



**Response to the  
Queensland Competition Authority's  
Draft Decision  
on the  
Revised Allgas Access Arrangement**

**Allgas Energy Pty Ltd**  
(ABN 52 009 656 446)

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# 1 INTRODUCTION

This submission is in response to the Queensland Competition Authority's (QCA) *Draft Decision: Revised Access Arrangement for Gas Distribution Networks: Allgas Energy Pty Ltd* (Draft Decision) as released on 22 December 2005.

In this submission, Allgas Energy Pty Ltd (Allgas) addresses the 23 amendments identified by the QCA in its Draft Decision and agrees to implement 15 of them without change. Allgas has partially accepted 8 of the recommendations but requests some adjustments, with the reasoning for the adjustments explained within this document.

In some areas, while not making specific amendments to Allgas' proposals, the QCA has requested further information on several issues. This information has also been provided.

Allgas has also:

- made additional changes to account for QCA amendments which have impacted on other aspects of the Allgas Access Arrangement; and
- proposed several new amendments to improve the Access Arrangement workability with regard to its terms and conditions.

The four major issues that Allgas believes were not given satisfactory consideration in the Draft Decision are:

- past non-system capital expenditure;
- capital expenditure forecasts from 2006/07 to 2010/11;
- non-capital cost forecasts from 2006/07 to 2010/11; and
- the demand forecasts for the Demand customer class.

Allgas recognises that the QCA required further information on several aspects of these forecasts before it could confidently approve the Allgas proposals. Allgas is happy to present additional information in support of each of these issues.

This submission is divided into seven major sections:

- sections 2 to 4 discuss the specific issues within the Draft Decision that Allgas believes were not given adequate consideration, specifically, the Allgas forecasts of capital expenditure, non-capital costs and demand;
- section 5 provides additional information in support of several of its proposals as requested by the QCA;
- section 6 details further issues that have arisen as a consequence of the amendments outlined in the Draft Decision and also addresses further improvements that Allgas has identified since the submission of its Revised Access Arrangement; and
- section 7 summarises Allgas' response to each of the 23 recommendations contained within the Draft Decision.

## **2 CAPITAL EXPENDITURE**

The components of the capital expenditure forecasts that Allgas believes were not adequately covered in the Draft Decision are:

- customer requested capital expenditure forecasts from 2006/07 to 2010/11;
- renewal capital expenditure forecasts from 2006/07 to 2010/11; and
- current and forecast non-system capital expenditure.

The Draft Decision requires Allgas to amend its Access Arrangement to reduce its capital expenditure forecasts over the future period from \$164 million to \$114 million. This was based on the Economic Consulting Group (ECG) review of Allgas' forecasts and included major reductions in customer requested capital expenditure and a slowing of the Allgas renewal program.

Allgas believes that ECG has not properly considered the data and reasoning provided by Allgas and the following sections:

- reiterate Allgas' request for its previously requested level of customer requested capital expenditure, supplemented by further evidence explaining the variations identified by ECG and supporting the expenditure;
- justify the external resourcing of Allgas' renewal program while including a downward revision to the renewal program from 10 years to 8 years to meet some of ECG's concerns;
- provide justification for the Allgas non-system capital expenditure in the current period; and
- include revised non-system capital expenditure for 2006/07 to 2010/11 to ensure the forecast methodology is in line with the process described for determining current non-system capital expenditure.

### **2.1 Customer Requested Works from 2006 to 2011**

In its Revised Access Arrangement, Allgas proposed a gradual increase in customer requested capital expenditure, which correlates with the increased customer growth that it was seeking to generate. Over the current period, Allgas has demonstrated its commitment to actively growing the gas network with its expenditure on customer requested works in excess of the total capital expenditure allowed by the QCA. Allgas wishes to continue this expansion, providing its forecast expenditure is approved by the QCA.

Although Allgas was prepared to spend above the capex allowance in the previous Access Arrangement period, Allgas considers that it has been able to demonstrate that the higher rate of capex spend is not only sustainable but prudent and is realising benefits not only to Allgas but network users. Given these reasons it is appropriate to have the higher rate of capex spend included within the total revenue requirement to determine Allgas' price paths to 2010/11.

In the Draft Decision, the QCA significantly reduced the Allgas proposal based on the recommendation of their consultants, ECG. ECG found the Allgas program of works was prudent, however, reduced capital expenditure based on their calculation of the average customer connection cost for Allgas, which was benchmarked against the average connection cost of other service providers. Allgas strongly opposes this finding.

The connection cost that ECG has calculated for Allgas is misleading and is inaccurate as a benchmark. In this section, Allgas explains in detail:

- why the ECG calculation and comparison is in error;
- what the average connection cost for Allgas is and compares it to the ECG benchmarks; and
- reaffirms the forecast Allgas submitted in its Revised Access Arrangement.

### 2.1.1 Infill residential customer connections – average cost calculation

New residential customers are connected to the Allgas network either through new residential estate developments or as infill customers.

Infill customers represent individual customers that connect to the existing mains in their suburbs directly with a service or with a short mains extension. The average mains extension is 8.8 metres per customer, but can vary between connections with no mains extension and connections with mains extensions of up to 20 metres. The estimated cost of connection for a single infill residential customer is \$1,880 as shown in the following table.

**Table 2.1: Estimated cost per single infill domestic customer (\$2005/06).**

Description	Quantity	Unit Cost (\$)	Total Cost (\$)
Mains extension, 40-160mm OD <sup>1</sup> PE <sup>2</sup>	8.8 metres	100/m	880
Service, 20mm OD PE and meter set	each	1,000	1,000
Average cost			1,880

This connection cost compares favourably with the benchmarks provided by ECG and is much less than the \$3,120 assumed by ECG as the average Allgas connection cost.

### 2.1.2 Residential customer connections in new developments – average cost calculation

New residential developments allow for multiple domestic customers to be connected to the natural gas supply, but over a period of time ranging between 2 to 10 years. These developments require a significant initial investment, as new estate developments are usually remote from the existing Allgas network in South East Queensland. Consequently, a long length of mains must be constructed to connect the development site to the existing Allgas network.

Despite this large initial capital expenditure, the average cost of connection for individual domestic customers in a new domestic development remains low when all customers that will connect over the 2 to 10 years period are considered. Table 2.2 highlights the average assets used for new development residential connection and the average cost of connection. The average cost of \$1,590 again compares favourably with the benchmarks used by ECG.

**Table 2.2: Average cost per domestic customer in new developments (Real \$2005/06)**

Description	Quantity	Unit Cost (\$)	Total Cost (\$)
External main extension, 40-160mm OD PE	2 m	100/m	200
Internal main extension, 40-63mm OD PE	13 m	30/m	390
Service, 20mm OD PE and meter set	ea	1,000	1,000
Average cost			1,590

<sup>1</sup> OD – outside diameter.

<sup>2</sup> PE – polyethylene.

To demonstrate how this average cost of connection is derived, Table 2.3 details a new residential development in full.

It has a predicted 1,000 domestic customers connected to the network over a 5 year period. The capital expenditure by Allgas on this development is shown for each year along with the number of customer connections planned annually. The main headworks, as discussed above, are shown as a \$200,000 investment in 2006/07 with only 10 customers connected that year. Using the ECG methodology, the average cost of connection per customer in 2006/07 is over \$33,000. However, in the following years, most of the development's internal mains have been installed and only the incremental capital expenditure to connect each customer's meter and service will be required. This is clearly demonstrated by the fall in the average cost per connection to \$1,000 per customer once all main installations are completed.

The average cost of connection over the entire project is \$1,590 per customer which again favourably compares to the benchmarks utilised by ECG.

**Table 2.3: Capital expenditure for standard new domestic development (Real \$2005/06)**

Description	06/07	07/08	08/09	09/10	10/11	Total
External main extension (\$'000)	200					
Internal main extension (\$'000)	121	117	98	55		390
Service and meter set (\$'000)	10	300	300	250	140	1,000
Total cost (\$'000)	331	417	398	305	140	1,590
New customer connections (no.)	10	300	300	250	140	1,000
Average cost per customer (\$)	33,090	1,390	1,325	1,218	1,000	1,590

### 2.1.3 Forecast of customer requested capital expenditure for residential customers

The Allgas forecast of customer requested capital expenditure incorporated predicted infill residential customer connections and Allgas' planned servicing of new residential developments over the next 5 years.

Table 2.4 shows the detailed forecast for the number of residential infill customers and the number of residential customers arising from different stages of new domestic developments.

**Table 2.4: Number of domestic connections as infill and in different stages of new developments**

Description	06/07	07/08	08/09	09/10	10/11	Total
Infill domestic customers	115	115	115	115	115	575
Developments starting:						
2002/03	354					354
2003/04	465	438				903
2004/05	700	580	430			1,710
2005/06	800	700	700	538		2,738
2006/07	158	750	750	700	639	2,997
2007/08		169	806	800	800	2,575
2008/09			174	968	950	2,092
2009/10				179	1,170	1,349
2010/11					211	211

Description	06/07	07/08	08/09	09/10	10/11	Total
Total	2,592	2,752	2,975	3,300	3,885	15,504

For example, in 2007/08, Allgas is forecasting 115 infill connections and 2,637 connections from new developments. However, only 169 of these connections are due to new developments commenced in 2007/08. The remaining connections are as a result of developments initiated in the four previous financial years.

Importantly, Allgas customer requested capital expenditure forecast is driven residential customer connections and Table 2.5 shows the break-up of Allgas' annual capital expenditure on residential connections by each individual development.

**Table 2.5: Capital expenditure forecast for residential connections (2005/06 Real \$'000)**

Description	06/07	07/08	08/09	09/10	10/11	Total
Infill domestic customers	216	216	216	216	216	1,081
New developments 02/03	354					354
New developments 03/04	567	438				1,005
New developments 04/05	928	707	430			2,064
New developments 05/06	1,112	928	853	538		3,430
New developments 06/07	5,228	1,043	994	853	639	8,756
New developments 07/08		5,592	1,120	1,060	975	8,747
New developments 08/09			5,758	1,346	1,259	8,362
New developments 09/10				5,923	1,626	7,549
New developments 10/11					6,982	6,982
Total expenditure	8,404	8,923	9,371	9,935	11,697	48,331
Cost per connection (\$/customer)	3,242	3,242	3,150	3,011	3,011	3,117

The cost per connection shown in Table 2.5 is the data derived by ECG and used in their benchmarking exercise. The breakdown of this data clearly shows why this is an erroneous comparison.

If you examine the capital expenditure forecast for customer requested residential connections in 2007/08 and exclude the new developments starting in that year, Allgas is proposing \$3.3 million to connect 2,583 customers with the connection cost varying from \$1,000 to \$1,880 per customer. This is well below the benchmarks used by ECG.

However, new developments in 2007/08 require expenditure of over \$5.5 million with only 169 customers connecting in that year. This average connection cost of over \$33,000 per customer is artificially increasing the annual average cost, as used by ECG, to over \$3,200 per customer. As shown above, this cost is driven by mains headworks, which occurs at the beginning of the development. The mains headworks is essential, otherwise Allgas cannot reticulate the residential development and loses the opportunity to connect these residential customers.

It is important to understand the location of the Allgas network as shown in its Access Arrangement Information document. Much of the Allgas network is in old inner-city suburbs of Brisbane with little network infrastructure on the outskirts where new residential developments are occurring. Similarly, the Allgas network on the South Coast is sparse and most planned developments are many kilometres from the current network. Consequently, if Allgas is to connect residential developments it must first invest in long mains extensions/ headworks to the specific region. This is in sharp contrast to established southern states such as Victoria where

the Service Provider has a comprehensive network covering most suburbs of Melbourne. This geographical difference needs to be taken into account by ECG when benchmarking the headworks spent on new developments in Queensland compared to the southern states.

It is also important to recognise that Allgas examines each new development over a sufficient planning horizon by requiring that all new developments are justified through its Capital Expenditure Policy. This policy requires that the average connection cost of the new development does not breach the maximum average cost for connecting new domestic customer of \$1,994. Capital expenditure for new development connection is not approved where the maximum average cost for connection is breached. This policy and supporting Financial Justification Model have been provided to ECG.

Allgas believes that the supporting information in this section should clarify Allgas' customer requested capital expenditure for residential customers and correct the misconception that ECG held during its benchmarking exercise. As shown above, Allgas' estimated average cost to connect:

- infill residential customers is \$1,880;
- customers in new residential developments is only \$1,590; however
- in different stages of development, the cost per customer connection in a year may vary from \$33,000 to only \$1,000 per customer, depending at what stage of the development the average cost 'snapshot' is taken. This further highlights the importance of ensuring that the cost to connect is determined by appropriate consideration of investment timeframe and the economics of infrastructure development.

These costs are closely comparable to the average costs of other natural gas distribution companies in Australia. Allgas requests that ECG reconsider Allgas' forecasts given the further explanation provided. Allgas also notes that its gas demand forecasts for the residential volume group would need to be revised if its capital expenditure program is not approved.

#### **2.1.4 Capital expenditure for new commercial and industrial customer connections**

With regard to commercial and industrial customer connections, Allgas stresses that there are significant variations between different customers in this category including in relation to:

- maximum hourly load;
- maximum daily load;
- annual consumption;
- required supply pressure;
- type of mains required to supply gas; and
- distance from supply point.

All these factors can impact the required capital expenditure for connection. The only similarity that Allgas can be assured is that each customer must meet Allgas' Capital Expenditure Policy and Financial Justification Model if it is to be connected without providing a capital contribution.

In the Draft Decision, ECG reduced the Allgas average connection cost on commercial and industrial customers from \$18,500 to \$13,500 based on an estimation of average connection cost in 2004/05 and 2005/06. Unfortunately, Allgas provided unsatisfactory data on these connections which led to the use of this misleading average. As shown in the ECG report, the average cost of commercial and industrial connections in 2004/05 was actually around \$17,000, which is consistent with Allgas' experience.

Table 2.6 highlights the actual moving annual average cost to connect commercial and industrial customers for Allgas from June 2004 to November 2005. This is an Allgas performance indicator and is monitored on monthly basis.

**Table 2.6: Actual C & I customer connection cost data from June 2004 to November 2005**

Month	12 Month Moving Total C&I Connections	Average C&I Connection Cost (\$/customer)
June 2004	191	15,142
July 2004	197	17,030
August 2004	207	17,615
September 2004	203	18,398
October 2004	209	19,429
November 2004	226	18,005
December 2004	220	19,779
January 2005	220	20,065
February 2005	223	19,528
March 2005	230	19,131
April 2005	238	22,143
May 2005	230	22,627
June 2005	228	23,817
July 2005	234	22,051
August 2005	239	20,239
September 2005	250	19,879
October 2005	252	18,782
November 2005	233	19,596

Given this is Allgas' actual cost of connection, Allgas would propose that its forecast of capital expenditure for customer requested commercial and industrial customers is consistent with historical information and be included as proposed in the Revised Access Arrangement.

The use of \$13,500 as an average cost of connection is clearly untenable if you consider that ECG has:

- recommended a connection cost for these customers meter and service of around \$5,000;
- accepted an average mains extension per customer of 90 meters; and
- accepted a unit cost of between \$120-\$140 per meter for mains extension as efficient.

These figures produce a cost per customer connection between \$16,000 and \$18,000, which is in line with the forecast provided by Allgas. Table 2.7 sets out Allgas' forecasts of connection costs for C & I customers to 2010/11.

**Table 2.7: Capital expenditure forecast for connection of C & I customers (\$m Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
Forecast C&I Connections	226	249	269	268	277
Average Cost (\$/customer)	17,825	17,912	18,399	19,004	19,218

<b>Description</b>	<b>06/07</b>	<b>07/08</b>	<b>08/09</b>	<b>09/10</b>	<b>10/11</b>
C&I Budget Forecast (\$M)	4.03	4.46	4.95	5.09	5.32

## 2.2 Renewal Capital Expenditure Forecast

The QCA reduced Allgas' renewal program on the basis of ECG's recommendation. ECG found the unit costs of the Allgas program to be efficient but believed that:

- Allgas should only target high leakage areas;
- Allgas may not have the resources to complete the program by 2010/11; and
- a more prudent renewals program would be over a 10 year period rather than the 5 years proposed.

The Allgas renewal program was developed to allow the Allgas natural gas distribution network to continue to be operated safely and economically, as noted by ECG, but also based on several economic drivers that are important. These factors include:

- minimising risks related to public safety;
- minimising risks related to security of natural gas supply to existing customers;
- minimising environmental impacts;
- improving network capacity;
- improving the capability for Allgas to meet the demands of potential new customers and increased demand for existing customers given the introduction of the Sustainable Building Code;
- minimising unaccounted for gas cost; and
- minimising planned and corrective maintenance costs.

A detailed renewal program was first developed by Allgas in June 1993. In November 1993, a special crew was established with targets to perform renewal of old cast iron network in the worst areas in Brisbane as well as to lower operating pressure in the medium pressure network. Renewal work started in Logan Road, Woolloongabba, Ipswich, Annerley, Moorooka and South Brisbane.

Allgas is currently in the 12<sup>th</sup> year of its renewal program. From early in the program, Allgas has been required to accelerate the pace of renewals on several occasions by involving secondary Allgas crews in Toowoomba or through crews of contractors.

Allgas believes it should complete the renewal of the network as quickly as possible to extract full benefit from the Sustainable Building Code as high pressure mains must be in place before it can connect new customers to its current network.<sup>3</sup>

The QCA has questioned Allgas' ability to resource its renewals program and Allgas can confirm its available resources to perform renewal work are:

- 2 ENERGEX crews of 4 people with the capability to renew 10.5km/crew/year; and
- 3 contractor crews of 7 people with the capability to renew 18.5km/crew/year.

Therefore, Allgas' total current renewal capacity is 76.5km/year.

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<sup>3</sup> As already noted by Allgas, existing low and medium pressured sections of the distribution network do not have the capability to provide uninterrupted supply of gas to modern equivalent consumer gas appliances. Without renewals Allgas will not be able to supply gas in these parts of the network, which currently constitute around 30% of the total distribution network.

Attachment A includes a confidential report by the Allgas contractor explaining its current and future resourcing capability. The plan describes their ability to increase renewal capacity to 95km/year by the recruitment and training of an additional crew.

Despite this information, Allgas has mitigated its proposed renewal program to only rely on current resources and to plan for completion of the program in June 2014, 20 years after the start of the program and 2 years before the recommendation of ECG in the Draft Decision.

Allgas' new proposal for renewals is shown in the following table and requires a total of \$49.4 million in capital expenditure. This is a significant reduction from its initial proposal of \$70 million in the Revised Access Arrangement but still ensures the renewals program is completed in a reasonable timeframe.

**Table 2.8: Revised renewal budget forecast (\$m Nominal)**

<b>Description</b>	<b>06/07</b>	<b>07/08</b>	<b>08/09</b>	<b>09/10</b>	<b>10/11</b>	<b>Total</b>
Renewed mains (km)	64	66	65	53	76	324
Renewal Budget	9.4	9.4	9.8	8.2	12.5	49.4

## 2.3 Non-System Capital Expenditure 2000/01 to 2005/06

The Draft Decision has only recognised \$0.3 million of non-system capital expenditure in each year of the current period despite Allgas submitting the figures from approved and audited Regulatory Accounts for these years. However, the Draft Decision indicates the provision of detailed information to substantiate the level of non-system capital expenditure may lead to the QCA reconsidering its decision to disallow the Allgas proposal.

Allgas produces a Cost Allocation Methodology and Procedures (CAMP) report to the QCA for its approval each year. The Allgas regulatory accounts are then prepared based on these procedures and audited accordingly. The allocation of these assets to Allgas means that they are not recognised in other parts of the business and no return is forthcoming on their investment if not recognised by the QCA as a legitimate part of the Allgas business as part of this process.

In order to give comfort to the QCA on the make-up of the non-system cost, Allgas provides a breakdown of the:

- methodology used;
- non-system costs for 2004/05; and
- physicals that match this capital expenditure.

### 2.3.1 2004/05 Non-system capital expenditure

Non-system capital expenditure is incurred as a function of support services to the direct activities of building, operating, and maintaining a natural gas distribution pipeline network. In Allgas, non-system capital expenditure is incurred in a shared services model for the whole of the ENERGEX Limited group of companies, and is then applied to each of the business units of ENERGEX utilising drivers and allocation rates as published in the CAMP.

Thus non-system capital expenditure is derived utilising the principles of the CAMP as reviewed and authorised by the QCA on an annual basis. The current CAMP has utilised a consistent methodology in relation to allocation rates since 2002/03.

Supporting data in Attachment B documents and verifies that the non-system capital expenditure allocated to Allgas is consistent with the CAMP methodology for the 2004/05 financial year.

Table 2.9 shows the break-up of non-system capital expenditure in 2004/05.

**Table 2.9: Non-system capital expenditure reported in 2004/05 (\$'000)**

Description	2004/05
Commercial Land and Buildings - Allocations	89
Other - Non-System Assets - Allocations	156
IT&T Equipment - Allocations	614
Motor Vehicles - Allocations	1,737
Other (balance)	152
Total	2,748

In addition, Allgas has completed an analysis to estimate the physical non-system assets, specifically the vehicle and IT infrastructure, that is needed for Allgas to support the proposed

capital expenditure and operating and maintenance activities on the gas distribution network to 2010/11.

In summary, this high level analysis shows that:

- the estimated replacement cost for the Allgas vehicle fleet of 88 in 2004/05 was \$5.3 million; and
- the estimated replacement cost for Allgas' total IT infrastructure requirement, incorporating hardware and operating software, in 2004/05 was \$1.4 million.

Given the short useful life of these assets, the non-system capital expenditure proposed by the QCA is clearly unreasonable. The detail of Allgas' analysis is in Attachment C. Allgas submits this information on a commercial-in-confidence basis.

The CAMP methodology described above was utilised in 2003/04 and is being utilised in 2005/06. Preliminary reports show non-system capital expenditure to be in the order of \$2.1 million after 6 months. Allgas therefore proposes past non-system capital expenditure as summarised in the following table be recognised in the Allgas asset base.

**Table 2.10: Actual historic non-system capital expenditure (\$m, Nominal)**

Description	01/02	02/03	03/04	04/05	05/06
Non-System Expenditure	0.6	0.6	2.2	2.7	2.9

## 2.4 Non-System Capital Expenditure Forecast

Allgas has included a revised non-system capital expenditure forecast for 2006/07 to 2010/11 to ensure the forecast utilises the same methodology, as described above in the examination of Allgas' current non-system capital expenditure.

The allocation rates for the future allocation of non-system costs between ENERGEX and Allgas are not available. Therefore, Allgas has forecast non-system capital expenditure for the regulated gas business, as per the allocation bases in the Allgas CAMP for 2004/05, but indexed for cost inflation as per the inflation rate of 2.77% used within the QCA's Draft Decision.

**Table 2.11: Allgas non-system capital expenditure forecast (\$'000 Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
Land & Buildings	94	96	99	102	104
Furniture, Office Equipment	165	169	174	179	184
IT - Ongoing	649	667	685	704	724
IT - Peace	4,040	0	0	0	0
Vehicle Fleet	1,834	1,885	1,937	1,991	2,046
Equipment <sup>4</sup>	160	165	169	174	179
Non-system CAPEX	6,942	2,982	3,065	3,150	3,237

The forecasts are consistent with Allgas actual non-system capital expenditure from the previous period and are in line with the findings from the analysis of physical assets as described in the commercial-in-confidence Attachment C.

<sup>4</sup> This includes tools, equipment, miscellaneous communication equipment and other assets which do not fit within the specific non-system capex items.

The IT – Peace project is a one-off project that will deliver substantial benefits to Allgas’ network billing, customer and network management activities. As the project is an ENERGEX Limited IT infrastructure project Allgas’ share of the projects capital cost has been allocated according to Allgas’ approved CAMP.

Moreover, Allgas has demonstrated that the QCA’s Draft Decision non-system capex allowance of \$300,000 per annum is well below what Allgas requires to 2010/11.

## 2.5 Revised Capital Expenditure Forecast

The Allgas Revised Capital Expenditure forecasts are included in Table 2.12 with the major changes to Allgas’ initial proposal being revisions to the renewal and non-system capital expenditure.

**Table 2.12: Revised capital expenditure forecast (\$m Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
Augmentation	1.5	2.5	3.0	5.7	0.1
Renewal	9.4	9.4	9.8	8.2	12.5
Customer Requested	12.9	14.3	15.9	17.3	20.1
System Total	23.8	26.2	28.7	31.3	32.7
Non-System	6.9	3.0	3.1	3.2	3.2
TOTAL	30.7	29.2	31.8	34.5	35.9

### **3 NON-CAPITAL COSTS**

The QCA's Draft Decision included a reduction in the proposed Allgas non-capital expenditure based on ECG's trend analysis and due to the increase in the expenditure from 2005/06 to 2006/07.

In this section, Allgas has provided a rigorous forecast of its 2005/06 non-capital expenditure based on the six months to December 2005 using the methodology adopted in providing its annual regulatory accounts. This indicates the change in works faced by Allgas as explained below in further detail.

Given these changes, Allgas cannot accept the trend analysis performed by ECG, especially given that Allgas provided comprehensive data on all operating and maintenance activities to ECG on an annual basis. Further explanation of the formulation of the Allgas forecast is contained below.

Allgas has also revised its Unaccounted for Gas forecast in line with the concerns of ECG and given the alteration to the Allgas renewals program.

#### **3.1 Estimated Non-Capital Costs in 2005/06**

ECG carried out its analysis by comparing the 2005/06 expenditure in the 2001 Access Arrangement Final Decision with the forecast expenditure in the Allgas' 2006 Revised Access Arrangement. This assumes that:

- the current Access Arrangement continues to provide a level of funding which facilitates prudent and efficient management of the Allgas network; and
- nothing changed in the last 5 years to justify change from the original Access Arrangement.

This is clearly incorrect as ECG has, at a minimum, ignored over \$610,000 in additional costs that were approved by the QCA for passthrough in 2005/06. These pass-through costs signify a permanent uplift in Allgas' non-capital costs, consequently are included in Allgas' non-capital cost forecasts.

In order to explain the forecast changes to Allgas' non-capital expenditure, Allgas has included in Attachment C a set of Regulatory Accounts for 2005/06 based on the first 6 months of this financial year.

This data shows the initial impacts the change in works is having on Allgas' non-capital costs and provides a more suitable comparison for the trend analysis by ECG.

Table 3.1 summarises that information and highlights that Allgas current expenditure is 3 per cent above the previous QCA benchmark and requires a further increase of 6 per cent in 2006/07. The changes to works creating these variations in expenditure are explained in the following section.

**Table 3.1: Non-capital expenditure comparison (Real 2005/06 \$m)**

Description	2001 Final Decision	Allgas 2005/06	Allgas 2006/07
Inspection		1.30	1.29
Planned Maintenance		2.97	3.20
Corrective Maintenance		2.34	2.65
Customer Service		0.91	0.97
Maintenance Planning & Support		2.41	2.38
Total	9.60 <sup>1</sup>	9.93	10.49

<sup>1</sup> The 9.60 million includes the QCA Final Decision figure of \$8.98 million, as derived by ECG, and \$0.61 million in cost pass throughs approved by the QCA for 2005/06.

### 3.2 Non-Capital Network Costs 2006/07 to 2010/11

There was a fundamental difference in the methodologies used by ECG and Allgas to examine the future non-capital costs required by the Allgas network.

The Allgas' non-capital forecast costs reflect what is required in order to manage the Allgas network in its current environment and fulfil its legal obligations. Allgas' five year Maintenance Plan and Budget for non-capital costs submitted to the QCA is based on the actual work to be performed in the Revised Access Arrangement period. The Maintenance Plan and Budget includes the works required by Allgas to satisfy:

- statutory requirements;
- safety requirements;
- customer requirements; and
- the requirements of other stakeholders.

ECG has substantially accepted Allgas' view of the required work with a few exceptions, which are discussed in Attachment E.

Allgas' historic non-capital expenditure comes off a low base, and reflects a network legacy where asset management practices were not based on an integrated approach to total system management and maintenance. More importantly, the non-capital expenditure base also reflected a legal environment that emphasised self-attestation with little use of behavioural regulatory and legal instruments.

The *Gas Supply Act 2003*, and the recent introduction of the *Petroleum and Gas (Production and Safety) Act 2004*, has changed Allgas' legal operating environment, with the most notable and significant change being the requirement that Allgas prepare substantive quality assured gas management and operating plans. Allgas' compliance with the newly codified management and safety requirements of the gas network has resulted in an increased level of operational activity associated with ensuring that planning and operating policies, processes and practices are consistent, with the direct consequence being a forecast step increase in non-capital expenditure as highlighted in the Draft Decision.

Moreover, the step increase in non-capital expenditure needed to meet the new statutory obligations makes the use of historic non-capital expenditure trends as the sole basis to set future non-capital expenditure redundant. As a minimum, Allgas' historic non-capital expenditure can only be used to set the "minimum" allowance in the future – with the most

important or relevant question being the quantum of the increment needed in non-capital costs that would allow Allgas to effectively and efficiently meet these new statutory obligations.

Allgas' proposed increment to non-capital costs was forecast by undertaking a comprehensive bottom-up assessment of costs driven by operating and maintenance activity associated with the new business environment to 2010/11. Despite these detailed costs being submitted to ECG there seems to be no recognition that Allgas is in fact operating in a changed business environment compared to the last access arrangement period, and that the forecasts of non-capital costs provided represent a reasonable assessment of expenditure need associated with operating within this changed business environment.

The above points are central to Allgas' criticism of the Draft Decision on the non-capital cost allowance. The QCA's consultants, ECG, effectively based future non-capital cost forecasts on historic trends. These should only be used to set the minimum, and there should be careful consideration of the additional non-capital costs that will be borne by Allgas when meeting the new statutory requirements.

Additionally, the Draft Decision accepted ECG's findings in support of Envestra's non-capital costs, which are considerably higher than Allgas', despite the gas distribution networks being of similar size, location and legal environment.

Allgas proposed on average annual efficiency gains of 6 per cent because of the increase in preventative maintenance and inspections included in its maintenance plan which will reap efficiency benefits in later years. ECG adopted these significant cost efficiencies and applied them from a lower base in year 2006/07. If the QCA continues to accept ECG's recommendation and reduce the scope of Allgas' preventative works in the initial years of the Revised Access Arrangement then the proposed efficiencies will not emerge as forecast by Allgas. Accordingly, if this were to occur, Allgas expects that the QCA should look to apply efficiency gains of around 1 to 2 per cent per annum, which are more consistent with its other regulatory decisions.

Examples of the increased works driving the stepped increase in non-capital costs are described in detail in Attachment D.

Allgas strongly suggests that while it may be valid to compare costs with previous determinations, ultimately any new determination should be evaluated with direct consideration of current and expected legal and operating environments, and be largely based on the information and analysis presented by Allgas.

**Table 3.2: Allgas forecast non-capital expenditure (\$m Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
Inspection	1.33	1.41	1.42	1.48	1.61
Planned Maintenance	3.31	3.43	3.39	3.14	3.11
Corrective Maintenance	2.74	2.60	2.45	2.20	1.95
Customer Service	0.97	1.04	1.10	1.18	1.26
Maintenance Planning, Support	2.46	2.32	2.35	2.40	2.43
Total	10.81	10.80	10.72	10.39	10.37

### 3.3 Unaccounted for Gas

In the Draft Decision, the QCA increased Allgas' allowance for UAG based on ECG's lengthening of the mains renewal program and subsequent reduction in annual renewal capital expenditure.

In this response, Allgas has proposed lengthening its mains renewals program out to June 2014. This mains replacement program results in a reduction of UAG costs over the term of the Access Arrangement relative to that proposed by ECG. The implementation of this program is subject to commercial justification of each individual stage.

The ECG recommendation for UAG and Allgas new estimates are shown in Table 3.3.

**Table 3.3: Forecast costs of UAG (\$m Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
ECG Recommended UAG	1.5	1.4	1.4	1.3	1.2
Allgas Cost of UAG	1.4	1.3	1.1	1.0	0.8

Allgas' renewal program will produce significant savings to consumers over the regulatory period through lower UAG costs. This will be achieved even though system use gas has to be firm (non-interruptible). The estimated quantities of UAG and the cost to Allgas to purchase this gas are shown in Attachment E.

### 3.4 Revised Non-Capital Cost Forecast

Allgas' revised forecast operating and maintenance costs for the five years to 30 June 2011 are summarised in Table 3.4.

**Table 3.4: Forecast non-capital costs (excluding UAG) (\$m Nominal)**

Year Ending 30 June	06/07	07/08	08/09	09/10	10/11
Inspection	1.3	1.4	1.4	1.5	1.6
Planned Maintenance	3.3	3.4	3.4	3.1	3.1
Corrective Maintenance	2.7	2.6	2.5	2.2	2.0
Customer Service	1.0	1.0	1.1	1.2	1.3
Maintenance Planning & Support	2.5	2.3	2.4	2.4	2.4
Network Development	0.6	0.6	0.6	0.6	0.6
Ancillary Service Costs	0.6	0.6	0.7	0.8	0.8
Total Non-Capital Costs (excluding UAG)	12.0	12.0	12.0	11.8	11.8

Numbers may not add due to rounding.

## 4 DEMAND FORECASTS

The Draft Decision:

- accepted Allgas' forecasts for Volume commercial and industrial customers;
- accepted its consultant's, McLennan Magasanic and Associates (MMA), forecasts for Volume residential customers; and
- accepted MMA's forecasts for Demand customers.

In rejecting Allgas' forecasts for residential customers, the QCA was concerned with Allgas' forecasts for the serviced hot water load. Allgas considers that the difference between the two forecasts is negligible and has amended its residential Volume customer forecasts accordingly.

However, Allgas has not amended its Access Arrangement to accommodate the rejection of the Allgas' Demand customer forecasts and accepting of the MMA forecasts in the Draft Decision.

The QCA's decision that the Allgas' Demand customer forecasts:

*"...are not best estimates arrived at on a reasonable basis and that the forecasts provided by MMA for demand customers provide a better estimate"*

is based on their concerns with:

- the assumption to adopt a one per cent per annum growth forecast for consumption;
- the lack of consideration to historic growth beyond three years; and
- not including consideration of the impact of the declining Load Factor (LF) on Demand customers.

Allgas considers that these concerns are misguided and has answered each of these in turn.

### 4.1 Assuming One per cent Growth Rate

The QCA's consultants, MMA, considered that Allgas' assumed annual one per cent growth rate only reflected the last three years of data and when a longer series was considered, the annual growth rate was a lot higher. In addition, the QCA agreed with MMA that the MDQ forecasts needed to incorporate the impact of a declining load factor as per recent history.

Allgas chose a one per cent per annum growth rate for Demand customers because it was consistent with the historic growth in consumption for these customers from 2000/01 to 2005/06 (Table 4.1). Allgas considered that given the average annual historic growth rate is 0.8%, and can actually be negative in some years, a forecast of future gas consumption at one per cent per annum is reasonable and recommends it be accepted by the QCA.

**Table 4.1: Actual gas demand forecasts (TJ)**

Actual Demand	00/01	01/02	02/03	03/04	04/05	05/06 <sup>E</sup>
Demand customers	7,247	6,944	7,013	7,183	7,286	7,213
Growth (%)	-	(4.2)	0.9	2.4	1.4	(1.0)

<sup>E</sup> Estimated

## 4.2 Load Factor Considerations

The LF is the ratio between average daily load and Maximum Daily Quantity (MDQ) of a customer. A high LF means that the customer's natural gas consumption is consistent through the year. A low LF means that the customer's natural gas consumption is peakier.

The efficient design and construction of the natural gas network dictates that the pipelines be built to carry peak consumption levels. Accordingly, a network with a low LF must be constructed to a design level of greater capital cost than if the LF was higher. Importantly, the LF is not used to determine MDQ, it is derived from actual consumption and MDQ.

The observed network wide decline in LFs can be attributed to:

- higher calculated MDQ within the existing customer group. It is unknown whether this increase is due to changing customer MDQs or the gathering of more accurate MDQ information through the use of interval meters and consistent meter readings; and
- low LFs for new customers, which is partly because smaller customers are connecting but also because new customers' consumption data does not reflect a full year of consumption while their MDQ does<sup>5</sup> - this artificially sets the initial LF towards the lower end.

However, Allgas has no customer information that would explain the upward trend in MDQ while experiencing little growth in gas consumption.

Allgas expects that its new customer billing and information system will provide Allgas with the necessary IT support systems to allow greater examination of these trends over the next Access Arrangement period.

## 4.3 MMA's MDQ Forecasts

MMA forecasts for the Demand customer group assumed that the apparent decline in load factor would continue in the next Access Arrangement. This assumption effectively increased MMA's forecast for MDQ growth to three per cent despite consumption for this customer band running at below one per cent.

Table 4.2 shows the MMA forecast for Allgas' Demand Customers but also includes an estimate of the MDQ forecast that MMA would have produced if they had not assumed that load factors would continue to decrease.

**Table 4.2: QCA draft decision on demand customer forecasts to 2010/11**

QCA Draft Decision	06/07	07/08	08/09	09/10	10/11	Growth %
Volume (TJ)	7,514	7,647	7,782	7,921	8,063	7.3
MMA LF (%)	68.0	67.1	66.6	66.0	65.5	
MMA MDQ (GJ per day)	30,258	31,220	32,025	32,877	33,722	15.5
Constant LF	69.3	69.3	69.3	69.3	69.3	-
Implied MDQ (GJ per day) <sup>6</sup>	29,719	30,241	30,776	31,326	31,889	9.2
Allgas MDQ (GJ per day)	30,345	30,628	31,022	31,418	31,817	4.9

<sup>5</sup> When forecasting MDQ for the next FY, Allgas uses an average of recent MDQ up to a maximum of 5 years, hence, a new customer's LF is strongly influenced by the first year LF estimation.

<sup>6</sup> Imputed the MDQ using MMA's (QCA Draft Decision) annual consumption forecasts and by assuming that the LF from 2005/06 remains constant to 2010/11.

Any difference between the MMA and the Allgas MDQ forecasts becomes negligible once the MMA assumption of decreasing LFs is removed. Given that the assumption of a decreasing load factor cannot be verified, Allgas has decided not to amend its MDQ forecasts for the Demand customer group as proposed by MMA. Allgas does not consider that the MMA estimates of MDQ growth to 2010/11 were arrived at on a reasonable basis because:

- the use of declining load factors to estimate MDQ when there is insufficient data to explain the recent decline is unreasonable;
- recent forecasts of Demand customer group growth has proven to be well over actuals; and
- pricing and capital expenditure implications must be factored into the Allgas Access Arrangement if MMA's higher growth MDQ forecast is accepted.

Given these factors, Allgas considers that it would be more reasonable to accept its proposed forecasts rather than that of MMA's and presents additional information to justify this in the following sections.

#### 4.3.1 Use of forecast LF for demand customers

MMA acknowledged that there was a lack of history and relative understanding as to the cause of the reduction in the LF over the current Access Arrangement period.<sup>7</sup> To cover these weaknesses, MMA chose to forecast LF by assuming that only half of the decline in LF would be experienced to 2010/11. In support of this assumption MMA cites that it is reasonable to be cautious given the weaknesses associated with the recent decline in LF.

Allgas considers that a more reasonable approach would be to assume that Demand customers MDQ actually increases at one per cent per annum, as per the assumed growth rate for consumption. This provides a constant LF that is actually 'observed', ie the most recent LF based on the meter read for MDQ etc.

#### 4.3.2 MMA's previous demand customer forecasts

Allgas' current Access Arrangement utilised the MMA forecasts for Demand customers because they were considered to be best estimates arrived on a reasonable basis. The MMA forecasts depended heavily on imputing a growth in natural gas consumption by Demand customers based on general economic growth.

Actual gas deliveries compared to the QCA approved forecast is outlined in Table 4.3.

**Table 4.3: Summary of previous gas demand forecasts (TJ)**

Description	00/01	01/02	02/03	03/04	04/05	05/06 <sup>E</sup>
Final Decision 2001	7,255	7,147	7,562	8,074	8,611	9,010
Actual Demand	7,247	6,944	7,013	7,183	7,286	7,213
Variance (%) <sup>B</sup>	(0.1)	(2.8)	(7.3)	(11.0)	(15.4)	(19.9)

By 2005/06, the QCA's approved demand forecasts for Demand customers were 1,686 TJ or 18.7% greater than actual natural gas consumption.

<sup>7</sup> MMA, 15 November 2005, Demand Forecasts for Allgas – Confidential, page 37.

<sup>8</sup> Variance on Final Decision 2001 Forecasts.

Forecasting future growth for gas consumption is not straightforward. It is for these reasons that the Gas Access Regime is based on the propose-respond model as it ensures that the regulated gas business puts forward reasonable proposals and estimates as the business wears the full consequences of these proposals.

Allgas is best placed to manage the consequences of incorrect MDQ forecasts in terms of the pricing and capital expenditure implications. As such, the QCA should err on the side of the regulated business where there is no clear or logical better estimate under consideration.

#### 4.3.3 Capital expenditure risk

Allgas' current network investment plans assume MDQ growth is consistent with the assumed growth profile for gas consumption. Accordingly, the Draft Decision acceptance of MMA's MDQ forecasts will have broader capital expenditure implications.

That is, if Demand customer MDQ is expected to grow as per the MMA forecasts, then Allgas would need to:

- identify the long-term capacity for existing connections to these customers; and
- examine the capacity of shared pipeline infrastructure as the basis for ensuring that the pipeline is able to service the customers' expected future MDQ.

If the QCA was to accept the MMA MDQ forecasts then Allgas would therefore need to revise capital expenditure upwards to ensure that the network has sufficient capacity to meet these estimates.

#### 4.4 Revised Demand Forecasts

Allgas has included the forecasts for the Volume and Demand customer groups in its Revised Access Arrangement as per Table 4.4.

**Table 4.4: Allgas' revised demand forecasts to 2010/11**

Customer groups	06/07	07/08	08/09	09/10	10/11
Volume customers (TJs)					
Residential	1,009	1,039	1,072	1,109	1,153
Commercial	1,974	2,052	2,139	2,230	2,323
Total	2,983	3,091	3,211	3,339	3,476
Demand customers					
Total Consumption (TJ)	7,355	7,443	7,533	7,623	7,714
MDQ (GJ)	30,345	30,628	31,022	31,418	31,817

## 5 FURTHER INFORMATION

This section provides additional information on several aspects of the Revised Allgas Access Arrangement as requested by the QCA within its Draft Decision.

### 5.1 Breakdown of Assets as at 30 June 2006

In order to provide a breakdown of Allgas' past capital expenditure in the detail required by the QCA, Allgas examined its asset register and aggregated assets based on the date that they commenced operation.

The construction of assets is often not completed within one financial year and is carried over to the next financial year as works in progress. These assets may not become operational and be entered into the asset register until the following year. Because of this, the data presented in Table 5.1 does not match exactly with Allgas' annual capital expenditure because of timing differences.

**Table 5.1: Breakdown of Allgas capital expenditure (\$m Nominal)**

Category	01/02	02/03	03/04	04/05	05/06f
MAINS					
STTP 4200 kpa	0.32	2.61	1.71	4.04	0.02
Steel 1200 kpa	2.78	0.59	0.46	0.63	1.29
Steel 700 kpa		0.53			0.25
Steel 200 kpa	0.02	0.17			
PE 500 kpa	5.72	4.37	5.11	5.36	7.39
SERVICES					
PE	2.44	4.13	5.88	4.91	1.72
Industrial 25 ST	0.08	0.13	0.08	0.12	0.03
METERS					
Domestic/Commercial PE	0.66	1.92	1.56	1.23	0.35
Commercial/ Industrial PE	1.07	0.24	0.57	0.68	0.32
Industrial ST	0.03	0.52	0.15	0.18	0.03
Regulator Stations	0.32	0.78	0.36	0.35	0.28
TOTAL	13.45	15.45	15.87	17.50	11.68
Allgas' Capital Expenditure	13.20	15.50	18.10	17.20	25.00

f: Allgas Capital Expenditure up to December 2005

### 5.1.1 Redundant and disposed assets

Allgas provided a breakdown of redundant assets over the current Access Arrangement to ECG. In order to satisfy the QCA Draft Decision, this information is repeated in further detail in Table 5.2.

**Table 5.2: Breakdown of Allgas redundant assets (\$'000 Nominal)**

Category	01/02	02/03	03/04	04/05	05/06
MAINS/SERVICES					
Steel	24	42	88	37	-
Cast Iron / PE	148	56	21	114	-
METERS	-	-	-	-	-
Regulator Stations	-	7	27	15	-
Gate Station	10	-	-	-	-
TOTAL	182	105	136	166	-

### 5.2 Regulatory Tax

The QCA's Draft Decision allowed for calculation of regulatory tax by applying the statutory rate of tax to the earnings based on the building blocks used to derive Allgas' revenue and gas prices. It is Allgas' understanding that this tax will only be revisited at the end of the period to account for the actual building block parameters that occur. It would not be necessary to analyse the ENERGEX Group's EBIT and tax paid and to determine Allgas' relevant proportion of this.

As such, Allgas has adjusted the tax forecast in its Revised Access Arrangement to include this method of calculating regulatory tax using an imputation rate of 0.50. Table 5.3 sets out Allgas' revised tax payable forecasts, which have now been included in Allgas' Revised Access Arrangement.

**Table 5.3: Allgas' revised tax forecasts (\$'000 Nominal)**

Description	06/07	07/08	08/09	09/10	10/11
Tax Payable	2.4	2.7	2.9	3.2	3.5
Regulatory Tax	1.2	1.3	1.4	1.5	1.6

### 5.3 Cost Reflectivity of Network Tariffs

The QCA's Draft Decision accepted Allgas' proposal for cost allocation between Volume and Demand customers, subject to Allgas providing additional supporting information. The QCA had particular focus on:

- providing a more thorough explanation of the incremental and stand-alone costs tests applied by Allgas;
- preparing an incremental costs analysis to a greater degree of granularity on a per customer basis; and
- providing supporting material to justify the inputs and assumptions used to determine the incremental and standalone cost tests.

Allgas' confidential response to the QCA is in Attachment H.

## **6 RECENT ISSUES**

Since the submission of the Allgas Access Arrangement on 30 September 2005, several key developments have arisen that Allgas would like to consider in the context of the revision of the Access Arrangement. These include:

- changes to the WACC; and
- additional terms and conditions.

### **6.1 WACC**

The Draft Decision accepted Allgas' proposed rate of return on capital of 8.75 per cent and accepted Envestra's proposed rate of return on capital of 8.80 per cent. The reasoning for accepting Allgas' proposed return on capital was that despite not agreeing with the service providers' methodology and selection of values for the parameters, the QCA's calculation of WACC arrived at a result similar to that proposed by the service providers.

Since the QCA's Draft Decision, there has been some confusion over whether the risk-free rate would be revisited given the proposed return on capital was accepted by the QCA. Allgas is concerned that by not allowing a reset of the risk free rate to an average 20 day period more closely aligned to the timing of the QCA's Final Decision, there is the potential risk that the return on capital is being set on a basis that has not fully taken account of prevailing conditions in the market for funds. Importantly, the risk free rate used by Allgas is now more than 6 months old (August 2005).

Allgas' Revised Access Arrangement incorporates a new rate of return on capital of 8.78 per cent, which reflects an increase in the risk free rate to 5.28 per cent (20 day average up to and including 24 February 2006), and is based on other WACC parameters used in the QCA's Draft Decision. Allgas has reset its debt over this 20 day period.

In this instance, revisiting the risk-free rate has not made a significant difference to the rate of return but Allgas believes this is the correct process given there could have been a significant movement in the risk-free rate between its' initial submission and the QCA's Final Decision. Allgas considers that its proposed rate of return on capital has been forecast on a reasonable basis and is consistent with:

- the Gas Access Regime, which requires the proposed rate of return on capital to be commensurate with the "prevailing conditions" in the market for funds;
- the QCA's WACC methodology for setting the return on capital; and
- the QCA's approach to setting of the risk free rate when setting the return on capital in all of its previous regulatory decisions.

### **6.2 Proposed Fixed Principle – Efficiency Carryover**

Allgas has accepted Amendment 10.2 of the Draft Decision which removes the glide path mechanism from its Access Arrangement. However, Allgas is proposing, as a Fixed Principle, that Allgas retain any efficiency gains generated as a consequence of changes to the gas market or industry for five years. Given the ever changing structure of the gas market, Allgas considers it important that this Principle be included to minimise regulatory risk.

Allgas has provided additional details on the proposed Fixed Principle at the commercial-in-confidence Attachment I.

### 6.3 Allgas Terms and Conditions

Allgas has also amended its Terms and Conditions, specifically, Clause 8 referring to Charges, Invoicing and Payments. Allgas' amendment provides greater certainty to Users by providing additional details as to its requirements relating to security of payment.

### 6.4 Allgas Actual Revenue Earned Year to Date 2005/06

An important element in making Allgas' Revised Access Arrangement is ensuring that the full year forecast for 2005/06 is to ensure that the starting values for the first financial year of the access period reflect actual revenue, demand and MDQ. Accordingly, Allgas has taken the year to date actuals for revenue earned and demand for the relevant groups to set estimated forecasts for the full year.

These are listed in Table 6.1.

**Table 6.1: Revenue and consumption forecasts for 2005/06**

Description	YTD Jan 2006	2005/06 Estimate
<b>Consumption (TJ)</b>		
Volume (Small) (TJ)	1,643	2,817
Demand (Large) (TJ)	4,208	7,213
Total Consumption (TJ)	5,851	10,030
MDQ (GJ/MONTH)	29,885	29,874
<b>Revenue (\$m)</b>		
Volume (Small)	15.2	26.7
Demand (Large)	6.6	11.4
Total	21.8	38.1
<b>Average Price</b>		
Volume (Small) (\$/GJ)	-	9.48
Demand (Large) (\$/GJ of MDQ)	-	381.6
Average (\$/GJ)	-	3.79

These estimates of consumption, revenue and average prices, for the 2005/06 financial year, were used as the basis for the Allgas price paths within the Revised Access Arrangement.

## 7 REQUIRED QCA AMENDMENTS: DRAFT DECISION

### *Amendment 4.1*

*In order for Allgas' access arrangement to be approved, Allgas must amend its terms and conditions to include a requirement on the network operator to maintain the quality of gas injected into the network in accordance with the relevant legislation.*

Agree.

### *Amendment 4.2*

*In order for Allgas' access arrangement to be approved, Allgas must adjust its invoicing policy so that it is required to provide sufficient information to allow reconciliation of DUOS charges at an individual customer level.*

Agree.

### *Amendment 4.3*

*In order for Allgas' access arrangement to be approved, Allgas must amend section 3.4 of the terms and conditions so that Allgas will have an obligation to maintain the network in accordance with good engineering and industry practices.*

Agree, however, Allgas has amended section 3.4 of the Terms and Conditions to accept the obligation to maintain the network in line with all statutory obligations. Good engineering and industry practice is subjective while complying with all statutory obligations is requirement which includes all industry standards and legislation.

### *Amendment 4.4*

*In order for Allgas' access arrangement to be approved, Allgas must amend its terms and conditions to the effect that revisions to MDQ for demand customers can only occur where the demand customer has an interval meter.*

Agree.

### *Amendment 4.5*

*In order for its access arrangement to be approved, Allgas must amend section 4.2.1(a) to the effect that Allgas will ensure that the metering at each delivery point of a volume customer is read every 90 days (or approximately every 90 days).*

Agree.

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*Amendment 4.6*

*In order for Allgas' access arrangement to be approved, Allgas must include provisions in sections 12 of its terms and conditions that:*

- *set out the order of priority with which various types of users will be subject to interruptions or curtailments of reference services;*
- *sets out how Allgas will treat users of reference services with the same priority when interrupting or curtailing reference services, noting that users with the same priority will be treated in an equitable manner;*
- *provides customers with the right to request an explanation from Allgas as to why they have been placed in a particular category; and*
- *requires Allgas to seek the views of retailers in establishing its order of priority for curtailment.*

Allgas cannot agree with all requirements of Amendment 4.6.

The *Gas Supply Act* requires that the gas distributor has in place emergency plans to manage supply disruptions, which would incorporate plans to turn off customers during localised supply disruptions to maintain the integrity of the network. In instances of significant supply disruptions that impact on the whole of the network, where a customer's supply must be curtailed, the contractual relationship prevails.

Accordingly, the contractual relationship between the User and their customers covering the supply of gas provides the basis for managing curtailment in such events. This allows the Users to curtail supply as per the conditions agreed with the customer.

This approach is consistent with national regulatory approach being pursued by the Ministerial Council on Energy (MCE), which emphasises the pre-eminence of commercially negotiated arrangements until that point in time where a supply disruption is severe warranting the imposition of Ministerial curtailment powers as per the *Gas Supply Act 2003*.

Allgas agrees to treat users of reference services equitably and with the same priority where localised supply disruptions occur.

*Amendment 10.1*

*In order for Allgas' access arrangement to be approved, Allgas must:*

- *define the of cost pass-through trigger event as;*
  - *a change in taxation or other statutory charges; or*
  - *any other major change in government policy (for example, costs associated with the introduction of full retail contestability), and*
- *include a materiality threshold for cost pass-through events of 1 per cent of (forecast) annual revenue per event based on the forecast revenue in the year in which the event occurred.*

Agree.

*Amendment 10.2*

*For Allgas' access arrangement to be approved, Allgas must remove the glide path mechanisms from its revised access arrangement.*

Agree. However, Allgas has included an efficiency mechanism as a Fixed Principle in its Access Arrangement that only applies for significant events. This principle will ensure that there is some certainty on the impact of any significant investments made in the industry that improve the overall efficiency of the network over the long term.

*Amendment 11.1*

*In order for Allgas' access arrangement to be approved, Allgas must amend its roll forward of the capital base for the current period must be amended in accordance with Table 11.6.*

Allgas has amended its roll-forward of the capital base, however, it has changed the numbers to reflect its actual non-system capital expenditure.

*Amendment 11.2*

*In order for Allgas' access arrangement to be approved, Allgas must amend its forecast capital expenditure for the five years of the next access arrangement period in accordance with Table 11.10. Allgas must also provide the additional information requested by the Authority.*

Allgas has revised its forecast capital expenditure. It has retained Allgas' initial proposal for customer requested and augmentation capital expenditure but has revised the renewal and non-system capital expenditure in line with the concerns of the QCA and additional information supplied in this response.

*Amendment 11.3*

*In order for Allgas' access arrangement to be approved, Allgas must amend its depreciation charges for the five years of the access arrangement period must be amended in accordance with Table 11.12.*

Allgas agrees to amend its depreciation in line with the QCA methodology but with changes relative to the new capital expenditure proposals.

*Amendment 11.4*

*In order for Allgas' access arrangement to be approved, Allgas must remove its claim for the inclusion of an additional amount in the capital base to reflect the cost of working capital.*

Agree.

*Amendment 11.5*

*In order for Allgas' access arrangement to be approved, Allgas must amend its expected inflation rate to 2.77 per cent over the revised access arrangement period.*

Agree.

*Amendment 11.6*

*In order for Allgas' access arrangement to be approved, Allgas must amend its roll forward of the capital base for the five years of the access arrangement period in accordance with Table 11.14.*

Allgas has amended its roll-forward of the capital base for the five years of the access arrangement period, however, it has changed the numbers to reflect the revised Allgas forecasts for capital expenditure and depreciation.

*Amendment 12.1*

*In order for the Allgas access arrangement to be approved, Allgas must amend its value for gamma to 0.5.*

Agree.

*Amendment 12.2*

*In order for Allgas' access arrangement to be approved, Allgas must adjust its measure of forecast inflation to 2.77 percent.*

Agree.

*Amendment 13.1*

*In order for Allgas' access arrangement to be approved, Allgas must amend its forecast non-capital costs (excluding UAG) over the next regulatory period must be amended in accordance with Table 13.3.*

Allgas has amended its forecast non-capital costs but has not accepted the reductions highlighted by the QCA in Table 13.3 of the Draft Decision. Allgas reasoning is explained in this document.

*Amendment 13.3*

*In order for Allgas' access arrangement to be approved, Allgas must:*

- *provide sufficient information to support its forecasts of consolidated tax for ENERGEX Limited and the allocation of this to Allgas based on shares of EBIT; and*
- *change its forecasts of regulatory tax to reflect a gamma of 0.5.*

The QCA Draft Decision allows for regulatory tax to be calculated based on the constituents of the building blocks used to derive Allgas' gas prices. It is Allgas' understanding that this tax will only be revisited at the end of the period to account for the actual building block parameters that occur.

Consequently, Allgas has adjusted the tax forecast in its Revised Access Arrangement to include this method of calculating regulatory tax using an imputation rate of 0.50.

*Amendment 14.1*

*In order for Allgas' access arrangement to be approved, Allgas must adjust its gas demand forecasts, and hence the reference tariffs, to reflect the MMA forecasts for:*

- *the residential customers section of the volume class of customers; and*
- *the MDQ for the demand class of customers.*

Allgas has accepted the MMA forecast for the residential section of the Volume customer class.

However, Allgas does not accept the MDQ forecast for the Demand customer class and Allgas' reasoning is included within this document.

*Amendment 15.1*

*In order for Allgas' access arrangement to be approved, Allgas must revise its total revenue requirements for each year of the access arrangement period must be revised to those indicated in Table 15.2.*

Allgas total revenue figures have been adjusted to account for the revisions in this document.

*Amendment 15.2*

*In order for Allgas' access arrangement to be approved, Allgas must amend:*

- *the weighted average price path for demand customers to CPI - 3.44 per cent over the revised access arrangement period (with a value in 2005-06 of \$403.35 per GJ of MDQ);*
- *the weighted average price path for volume customers to CPI + 0.41 per cent over the revised access arrangement period (with a value in 2005-06 of \$10.09 per GJ).*

Allgas has produced revised price paths to account for the changes to revenue and demand in this document. They do not align with Amendment 15.2.

*Amendment 15.3*

*In order for Allgas' access arrangement to be approved, Allgas must provide further information on the cost-reflectivity of proposed tariffs, as detailed above.*

Agree. Allgas has included comprehensive information on the cost-reflectivity of the Allgas proposed tariffs.

*Amendment 15.4*

*In order for Allgas' access arrangement to be approved, Allgas must revise its tariff schedules such they are consistent with the revenue requirement amendments of this Draft Decision.*

Agree. Allgas has revised the tariff schedules to be consistent with the revenue forecasts in its Revised Access Arrangement.