Minutes of the public forum on Envestra's access arrangement revision proposal (1 July 2011 to 30 June 2016)

29 October 2010

Location:	**Stamford Plaza Hotel**
	150 North Terrace Adelaide
Date:	**29 October 2010**
Forum chair:	**Warwick Anderson**
Attendees:	**(see appendix 1)**

1. Summary of discussion

Warwick Anderson opened the forum. The presentation slides are available on the AER's website.

2. Presentation by Andrew Staniford (Envestra)

Andrew Staniford provided a presentation on Envestra's access arrangement proposal. The presentation slides are available on the AER's website.

3. Questions and discussion

Simon Gramp – DTEI, noted that the assumed asset lives had been revised to more realistic ones. Mr Gramp asked whether the capital base had been adjusted to reflect this.

Andrew Staniford responded by noting that the capital base had not been changed, and that in regulatory terms changing the asset life assumptions does not change the regulated asset base. He said that the asset depreciation is incorporated into the revenue requirement, that in the past Envestra has recovered depreciation based on the assumed economic life of its assets at the time, and that going forward Envestra proposed to reduce the assumed asset life to be in line with that assumed by other service providers. Mr Staniford noted that the regulatory arrangements do not necessarily reflect what has actually happened in the field.

Mr Gramp queried how Envestra could still claim to be using straight line depreciation, and whether Envestra's depreciation calculation continues the use of a 10% residual factor.

Mr Staniford stated that Envestra's RAB had been calculated using the 10% residual assumption and following the revision there would essentially be 'two straight lines' for depreciation, before and after the adjustment to assumed asset lives.

Steve Macmillan – Origin Energy, noted that the marketing spoken of by Mr Staniford was to encourage the use of natural gas as a fuel source. Mr Macmillan asked whether the effects of this marketing had been reflected in the demand forecasts.

Mr Staniford said that the effects of the proposed marketing had been reflected in the demand forecasts. He added that Envestra anticipates that most of the impact on demand will occur in the medium and long term rather than in the short term.

Mr Macmillan asked whether Envestra could see a reversal in demand decline.

Mr Staniford stated that Envestra's marketing program would assist to reduce the rate of the decline. He remarked that if new gas appliances and new technologies could be encouraged there could be a stabilisation of gas demand volumes, however it would not happen over the upcoming access arrangement period but would rather be a long term prospect.

Mr Gramp observed that a 5% increase in prices per annum is likely to decrease demand for gas.

Mr Staniford responded by saying that it was a tension that Envestra had to deal with, and that they were cognisant of the fact that higher prices will not encourage potential customers to connect to the network. However, he stated that Envestra needed to make sure its network was attractive as possible to users and a large part of that is to ensure the network is safe and reliable, and to do that more investment was necessary.

Mr Gramp noted that the network did have to meet a high level of reliability, and also noted that although Envestra could not point it out in its access arrangement proposal, electricity prices were also going up at the moment.

Mr Staniford said that electricity prices would be going up, and that it was a critical time for Envestra to invest and make sure it positions natural gas as a competitive fuel to meet future demand for energy.

John Pike – Major Energy Users/Energy Consumers Coalition of South Australia agreed that the gas objectives of safety, reliability and low price were good ones. He noted that Envestra had faced the Global Financial Crisis, however, also noted that businesses have faced this too. Mr Pike asked whether, since Envestra is facing a 300 point increase in the cost of capital now, wouldn't it be prudent to defer the large capex program that has been put forward?

Mr Staniford responded that Envestra is not asking for a 300 point increase in the cost of capital. Envestra was, however, taking a forward-looking approach in setting its required rate of return. He stated that the AER has set a lower amount than it thinks appropriate in recent decisions. Mr Staniford stated that Envestra was forced to curtail expenditure in the previous period due to the GFC. However, what Envestra has provided to the AER in its access arrangement proposal is the rate of return needed for it to access adequate capital.

Mr Pike stated that he understood that the APA Group has recently been able to access debt at a lower cost than sought by Envestra.

Mr Staniford responded that there are other factors besides debt in the WACC, such as the cost of equity, and in the end a certain return on equity is required in order to encourage equity holders.

Mr Pike further noted that Envestra is more highly geared than the benchmark 60/40 debt/equity ratio.

Mr Staniford said that Envestra is indeed highly geared but not unreasonably higher than the benchmark rate. Mr Staniford said that in the wake of the GFC Envestra has been deleveraging, in line with many similar businesses.

Mr Pike pointed out that Envestra faces an international capital market, and that there may be flow-on effects from the upcoming quantitative easing signalled by the United States Federal Reserve.

Mr Staniford stated that companies still face uncertainty whether that easing occurs or not, and Envestra's proposed WACC is based on prevailing market conditions.

Mark Henley – Uniting Care Australia asked whether any analysis had been done on the impact of increasing tariffs on lower income earners, and why Envestra had proposed declining block tariffs rather than inclining block tariffs.

Mr Staniford responded that Envestra has not done any analysis on the impacts on low income earners, and that there is not sufficient information available to it for such analysis to take place. However, he stated that it is something of which Envestra is mindful. Mr Staniford stated that he is not sure that Envestra is the most appropriate body to be remedying this issue, although Envestra do drive to get the lowest possible price. On the matter of an inclining block tariff versus a declining block tariff Mr Staniford said that Envestra need to use the declining block tariff to encourage higher volume on the network. Mr Staniford said that a declining block tariff would encourage people to consume gas, and that if volumes continue to decline the network would become more expensive for all. Mr Staniford remarked that Envestra needed to encourage the uptake of more gas appliances by customers, as greater volumes will make the network more economically efficient.

Mr Henley noted that a declining block tariff could act as a barrier to entry. He also noted that the banning of electric storage hot water should assist gas volumes.

Mr Staniford stated that he was aware of the policy but was not sure of what the numbers are showing. He also said that he was acutely aware of the fact that a declining block tariff could act as a barrier to entry, and that it was something Envestra took into account when setting its tariffs.

Mr Henley further asked why there would be a linear price path rather than a decrease in the path towards the end of the period, since leakages would be declining at that stage if Envestra goes ahead with its planned mains replacement.

Mr Staniford replied that the figure he used in the presentation was an average, and that actually Envestra had proposed a higher increase at the start of the period, which decreased towards the end of the period. However, he said that the AER would have a lot of influence on the outcome in this area.

Mr Henley asked if there would be more room for discussion with Envestra about the price path.

Adam Petersen – AER said that the AER would consider an appropriate price path as part of the decision. He said that pricing in the gas process was different to electricity. There is no pricing proposal process at the end of the gas review and the effect on tariffs will be visible during the course of the review. Mr Petersen highlighted the tariff impacts set out in Envestra's proposal.

Mr Staniford reminded Mr Henley that this was at the distribution end, which only accounted for part of the prices on the retail end.

Mr Henley stated that he understood those issues, and that it was essentially up to the retailers how those prices are then passed on to the consumers.

Warwick Anderson – AER then thanked all the attendees for participating, and closed the forum.

Appendix 1

Attendees

Warwick Anderson, AER

Adam Petersen, AER

Andrew Staniford, Envestra

Geoff Barton, Envestra

Craig deLaine, Envestra

Peter Buchi, Envestra

Ryan Reynolds, KPMG

Simon Gramp, Department for Transport, Energy and Infrastructure

Jinny Pavanello, Department for Transport, Energy and Infrastructure

Steve Macmillan, Origin Energy

John Pike, Energy Consumers Coaltion of South Australia

Mark Henley, Uniting Care Australia