Submission
No 34

INQUIRY INTO THE SUPPLY AND COST OF GAS AND LIQUID FUELS IN NEW SOUTH WALES

Organisation: Jemena

Date received: 9/01/2015

Select Committee on the
Supply and cost of gas and liquid fuels in New South Wales
Upper House Committees
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9 January 2015

Dear Ms Wood

The supply and cost of gas and liquid fuels in New South Wales

Jemena Limited (**Jemena**) welcomes the opportunity to make a submission to the Legislative Council Select Committee on the supply and cost of gas and liquid fuels in New South Wales.

Jemena is an $8.5 billion company that owns and manages some of Australia's most significant gas and electricity assets. These include the Jemena gas distribution network servicing 1.2 million customers around NSW, the Eastern Gas Pipeline which delivers gas from Victoria's Gippsland basin to the ACT, Sydney and regional NSW, the Queensland Gas Pipeline which supplies Gladstone and Rockhampton, and our Victorian electricity network which delivers power to over 320,000 homes and businesses in north-west Melbourne.

We also part own the ActewAGL electricity and gas distribution networks in the ACT as well as United Energy, which supplies electricity to over 600,000 customers across south-eastern Melbourne and the Mornington Peninsula.

Please find attached Jemena's submission. This submission does not contain any confidential information and can be made publically available.

If you wish to discuss any matter related to this submission, please contact me

Yours sincerely

Ian Israelsohn
General Manager Policy & External Affairs
Jemena Limited

Jemena Limited

Submission to the Select Committee on the supply and cost of gas and liquid fuels in New South Wales

Public

9 January 2015

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OVERVIEW

Jemena welcomes the opportunity to respond and is well placed to provide feedback to the New South Wales (**NSW**) Legislative Council's (**Gas and liquid fuels supply Committee**) Inquiry into the supply and cost of gas and liquid fuels in NSW (**the Inquiry**).

Jemena is an $8.5 billion company that owns and manages some of Australia's most significant gas and electricity assets. Two of our key assets include the Jemena gas distribution network (**JGN**) servicing 1.2 million customers around NSW, and the Eastern Gas Pipeline, a key supply artery which runs from Longford, Victoria, into the ACT and NSW, delivering more than half of NSW's annual gas supply.

Jemena also owns and manages the Queensland Gas Pipeline which supplies Gladstone, Queensland, and our Victorian electricity network which delivers power to over 330,000 homes and businesses in north-west Melbourne. In addition we have part ownership of the ActewAGL distribution partnership in the ACT and United Energy which distributes electricity across south-eastern Melbourne and the Mornington Peninsula.

As an owner of gas distribution and transmission pipelines with over 1.2 million customers in NSW (residential, commercial and industrial), Jemena has a strong interest in the review. The functioning and performance of the NSW gas market has a significant influence on the customer experience and 'gas brand' in NSW. Australia's gas markets are expected to undergo significant changes over the next 15 years, with major implications for us and for our customers. As widely acknowledged, these changes are likely to put upward pressure on gas prices.

Jemena's submission to the Inquiry is further informed by our development of a five year plan[1] for the Jemena Gas Network (**JGN Plan**), submitted to the Australian Energy Regulator in June 2014. JGN's Plan, which covers the period 1 July 2015 to 30 June 2020, sets out the proposed revenue we require to continue to provide safe and reliable distribution network services to our customers over this period. JGN's Plan has been informed by targeted and effective engagement with our residential, commercial and industrial customers and other key stakeholders, as well as extensive market analysis, to ensure the decisions we make about our services, costs and prices reflect our customers' priorities and long-term interests. A copy of the Customer Overview document which summarises the JGN Plan is provided as Appendix A.

Jemena believes that the most important issue facing Australia's energy markets is that of gas supply development and wholesale prices in east Australia. In NSW, increasing wholesale gas prices will most significantly impact large gas-consuming businesses and to a lesser extent households and smaller businesses.

Our JGN Plan proposes 20 per cent and 10 per cent reductions in distribution tariffs for NSW's 1.2 million household and 15,000 commercial customers respectively in real terms over the 2015 to 2020 period. These proposed decreases will significantly offset some of the wholesale gas price increases and have been designed in such a way so that residential and commercial customers will face lower and more stable total gas bills than would otherwise be the case. Over this period Jemena also intends to maintain consistency with its long term objective to provide stable network charges for our 400 industrial customers.

However, gas infrastructure charges comprise only part of a customer's bill, with rising wholesale prices also likely to have a material impact. Allowing new supply to be brought online as soon as possible is the most important action which should be taken in relation to the current pressures in the east Australian gas market, and should ultimately lead to lower prices for NSW gas users. Jemena is supportive of the NSW Government's Gas Plan (**NSW Plan**) released in November 2014 and agrees with its focus on policy measures to develop a competitive gas industry in NSW and secure the state's gas supply needs. We encourage the NSW

1 http://jemena.com.au/Gas/Customer-Engagement-and-Price-Review/Our-2015-plan.aspx

Government to work both methodically and swiftly to conduct the reviews and implement reforms outlined in the NSW Plan.

We strongly believe that governments must employ an evidence-based policy approach to the issue of unconventional gas development. We are encouraged by recent moves to explore innovative options to address NSW gas supply and price concerns, such as the NSW, Northern Territory and Federal Governments working together to consider the development of a new transmission pipeline linking Australia's northern and eastern markets.

Jemena is also supportive of further reforms to introduce retail price deregulation in the NSW gas market and to overcome emerging barriers to retail competition. Finally, we believe industry-led initiatives to address stakeholder concerns regarding national gas market development should be encouraged and preferred to regulatory interventions designed to address such concerns.

1. FACTORS IN THE GAS SUPPLY CHAIN IMPACTING NSW CUSTOMERS

1.1 WHOLESALE

Jemena believes the most important issue facing the NSW energy market is that of gas supply development and wholesale prices. In the east Australian market, producers are developing new conventional and coal seam gas fields and establishing liquefied natural gas (**LNG**) export facilities. For the first time, east Australian producers will be able to access the international natural gas market, including buyers who are prepared to pay significantly higher prices than those historically seen in the east Australian market. As the LNG facilities come on stream and supply becomes increasingly constrained, domestic wholesale gas prices are expected to rise.

Furthermore, restrictions have been placed on the development of new coal seam gas supplies, in the form of exclusion zones and moratoriums in NSW and Victoria, inhibiting producers' ability to respond to strong demand and rising prices by bringing new supplies online, and therefore continuing upward pressure on prices.

Jemena is not a gas producer and therefore has no control over wholesale prices, however we do forecast these prices as part of our gas distribution network planning process. Our most recent forecasts by expert consultants Core Energy show that wholesale prices for customers connected to the JGN network will double in real terms (i.e. excluding inflation) from $4 per gigajoule in 2014 to $8 in 2018, then remain flat through to 2020[2]. Research by others such as Ai Group also indicates wholesale gas price increases of a similar magnitude[3].

Wholesale prices influence the gas bills of different customer types by different orders of magnitude—a doubling of wholesale gas prices would have its most significant impact on large gas-consuming businesses in NSW. These businesses consume substantial quantities of gas, and a wholesale price of $8 per gigajoule would represent by far the largest proportion of a typical large customer bill (we estimate at least three quarters).

For households, rising wholesale prices are also the key factor that will drive higher bills over the next few years in NSW, although its impact, compared to industrial gas users, will be muted somewhat given that wholesale prices currently account for around 20% of a residential gas bill.

1.2 DISTRIBUTION

As the largest gas distribution network in NSW, we understand the role of gas as a competitive fuel and rising gas prices will make it more challenging to ensure customers remain connected to gas. JGN is one of the lowest cost and most efficient gas utilities in Australia and these benefits will be passed on to our customers through lower prices over the next five years.

The extensive engagement that we conducted during the development of the JGN Plan indicated customers were concerned about rising gas prices, and we have responded by acting to put downward pressure on our network charges over the next five years

[2] Core Energy Group, Gas Demand and Customer Forecasts; 2015-20 Jemena Gas Networks Access Arrangement Information; April 2014, p. 66 – http://jemena.com.au/Gas/Jemena/media/JemenaGasNetworksMedia/Community-Engagement-Document/Our-regulatory-proposal/Appendix%2005.1%20Demand%20forecasting%20report.pdf

[3] Ibid, pp. 72 - 80

The average revenue per customer per year proposed under our JGN Plan is 4.6 per cent lower (in real terms) than in the current period (2010/11 to 2014/15). In particular, we have proposed:

- a 20 per cent reduction distribution tariffs in real terms for residential customers, which will significantly offset the impacts of the forecast wholesale-related price increases. Distribution costs make up around half of the household gas bill in NSW, so these price reductions represent savings of around $270 for a typical customer over the five year period
- a 10 per cent reduction in real terms for our 15,000 commercial customers, which translates to a saving of over $5000 for the average customer by 2020. These proposed price decreases will offset some of the wholesale gas cost increases, so customers will face lower total gas bills than would otherwise be the case[4]
- to continue to deliver our long-term objective of providing stable network charges to our 400 large industrial customers. This was evident during the 2010-15 period, when we sought to minimise the increases in our network charges for our large industrial customers[5]. Consistent with this long-term strategy, we propose to continue to increase the average network charges for these customers slowly through stable and small price increases that are slightly above inflation. This will restore the balance in our cost recovery between our industrial customers and other customers.

In NSW, we expect residential and business demand for natural gas will plateau in the coming years (due in part to the increases in gas wholesale prices, and consequently retail prices), while industrial demand will decline due to the closure of several large industrial facilities.

In order to offset this decline in demand, we plan to be proactive in attracting new customers to the network to help spread our fixed costs over a larger customer base and put further downward pressure on our prices. We forecast that we will attract over 30,000 new customers to the network per annum (over 150,000 new customers over the period). A key part of this is continued investment in our Natural Gas, The Natural Choice marketing campaign which promotes the benefits of natural gas and encourages home and businesses to connect to the gas network in New South Wales.

We are also responding to customer feedback we've heard through our customer engagement by keeping our fixed charges for residential and small business customers low, and by implementing a range of measures to assist customers who are vulnerable. Further details of these measures are contained in Appendix A.

There has been some concern that gas distribution customers in NSW may face physical gas shortages on peak demand (winter) days in coming years. While we certainly agree that tightening supply conditions in the east Australian market are leading to increased wholesale prices, as the operator of the largest gas distribution network in NSW, we believe we are well placed maintain a continuous supply of gas to all of our residential and commercial customers. Some of our largest industrial customers have entered into voluntary agreements with us, in exchange for discounted tariffs, which allow us to curtail their supply during emergency events, thus ensuring smaller customers remain on supply. Additional responses by other market participants are also likely via existing market mechanisms—for example, a customer may elect to not operate on a peak day and instead sell its gas to another party.

It is important to note that over half the total gas transported by JGN is used by our 400 largest customers, with 1.2 million smaller commercial and residential customers consuming the remainder. For example, some of the largest single industrial customers consume volumes of gas equivalent to approximately 200,000 residential customers each year. We are therefore well placed to ensure supply to smaller customers during a shortfall by

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4 Ibid, pp. 37-39

5 When we submitted our 2010 plan five years ago, our rates of 'borrowing' were high due to the unusual conditions in financial markets at that time (the global financial crisis). Our high funding costs were a key driver of the material increases in our average network prices in the 2012/13-14/15 period (8-9 per cent per year, excluding inflation). However, we maintained an average price increase of 2-3 per cent per year (excluding inflation) for our large industrial customers during this period.

curtailing supply to large customers who have agreed to shed load in an emergency event such as a peak day shortage.

1.3 TRANSMISSION

Some stakeholders have also pointed to the gas transmission sector in recent years as contributing to increased gas prices. However, Jemena's reference gas transmission tariff for the Eastern Gas Pipeline (**EGP**) to deliver gas to the Sydney market has actually reduced, in real terms, every year since 2004. The EGP reference tariff of $1.21/GJ in 2014 is approximately 5 per cent lower, excluding the impacts of inflation, than a decade ago. Assuming a wholesale gas price of $8 per gigajoule, we estimate EGP's transmission charges would be under 15% of the typical large industrial gas user's gas bill, and less than 5% of a household's typical bill.

We are committed to providing gas transmission services which allow our customers greater flexibility to participate in an increasingly dynamic market. We offer our customers gas park services and the ability to change delivery points, providing them with the flexibility to participate in markets and effectively manage their gas portfolios across east Australia. In addition to allowing our shippers to trade spare pipeline capacity they have, Jemena has also recently established a capacity trade facilitator service for our customers on the Queensland Gas Pipeline and will implement a similar service on the EGP in 2015.

Jemena has been, and always will be, committed to ensuring that any market participant (or prospective market participant) is able to access capacity on our pipelines within a framework that takes into account sound commercial principles and provides a fair and reasonable foundation to meet shippers' needs. It is strongly in our long-term commercial interest to do this.

We also remain committed to investing in new infrastructure to meet our customers' needs and timeframes as the dynamics of the east Australian gas market change. Jemena has invested $450 million in new transmission capacity for our customers over the past seven years. We're currently working to provide greater flexibility to market participants and additional security of supply to Sydney with our Wilton Interconnect project, which will allow extra capacity for the delivery of gas into the Sydney short term trading market or the Moomba to Sydney Pipeline. Jemena is also participating in the expression of interest process to build the Northern Territory pipeline and actively exploring other new pipelines and expansion opportunities.

One of the COAG Energy Council's current focuses is on gas market development, including some initiatives which impact the transmission sector. As discussed in section 2.3, we believe that industry-led responses to market needs are preferable to regulatory interventions.

1.4 RETAIL

In an environment of rising wholesale gas prices, it is crucial for customers to be encouraged and supported in their participation in the NSW retail gas market. Network businesses, retailers, regulators and policy makers need to create positive retail market conditions if we are to put downward pressure on customer bills.

While Jemena is not a retailer, our NSW distribution business can help support our customers' participation in the retail market and the effectiveness with which this occurs. Our proposed JGN Plan responds to what we heard from our customers and commits to doing what we can to assist our customers participate in the gas retail market[6]. However, these actions must also be supported by appropriate policy and regulatory settings, as explained in section 2.2.

6 See pp. 13-14 of Appendix A for details

2. KEY POLICY DEVELOPMENT ACTIONS AND CONSIDERATIONS

Allowing new supply to be brought online as soon as possible is the most important action which should be taken in relation to the current pressures in the east Australian gas market. Increased supply development can reduce upward pressure on gas prices (potentially alleviating demand destruction and associated job losses in some sectors of the economy, such as manufacturing) and open the door for gas to play a bigger role as a transitional fuel in Australia's energy mix (reducing greenhouse gas emission intensity).

Jemena is also supportive of further reform to introduce retail price deregulation in the NSW gas market and acting on the emerging issue of declining individual metering which can be a barrier that prevents customers from switching to better retail offers. Finally, we believe industry-led responses to national gas market development should be encouraged in preference to regulatory intervention.

2.1 NSW GAS PLAN REQUIRES SWIFT YET METHODICAL ACTION TO UNLOCK NEW SUPPLY

Jemena is supportive of the NSW Government's Gas Plan released in November 2014 and agrees with its focus on policy measures to develop a competitive gas industry in NSW and secure the state's gas supply needs. We encourage the NSW Government to work both methodically and swiftly to conduct the reviews and implement reforms outlined in the NSW Plan.

We strongly believe that governments must employ an evidence-based policy approach to the issue of unconventional gas development. As noted in the NSW Plan, the State Government has accepted all of the Chief Scientist and Engineer's recommendations contained in their independent review into coal seam gas activities. We support the view, as stated in the NSW Plan, that the risks of gas development can be effectively managed with the right regulation, engineering solutions and constant learning through monitoring and research.

As outlined in both the Federal Government's Energy White Paper – Green Paper and the NSW Plan, it is of critical importance that producers continue to engage appropriately with affected communities in order to build a social licence to operate. This must involve a two-way dialogue between industry and the community, backed by clear and rigorous information about the impacts of coal seam gas development. We consider that engagement should not only involve conversations with local communities about potential impacts on them, but also about the benefits to the broader community of increased gas supply development.

Jemena is supportive of the NSW and Federal Government's commitment to streamlining environmental and other approvals processes, which, once State barriers to unconventional gas development are appropriately addressed, will help ensure that new gas supplies are brought to market in a more timely and cost-efficient manner. We also welcome the cooperation between the Commonwealth and State Governments to address gas supply and price concerns in relation to the development of a potential new gas transmission pipeline linking the Northern Territory and east Australian gas markets.

The implications on the domestic gas industry of the recent falls in international oil and gas prices are yet to become evident. However, in recent weeks a number of gas companies have indicated their intention to significantly cut back capital expenditure programs, including the development of new gas supplies. In this environment, projects which face significant regulatory uncertainty or barriers are less likely to proceed. It is therefore critical that the NSW Government creates an environment that encourages and enables investment in new supplies.

2.2 NSW RETAIL MARKET REQUIRES REFORM TO CREATE POSITIVE MARKET CONDITIONS

The deregulation of retail gas prices in NSW remains a key outstanding reform, yet one which can deliver increased competition and customer choice. IPART recently reiterated its view in its 2014 determination that retail competition has developed to the point where price regulation may no longer be necessary.

Additionally, we believe that an emerging issue relating to energy intermediaries[7] should be considered in discussions about the policy and regulatory framework that governs gas supply.

We estimate that by 2020 around half of our new gas customers in medium-density and high-rise residential and commercial developments could be supplied gas, hot water and potentially electricity through an energy intermediary. Under these arrangements, many of the core responsibilities for supplying these residential and business customers would rest with the intermediary—including the provision of metering that facilitates individual billing and the customer's ability to choose their retailer—rather than with the distributor.

This could adversely affect the customer experience and effectively create a barrier both to customer participation in the retail market and retail competition in this market, given that:

- it is not clear whether energy intermediaries and developers are incentivised to provide customers with access to individual metering and their choice of retailer in the competitive market
- the policy and regulatory frameworks that support these arrangements are in the early stages of development, only cover some of the issues relating to gas supply (i.e. exclude gas used for hot water), or are not in force under the transitional National Energy Customer Framework provisions in NSW[8].

Policy-makers should be focused on ensuring that the policy and regulatory frameworks—including the role of the Australian Energy Regulator (**AER**) in regulating gas intermediaries and other new energy selling arrangements under the National Energy Retail Law[9]—facilitate customers' access to individual metering, billing and choice of retailer for all of their gas usage (including gas used to provide hot water[10]).

2.3 INDUSTRY-LED RESPONSES TO NATIONAL GAS MARKET DEVELOPMENT SHOULD BE ENCOURAGED IN PREFERENCE TO REGULATORY INTERVENTION

Jemena welcomes the COAG Energy Council's (**the Council**) vision for Australia's future gas market, and is supportive of the outcomes it is seeking under its four policy work streams that will comprise the next phase of

7 Energy intermediaries (e.g. body corporates and third party providers) may supply customers (such as residents in an apartment complex) with gas, hot water and potentially electricity over small, localised networks (embedded networks), in some cases sourcing energy from small-scale gas-fired generators (embedded generators). Energy intermediaries could be authorised energy retailers or entities that have been granted an exemption by the Australian Energy Regulator under the National Energy Retail Law

8 Schedule 3 of the National Energy Retail Rules

http://www.aemc.gov.au/getattachment/524ca290-a33d-4ef0-b045-c7b12d32cd8e/National-Energy-Rule-Version-1.aspx

9 The AER regulates the sale of energy under the National Energy Retail Law. The National Energy Retail Law allows the AER to grant an intermediary or energy supplier a 'retail exemption' from a range of obligations that apply to other authorised providers. The framework for making these decisions is known as the 'exempt seller regime'

10 The AER's regulatory framework may not apply to those customers that are supplied hot water from a centralised gas hot water unit in a residential or commercial development, given that the provision of hot water may not be considered the 'sale of 'energy' under the National Energy Retail Law. Currently our customers have individual hot water meters that record the water (and therefore gas used), and allow customers to access to individual metering, a choice of retailer and customer protection measures—however this may not occur if gas is supplied by an intermediary. Gas used to produce hot water typically accounts for 80% of individual customers' gas usage in medium or high rise developments

gas market reform and development—Competitive Supply; Transparency and Price Discovery; Risk Management; and Removing Unnecessary Regulatory Barriers.

We support the development of a gas market which provides participants with appropriate levels of transparency, liquidity and flexibility. However, in the context of the gas market as a whole, we reiterate our strong belief that the primary issue to be addressed should be that of current barriers to new supply development.

The Council is currently considering measures to mandate the provision of greater pipeline capacity trading information, and we have actively participated in the consultation processes to date. We have worked with the Australian Pipeline Industry Association to propose an industry-led response to the proposal for enhanced capacity information. As previously noted, we also provide a capacity trading service for our customers.

Jemena believes that such industry-led responses are likely to deliver greater net benefits and result in more efficient transaction costs for gas market participants than ‘heavy-handed’ interventions, as well as solutions which are better tailored to customers’ requirements. It is also important to ensure that all market participants have sufficient flexibility to respond to the needs of other participants—as a transmission business, it is certainly in our commercial interest to respond to the needs of the market, and it is important that the market continues to allow us to do this.

Jemena welcomes the Council’s statement in the vision document that it ‘will not support presumptive interventions without regard to their costs and benefits and will continue to monitor its work plan to ensure regulatory changes remain appropriate’[11]. When guiding future gas market development it is important to ensure that efficient transaction costs are a key and constant focus, including careful consideration that any interventions must demonstrate clear net benefits and that the costs of such interventions are recovered from the market participants which benefit from them. This will lessen the risk posed to efficient market development of interventions without an appropriately clear objective being pushed for by parties which do not bear the costs of such measures.

If the market is allowed to respond to the market’s needs, then solutions which best suit participants’ requirements in a way which minimises transaction costs are likely to emerge, helping improve the gas market and allowing it to be better placed to meet the long-term interests of gas customers.

2.4 OTHER POLICY-RELATED CONSIDERATIONS

While Jemena supports a greater focus on assisting gas consumers, care must be taken when considering modifying assistance programs such as the Energy Savings Scheme (**ESS**) to include gas as noted in the NSW Plan. The inclusion of gas in the current electricity-based ESS scheme without careful design may lead to unintended consequences for gas consumers and the broader community, such as higher energy costs and sub-optimum greenhouse emission reduction outcomes.

Jemena also believes that the NSW Government should review their energy concession payments (which are currently electricity-focussed) and that a consistent approach to energy concession payments across all jurisdictions may be beneficial.

[11] https://scer.govspace.gov.au/files/2014/12/COAG-Energy-Council-Australian-Gas-Market-Vision-Dec-2014-FINAL1.pdf

Appendix A
Jemena Gas Networks 5-Year Plan – Customer Overview

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JEMENA GAS NETWORKS (NSW) LTD

JEMENA'S 5-YEAR PLAN:
2015/16 – 2019/20

CUSTOMER OVERVIEW
JUNE 2014

An appropriate citation for this paper is:

Customer Overview of JGN's 5-year plan:
2015/16 - 2019/20

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INTRODUCTION

INTRODUCTION

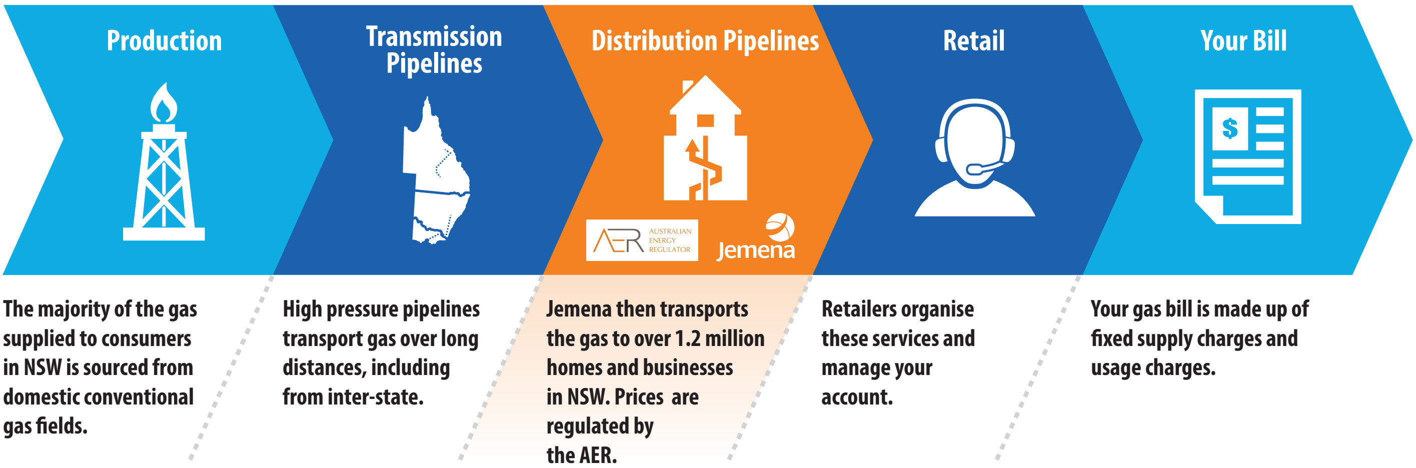
If you're like most people, you rarely think about your natural gas supply – you just expect the water to be hot when you step into the shower, and a flame to appear when you turn on your stove. So you might not be aware of Jemena – the company that delivers the gas to your premises.

We own and manage the 25,000 kilometres of pipelines that distribute natural gas to over 1.2 million homes and businesses across NSW. We also read and maintain the meters which measure how much gas is being used by each customer each day.

Like most businesses, we need to recover the costs of providing our distribution network services from the customers who use them. We do this by charging for these services, and our network charges make up around half of a typical residential customer's gas bill.

We are lowering our network charges by an average of 14.8% over the 5 year period from 1 July 2015, excluding the impact of inflation.

Figure 1: Getting the gas to you



INTRODUCTION

We are currently developing a 5-year plan for the period 1 July 2015 to 30 June 2020 (2015 Plan). Our 2015 Plan sets out how much funding we need - in terms of the costs we need to recover from our customers - to continue to provide safe and reliable services.

As part of this process, we engaged with our customers, stakeholders and the community to better understand what you want and value in your gas supply. We want to make sure the decisions we make about our services, costs and prices reflect your priorities and long-term interests.

This document explains our proposed 2015 Plan. It focuses on what the plan will mean for you – including how our prices will change so we can provide the services you value. It also discusses how we engaged with you in developing the plan, and how we responded to your feedback.

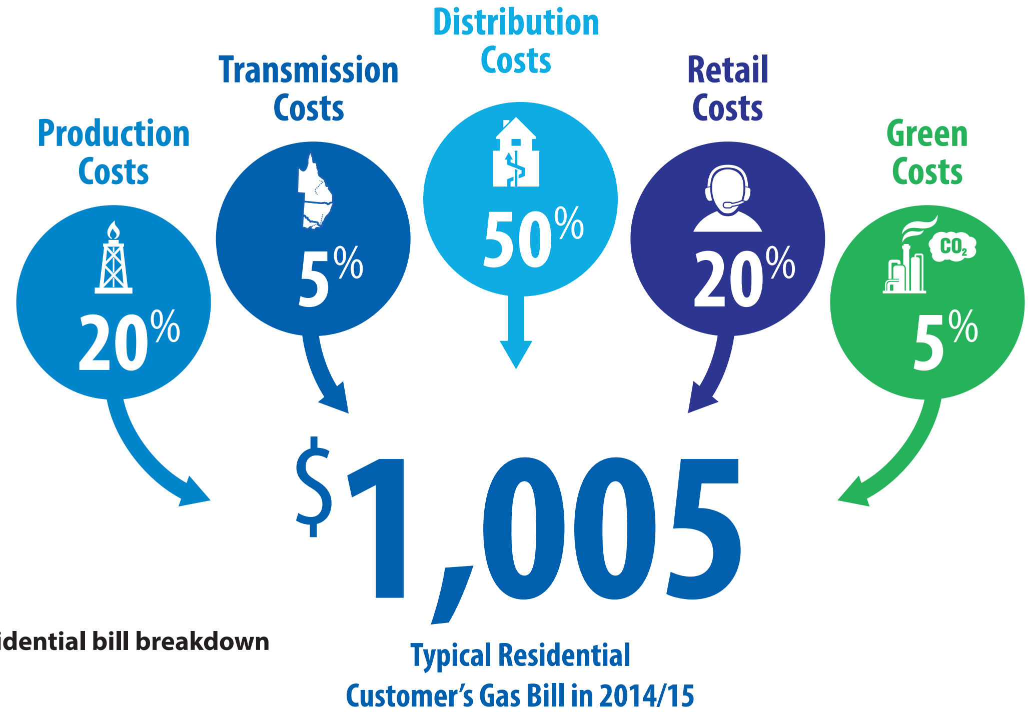


Figure 2: Typical residential bill breakdown

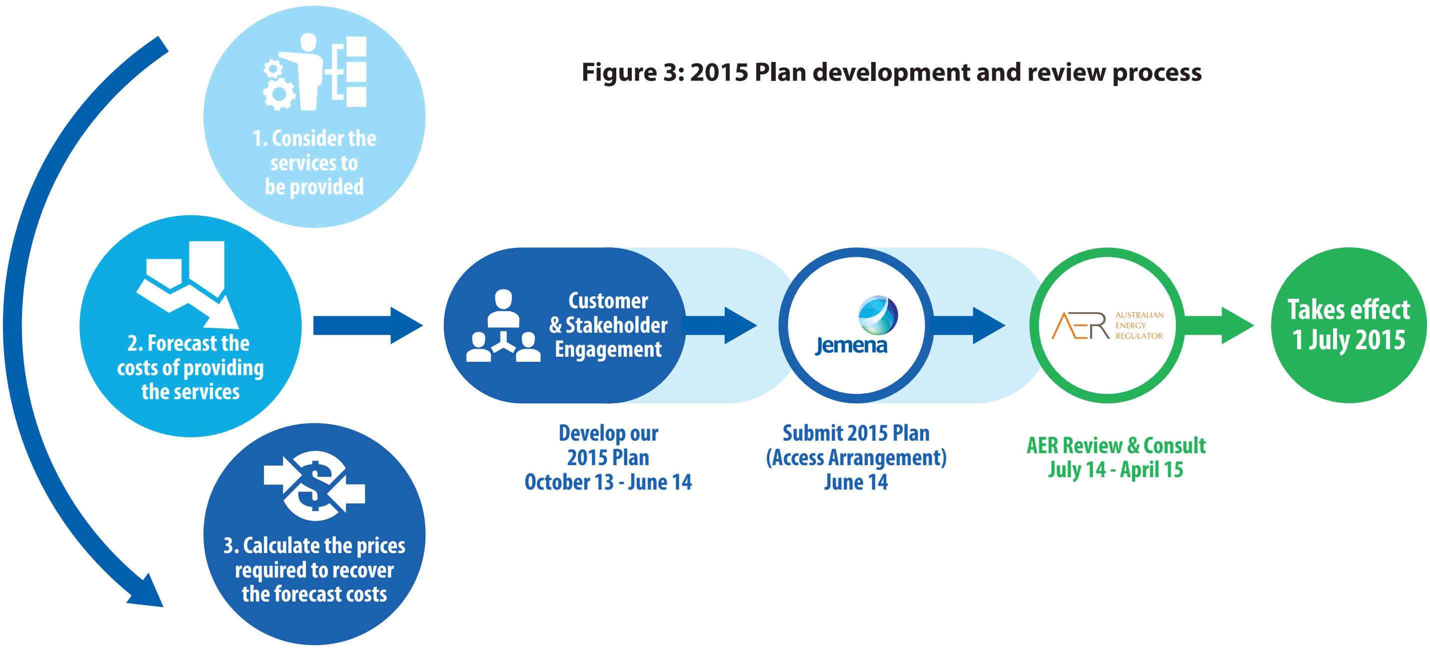
OUR 2015 PLAN

WHAT IS OUR 2015 PLAN?

Like most distribution network businesses in Australia, the prices we charge are regulated. That means every 5 years we submit a plan to the Australian Energy Regulator (AER) that explains the services we will offer, the costs we are likely to incur, and the prices we propose to charge. The National Gas Law requires our plan to promote "the long-term interests of customers".

The AER reviews our proposed plan to check that it complies with this legislation and meets your long-term interests. It then either approves the plan, or specifies the changes we must make. Once approved, we must set our prices in line with the plan.

Figure 3: 2015 Plan development and review process



DEVELOPING THE 2015 PLAN

To develop our proposed 2015 Plan, we considered:

- The safety and service levels we are expected to provide over the 5-year period from 1 July 2015
- Forecasting the efficient level of costs required over this period and future periods to meet these safety and service levels, and run our business effectively to promote your long-term interests
- Calculating the prices we need to charge to recover these costs

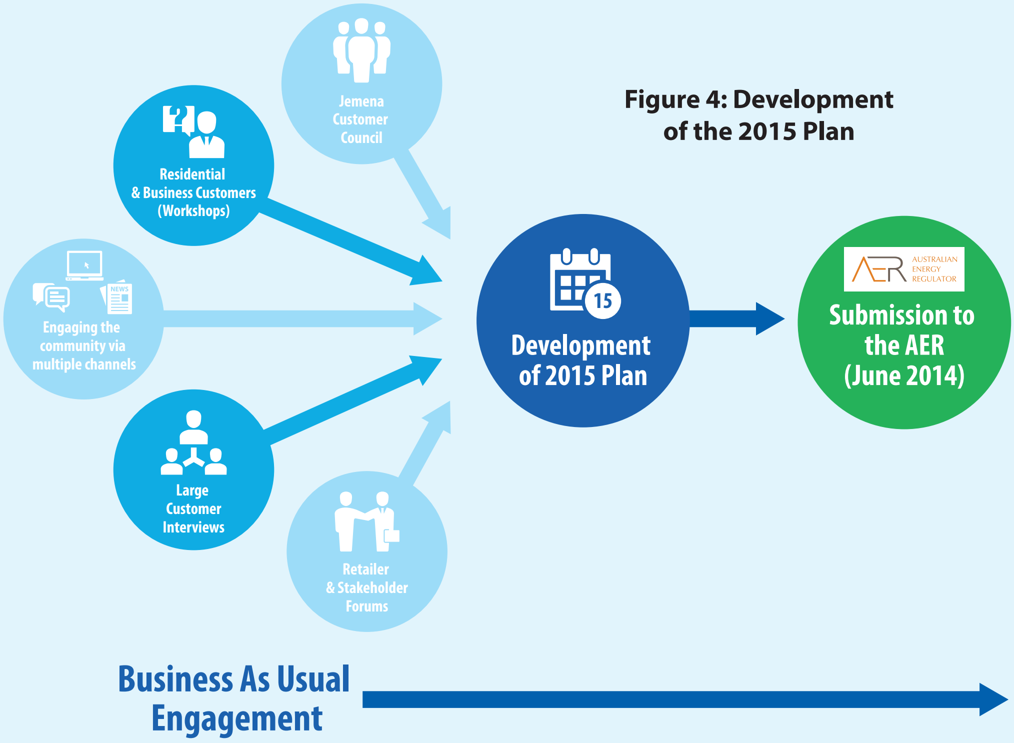
During this process, we engaged with you to help us understand your views and concerns, and to test whether our proposed service levels, costs and prices promote your long-term interests. **[Box 1]** We also took into account expected cost changes in the other parts of the gas supply chain and how they will affect you. **[Box 2]**

BOX 1: How we engaged with you in developing our 2015 Plan

To help ensure our 2015 Plan reflects your views and concerns, and promotes your long-term interests, we engaged with customers, stakeholder and community groups in a range of forums.

We explained the context for our plan, including the role of gas as a competitive fuel in NSW; the different parts of the gas supply chain; the costs associated with each part; and the roles of the AER in regulating our network service prices and IPART in regulating some end-retail prices.

Figure 4: Development of the 2015 Plan



We then explored your views on the decisions we need to make for the coming 5 years by outlining how this will affect services and prices over this period and future periods. This included how we can best balance the prices we charge for our services, the long-term safety of these services, and the service levels our network provides to current and new customers. Some of the specific issues we sought your views on were:

- The current levels of safety and service we provide, and whether we should invest to provide a universal level of service quality across our network
- Our proposed investments to manage expected changes in Australia's gas markets over the coming years, as new sources of gas become available in NSW
- Whether and to what extent we should focus on attracting new customers – for example by extending our network to new suburbs and areas
- Various options for recovering our costs over the period, including whether we should consider the movement in end-retail prices when setting our network prices
- Various options for the structure of our prices, including the balance between our fixed charges and usage charges.

We think the approach we used, the background information we provided, and the issues we explored are consistent with the AER's Consumer Engagement Guidelines. We are committed to continuing this best-practice approach to customer engagement as part of our usual business practice.

> ***"There should be the same service for everyone"***
>
> *Residential Customer*
> *Parramatta forum, 9 April 2014*

BOX 2: Key changes in the gas market in the coming years

Australia's gas markets are expected to undergo big changes over the next 15 years, with major implications for us and for you. The changes are likely to put upward pressure on gas prices. As most customers in NSW have a range of other options to power their homes and business, rising gas prices will make it more difficult for us to attract new customers and lower our prices.

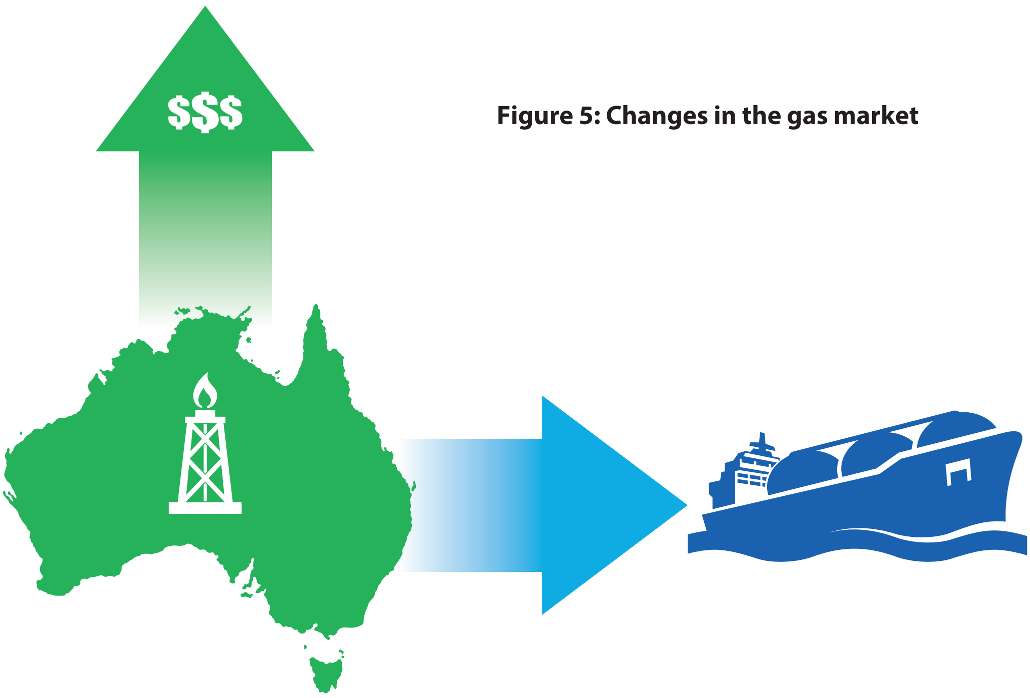
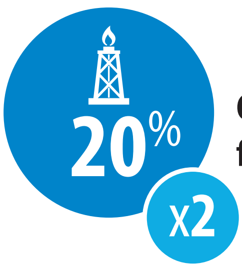


Figure 5: Changes in the gas market

In the Eastern Australian markets, producers are developing new conventional and coal seam gas fields and establishing Liquefied Natural Gas (LNG) export facilities. This will enable them to access the international market for natural gas, with its strong demand and higher prices. As these facilities come on stream, we expect the domestic wholesale price of gas (or production costs) to rise towards international levels. How fast and how far this price will rise is not certain, as it depends on many factors. However, it is expected to have a significant impact on gas prices over the next 5 years.



Gas production costs forecast to double by 2020

In NSW, we expect residential and business demand for natural gas will plateau in the coming years (due in part to the increases in gas wholesale prices), while industrial demand will decline due to the closure of several large industrial facilities. We will need to be proactive in attracting new customers to the network to help spread our fixed costs over a larger customer base and put downward pressure on our prices.

In addition, there are changes in the way that gas will be brought to the NSW market – for example, construction is currently underway to allow gas to enter our network near Newcastle – which will require us to make changes to the way we operate our physical gas network.

At the national level, the National Energy Customer Framework (which was implemented in NSW on 1 July 2013) ensures that all energy customers now have access to consistent, effective consumer protection measures.

Increased production costs mean higher charges to customers

OUR 2015 PLAN

YOU TALKED AND WE LISTENED

Through our various forums, our customers have told us what they want and expect from their gas distributor and we have heard you.

You are concerned about gas prices

Although we can't influence the cost of wholesale gas or your retail charges, by reducing our distribution charges we can do our bit to try to try to keep your bill as low as possible.

Our proposed prices have been developed in response to your concerns about affordability of energy, including the forecast increases in end-retail gas prices over the next 5 years. They also take account our customers' views that we should consider the total cost of gas, not just our own distribution costs, when setting our prices.

We are proposing that our network charges fall by an average of 14.8% over the 5 year period from 2015/16, excluding the impact of inflation. For typical residential customers the network component of their annual gas bill will decrease by $271 over the period and more than offset the impact of inflation. **[Figure 6]**

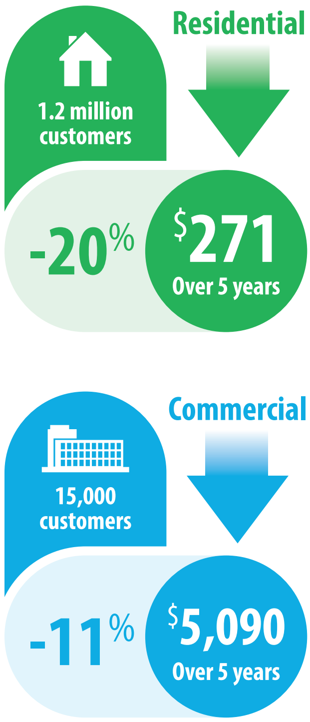
You say you've lowered your prices so why is my bill still going up?

Customers may not see their network tariff itemised on their gas bill, as retailers incorporate our tariffs in their end prices and charges, along with the other costs of producing and supplying gas.

As the network component represents only about half of a typical customer bill, customers won't see their total gas bill fall by this amount. In fact, because the other components of these bills are expected to increase (due to rising wholesale gas costs) most customers will face higher total gas bills. However, our price decreases will offset some of the wholesale gas cost increases, so customers will face lower total gas bills than would otherwise be the case.

We think our plan strikes the right balance between the business and customer outcomes necessary to promote your long-term interests and reflects the feedback you have given us. **[Box 3]** Most importantly, it recognises that you are concerned about the affordability of energy and value our network prices promoting stable end-retail gas prices. It also recognises that NSW energy prices (including gas prices) have increased significantly over the past 5 years, and end-retail gas prices are expected to rise further in coming years, largely because wholesale gas costs are rising.

Figure 6: Changes in our prices over the 5 year period for typical customers (excluding the impact of inflation)

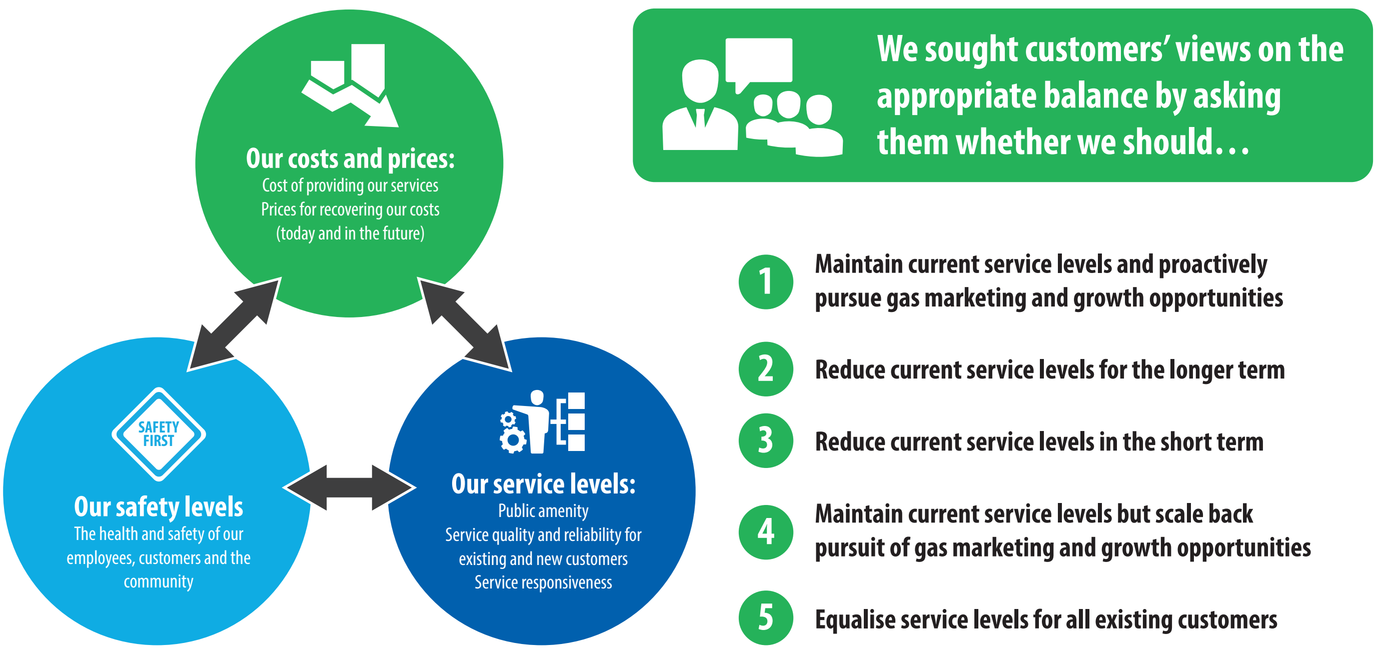


BOX 3: What do we mean by the long-term interests of customers?

To ensure our 2015 Plan promotes the long-term interests of customers, we considered what this means in practical terms. Essentially, we think it means we must strive to run our business as smartly and efficiently as possible, so our:

- Prices reflect the lowest sustainable cost of providing our services and meeting the required safety and service levels (and are not higher than they need to be because of inefficient operations or poor investments).
- Service levels reflect what our customers want and are willing to pay for (no 'gold plating'), and are priced to support efficient use.
- Combination of prices and service levels represents good value for money and encourages new customers to connect to the network and install more gas appliances, which helps reduce prices for all customers.
- Management thinks and plans for the long term, so we can respond to changes in our market and innovate to help ensure gas remains a competitive fuel option over the long term.

Figure 7: Balancing safety, services and prices in the long term interests of customers



You want your gas supply to be safe and reliable

We know that not having gas when you need it is more than an inconvenience, it impacts the entire family or business. We asked you about the current balance between the prices we charge for our services, the long-term safety of these services, and the service levels our network provides to current and new customers. While we found there is some support for modest improvements, your overall satisfaction with our current service levels is strong.

While our service quality is high for most customers, those in certain areas of the network have relatively low gas pressure. This limits the gas appliances they can use effectively. You told us that all our customers should receive the same service levels, regardless of their location. We agree, and propose to improve pressure levels in these underperforming areas. Our 2015 plan includes investing $22m over the 5-year period (adding around $1 to a typical customer bill per year) to ensure all customers across our network enjoy the same quality of service and receive the same value for money.

BOX 4: What do we mean by our service levels?

Our service levels have 5 key aspects:

1. **Public amenity** – minimising gas leaks (which smell bad and can be dangerous) and planning maintenance work to minimise traffic disruptions (from digging up streets, driveways and footpaths)
2. **Service quality** – providing the gas pressure needed to meet customer expectations, particularly for new more efficient (and more demanding) gas appliances
3. **Reliability** – making sure gas is available when it is needed and reducing customer frustration due to service disruption
4. **Responsiveness** – minimising the time it takes to respond to supply disruptions and to reconnect customers
5. **Availability** – making sure new customers can connect to our network

WHAT DO WE MEAN BY OUR COSTS?

You told us you want to know where your money goes, so we're going to be more transparent in exactly what you are paying for.

Like most businesses, we incur two broad types of costs in providing our network services – operating and capital costs.

Operating costs includes the costs of operating and maintaining our physical assets (e.g. pipes, meters and computer systems) to provide our services and meet our safety and service levels. It also covers the costs of performing related functions like reading meters and providing billing information to retailers, and meeting legal and regulatory requirements. These costs are generally recurrent, much like the costs of running a household (buying groceries, paying bills, general home maintenance). We expect our operating costs to decrease slightly (-0.1% per annum, excluding the impact of inflation).

Some of the things that impact our operating costs include cost pressures from competing for skilled labour with other sectors in the economy, the cost of changing our systems and meeting new regulatory obligations.

You told us that you expect us (and other gas market players) to continually strive to improve our cost efficiency, to help lower our costs. We agree, and our 2015 Plan commits us to making a 5% efficiency saving in operating costs over the next 5 years and introducing a new mechanism – like the AER has introduced for other network businesses – to further encourage cost savings.

Capital costs include the investments we make to buy and build physical assets that will deliver our required safety and service levels now and into the future. Our capital works range from small standard projects (like installing a small length of pipe and a meter to connect a new customer to the existing network) to large multi-million-dollar projects (like extending the network and installing multiple meters to connect a new town or housing estate). These costs are generally funded through borrowings and paid back over the long term.

We expect our capital costs to increase moderately (3.7% per annum, excluding the impact of inflation), due to higher spending on reinforcing, renewing and replacing assets, such as replacing old gas meters, to maintain service reliability and to accommodate changes in the gas market, including changes to the way gas comes into our network. We also propose to make smart investments in attracting new customers, which will lower our average costs per customer. (See 'What else are we doing in response to customer feedback?' for more detail.)

YOU WANT US TO BE MORE TRANSPARENT ABOUT OUR REVENUE

You told us you want to know how our network prices are determined, to be assured that we aren't recovering more than we need to.

To run our business effectively we need to generate enough revenue to recover:

- Our forecast operating costs over the 5-year period
- Our funding costs over the 5-year period (interest and other costs related to our 'borrowings' for our debt and equity for past and forecast capital costs)
- The depreciation on our assets over the 5-year period (the amount we need to recover over this period so that we will recover our capital costs over the expected life-time of each asset)
- Our tax costs over the 5-year period (to pay our tax liabilities to the Australian Tax Office)

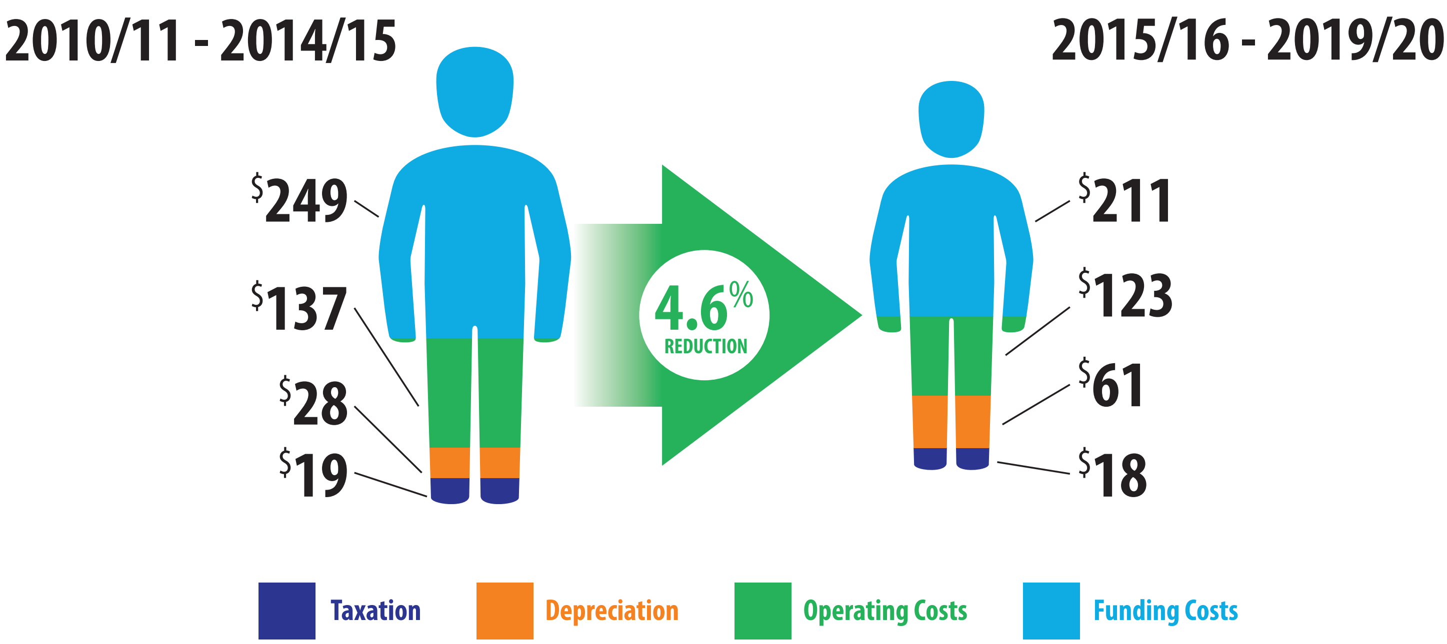
We recover these costs from our customers by adding up our 'building block costs', using an approach specified in the gas regulatory framework. These building block costs form the basis of the revenue approved by the AER. Over the next 5 year period, the required revenue per customer will fall by 4.6% per year and we will pass this saving on to our customers.

There are several key reasons for this.

Firstly, our funding costs will decrease over the period reducing our required revenue per customer by $37 per year. Like home interest rates, the costs of funding our past and forecast capital costs vary with economic and financial market conditions. When we submitted our current plan 5 years ago, our rates of 'borrowing' were high due to the unusual conditions in financial markets at that time (the global financial crisis). Since then, conditions have improved and our costs have come down.

Secondly, we are continuing to attract new customers to the network. Attracting new customers helps to lower the average costs we must recover from each customer. The forecast increase of over 150,000 new customers over the next 5 years puts downward pressure on our revenue requirement per customer and ultimately our network prices.

Figure 8: Changes in our required revenue per customer per year ($ 2015)



YOU WANT US TO FIND WAYS TO DRIVE DOWN COSTS

Attracting more customers is beneficial for you and us.

Like most businesses, attracting more customers can be a profitable way of expanding our business. However attracting new customers also helps to lower our prices over time because a large proportion of our costs are 'fixed' – that is, they remain largely the same no matter how many customers we have and how much gas our customers use. Just as sharing a rental property lowers the rental cost per person, increasing the number of customers we serve and the amount of gas we supply lowers the average costs we must recover from each customer. In turn, lower average prices are likely to make gas supply more attractive.

We are committed to attracting new customers to put downward pressure on our prices. We forecast that we will attract over 30,000 new customers per annum, or over 150,000 customers over the period. These new customers will lower our average costs and prices, and will largely offset the fall in gas demand as a result of rising end-retail gas prices.

A key part of this is continued investment in our Natural Gas, The Natural Choice marketing campaign which promotes the benefits of natural gas and encourages home and businesses to connect to the gas network in New South Wales.

Natural Gas
brought to you by Jemena
thenaturalchoice.com.au

Figure 9: Cost efficiency benefits of attracting new customers

"I like the idea of attracting new customers to lower the price"

Residential Customer, Parramatta Forum, 9 April 2014

IMPROVING OUR EFFICIENCY

Improving our efficiency by being smarter and more innovative in how we plan and operate our network also helps lower our prices over time. You told us that you want to see us continually striving to improve our efficiency so our services provide more value for money.

Currently, we are one of the lowest cost and most efficient gas utilities in Australia. For example, our operating costs have been found to be amongst the most efficient of these businesses for the last 15 years. However, as markets change and knowledge and technologies improve, there are always opportunities for further improvements in efficiency.

That is why we are committed to pursuing more efficiency improvements including reducing our operating costs by 5% over the next 5 years and proposing the introduction of a new mechanism that will strengthen our incentives.

RECOVERING OUR COSTS IN A WAY THAT MINIMISES END-RETAIL GAS PRICE SHOCKS

We asked you how we should recover our costs over the next 5 years. You told us that you are concerned about the affordability of gas, which depends on the overall end-retail price of gas, not just our distribution prices, and were concerned about rapid increases in your bills as a result of forecast increases in wholesale gas costs. You also told us that we should consider the end- retail price when setting our distribution prices to promote the stability of end-retail prices over the next 5 years.

With large forecast increases in wholesale gas costs over the next 5 years, we have proposed to recover our costs in a way that provides greater stability in end-retail prices. Our proposed network prices place downward pressure on these end-retail prices and offset some of the expected increases due to rising wholesale gas costs. As a result, the affordability and stability of end-retail gas prices will be greater than would otherwise be the case.

KEEPING OUR FIXED CHARGES LOW FOR RESIDENTIAL AND SMALL BUSINESS CUSTOMERS

Our current price structure for residential and business customers includes fixed charges ($ per quarter) plus usage charges ($ per unit of gas used). Given the size and value of our existing assets (valued at over $3 billion), most of our costs in supplying gas to you are fixed. However, we set the fixed charges at a low level, so most of the network component of a typical residential or small business gas bill reflects the volume of gas the customer used. We set our prices this way because:

- You told us you value having control over your gas bills and expect to pay less when you use less gas
- We want to create incentives for you to connect to gas supply and install gas appliances, which would lower the average cost per customers, and you have told us that high fixed charges are a barrier to this

As most of our costs in supplying gas to you are fixed, we will also ensure that our usage charges continue to encourage customers to use multiple gas appliances (which puts downward pressure on our prices), by offering 'bulk discounts' to our customers. This means that the price of gas decreases as more gas is used.

SIMPLIFYING OUR PRICING

While our fixed charges are set at a low level that encourages customers to connect to gas and manage their gas bills, there are currently 3 separate fixed charge components for each customer group. You told us that you value network pricing that is simple and easy to understand, particularly as many retail market contracts in NSW include a pass through of our network charges. In response, we propose to simplify our pricing where we can.

Under our 2015 Plan, all residential and small business customers in NSW will pay just one fixed charge and one usage charge. This should make it easier for customers to understand our prices and for retailers to incorporate these prices in their market offers.

We have also simplified our disconnection charges to make it easier for customers and retailers to understand.

PROVIDING CLEARER INFORMATION ON OUR PRICING DECISIONS

You told us that you would like to know more about how your gas prices are set, and how they may change over time.
We think we can do more to assist you in understanding how energy pricing decisions are made, including the matters we are required to consider in making these decisions, and how these prices may change over time. For this reason, we have:

- Made clear and accessible information available on our website on how retail gas prices are set, how our network prices are regulated and how customers can get involved

- Prepared a Tariff Structures Statement that provides clear, accessible guidance on how we decided on our current prices, and how our price structures and levels may change in the future. This statement is available on our website.

PROVIDING MORE ASSISTANCE TO VULNERABLE CUSTOMERS STRUGGLING TO PAY ENERGY BILLS

You told us that vulnerable customers in our community need assistance to manage their energy bills, and that we should play a role. In response, we are committed to taking the following steps:

- Making it easier for customers to manage their gas bills by:
  - providing clear, accessible information for customers to make it easier for them to manage their gas consumption, find a better retail market offer, and take advantage of any rebates that may be available to them
  - advocating for policy and regulatory changes to ensure all customers – including those who rent their property, or live in a caravan park or boarding house – have the choice of individual billing and metering and their choice of retail supplier
- Advocating for additional Government programs to assist vulnerable customers (for example, by providing rebates for larger gas bills, and conducting energy audits to identify steps they can take to use gas more efficiently)
- Assisting vulnerable customers to reduce their energy consumption by using gas more efficiently:
  - working with the NSW Government and other partners organisation to upgrade gas appliances in public housing
  - becoming a partner of NILS NSW, a No Interest Loan Scheme, to help vulnerable customers access funds to replace old their gas appliances with new, more efficient models

HELPING MAKE THE GAS MARKETS WORK MORE EFFECTIVELY FOR ALL CUSTOMERS

You told us that we should help make the state's energy markets "work better" for customers. Our 2015 Plan includes 5 steps towards this goal.

WE WILL MAKE IT EASIER TO SWITCH RETAILERS

We have reduced our charges for special meter reads to reduce barriers to customer switching. This should make it easier for customers to take-up a competitive retail market offer that suits their needs.

WE WILL MAKE INVESTMENTS TO ACCOMMODATE NEW SOURCES OF GAS INTO SYDNEY AND REGIONAL NSW

Australia's gas markets are expected to undergo big changes over the next 15 years, with implications for Jemena Gas Networks and our customers. One of the major changes is the availability of new gas sources across NSW.

To manage these expected changes we will make investments to ensure these new sources of gas become available to our customers. This should put downward pressure on end- retail gas prices by offering retailers alternative sources of gas supply.

WE WILL SCALE UP THE REPLACEMENT OF METERS ACROSS OUR NETWORK

We seek to manage our assets prudently. This means we look to minimise the long term cost of providing our services and meeting the required safety and service levels.

Many of our gas meters are over 20 years old, and require replacing. We plan to invest over $194m in a large scale replacement of gas meters across our network to improve the accuracy of our billing and to improve market outcomes.

YOU WANT TO KNOW ABOUT ANY PRICE RISES EARLY

Currently we prepare our proposed distribution prices by 15 April each year. You have told us that publishing our proposed distribution service prices earlier in the year would give retailers more time to develop and market new retail offers before the annual energy price change on 1 July, and give customers more time to compare retailers' offers and find the best deal.

We agree that this will make the competitive gas market work better for all participants. We will ask the AER to approve the changes necessary to allow us to prepare our proposed prices by 15 March each year (more than 3 months before they start).

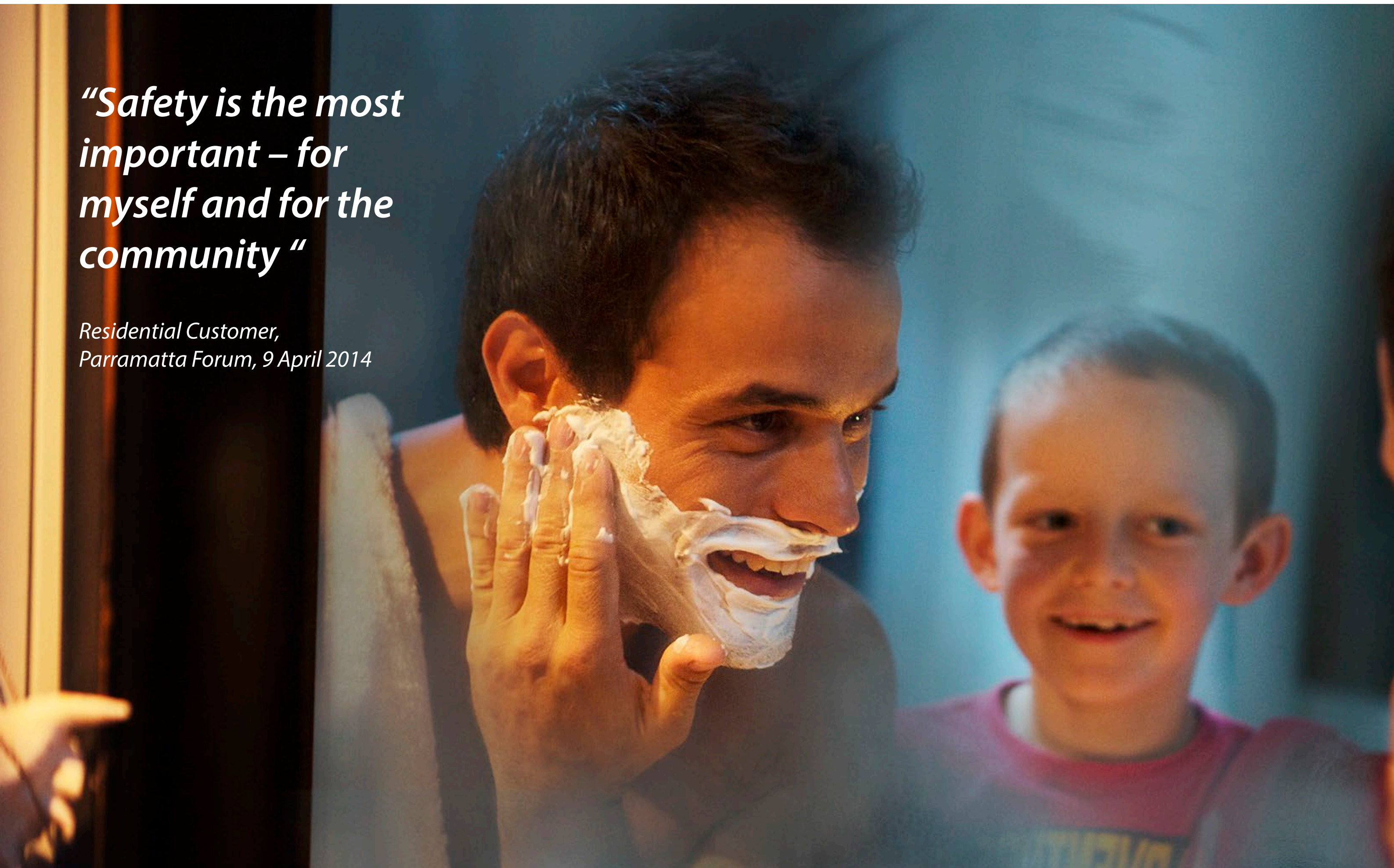
WE WILL ADVOCATE FOR A NEW REGULATORY MECHANISM TO STRENGTHEN INCENTIVES FOR EFFICIENCY IMPROVEMENTS

We recognise that to work best for customers, the regulated energy market needs to create incentives for distribution businesses that are like those we would face in a competitive market. In particular, regulation should provide us with strong incentives to continually strive to improve the efficiency of our operations. This will enable us to provide the same or better service levels for less cost, and help ensure gas remains a competitive, value-for-money fuel option in line with customers' long-term interests.

With your support, our 2015 Plan proposes the introduction of a new regulatory mechanism – the Efficiency Benefit Sharing Scheme – that will strengthen our incentives by:

- Allowing us to keep the savings we make by improving the efficiency of our operating costs (or cost underspends) for 5 years
- Requiring us to bear the burden of operating cost overspends for 5 years.

These benefits are then passed on to our customers through lower prices over the next 5 years.



"Safety is the most important – for myself and for the community "

Residential Customer,
Parramatta Forum, 9 April 2014

HAVE YOUR SAY & STAY INFORMED

We welcome your views on our 2015 plan

We will keep you informed of the AER's review process and how it impacts you

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Jemena