

Submission to the Essential Services Commission

Re: Gas Full Retail Contestability - Multinet Adjustment Factor Process for FRC Recoverable Expenditure



Submitted by: Multinet Gas Distribution Partnerships

422 Warrigal Road

Moorabbin Vic 3189

Phone: (03) 9265 7738

Fax: (03) 9222 7887

Contact: Verity Watson

30 September 2005

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Summary

The Cost Recovery Order in Council (OIC) issued by the Government under section 68 of the Gas Industry Act provides for the setting of prices, fees and charges that a gas distribution company may charge in connection with the implementation of approved retail gas market rules, and for the recovery of those prices, fees and charges from gas Retailers.

The Essential Services Commission (Commission) has made Determinations in respect of Recoverable Expenditure and Operations and Maintenance Expenditure and has put in place a mechanism for the adjustment of prices, fees and charges set under those Determinations. This submission sets out Multinet Gas Distribution Partnership's (Multinet) response to the Commission request of 9 August 2005 in respect of that adjustment mechanism.

Specifically in Part A of this submission, Multinet seeks to:

- a) Advise of an underspend in Recoverable Expenditure for the period to 31 December 2004 of \$99,000.
- b) We seek to recover Operations and Maintenance expenditure for calendar year 2005 of \$5,029,332.

Part A also details Multinet's:

- a) actual revenue for the calendar year 2004 and the period to 31 August 2005 together with forecast revenue for the 4 month period from 1 September 2005 to 31 December 2005; and
- b) actual fee structuring parameters for calendar year 2004 and the period to 31 August 2005, together with forecast fee-structuring parameters for the 16 month period from 1 September 2005 to 31 December 2006.

In Part B of its submission, Multinet seeks to recover:

- a) An overrun in Operations and Maintenance expenditure in 2005 of \$141,160 plus the time value of money.
- b) Additional Recoverable Expenditure relating to capital expenditure for 2005 for the gas market release amounting to \$79,928.

Multinet's submission and the actual and forecast data contained therein has been audited by its external auditor in accordance with the requirements of the OIC and the Commission's letter of 9 August 2005.

1 Background

Full Retail Contestability (FRC) was introduced for all gas customers in Victoria from 1 October 2002. The Victorian Retail Gas Market Rules (Rules), initially approved in October 2001, set out the responsibilities of the various participants for the development and implementation of FRC.

The establishment of the Rules imposed additional obligations on gas Distribution Businesses (DBs), with respect to FRC, beyond those reasonably anticipated at the time when the gas distribution businesses were purchased. To enable DBs to recover the unanticipated costs of these additional obligations, the Government made an OIC under section 68 of the Gas Industry Act 2001. The OIC provides for DBs to make submissions to the Commission on the recovery of costs arising from the implementation of the Rules and for the Commission to make determinations in respect of cost recovery.

Clause 14 of the OIC required the Commission to put in place a mechanism to adjust the prices, fees and charges imposed by DBs for the recovery of the approved expenditure associated with FRC.

This submission by Multinet is in response to its obligations under the OIC and a request for information as set out in the Commission's letter dated 9 August 2005, in respect of the adjustment factor process for FRC Recoverable Expenditure. Multinet's response is in two parts, with Part A responding to clauses 1-4 of the Commission letter, whilst Part B responds to clause 5.

2 Commission Final Determination and Adjustment Process

In its Final Determination on the Annual Adjustment of Prices, Fees and Charges dated 30 November 2004, in relation to Multinet, the Commission determined in part:

- To approve a variation to Multinet's recoverable expenditure from \$17,375,910 for a change in 2003 capital expenditure amounting to \$32,000 and 2004 capital expenditure amounting to \$536,000.
- To approve a variation to Multinet's operations and maintenance expenditure for 2003-2005 from \$4,835,000 to \$4,955,000, an amount of \$120,000.
- To maintain Multinet's operations and maintenance expenditure for 2005 at \$4,888,000 as approved in its 2002 Determination.
- To set Multinet's Gas FRC prices, fees and charges for 2005 as set out in the tables on page 94 of the Final Determination.

The Commission, in its letter of 9 August 2005, has confirmed its approach to the adjustment factor process under which it will review a DB's actual and forecast capital, operations and maintenance expenditure, and revenue. It has also confirmed an extension to the time to 30 September 2005 for DBs to provide submissions in respect of additional capital expenditure.

In summary the Commission requires that a DB submit:

1. Audited records of actual capital expenditure compared to the Additional Expenditure accepted by the Commission in its 2004 Final Determination.
2. For the period 1 September 2004 to 31 August 2005, audited records for:
 - a) actual operations and maintenance expenditure (separately identifying expenditure for meter reading and meter data management, and non-meter reading and meter data management); and
 - b) revenue from all FRC services (separately identifying revenue for meter reading and meter data management, and non-meter reading and meter data management).
3. Audited records for:
 - a) operations and maintenance expenditure forecast to be incurred in the 16 month period from 1 September 2005 to 31 December 2006;
 - b) revenue forecast to be received in the four month period from 1 September 2005 to 31 December 2005.
4. Actual fee-structuring parameters for the period 1 September 2004 to 31 August 2005 and the forecast fee-structuring parameters for the 16 month period from 1 September 2005 to 31 December 2006.

These requirements for capital, operating and maintenance, revenue and fee structuring parameters are covered in Part A of this submission.

A separate submission is required by the Commission where one or more of the following circumstances applies:

- a) actual operations and maintenance expenditure is greater than that approved by the Commission in the 2002 Final Determination and the 2003/2004 Final Determinations (as appropriate);
- b) a request is to be made for an increase in the prices, fees and charges set under clause 12 of the OIC as a result of a future requirement for additional capital expenditure not previously accepted in the 2002 Final Determination and the 2003/2004 Final Determination;
- c) a request is to be made for an increase in the prices, fees or charges set under clause 12 of the OIC as a result of lower volumes and / or customer numbers than forecast and the increase is greater than CPI.

Clauses (a), (b) and (c) are covered in Part B of this submission.

3 Audit

The OIC and the Commission's Adjustment Factor Process require that expenditure or revenue records and forecasts be accompanied by an external audit report, which:

- Shall express an opinion as to whether each item of expenditure (incurred or to be incurred) complies with each of the Cost Recovery Principles contained in clause 15 of the Order;
- Set out the basis for that opinion and the enquiries the auditor has conducted and the material that it has had regard to in preparing its report; and
- Not express an opinion as to the reasonableness of expenditure unless the auditor is of the opinion, and has expressed that opinion, that each identified item of expenditure complies with each of the Cost Recovery Principles contained in clause 15 of the Order.

Multinet engaged its external auditor Ernst & Young to perform this function and the report has been provided in hardcopy to the Commission. The report in summary states:

"Audit opinion

In our opinion, the actual expenditure and revenue presented in the submission to the ESC has been incurred in compliance with the budget and cost approval process approved by the ESC pursuant to clause 7.

We report that the expenditure incurred, by line item, was consistent with the ESC Final Determination budget and variances were minimal and reasonable.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that causes us to believe that the forecast expenditure and forecast revenue as detailed in the submission is not reasonable in accordance with the ESC Final Determination Budget or does not comply with the budget and cost approval process approved by the Commission pursuant to Clause 7.

We report that the forecasts by line item were consistent with the ESC Final Determination budget and nothing has come to our attention to indicate that the forecasts are not reasonable."

The report also provides statements in relation to each of the cost recovery principles.

Part A

4 Recoverable Expenditure

4.1 Approved Recoverable Expenditure

In its submission¹ to the Commission, dated 1 October 2004, Multinet sought additional capital expenditure for the period 2002-2004 for changes related to the Retail Gas Market Rules and for system enhancements for both 2002/03 and 2004. The Commission approved Multinet's claim in part.

The 2004 Final Determination as set out below summarises Multinet's submission and the Commission's Determination.

Multinet Approved Capital Expenditure Change

Multinet Capital Expenditure	Final Determination 2003	Additional Expenditure claimed by Multinet	Additional Expenditure Accepted by Commission 2004 Determination
Approved project expenditure	\$17,375,910		
2002/03 Capital Change		\$245,000	\$32,000
2004 Capital Change		\$610,000	\$536,000
Sub-Total 2002/03 and 2004 Capital Expenditure Change		\$855,000	\$568,000
2003 Determination		\$17,375,910	\$17,375,910
Total Capital Expenditure		\$18,230,910	\$17,943,910

4.2 Actual Recoverable Expenditure

The Commission allowed additional capital expenditure for the period 2002/04 totalling \$568,000 in the 2004 Final Determination as detailed above.

4.2.1 2002/03 expenditure

The 2002/03 expenditure relates to changes undertaken by Multinet as a result of VENCORP system modifications. As the Commission considered this expenditure in both the 2003 and 2004 Determination processes, and assessed the expenditure as consistent with the Cost Recovery Principles², Multinet does not believe that it is required to submit further information on this matter.

¹ Multinet, 1 October 2004, Gas FRC Multinet Adjustment Factor Process for FRC Recoverable Expenditure

² ESC, 30 November 2004, Annual Adjustment of Prices, Fees and Charges 2004- Final Determination, p86

4.2.2 2004 expenditure

The Commission's approved additional capital expenditure for 2004 comprising:

	Item	Approved Capital
1	CR 7A, 40, 42, 50, 53	\$168,000
2	AseXML upgrade	\$56,000
3	CR 14b, 37,49,51,55,61 plus testing and project management	\$267,000
4	2 nd tier reconciliation	\$45,000

In relation to items 1, 2 and 4 above, Multinet submitted to the Commission audited, actual expenditure for these items as part of the 2004 submission. The Commission subsequently accepted this expenditure as being consistent with the Cost Recovery Principles therefore Multinet does not believe that it is required to submit further information on this expenditure.

For item 3, Multinet submitted audited actual expenditure to August 2004 of \$117,000 and a forecast amount of \$150,000 for the balance of the project. As the Commission has already accepted the initial actual expenditure of \$117,000, Multinet believes that it is only necessary to address the remaining expenditure post August 2004 as part of this submission.

As the Commission is aware the above change requests were implemented in November 2004. In the period September – December 2004, Multinet completed the outstanding system build, undertook internal testing and participated in industry-wide testing and commissioning of the changes.

Multinet was able to implement the outstanding work for less than the \$150,000 forecast and now seeks to recover only \$51,000 in actual expenditure, bringing the total project cost to \$168,000 (underspend \$99,000). Multinet believes this additional expenditure to have been prudent and reasonable.

5 Operations and Maintenance Expenditure

5.1 Approved Operations and Maintenance Expenditure for 2005 (exclusive of Special Meter read costs)

For 2005, the Commission's 2004 Final Determination provided an amount of \$4,888,000 for Operations and Maintenance Expenditure exclusive of the costs of Special Meter Reads.

5.2 Actual Operations and Maintenance Expenditure for 2005 (exclusive of Special Meter Read costs)

Multinet's Operations and Maintenance expenditure for 2005 amounts to \$5,029,332 or 2.9% over the Commission's Determination amount. The figure comprises actual expenditure to 31 August 2005 of \$3,329,724 and forecast expenditure to the end of 2005 amounting to \$1,699,608. The cost over run is \$141,160.

Meter reading, meter data management and other FRC systems and processes are undertaken by third parties on Multinet’s behalf, under commercial contracts. As previously advised the cost structures within the controlling contracts do not directly translate to the line item categories set out in Multinet’s July 2002 submission and the ESC’s 2002 Determination. As with previous submissions, Multinet has allocated costs incurred on the basis of the work breakdown used for its July 2002 submission and the ESC approved FTE numbers.

Multinet has then applied the meter reading percentage allocation set out in the ESC FRC cost model used as part of the 2002 Final Determination to arrive at the meter reading, meter data management charge and the non meter reading charge (ie other FRC cost) split required. While there may be some minor variation between line item allocations, and thus the final meter reading / non-metering allocation, these are considered not to be material given that the overall costs approximate the ESC Determination.

Multinet’s initial 2002 submission was based on average churn rates of 5%, however gas FRC has continued to experience rates significantly higher than this figure. As a result, Multinet has found it necessary to maintain a higher level of resourcing to deal with customer transfers, MIRN discovery queries and errors and error queue management in relation to many end to end processes, including any meter and meter data communications; and meter reading, data validation and substitution, and meter data queries.

Multinet therefore considers that the higher level of costs being incurred accurately reflects the real workload involved and given the minimal level of cost overrun that the costs are both prudent and efficient.

5.3 Forecast Operations & Maintenance Expenditure for 2006 (excluding special meter reads)

Multinet’s Operations and Maintenance expenditure for 2006, exclusive of Special Meter Reading expenditure, is forecast to be \$5,010,000, the same figure as forecast in the Commission’s 2004 Determination.

5.3.1 Summary of Operations and Maintenance Costs

(\$ OF DAY)	Actual Costs 1 Jan 2004 to 31 Aug 2004	Actual Costs 1 Sep 2004 to 31 Dec 2004	Actual Costs 1 Jan 2005 to 31 Aug 2005	Forecast Costs 1 Sep 2005 to 31 Dec 2005	Forecast Costs for Full Year to 31 Dec 2006
Meter Reading & Meter Data Management	2,169,869	1,094,483	2,204,301	1,103,577	3,360,000
Non Meter Reading & Meter Data Management (other FRC)	1,108,563	592,881	1,125,423	596,031	1,650,000

5.4 Special Meter Reading Costs

5.4.1 Approved Special Meter Reading Costs

Multinet's approved Special Meter Reading Expenditure under the Commission's 2004 Final Determination amounted to \$742,969 for 2005.

5.4.2 Actual Special Meter Reading Costs to 31 August 2005

Actual costs for the 8 months to 31 August 2005 amounted to \$528,169 or 71% of the Commission's annual determination with total costs for the year forecast to be \$793,918 or 6.9% higher than the 2004 Determination. This higher level of costs reflects the higher proportion of service requests being received and actioned.

5.4.3 Forecast Special Meter Reading Costs - 2006

Multinet's Special Meter Reading Costs for the period 1 January 2006 to 31 December 2006 are forecast to be \$798,559. Volumes of special meter reads have been revised to reflect current levels of requests.

5.4.4 Special Meter Reading Costs Summary

(\$ OF DAY)	Actual Costs 1 Jan 2004 to 31 Aug 2004	Actual Costs 1 Sep 2004 to 31 Dec 2004	Actual Costs 1 Jan 2005 to 31 Aug 2005	Forecast Costs 1 Sep 2005 to 31 Dec 2005	Forecast Costs for Full Year to 31 Dec 2006
SMR Reading Costs	491,112	265,749	528,169	264,637	798,559

6 Revenue

6.1 Approved Recoverable Revenue

Clauses 12 and 13 of the Cost Recovery OIC provide for the Commission to determine prices, fees and charges to enable gas distributors to recover recoverable capital expenditure, and operations and maintenance expenditure.

The fee structure determined by the Commission treats customers as either a fixed payment customer (those using more than the maximum variable volume charge of 5,000 GJ pa), or fixed and volume (\$/GJ) customers (being those using less than the maximum variable volume charge of 5,000 GJ pa.)

6.2 Actual and Forecast Revenue to 31 December 2005

6.2.1 FRC Revenue

Multinet's actual and forecast 2005 revenue is \$9,146,623 compared to the Commission's Determination for revenue of \$9,292,481³. This corresponds to an under-recovery of \$145,859 or 1.6%, which is largely attributed to the lower volume

³ Ibid., Table 6.11, p94.

of gas delivered than that forecast. This type of variation is expected as part of this process where revenue is dependent on both customer number and gas volumes consumed.

6.2.2 Special Meter Reading Revenue

Multinet’s actual and forecast special read revenue for 2005 is \$789,810 compared to the Commission’s Determination for revenue of \$742,969⁴. This variance of \$46,841 is due to the variation in the number of reads. Multinet has undertaken 75,162 special reads to the end of August and forecasts a total for the year of 112,830 compared to the Commission’s Determination figure of 106,327⁵.

6.3 Revenue Summary

(\$ of day)	Actual Revenue 1 Jan 2004 to 31 Aug 2004	Actual Revenue 1 Sep 2004 to 31 Dec 2004	Actual Revenue 1 Jan 2005 to 31 Aug 2005	Forecast Revenue 1 Sep 2005 to 31 Dec 2005
Meter Reading & Meter Data Management (incl SMR revenue)	4,337,288	1,860,873	3,915,486	1,678,699
Non Meter Reading & Meter Data Management Revenue (other FRC)	2,628,027	1,119,456	2,486,613	1,065,825
Special Meter Reading Revenue	491,496	268,319	526,134	263,676

7 Fee Structuring

7.1 Parameters

Actual gas volumes delivered in the September - December 2004 period were approximately 2.5% lower than forecast, while actual and forecast 2005 gas volumes are approximately 5.4% lower than forecast in Multinet's 2004 submission, due to a milder winter than expected.

Customer numbers are close to those predicted in Multinet's 2004 submission.

Forecast customer numbers and load growth for 2006 are based on historic trends and NIEIR forecasts, and are subject to external factors, particularly weather. Variations in these factors will impact the volume of gas delivered and revenues recovered.

The actual number of special reads for calendar year to 31 August 2005 was 75,162 with a further 37,668 reads forecast to end of 2005. In view of the number of special

⁴ Ibid., Table 6.9, p93.

⁵ \$742,969 divided by \$7 per read.

reads for 2005 being slightly higher than forecast, the 2006 forecast has been increased accordingly.

7.2 Summary

FEE STRUCTURING PARAMETERS	Actual 1 Jan 2004 to 31 Aug 2004	Actual 1 Sep 2004 to 31 Dec 2004	Actual 1 Jan 2005 to 31 Aug 2005	Forecast 1 Sep 2005 to 31 Dec 2005	Forecast for Full Year to 31 Dec 2006
Total GJ-Volume for <5,000GJ Customer Group	32,935	11,836	30,738	12,067	45,546
Total Number of <5,000GJ Customers	636,035	640,090	643,582	647,725	652,930
Total Number of >5,000GJ Customers (includes tariff D)	434	475	484	484	492
Number of Special Meter Reads	70,214	38,331	75,162	37,668	113,737

Part B

As referred to in Section 2 of this submission, the Commission require a separate submission where one or more of the following circumstances applies:

- a) actual operations and maintenance expenditure is greater than that approved by the Commission in the Final Determination;
- b) a request is to be made for an increase in the prices, fees and charges set under clause 12 of the OIC as a result of a future requirement for additional capital expenditure;
- c) a request is made for an increase in the prices, fees or charges set under clause 12 of the OIC as a result of lower volumes and / or customer numbers than forecast and the increase is greater than CPI.

8 Additional Expenditure

Multinet seeks to claim additional expenditure in the following areas:

- additional actual operations and maintenance expenses in 2005; and
- an increase in the prices, fees and charges set under clause 12 of the OIC as a result of additional capital expenditure in 2005 and to reserve its right to claim additional capital for future years in the October annual submissions.

8.1 Additional Actual Operations and Maintenance

As discussed in Part A, Section 5.2, 2005 operating costs are expected to slightly overrun the Commission Determination by \$141,160. Multinet seeks to claim this additional expenditure (including the time value of money) as prudent and efficient in light of the level of activity experienced, and recommends that the overrun be added into the reforecast 2006 operating and maintenance costs.

2006 O&M Adjustment	2006 Amount \$
O&M costs incurred above determined amount in 2005, \$ of day	141,160
Time Value of Money	3,529
Total 2006 O&M Adjustment	144,689

8.2 Additional Capital Expenditure

8.2.1 Additional Actual Capital expenditure January-August 2005

In July 2005, Change Request (CR) 68 for Non PTS FRC Services was implemented. The purpose of CR 68 was to provide common FRC systems and services for all Victorian gas customers, an approach endorsed by the Commission in its letter to VENCORP dated 27 September 2004 as being “...more efficient than industry developing separate systems for non-PTS networks.”

Key tasks involved in delivering CR 68 included:

- Testing of the aseXML schema to accommodate the inclusion of the Network_id,
- Certification of the schema release, and
- Bi-lateral testing of back-end systems with affected participants.

Total industry costs (including VENCORP) were estimated at \$617,000 for CR 68 with an additional \$228,000 for all-inclusive industry testing including implementing and testing the new aseXML schema version (R16).

Multinet modified its systems to meet the requirements of CR 68 as set out in the Release Document issued in March 2005. At the time, as Multinet had no reason to interface with a non-PTS, changes were limited to the aseXML upgrade, stopping possible requests for other network identifiers at its system gateway and participating in industry testing. Multinet now seeks to recover its audited, actual costs for this work of \$79,928 as fair and reasonable and prudent expenditure. Multinet considers this expenditure has been driven by market requirements, could not have been reasonably anticipated and as endorsed by the Commission represents a more efficient industry approach to resolving a state-wide issue.

In August 2005, Multinet was announced as the successful bidder for the South Gippsland network construction under the Victorian Government Natural Gas Extension Project. Multinet will need to modify FRC systems to accommodate this non-PTS system. However, as customer connections are not expected before 2007, Multinet is not proposing to make a submission on this work at this time.

8.2.2 Forecast Additional Capital Expenditure 2006-2007

Multinet believes that the OIC was predicated on the basis of a Distributor being able to forecast the expected cost of capital expenditure to be incurred and for the Commission to make a determination for recoverable expenditure purposes based on such forecasts. Further clause 12(12) clearly empowers the Commission to set prices, fees and charges based in part on such forecast expenditure. In its 2003 Determination, the Commission adopted an approach of rejecting forecast capital expenditure due to “*a degree of doubt about the scope and timing*” of such expenditure. Multinet does not support this approach.

Multinet believes that, as has happened in past years, Distributors will be required to fund works associated with market releases such as CR80 (relating to MORN listing)⁶, transitional changes arising from the wholesale market project (21 hour day billing and possible MIBB report changes) and other miscellaneous works during the coming period. At the time of this submission, Multinet is unable to meet the Commission’s expectation with respect to forecast expenditure as set out in the 2004 Determination on page 31 where the Commission stated “*...businesses will substantiate their claims by providing full details about the expenditure, including a detailed scope of the work, costing based on that scope of work and a defined project schedule.*”

Multinet proposes not to make any submission for forecast capital expenditure for the 2006/07 period at this time, rather it will seek to recover any future capital expenditure related to industry and internal change requests when scope and timings are more certain.

⁶ Note: expected to be considered by the RMCC at the October 2005 meeting.

Appendix 1: COMMISSION Tables

Table 1 Multinet Capital Expenditure

	2004 Determination	Multinet Submission
Revised approved project expenditure ⁽¹⁾	\$17,943,910	
2004 Capital Change		
Underspend 2004 Industry change No2		-\$99,000
2005 Capital Change		
CR 68		+\$79,928
2006 Capital Change		
Not applicable		Nil
Sub-total 2006 Capital Change		+\$0
Sub-total 2004,2005 change		-\$19,072
Total Capital Expenditure		\$17,924,838

⁽¹⁾ ESC 2004 Determination

Table 2: Multinet Operation and Maintenance Expenditure

(\$ OF DAY)	Actual Costs 1 Jan 2004 to 31 Aug 2004	Actual Costs 1 Sep 2004 to 31 Dec 2004	Actual Costs 1 Jan 2005 to 31 Aug 2005	Forecast Costs 1 Sep 2005 to 31 Dec 2005	Forecast Costs for Full Year to 31 Dec 2006
Meter Reading & Meter Data Management	2,169,869	1,094,483	2,204,301	1,103,577	3,360,000
Non Meter Reading & Meter Data Management (other FRC)	1,108,563	592,881	1,125,423	596,031	1,650,000
Special Meter Reading Costs	491,112	265,749	528,169	264,637	798,559

Table 3: Multinet Revenue

(\$ of day)	Actual Revenue 1 Jan 2004 to 31 Aug 2004	Actual Revenue 1 Sep 2004 to 31 Dec 2004	Actual Revenue 1 Jan 2005 to 31 Aug 2005	Forecast Revenue 1 Sep 2005 to 31 Dec 2005
Meter Reading & Meter Data Management	4,337,287	1,860,873	3,915,485	1,678,699
Non Meter Reading & Meter Data Management Revenue (other FRC)	2,628,027	1,119,456	2,486,613	1,065,825
Special Meter Reading Revenue	491,496	268,319	526,134	263,676

Table 4: Fee Structuring Parameters

FEE STRUCTURING PARAMETERS	Actual 1 Jan 2004 to 31 Aug 2004	Actual 1 Sep 2004 to 31 Dec 2004	Actual 1 Jan 2005 to 31 Aug 2005	Forecast 1 Sep 2005 to 31 Dec 2005	Forecast for Full Year to 31 Dec 2006
Total GJ-Volume for <5,000GJ Customer Group	32,935	11,836	30,738	12,067	45,543
Total Number of <5,000GJ Customers	636,035	640,090	643,582	647,725	652,930
Total Number of >5,000GJ Customers (includes tariff D)	434	475	484	484	492
Number of Special Meter Reads	70,214	38,331	75,162	37,668	113,737