

1 March 2016

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Dear Sebastian

Thank you for meeting with Craig de Laine and I on 23 February 2016 to discuss the implications of certain AER staff preliminary positions on our proposed mains replacement program. As we said to the AER Board on 25 February, I appreciate the constructive engagement between our offices on this important matter for the business.

We have provided our view, including in further submissions provided to the AER on 29 February 2016, that the preliminary positions of AER staff do not undermine the justification for the mains replacement program provided in our revised Access Arrangement (AA) proposal. In response to these positions, I reiterate that:

- AS/NZS 4645 is the relevant standard and requires AGN to reduce the identified 'High' and 'Extreme' risk mains to 'Low' risk;
- ISO 31000 does not change the required risk assessment and expressly states decisions should not be based on economic grounds;
- only replacement will reduce the 'High' or 'Extreme' risk to 'Low' risk;
- Neither the National Gas Rules or the relevant standards require a cost-benefit analysis (CBA) to inform the required volume of mains replacement;
- CBA is only required if a business is not operating in accordance with AS/NZS 4645 by reducing the risk to low;
- In any event, CBA is imprecise and cannot be relied upon to inform a decision on the prudent volume of mains replacement;
- AGN's risk prioritisation model (like the HSE/Ofgem model) guides the order of mains to be replaced, not the volume of mains to be replaced; and
- International experience with CI/UPS and HDPE support the replacement of these mains as a priority (see the Jacobs report).

We also note the submission of 24 February from the South Australian Government. This submission states that the Government:

- Welcomes AGN's risk assessment undertaken in accordance with gas distribution networks standard AS/NZS 4645 (which implies AGN has applied the appropriate standard, as reviewed by the Office of the Technical Regulator);
- Considers our revised AA proposal provides a clearer picture of the risk facing the gas network than was previously available; and
- Notes the Office of the Technical Regulator supports AGN's revised approach to its mains replacement program, particularly as it now prioritises work in order of risk.

We also note however, that the Government expressed concern over our ability to deliver the proposed 1,265 km of mains replacement. Specifically, the South Australian Government submitted:

"Despite AGN's work on identifying at risk gas mains, it is critical that as part of its independent technical engineering assessment the AER examine whether AGN's proposal to replace 1,265 kilometres ... is achievable. AGN provide that, based on its performance over the last 3 years, it is able to replace around 250 kilometres per annum. However, the AER needs to ensure that AGN has taken into account that replacement of mains in the CBD area may be more complex and could take longer thereby reducing the overall level of replacement that it can achieve."

We also recognise that the AER has some remaining concerns with our proposal, including in relation to the proposed volume of mains replacement to be undertaken over the next AA period.

In light of the above, AGN has modified its plan to reflect the volume of mains replacement set for the current AA period (1,072 km). AGN has demonstrated that it can deliver this volume. While this volume of mains replacement represents a lower annual volume than recent levels, it recognises the concern of the South Australian Government over maintaining current deliverability as the program moves into more complex areas such as the CBD.

AGN has calculated the impact of this change to our mains replacement program relative to our initial AA proposal provided to the AER on 1 July 2015. For the purposes of comparison, the required capex under our revised plan to replace 1,072 km is \$277 million (including multi-user service inlets), which is around 200 km and \$100 million less than our initial AA proposal. I have provided a model with this letter setting out the derivation of this revised amount.

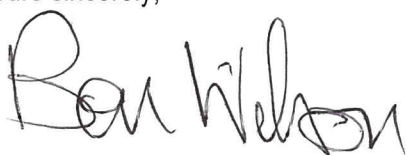
I understand that the AER has accepted the risk mitigation activities proposed by AGN in its revised AA proposal. Our proposal to reduce the volume of mains replacement to 1,072 km is based on the AER accepting these aspects of our proposal. While it could be argued that, with lower volumes of mains replacement risk mitigation and UAFG costs will increase, I am not proposing to assess these impacts unless the AER instructs me to do so.

Given the change to our plan, AGN will now formally revise its safety case to reflect the lower replacement volume and seek the endorsement of the Office of the Technical Regulator for the amended plan. To this end, I note that the Office of the Technical Regulator has endorsed a plan that has replacement volumes that are consistent with our initial (and revised) AA proposal.

We have also touched on our upcoming plan for Victoria for the 2018 to 2022 AA period. As noted at our meeting, we are expecting that our Victorian AA proposal will include lower levels of mains replacement both in terms of volume and cost relative to both the benchmark and actual mains replacement delivered over the current AA period.

Please let me know when you are in a position to discuss the issues raised in this letter further.

Yours sincerely,



Ben Wilson
Chief Executive Officer

Attachment: Derivation of revised mains replacement capex

