest over \$194m in a large scale replacement of gas meters across our network to improve the accuracy of our billing and to improve market outcomes.

YOU WANT TO KNOW ABOUT ANY PRICE RISES EARLY

Currently we prepare our proposed distribution prices by 15 April each year. You have told us that publishing our proposed distribution service prices earlier in the year would give retailers more time to develop and market new retail offers before the annual energy price change on 1 July, and give customers more time to compare retailers' offers and find the best deal.

We agree that this will make the competitive gas market work better for all participants. We will ask the AER to approve the changes necessary to allow us to prepare our proposed prices by 15 March each year (more than 3 months before they start).

WE WILL ADVOCATE FOR A NEW REGULATORY MECHANISM TO STRENGTHEN INCENTIVES FOR EFFICIENCY IMPROVEMENTS

We recognise that to work best for customers, the regulated energy market needs to create incentives for distribution businesses that are like those we would face in a competitive market. In particular, regulation should provide us with strong incentives to continually strive to improve the efficiency of our operations. This will enable us to provide the same or better service levels for less cost, and help ensure gas remains a competitive, value-for-money fuel option in line with customers' long-term interests.

With your support, our 2015 Plan proposes the introduction of a new regulatory mechanism – the Efficiency Benefit Sharing Scheme – that will strengthen our incentives by:

- Allowing us to keep the savings we make by improving the efficiency of our operating costs (or cost underspends) for 5 years
- Requiring us to bear the burden of operating cost overspends for 5 years.

These benefits are then passed on to our customers through lower prices over the next 5 years.

“Safety is the most important – for myself and for the community “

*Residential Customer,
Parramatta Forum, 9 April 2014*

HAVE YOUR SAY & STAY INFORMED



We welcome your views on our 2015 plan

We will keep you informed of the AER's review process and how it impacts you



www.jemena.com.au



haveyoursay@jemena.com.au



Jemena