
Presentation

Independent Pricing and Regulatory Tribunal

AGL Gas Networks

Capital and Non Capital Expenditure

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Agenda

- Background
- Approach
- Condition of the Network
- Capital Expenditure
- Non Capital Expenditure

Background

- AGLGN has submitted a revision to its Access Arrangement for the 2005 -2010 period.
- The Tribunal has engaged ECG to carry out a review of the capital and non capital expenditure:
 - Make recommendations on the capital expenditure for the AA period.
 - Analyse the forecast capital expenditure for the period 2005 - 2010.
 - Analyse the forecast non capital expenditure for 2005-2010.

Approach

- Gas Code:
- *“The amount does not exceed the amount that would be invested by a prudent Service Provider acting efficiently, in accordance with accepted good industry practice to achieve the lowest sustainable cost of providing the Services.”*
- Network has a long term economic life.
- Effective business process to control cost.
- Optimum balance between capital and non capital expenditure.
- Consideration be given to safety and integrity of the network.
- Using good industry standard to manage the networks.
- Benchmark costs with other jurisdictions allowing for NSW’s conditions.

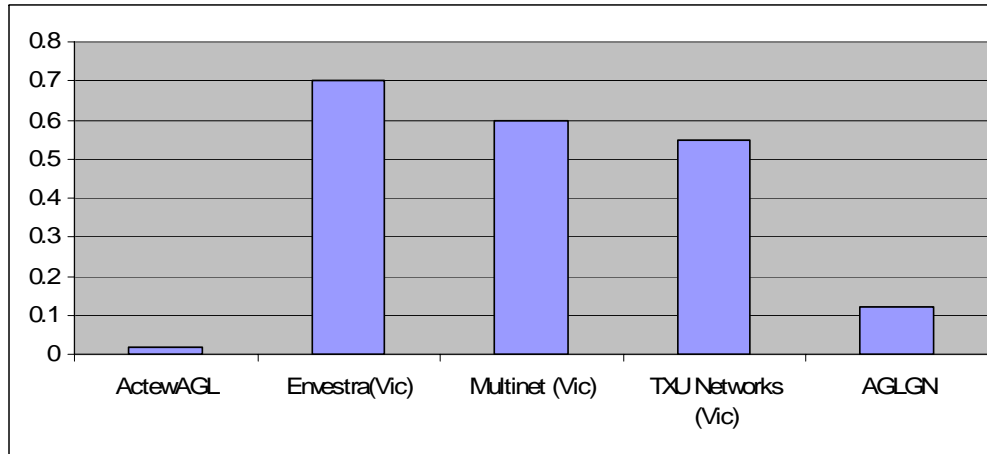
Approach

- Went through a series of question and answer process with AGLGN and Agility.
- Met with stakeholders including Orica, Energy Australia and Energy Advice.
- Considered a number of documents including:
 - Asset Management Plan.
 - Safety and Operating Plans.
 - Marketing strategy and business plan.
 - Processes for Approving Expenditure.
 - AGLGN and Agility contractual arrangement.
 - Project Justifications.
 - Key Performance Indicators.

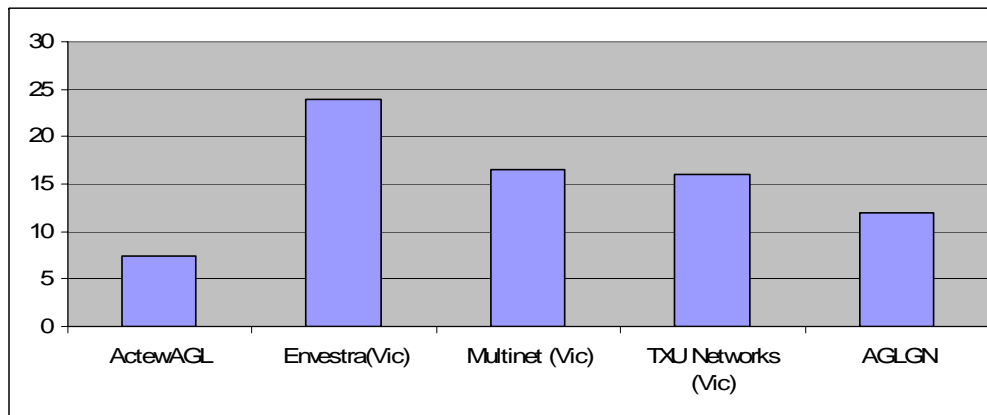
AGLGN Gas Networks

- Trunk and primary mains in good condition – corrosion protection
- 95% of the MP/LP system has been rehabilitated.
- Regulating stations generally good condition – issue with spare parts availability.
- Residential meters are subject to field life extension program – extending service life by 10 years.
- Industrial meters are subject to 15 years life cycle.

Network Key Performance Indicators.



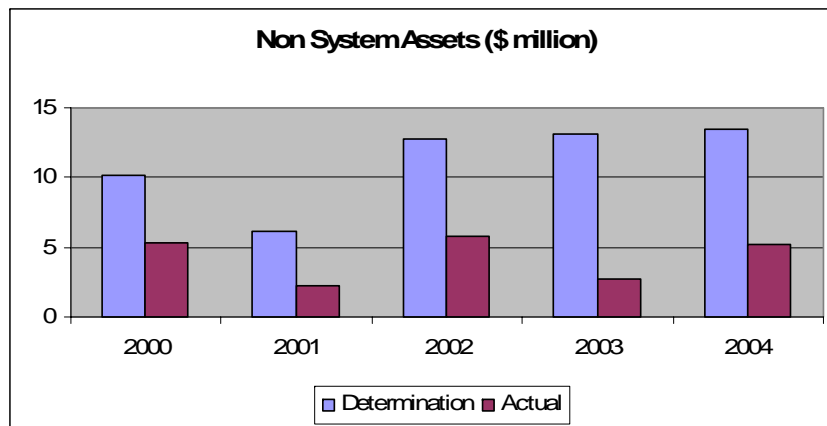
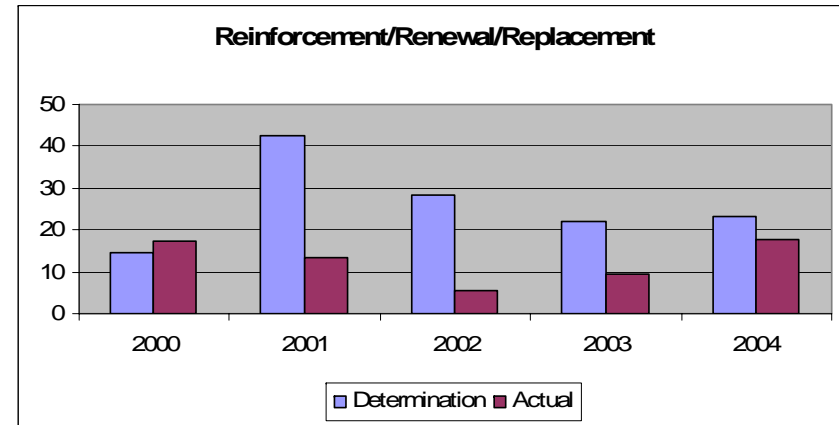
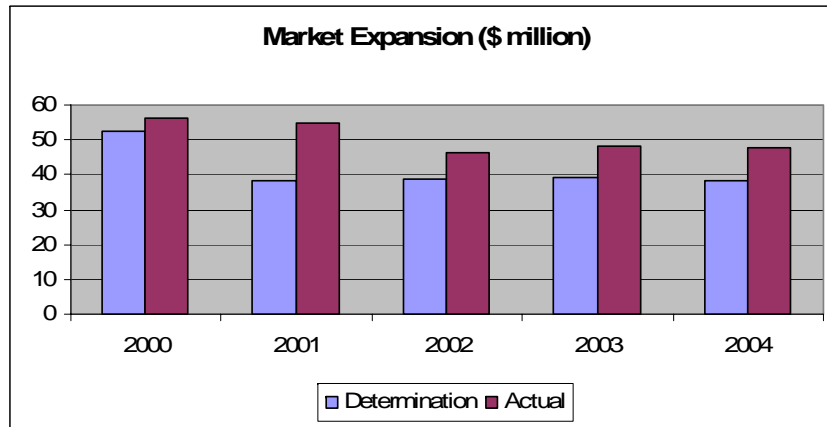
No of leaks per km of pipe



No of public reported leaks per 1000 customers

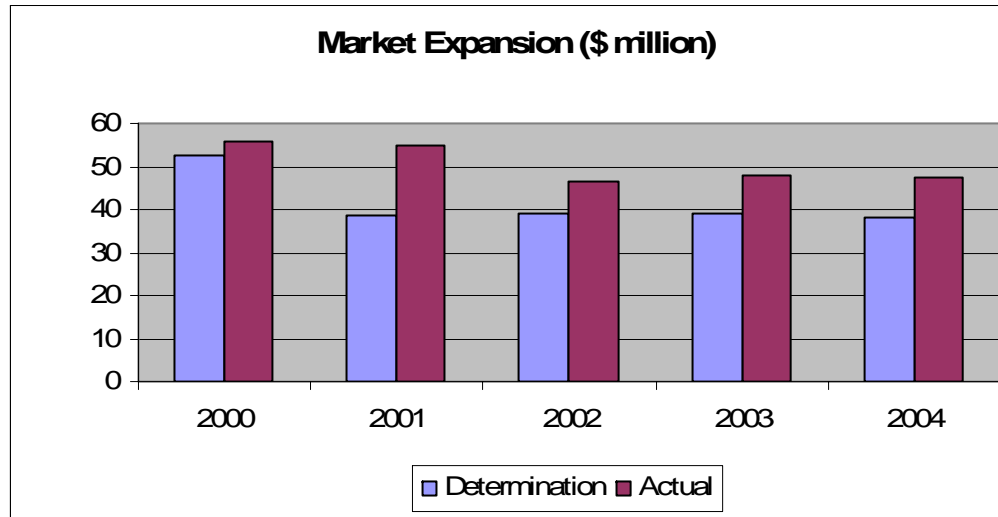
Derived from ESC and ICRC Compliance reports

Determination versus Actual Capital Expenditure 2000-2004



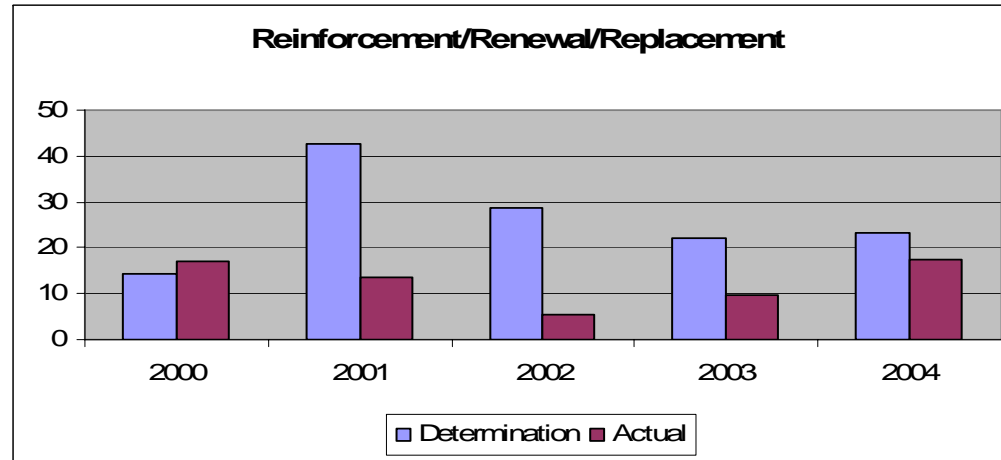
Total 2000 -2004 \$million	
•Determination	\$393.3
•Actual	\$337.4
•Variance	
•Expansion	\$45.7
•System Related	(\$67.2)
•Non System	(\$34.3)
•Total variance	(\$55.9)

Market Expansion 2000-2004



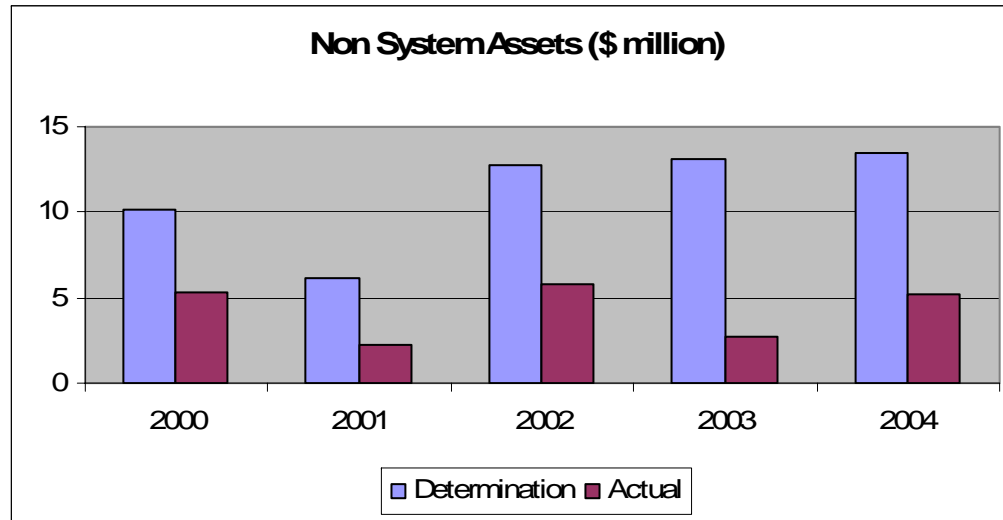
- Expenditure \$252.8m is 22% more than Determination
- Only detail 2004 data available (i.e. cost per customer type).
- Analysis based unit cost per customer.
- Mains costs for established areas considered high.
- Service and meter unit costs considered reasonable.
- Recommended Expenditure \$249m versus actual \$253m.

Reinforcement/Renewal/Replacement 2000-2004



- Expenditure \$63.3m is 48% less than Determination due to:
 - Deferral of Primary Mains Loop.
 - Reduction of meter replacement.
 - Deferral of medium and low pressure rehabilitation program.
- Reinforcement projects considered reasonable.
- Mains rehabilitation and meter replacement program considered reasonable.
- Recommends expenditure \$61.3m (\$2m 2004 project deferred).

Non System 2000-2004



- Expenditure \$21.3m is 38% less than Determination
- \$7.5 m of motor vehicle cost considered prudent.
- \$5.3 of IT cost considered prudent.
- Recommended expenditure \$21.3m.

- \$24.9m for corporate IT was excluded by AGLGN in submission.
- \$24.9m separately reviewed – considered prudent.

Recommendation

2000-2004

	2000	2001	2002	2003	2004	Total
Actual						
Market Expansion	56	55	46.3	48.1	47.5	252.9
System Reinforcement/ Renewal/Replacement	17.2	13.4	5.6	9.5	17.6	63.3
Non System Assets	5.3	2.2	5.8	2.7	5.2	21.2
Total	78.5	70.6	57.7	60.3	70.3	337.4
Recommended						
Market Expansion	55.2	54.1	45.5	47.6	46.8	249.2
System Reinforcement/ Renewal/Replacement	17.1	13.4	5.6	9.5	15.6	61.2
Non System Assets	5.3	2.2	5.8	2.7	5.2	21.2
Total	77.6	69.7	56.9	59.8	67.6	331.6

Forecast Capital Expenditure 2005-2010

Real \$ million	2005	2006	2007	2008	2009	2010
Forecast						
Market Expansion	49.0	51.7	50.3	48.7	48.5	48.4
System Reinforcement/ Renewal/Replacement	31.2	63.3	47.0	45.9	30.8	28.2
Non System Assets	12.7	13.0	9.9	8.0	8.2	10.9
Total	92.9	128.0	107.2	102.6	87.5	87.5

Capital Expenditure 2000 -2010 \$ m nominal



Growth Market Expansion 2005-2010

Analysis based on unit cost per customer connected:

- Residential: E to G, new homes
- Industrial and commercial (Tariff and contract)

Cost per customer	
Residential Mains	High
Residential Service	Agree
Residential Meters	High
I&C Mains	Agree
I&C Service	Agree
I&C Meters	Agree

Capital \$m Real	2005	2006	2007	2008	2009	2010	Total
Forecast	24.5	51.7	50.3	48.7	48.5	48.4	272.1
Recommended	23.2	49.0	47.4	45.9	45.6	45.4	256.5

System Reinforcement 2005-2010

- 70 Projects proposed – majority less than \$0.5m.
- Reviewed 8 out of 13 major projects including:
 - North Turrumurra Primary Mains \$10.9m
 - Wollongong Secondary Mains \$5.4m
 - Narellan-Camden Medium Pressure \$1.0m
- Projects excluding Wollongong, Narellan reasonable.
- Changes in scope and timing occurred in current AA period.
- Recommend further 10% reduction in expenditure.

Capital \$m Real	2005	2006	2007	2008	2009	2010	Total
Forecast	4	17	9.1	5.4	4.5	8.9	48.9
Recommended	5.6	16.4	8.2	3.5	4.0	4.1	41.8

Renew/Replacement 2005-2010

- \$39.2 m of programmed rehabilitation-recommend \$17.2m.
- Government Authority Work reduce from \$15.3m to \$11.5m. Excluding \$3.7m Breakfast Pt project, cost increased four times.
- Meter and regulator replacement program reduce from \$55.8m to \$50.7m.

Capital \$m Real	2005	2006	2007	2008	2009	2010	Total
Forecast*	27.2	46.3	37.9	40.5	26.3	19.3	197.5
Recommended*	26	43.5	31.8	33.8	19.1	13.0	167.2

*Includes Sydney Primary Loop project.

Sydney Primary Loop Project

- 30kms pipe to provide secondary supply to Sydney.
- Expenditure increased from \$35.6m to \$51.6m due to:
 - Decreased construction rate 50 metres from 150 metres.
 - Extra 3 km of pipeline.
 - Higher reinstatement cost.
- Risk mitigation project potential loss significant number of customers.
- Compared to Victoria ring main supply around Melbourne.
- \$200 million for Underground storage in 1998.
- Recommends the project in comparison to system security in Victoria.

Non System 2005 -2010

- Submitted IT expenditure of \$37m.
- Identified business cases for \$23.7m. No other business plans for additional expenditure.
- Total recommended expenditure \$30m compared with \$37m. Contingency of \$1.2m for ad hoc changes. Consistent with current IT expenditure.
- Submitted vehicle expenditure of \$13.4m.
- Vehicles cyclic changes based on current practice. Expenditure should be set at current level \$11.7m.

Capital \$m Real	2005	2006	2007	2008	2009	2010	Total
Forecast	6.4	13	9.9	8	8.2	10.9	56.4
Recommended	4	8	8	8	9.2	9.7	46.9

Recommended Forecast Capital Expenditure 2005-2010

Categories	Capital \$m	2005	2006	2007	2008	2009	2010	Total
Market Expansion	Forecast	24.5	51.7	50.3	48.7	48.5	48.4	272.1
	Recommended	23.2	49	47.4	45.9	45.6	45.4	256.5
Reinforcement/Renewal /Replacement	Forecast	15.6	63.3	47	45.9	30.8	28.2	230.8
	Recommended	15.8	59.9	40.2	37.4	23.2	17.1	193.6
Non System Assets	Forecast	6.4	13	9.9	8	8.2	10.9	56.4
	Recommended	4	8	8	8	9.2	9.7	46.9
Total	Forecast	46.5	128	107.2	102.6	87.5	87.5	559.3
	Recommended	43.0	116.9	95.6	91.3	78.0	72.2	497.0

Non Capital Cost

- Determine the reasonableness of the non capital expenditure for 2000-2004.
- Starting point is the Tribunal's 2000 Access Arrangement.
- Compare actual costs to the Tribunal's decision.
- Consider the reasons for variations (e.g. increase in customer numbers and gas load).
- Conclude on the efficient cost for 2004 which is the starting point for establishing the efficient cost for 2005-2010.

Non Capital Costs 2000-2005

Year Ending June	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Forecast
Controllable Costs					
Operation & Maintenance	54.1	57.3	61.4	60.7	65.2
Administration & Overheads	17	18.4	17.8	17.9	18.2
Marketing	23.3	17.1	12.4	13.1	13.1
Controllable Opex	94.4	92.8	91.6	91.7	96.5
Other Costs					
Government Levies	6.4	5.3	4.4	3.8	3.8
Retail Contestability	0	0	4.5	4.7	4.7
UAG	10.2	8.1	6.8	7.7	8.3
Total Opex	111	106.2	107.3	107.9	113.3
Allowable Costs in Final Decision 2000					
Controllable Costs	97.4	94.4	90.9	90.6	90
Total Costs	112.4	109.9	112.6	112.9	111.9

Conclusions on Non Capital Expenditure 2000-2004

- Consideration should be given for including some market operations cost .
- Allowing for customer growth and demand, the operations and maintenance cost and overheads costs is considered reasonable.
- 2004 overheads should be reduced to \$17.6m from \$18.2m due to lower insurance.
- Marketing expenditure has been reduced substantially – considered at a reasonable level– \$320 per customer is considered prudent..
- Government charges lower than in the Determination.
- UAG achieved is 2.1% compared to 2.2% in the Determination.

Non Capital Costs 2005-2010

Real 2005 \$	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Controllable Costs						
Operation & Maintenance	61.4	61.5	62.2	62.5	62.9	63.2
Administration & Overheads	18.9	19.0	19.2	19.3	19.3	19.4
Market Operations	4.3	4.3	4.3	4.3	4.3	4.3
Marketing	16.5	16.5	16.5	16.5	16.5	16.5
Controllable	101.1	101.3	102.2	102.6	103.0	103.4
Other Costs						
Government Levies	3.9	3.9	3.9	3.9	3.9	3.9
Retail Contestability	3.9	3.9	3.9	3.9	3.9	3.9
UAG	9.1	9.1	9.3	9.3	9.4	9.5
Total Non Capital	118.0	118.2	119.7	119.7	120.2	120.7

Conclusions on Non Capital Costs 2005-2010

- Efficient O&M costs is set at \$61.4m for 2005.
- O&M costs be adjusted for growth and efficiency of 1.5%.
- Corporate overheads be subject to efficiency of 1.5% after adjusting for growth.
- Efficient market operations cost be set at \$3.5m instead of \$4.2m.
- FRC cost set at \$3.9m per annum
- UAG be set at 2.1% instead of 2.2%.

Marketing Expenditure 2005-2010

- Expenditure of \$13.5m is for new homes market – basis of AGLGN growth assumptions.
- Incentive payment for new homes set at current level of \$320 per customer.
- \$3m business case targeting hot water market.
- Currently 34% of existing customers have non gas hot water market.
- Average load increase from 2.3GJ to 15.6GJ per annum.
- Incentive payment for hot water market set at \$300 per customer for 10,000 customers per annum.
- Recommend marketing expenditure of \$16.5m.

Recommended Non Capital Costs 2005-2010

Year ending 30 June	\$ million, real 2004-2005						
	2005	2006	2007	2008	2009	2010	Total
Controllable Costs							
Forecast	101.1	101.3	102.2	102.6	103.0	103.4	613.6
Recommended	99.7	99.9	100.8	101.2	101.6	102.0	605.2
Other Costs							
Forecast	16.9	16.9	17.1	17.1	17.2	17.3	102.5
Recommended	16.2	16.2	16.0	16.1	16.1	16.2	96.8
Forecast Total	118.0	118.2	119.3	119.7	120.2	120.7	716.1
Recommended Total	115.9	116.1	116.8	117.3	117.7	118.2	702.0