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8 July 2005

Mr Jim Cox
 Chief Executive Officer
 Independent Pricing and Regulatory Tribunal
 PO Box Q290
QVB Post Office NSW 1230

Dear Mr Cox

Review of Country Energy Gas' Gas Access Arrangement for Independent Pricing and Regulatory Tribunal

Country Energy Gas (CEG) would like to thank the Independent Pricing and Regulatory Tribunal (the Tribunal) for the opportunity to respond to the 14 June 2005 Energy Consulting Group (ECG) report "*Review of Country Energy Gas' Gas Access Arrangement For Independent Pricing and Regulatory Tribunal*" (the Report).

CEG would like to take this opportunity to acknowledge the highly consultative approach adopted by ECG during the extensive and important total cost review process. In this response we have provided an overview of our submission and the overall process and ECG report, and have then specifically addressed individual sections contained in the Report.

Overview

Table 1 below compares the overall levels of operating and capital expenditures proposed by CEG to the recommendations put forward by ECG for both the current and future regulatory period.

Table 1: Actual/Forecast expenditure versus ECG recommendations

	Actual/Forecast (\$m 2005/06)	ECG Recommended (\$m 2005/06)	Reduction (\$m 2005/06)	Annual Reduction (\$m 2005/06)
Capital Expenditure 1999-2003	13.726	12.430	1.296	0.259
Capital Expenditure 2004-10	12.465	8.603	3.862	0.594
Non-Capital Costs 2004-10	14.656	13.723	0.933	0.144
TOTAL	40.849	34.738	6.111	N/A

This submission is limited to the key points of difference that CEG believes exist between the levels of expenditure put forward by CEG and the recommendations proposed by ECG in their report. CEG accepts the majority of ECG's report, however there are four key areas where we believe expenditure has been excluded from ECG's recommendations that should be reconsidered. The key areas at issue are summarised in Table 2 below.

Table 2: Key areas of difference between CEG expenditure levels and ECG recommendations

	Actual/Forecast (\$m 2005/06)	ECG Recommended (\$m 2005/06)	Reduction (\$m 2005/06)	Annual Reduction (\$m 2005/06)
Aged Meter Replacement 99-03	0.931	0.761	0.170	0.034
Glenfield Road Reinforcement 99-03	0.671	0.504	0.167	0.033
General Expansion/Reinforcement 99-03	6.391	5.426	0.965	0.193
Non-Capital Costs 04-10	14.656	13.723	0.933	0.144
TOTAL	22.649	20.414	2.235	N/A

As you can see from the above table our key areas of concern predominantly relate to actual expenditure during 1999-2003 which has not been included in ECG's recommendations. This expenditure has been incurred in an efficient manner throughout the period and at levels below the allowances established in the previous Access Arrangement process. CEG therefore believes that this expenditure is prudent and should be included in the roll forward of its asset base.

On several occasions ECG has recommended to the Tribunal a reduction in CEG's actual level of expenditure by applying forward looking unit rates to historical expenditure that is already below the levels considered prudent and efficient by the Tribunal in 1999.

Section 6.3.3 Review of Actual Expenditure – Aged Meter Replacement

ECG has recommended a reduction in the amount CEG has spent on meter replacements for the period 1999–2003. CEG does not agree with ECG's recommendation to reduce the allowed expenditure for aged meter replacement from \$931,000 to \$761,300, by applying proposed unit cost per aged meter change for the next regulatory period back to the current regulatory period.

During the period 1999–2003 CEG spent \$931,000 replacing 4,301 meters, representing a cost of \$216 per metre. This expenditure was under the current Access Arrangement allowance of \$980,000 for meter replacements despite replacing more than the anticipated number of meters. CEG replaced 4,301 meters during the regulatory period compared to an estimated allowance of approximately 4,020 meters, but still managed to spend less than the allowance.

This underspend of aged meter replacement expenditure by CEG is similar to the situation that occurred for ActewAGL and AGLGN, however they were not able to provide actual meter quantity details. Despite this, their actual past expenditure was still recommended for inclusion by ECG. CEG have made efficiency gains on what was allowed for the current regulatory period, and yet ECG have proposed to impose further efficiency gains on money that has already been spent.

For these reasons CEG believes that its actual expenditure for the period was prudent and should be reinstated to the full amount of expenditure allocated to aged meter replacement for the current regulatory period 1999-2003 in ECG's report.

Section 6.4.1 Glenfield Road Reinforcement

CEG does not agree with ECG's recommendation to reduce the allowed expenditure for this project from \$671,000 to \$504,000. CEG believes there are a number of facts overlooked by ECG that warrant consideration in determining the allowed expenditure for this project.

It appears from the Report that ECG has benchmarked the Glenfield Road project against the later Southern Gate Station project and come to the conclusion that they both should be equal in terms of unit costs for 200mm steel main. However, there are a number of differences that have not been acknowledged in regards to why the two projects are in no way similar, both in terms of scope and costs.

CEG was able to achieve significant savings by constructing the Southern Gate Station at the same time that the pipeline into Tumut was being constructed. This was anticipated during the planning and design of the two projects, and is outlined in the Board paper supplied to ECG in relation to this.

Substantial savings were achieved during the construction phase of the Southern Gate Station due to:

- the use of the same contractor for both the Southern Gate Station and Tumut pipeline projects, thereby eliminating mobilisation costs,
- the use of local project management skills that were developed during the Tumut pipeline project, the significant economies of scale, and the resulting reduced costs obtained through the bulk purchase of steel pipe through the ordering of a much greater quantity by placing one large order for both projects.

The Glenfield Road project did not have these same advantages. It was a stand-alone, one-off project completed up to a year ahead of the Southern Gate Station project, and minor in scope compared to that project. The Glenfield Road project also had to contend with much more difficult laying conditions. The Southern Gate project was predominantly

carried out in vacated open land, whereas Glenfield Road was in a built up area and had to contend with urban challenges such as trees and traffic conditions.

CEG took advantage of the situation and conditions to deliver the Southern Gate project at well below initial budget forecasts at an efficiency and cost level that would be extremely difficult if not impossible to replicate for any other project undertaken either in the past or in future for a network the size of Wagga Wagga, especially given that a project of such scope will not occur again in Wagga Wagga in the foreseeable future. As Glenfield Road was completed before the Southern Gate project, it did not have access to the same favourable conditions that Southern Gate was able to take advantage of. The Southern Gate Station project proved to be a great achievement for CEG and credit to everyone involved, delivered well above expectations.

In summary, while Glenfield Road was the initial stage that needed to be undertaken in preparation for the Southern Gate project to proceed, it was an isolated stand alone project, completed before the Southern Gate project commenced, under completely different laying conditions, and with a wide variation in scope and costs.

CEG believes it is unrealistic for ECG to expect that the Glenfield Road project undertaken by CEG to be consistent in scope, timing and costs as the Southern Gate Station Project. CEG notes below that ECG approved a number of system reinforcement projects for AGLGN that varied widely in scope and costs.

CEG observes that ECG recommended that a number of system reinforcement projects should be included in AGLGN's recently approved Access Arrangement. The projects involving 150mm and 200mm secondary mains differ in scope and range in costs from approximately \$240 per metre to over \$750 per metre. The cost of the Glenfield Road project of \$240 per metre is at the very bottom of this range.

CEG also notes that the rate for 200mm steel main used by Kinhill in its report "Review of the Optimised Replacement Cost of the Natural Gas Distribution Network in Wagga Wagga" was \$201 per metre in 1998 dollars. This compares favourably with the \$240 per metre rate (real \$2005/06) for the Glenfield Road reinforcement project.

Finally, the Board of Great Southern Energy Gas Networks (GSEGN) approved the project at the reported cost. The Board of GSEGN was charged with the responsibility to help GSEGN achieve its business objectives of operating at least as efficiently as any comparable business, thereby maximising shareholder value. It was their duty to act with care and diligence on any proposal brought before them, ensuring each approved project was at an efficient and prudent level. CEG finds it difficult to understand why ECG has recommended the reduction to this expenditure, 7 years after the project was approved and completed.

Section 6.4.2 General Expansion/Reinforcement

CEG was unfortunately not able to provide the growth related capital actual expenditure in the same categorisation that was used for the allowances given in the 1999 Access Arrangement, due to the many mergers and system integration issues that have taken place during the current regulatory period. ECG therefore derived category expenditure analysis by applying proposed forward rates and splits to the historical data and categories supplied by CEG. While this is useful for overall analysis it is not a sound basis to recommend retrospective adjustments to the historical spends for only some of the categories. The methodology applied by ECG adjusted downward any category where there were reductions in the forward rates, however when there were increases in the forward rates there were no upward adjustments. Given the derived method to classify costs into each category we do not agree with the recommended reductions.

CEG believes the actual growth related expenditure needs to be examined in total and not split between categories on a subjective basis by ECG.

The total actual growth related capital expenditure compared to the total 1999 allowances is presented in Table 3 below.

Table 3: Growth related capital expenditure 1999-2003

	Total (\$m 05/06)	Customers	\$/Customer
1999 AAI Allowances	4.112	731	5,625
Actual 1999-2003*	7.062	2,290	3,084
Actual 1999-2003**	2.254	731	3,084

* Includes Glenfield Road reinforcement

** Assuming actual customers equalled 1999 forecasts

An analysis of the data presented in Table 3 above reveals the following:

- Actual expenditure exceeded allowances by 72%, however actual customer numbers were 213% above the forecast used for the allowance.
- At the same actual \$/customer rate achieved by CEG during the period, the actual expenditure on the same 731 customers forecast in 1999 would have been only \$2.254 million, compared to the allowance of \$4.112 million. Likewise, if CEG would have spent the equivalent \$/customer amount approved as being prudent and efficient in 1999 on the actual 2,290 customers connected, the actual expenditure would have been \$12.882 million, however CEG only spent \$7.062 million.
- The rates above indicate that CEG has achieved an approximate efficiency saving of 45% compared to the rate allowed in 1999. However, ECG are looking to impose a further efficiency reduction of approximately 9%.

- CEG has spent the money on growth related capital in good faith based on the prudent and efficient levels approved in 1999 and the rules set in place at that time. CEG has always believed that while tracking at a 45% efficiency saving, it was completely prudent and acceptable to continue to connect new customers over and above what was originally forecast in 1999.
- The levels of expenditure recommended by ECG mean that CEG should have been able to connect an extra 213% in customers above forecast by only spending 44% above the approved allowance level, or suggests that CEG should have stopped connecting new customers after the 731st and banked an efficiency saving of \$1.858 million.

CEG believes the above facts show that the money actually expended on growth related capital was well below the approved prudent and efficient levels adopted in 1999 and therefore should be included in full in the roll forward of the asset base. CEG does not think it is appropriate that ECG try to impose further efficiency gains over and above the substantial levels already achieved by CEG on money that has already been spent.

Section 9 Non Capital Costs 2004 to 2010

Gas Network Management

ECG notes that the staff engineer lost in 2002 will need to be replaced in the short to medium term as the current level of staffing is not sustainable. CEG has actually made allowance for this position to be filled in the budgeted staff for 2005/06. CEG therefore believes that the current recommended approved level of gas network management operating expenditure needs to be increased in recognition of the impending recruitment of an additional qualified professional staff engineer.

CEG suggests the addition of \$150,000 would be appropriate to cover wages, oncosts, overheads and plant costs.

Efficiency Factor

CEG would like clarification from ECG on how they arrived at an efficiency factor level of 1.5%. As it stands, AGLGN have secured a 50% reduction, while ECG have proposed a 50% increase in the rate for CEG. CEG achieved efficiency gains above the 1% level used in the 1999 decision, especially considering the 213% increase in customer numbers above forecast levels. Given the size and scope of the Wagga Wagga operation and the significant efficiency gains achieved in the current regulatory period, CEG firmly believes that any future efficiency gains will be minimal, but is willing to explore a 0.5% efficiency factor consistent with the 50% reduction from 3% to 1.5% recently approved for AGLGN. CEG does not have the flexibility or capacity available to larger organisations like AGLGN to realise efficiency gains above this level.

Marketing Expenditure

CEG believes there may have been some misunderstanding in relation to the actual marketing expenditure for 2003 that ECG has used as the starting base for the recommended level of marketing expenditure going forward. The marketing incentives program that CEG is looking to implement in this Access Arrangement period bears no relationship to the marketing expenditure that took place in the 1999-2003 regulatory period, and therefore using the 2003 marketing expenditure as the base going forward is not appropriate.

ECG have concluded that the proposed level of expenditure on marketing incentives and gas awareness programs are prudent, and CEG therefore believes the total amount it has proposed should be included. CEG also notes that as a proportion of total operating costs, the proposed marketing expenditure is well below the levels approved in 1999, and most recently approved for ActewAGL and AGLGN. CEG believes that the full \$146,000 originally proposed should be reinstated.

We look forward to working with the Tribunal and ECG to conclude this review in a timely manner.

If you have any questions on this matter or would like further information please do not hesitate to contact Jason Cooke on (02) 6338 3685.

Yours sincerely

A handwritten signature in blue ink, appearing to be 'TB', with a horizontal line above it.

Terri Benson
Group General Manager Corporate Services