Appendix 7.02

Hoskinstown operations and maintenance contract costs base year adjustment

Revised 2016-21 access arrangement proposal

Response to the AER's draft decision

January 2016

PUBLIC

Hoskinstown operations and maintenance contract costs base year adjustment

ActewAGL Distribution's opex forecast included a $0.3 million ($2015/16) step change for additional costs for the renegotiation of the operations and maintenance (O&M) agreement for the Hoskinstown customer transfer station (CTS) during the 2016-21 access arrangement period. The current agreement is expected to expire on 31 March 2016, when station throughput is forecast to exceed the original design capacity.[1] Under the current agreement, JAM had provided O&M services for a [redacted]. This unusually (and unsustainably) low fee will no longer apply for reasons explained in our initial proposal and discussed further below. As a result, our initial proposal included a proposed step change for the more cost-reflective and sustainable ongoing O&M costs for the Hoskinstown CTS to ensure we were provided with a reasonable opportunity to recover at least the efficient costs that it will incur in operating and maintaining its assets, as required under section 24(2) of the NGL.

We have considered the draft decision in respect of the step change for the renegotiation of the Hoskinstown O&M contract and the AER's reasons for rejecting the new costs for O&M of the Hoskinstown CTS as a step change. The AER considered that there should be no need for a step change as the contract is part of a business as usual service and any additional costs associated with increased throughput would be catered for in the output growth component of the rate of change factor.

We agree that the O&M work currently performed by JAM is a business as usual service on ActewAGL Distribution's network. It is the unusually low price in the O&M contract with Jemena, and the circumstances leading to its renegotiation, that distinguish this proposed opex step change from others that the AER may consider to be recurrent, business as usual opex.

The current contract price between ActewAGL Distribution and Jemena for the O&M for the Hoskinstown CTS is only [redacted] This fee was a concession negotiated by ActewAGL Distribution at the time Watson CTS was added to the Eastern Gas Pipeline (EGP). The fee was to stand as long as the Watson CTS throughput remained below the 10 TJ peak demand level agreed with Jemena.

It is this low fee that has been reflected in our operating cost base and is, in effect, a windfall gain that our customers have received over the past 10 years.

JAM, quite reasonably, is no longer willing to provide the services at this contract price, because the Hoskinstown CTS will need to be expanded to cater for the shift in the supply balance from the Watson CTS. A new contract must be negotiated and the concessional fee will end. In this circumstance, the opex base year allowance no longer includes these business as usual costs. With the concession ending, the full costs of O&M at Hoskinstown CTS will be borne by ActewAGL Distribution. It is appropriate that these costs be passed on to our customers.

[1] The AER's draft decision recognises this fact by approving the capex for upgrading the station.

Rule 91 sets out the criteria governing opex. Opex must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest *sustainable* cost of delivering pipeline services (emphasis added). The new contract with JAM will reflect the lowest *sustainable* cost of providing the O&M services, which is increasing from an unsustainable cost because of the change in the sourcing of gas into the network. It is appropriate and consistent with rule 91 that these costs should be included as an adjustment to the base year opex to reflect the *sustainable* costs for O&M of the Hoskinstown CTS. Under section 24(2) of the NGL, ActewAGL Distribution must be provided with a reasonable opportunity to recover at least the efficient costs that it will incur in operating and maintaining its assets.

Further, the increased costs are not simply a function of increased demand, but a change in the supply balance. Supply into the network will shift from the current balance between Watson CTS and Hoskinstown CTS. Currently, 50 to 60 per cent of network supply flows through the Hoskinstown CTS; this will change to between 90 and 100 per cent flows through the Hoskinstown CTS. The reason for this change (and the increased O&M cost) is due to gas supply to the ACT shifting to be almost exclusively from Victoria (via the Eastern Gas Pipeline). Historically gas had been supplied from both South Australia and Queensland (via the Moomba to Sydney Pipeline), and Victoria. This change in supply is in effect a change in the service provided by the ActewAGL Distribution network to retailers and customers. It enables retailers to have all gas delivered through the Hoskinstown CTS, whereas previously they were required to supply gas to both Watson CTS and Hoskinstown CTS.

For the reasons explained above, we have included an upward base opex adjustment of $0.04 million for business as usual Hoskinstown CTS O&M, rather than maintaining these costs as a step change. This amount is based on an average of these forecast costs between 2015/16 and 2021/21.