



INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

**Review of capital expenditure and operating expenditure of NSW gas network
companies AGLGN and CEG (ref: 04/179)**

Invitation to Tender

The Independent Pricing and Regulatory Tribunal (IPART) is seeking suitably qualified consultants to conduct a review of the capital expenditure and operating expenditure of AGL Gas Networks (AGLGN) and Country Energy Gas (CEG). Copies of the consultancy brief may be obtained from the Tribunal's website, www.ipart.nsw.gov.au. Tenders should be lodged by 5.00pm on Friday 30 April 2004. Inquiries to Alex Dobes on (02) 9290 8446.

To appear in the *Sydney Morning Herald* on Monday 19 April 2004.



INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

I N V I T A T I O N T O T E N D E R

REVIEW OF CAPITAL AND NON CAPITAL EXPENDITURE (TOTAL COST) OF THE NSW GAS NETWORK COMPANIES

BACKGROUND

The Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) is the Relevant Regulator in NSW for the National Third Party Access Code for Natural Gas Pipeline Systems (the 'Gas Code'). As such, the Tribunal regulates gas network companies who operate as Service Providers under the Gas Code. The Tribunal currently regulates only 2 gas network companies: AGL Gas Networks (AGLGN); and Country Energy Gas (CEG)¹. As outlined in Attachment A, the current Access Arrangements for AGLGN and CEG specify that a review should occur during 2004. AGLGN and CEG submitted their proposed revisions in December 2003.

The Tribunal requires a review of the gas network companies' capital and non capital expenditure (together referred to as "total cost") to assist in its assessment of the proposed Access Arrangements. Because each gas network company has a separate Access Arrangement, the Tribunal requires a separate report for each company.

Section 8 of the Gas Code² sets out the principles with which Reference Tariffs and a Reference Tariff Policy (the principles underlying the calculation of Reference Tariffs) included in an Access Arrangement must comply. Section 8.4 sets out that, under a cost of service approach (adopted by both AGLGN and CEG in their proposed revisions), total revenue is the sum of a return on capital, a return of capital (depreciation) and non-capital costs. Therefore, past and forecast capital expenditure are important because of their effect on the capital base, used in calculating the return on capital and return of capital. Non capital costs are commonly referred to as operating expenditure, and form the third component of the total cost of service.

Assessment of future capital and non capital expenditure rests on assumptions about future demand. In order to ensure that these demand assumptions represent best estimates arrived at on a reasonable basis (as set out in section 8.2(e) of the Gas Code), the Tribunal has commissioned a separate review of forecast demand of the gas network companies.

¹ Other gas network companies in NSW are either unregulated, or have had their regulation cross-vested to other regulators because their network borders the jurisdictional boundary of those other regulators. The Tribunal also regulates retail tariffs for certain gas customers, but these are not the subject of this Access Arrangement review. The Tribunal's retail tariff review partially overlaps with the Access Arrangement review – a timetable for the retail tariff review is on the Tribunal's website.

² A full and current version of the Gas Code is available at <http://www.coderegistrar.sa.gov.au/>

Issues

Non capital expenditure

Non capital costs form a significant portion of the total revenue in the proposed revisions to Access Arrangements put forward by AGLGN and CEG. Forecasts of non capital costs also provide a point of reference for future efficiency gains – an important aspect of incentive regulation.

Sections 8.36 and 8.37 of the Code define non capital costs and how they are recovered through reference tariffs. Essentially, non capital costs are operating, maintenance and other costs incurred in the delivery of reference services. These non capital costs should be those which would be incurred by a prudent gas network company, acting efficiently, in accordance with accepted and good industry practice, to achieve the lowest sustainable cost of delivering the reference service.

Capital expenditure

Sections 8.16 to 8.19 of the Gas Code set out how the capital base of a pipeline is increased by actual capital expenditure. Sections 8.20 to 8.22 deal with forecast capital expenditure. For both actual and forecast capital expenditure, section 8.16(a) specifies that the Tribunal should ensure that

- capital expenditure does not exceed the amount that would be invested by a prudent gas network company acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering services; and
- at least one of the following is satisfied
 - the anticipated incremental revenue generated exceeds the capital expenditure; or
 - the Tribunal is satisfied that the capital expenditure has system-wide benefits which justify the approval of a higher tariff for all gas users; or
 - the capital expenditure is necessary to maintain the safety, integrity or contracted capacity of the pipeline.

Where capital expenditure satisfies the above conditions, the Tribunal increases the gas network company's capital base by the relevant amount. If only part of the capital expenditure satisfies those conditions, that part can be added to the capital base.

It is worth noting that the capital base can be decreased if assets become redundant, and redundant assets can also be added back to the capital base (in the same way that capital expenditure is added) if they subsequently become useful again. Sections 8.27 – 8.29 of the Gas Code deal with the treatment of redundant assets. The Tribunal requires the total cost consultant to examine redundancy of assets as part of this total cost study.

The Tribunal requires the total cost consultant to examine capital expenditure from the beginning of the current Access Arrangements³.

³ The current Access Arrangement for AGLGN commenced 1st October 2000 and is scheduled to end on 31 December 2004. The current Access Arrangement for CEG (formerly GSN) commenced 1st October 1999 and is scheduled to end on 31 December 2004.

INVITATION TO TENDER

Objectives and scope of consultancy

The Tribunal is seeking suitably qualified consultants to conduct a review of the capital and non capital expenditure of the 2 gas network companies it regulates – AGL Gas Networks (AGLGN) and Country Energy Gas (CEG). The consultant should deal separately with each company. The Tribunal plans to complete the AGLGN total cost study before the CEG total cost study.

In undertaking the consultancy, the consultant must apply the requirements of the Gas Code, particularly section 8. The consultant is required to apply section 8 of the Gas Code to:

- make recommendations on actual and forecast capital expenditure undertaken in the course of the current Access Arrangements⁴;
- analyse capital expenditure forecast for the period of the proposed revised Access Arrangements⁵;
- report on any possible capital redundancy in the assets of the gas network companies; and
- analyse forecast non capital costs of the gas network companies.

The consultant must give a detailed account of the methodology that has been used in each analysis.

The consultant must deliver a report written in a clear and concise manner with recommendations that require no clarification. The consultant is to ensure that all numbers are presented consistently either in nominal or in real terms, and provide explicit assumptions on CPI.

The consultant should also have regard to:

- current demand and likely future demand, as forecast by the gas network companies and reviewed by the demand consultant;
- the gas network companies' proposed Access Arrangements and Access Arrangement Information (December 2003), and any further revisions to the Access Arrangement Information;
- the gas network companies' current Access Arrangements and Access Arrangement Information;
- stakeholder submissions on the proposed Access Arrangements;
- discussions with stakeholders, including the gas network companies;
- other relevant studies and reports available to the consultant.

⁴ The current Access Arrangement for AGLGN commenced 1st October 2000 and is scheduled to end on 31 December 2004. The current Access Arrangement for CEG (formerly GSN) commenced 1st October 1999 and is scheduled to end on 31 December 2004.

⁵ AGLGN and CEG have proposed revisions commencing 1st January 2005 and ending 30 June 2010.

In assessing actual and forecast capital expenditures, the consultant must report on whether the capital expenditure complies with the criteria in section 8.16 of the Gas Code. The consultant should also

- individually assess capital expenditure projects which are significant for the purposes of the total cost review
- examine the effect of capital expenditure decisions on the level and quality of reticulation services
- examine trade-offs between capital and non capital expenditure
- identify and segregate capital expenditure to which users may make capital contributions

The consultant's analysis of capital and non capital expenditure should as far as possible distinguish between

- different categories of customers, particularly contract customers and tariff customers
- different regions
- the low pressure, medium pressure and high pressure sections of the network

In applying the Gas Code, the consultant should consider the following:

'Prudent', in its ordinary sense, means "discreet or cautious in managing one's activities; practical and careful in providing for the future & exercising good judgement"⁶.

'Efficient', in the ordinary sense of the word is "functioning or producing effectively and with the least waste of effort"⁷. For the purposes of this total cost review, a test of efficiency requires an assessment of operating and maintenance and capital expenditure from a least-cost perspective over the life-cycle of the assets.

Efficiency should be assessed on the basis that the projected expenditures will deliver the identified outcomes and service standards, and should consider network and non-network options. Over time, efficient investments should minimise costs for the expected outputs and ensure that resources are allocated appropriately.

TIMETABLE

The Tribunal expects to follow the indicative timetables in Tables 1 & 2 below for the total cost reviews. Tenderers should note that these indicative timetables envisage a relatively short period for completion of each report, and should factor this short period into their estimates of staffing requirements for the consultancy.

⁶ *Collins Concise Dictionary (2nd Australian edition)*

⁷ *Collins Concise Dictionary (2nd Australian edition)*

Table 1 Indicative timetable for total cost review - AGLGN	
14 April 2004	Tribunal releases total cost review terms of reference
30 April 2004	Tribunal appoints successful consultant
31 May 2004	Total cost consultant supplies draft report to Tribunal and to AGLGN for factual comment and identification of confidential information
11 June 2004	Total cost consultant provides final report on AGLGN
17 June 2004	Consultant makes public presentation on AGLGN total cost study

Table 2 Indicative timetable for total cost review - CEG	
14 April 2004	Tribunal releases total cost review terms of reference
30 April 2004	Tribunal appoints successful consultant
19 July 2004	Total cost consultant supplies draft report to Tribunal and to CEG for factual comment and identification of confidential information
2 August 2004	Total cost consultant provides final report on CEG
5 August 2004	Consultant makes public presentation on CEG total cost study

OUTPUTS

The consultant must deliver the following:

1. One first draft written report for each gas network company and one final written report for each gas network company, which each address the objectives of the consultancy.
2. Discussions and meetings with gas network companies, the Tribunal and/or Tribunal Secretariat.
3. Presentation of draft findings to gas network companies, the Tribunal and/or the Tribunal Secretariat, incorporating any comments where agreed and noting where there is any disagreement.
4. Presentations at public forums.
5. Presentations to the Tribunal and/or Tribunal Secretariat which outline the major issues and findings.

The Tribunal intends to hold a separate public forum on each company's total costs after the release of the final reports. The consultant is to make a presentation to those public forums. The Tribunal will circulate the final reports to all interested parties prior to the public forums.

The consultant should note that the Tribunal plans to release the final reports as public documents. As such, the reports should be clearly and logically set out and written in plain English, avoiding the use of unnecessary technical terms.

The draft reports and final written reports should be provided in 5 bound copies and 1 loose-leaf copy, as well as in PDF format suitable for web publication. Tables and graphs in the final reports must also be provided in Excel format.

On completion of the consultancy, the consultant's reports, working papers and advice provided to the Tribunal will become the property of the Tribunal.

CONDITIONS OF QUOTATION

Timing

The successful consultant must be able to meet the work schedule set out in Tables 1 and 2 above.

The consultant is to provide a weekly update of progress in writing to the Tribunal Secretariat. In addition, the consultant's work program should include regular progress meetings.

Fee

The fee quoted is to be inclusive of all costs including Goods and Services Tax (where applicable), incidental expenses and disbursements. Payments will be due within 28 days of receiving an invoice as per an agreed payment schedule. The consultant may wish to outline a draft payment schedule.

A detailed breakdown of the consultancy costs is required with the proposal. The proposal should include estimates of the time required for the project, consultants to be involved in the project, their rates, and a total fee estimate. Staff costs should be clearly reconciled to the detailed work plan.

The consultant should allow for presentations to the Tribunal, discussion and meetings with staff of the Tribunal, and stakeholder meetings as required.

Proposal

The consultancy proposal should:

- demonstrate an appreciation for the task as well as describe the intended approach for carrying it out
- list the personnel to be involved, including resumes detailing their experience
- include a detailed work plan
- outline any potential conflicts of interest
- preferably include details of previous clients who can be contacted.

Presentation

Shortlisted consultants may be required to make a presentation on their proposal as part of the quotation evaluation process.

Criteria for selection

In selecting the successful consultant, the Tribunal may consider any relevant matter including:

- extent of knowledge of gas distribution networks
- experience in similar projects
- understanding of gas network companies' operating and regulatory framework
- proposed consultancy fee
- adequate resourcing and ability to provide results within the stated time frame
- proposed quality assurance procedures
- guaranteed availability of key staff
- demonstrated ability to enlist the gas network companies' cooperation.

Acceptance

The Tribunal reserves the right to:

- accept no quotation at all
- postpone indefinitely the acceptance of a quotation
- call for new quotations
- appoint one or more consultants to undertake the review
- approve or reject any sub-contractors the consultant may wish to appoint.

Consultancy Contract

The successful consultant will be obliged to enter into a contract with the Tribunal prior to commencing the consultancy.

The Tribunal has a consultancy contract that covers issues including, but not limited to:

- consultancy information and documentation
- ownership of intellectual property
- conflicts of interest
- confidentiality
- insurance.

The Tribunal reserves the right to modify contract terms for the final contract as it considers appropriate. A copy of the Tribunal's draft contract is available on request.

One or both gas network companies may require the successful consultant to sign a confidentiality agreement separate to that included in the Tribunal's contract.

PARTIES TO THE CONSULTANCY

The party managing and commissioning the consultancy is the Independent Pricing and Regulatory Tribunal of New South Wales. The primary contact is:

Alex Dobes Program Manager Gas
tel: +61-2-9290-8446, mobile +61-419-229127
e-mail: alex_dobes@ipart.nsw.gov.au

LODGEMENT OF QUOTATION

Three bound copies and 1 loose-leaf copy of the quotation should be lodged in a sealed envelope marked 'Review of total cost of the NSW gas network companies' and addressed to:

Alex Dobes
Program Manager Gas
Independent Pricing and Regulatory Tribunal of NSW

at, PO Box Q290
QVB POST OFFICE NSW 1230

or, Level 2
44 Market Street
SYDNEY NSW 2000

so that it is received by no later than 5:00 pm Sydney time, 30 April 2004.

ATTACHMENT A

BACKGROUND TO CURRENT ACCESS ARRANGEMENTS

Documents relevant to the Access Arrangements can be viewed on the Tribunal's website <http://www.ipart.nsw.gov.au> under the headings "Gas" and "Third party access".

1999/2000 Access Arrangement review - AGL Gas Networks (AGLGN)

In January 1999, AGLGN submitted proposed revisions to its Access Arrangement (originally established in 1997). The proposed revisions covered an Access Arrangement period from 1999/2000 to 2003/04.

Some of the milestones in the review were as follows:

- The Tribunal's draft decision was released on 28 October 1999. The Tribunal proposed not to approve AGLGN's proposed revisions to the Access Arrangement. A number of requirements had to be met by AGLGN to enable a final decision to be made.
- In February 2000, AGLGN submitted additional documents to reflect prices, terms and conditions under the draft decision.
- The Tribunal released its final decision on 21 July 2000.

On 14 September 2000, the Tribunal approved the revised Access Arrangement and Access Arrangement Information for AGLGN relating to the natural gas distribution system in NSW. These revisions came into effect on 1 October 2000.

The Access Arrangement for AGLGN required AGLGN to submit its proposed revisions to the Access Arrangement by 30 June 2003, and expected the new Access Arrangement to be effective from 1 July 2004.

On 26 February 2003, AGLGN sought the Tribunal's approval to vary the Revisions Submissions Date to 31 December 2003 and the Revisions Commencement Date to 1 January 2005. After considering AGLGN's representations, customer views, and the requirements of the Code, the Tribunal agreed to this revision to the Access Arrangement.

1998/1999 Access Arrangement review - Great Southern Energy Gas Networks (GSN)

Great Southern Energy Gas Networks (GSN) changed its name to Country Energy Gas (CEG) in July 2002.

The Access Arrangement for CEG (formerly GSN) originally applied from 1 October 1999 to the end of 2003 and required CEG to submit its proposed revisions to the Access Arrangement by 31 December 2002.

On 16 December 2002, CEG sought the Tribunal's approval to vary the Revisions Submissions Date to 30 June 2003.

On 13 June 2003, CEG sought the Tribunal's approval to vary the Revisions Submissions Date to 31 December 2003 and the Revisions Commencement Date to 1 January 2005. After considering CEG's representations, customer views, and the requirements of the Code, the Tribunal agreed to these revisions to the Access Arrangement.