

# Final decision: Jemena Gas Networks (NSW) 2015–20

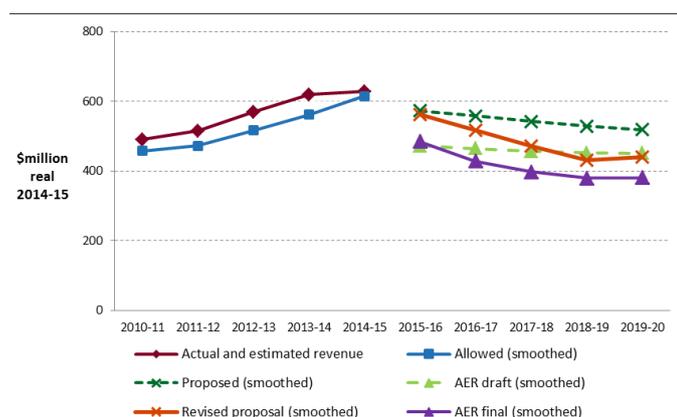
We have made a final decision on the access arrangement for Jemena Gas Networks (NSW) Ltd (JGN). JGN is the largest gas distribution network operator in NSW. Our final decision allows JGN to recover \$2,229.0 million (\$ nominal, smoothed) from its customers over five years commencing 1 July 2015.

## Overview

The Australian Energy Regulator (AER) approves access arrangements for JGN and other major gas networks in eastern and southern Australia under the National Gas Law (NGL) and National Gas Rules (NGR).

Our final decision allows JGN to recover \$2229.0 million (\$nominal, smoothed) over the 2015-20 access arrangement period. If we had accepted JGN's proposal, it would have recovered \$2605.2 million (\$nominal) over the 2015-20 period. Our final decision is 14.4% less than JGN's proposal.

### JGN's' past total revenue, proposed total revenue and AER final decision revenue allowance (\$ million, \$2014–15)



Our final decision allows JGN to recover \$2,229.0 million (\$ nominal, smoothed) from its customers over five years commencing 1 July 2015. As a result of our forecast of lower total revenue, we expect the average annual gas bill to fall by around 9.2 per cent for residential and small business customers. This translates into a \$96 reduction in bills for residential customers and a \$462 reduction for small business customers. Bills will continue to fall over the following three years, before a small increase of 1 per cent in 2019-20.

The revenue we determined in this final decision affects the distribution component of a customer's final gas bill. Distribution charges are only one component of the customer's gas bill, which also includes wholesale, transmission and retail costs.

## Our assessment

Most Australian distribution networks are subject to full regulation, which requires the service provider to submit an initial access arrangement to the regulator for approval, and revise it periodically. An access arrangement sets out the terms and conditions under which third parties can use a pipeline. It must specify at least one reference service likely to be sought by a significant part of the market, and a reference tariff for that service.

Our assessment process includes a building block approach to determine total network revenues and derive reference tariffs.

Together, the building blocks add up to the total revenue JGN can earn through levying reference tariffs on customers. In this way, it should recover no more than the efficient cost of providing pipeline services to its customers.

## Capital expenditure

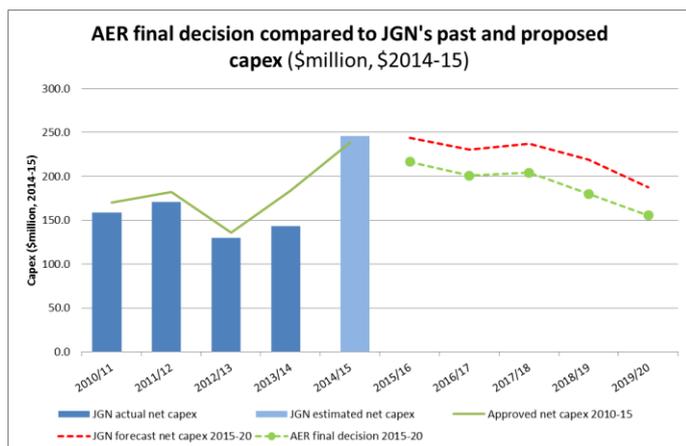
Capex refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence the required level of capex include expected growth in the network and the age and condition of existing assets.

We have approved total forecast capex of \$957.2 million (\$2014-15) for the 2015-20 access arrangement period. This is 14.4 per cent lower than the \$1118.3 million (\$2014-15) proposed by JGN.

We must be satisfied that the level of capex reflects costs that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

Most of our capital expenditure adjustments are to JGN's cost estimates for new residential connections, facilities renewal and upgrade and overheads.

### AER final decision compared to JGN's past and proposed capex (\$million, \$2014-15)



## Operating expenditure

Opex includes forecast operating, maintenance and other non-capital costs incurred in the provision of gas distribution services. It includes labour costs and other non-capital costs that JGN is likely to require during the 2015-20 access arrangement period for the efficient operation of its network.

We have estimated total forecast opex of \$800 million (\$2014-15) for JGN for the 2015-20 access arrangement period.

We must be satisfied that the level of opex reflects costs that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

Our opex forecast is one per cent less than the \$808.2 million (\$2014-15) JGN proposed. This is because we have forecast lower input price growth than JGN over the 2015-20 access arrangement period. Our forecast also excludes the step

change increase in opex JGN proposed for its asbestos meter cover removal program. We consider that JGN can fund this program without a step change.

### AER final decision compared to JGN's past and proposed opex (\$million, \$2014-15)



## Rate of return

Significant investment is required to build and maintain a gas distribution network. The return JGN must pay lenders and investors is referred to as the rate of return. Even a small difference in the rate of return can have a big impact on revenues.

Our final decision sets the allowed rate of return (or 'cost of capital') at 5.41 per cent (nominal vanilla) for 2015-16. We have not accepted JGN's proposal for rate of return of 7.06 per cent.<sup>i</sup>

The investment environment has improved since our previous decision, which was made during the height of uncertainty surrounding the global financial crisis. This improved investment environment translates to lower financing costs necessary to attract efficient investment. We consider that JGN has sought a rate of return that is higher than necessary given the current investment environment.

In our final decision we did not accept the methodology proposed by JGN to set its rate of return. Instead, we have used our methodology developed with extensive consultation during our Better Regulation program in 2013. We consider that our approach provides for a rate of return that better reflects the allowed rate of return objective.

The lower rate of return in this decision will reduce JGN's average revenue compared to the past.

More information on our final decision can be found on our website: [www.aer.gov.au](http://www.aer.gov.au).

<sup>i</sup> The rate of return JGN included in its revised proposal is an indicative value. Its proposal includes provision for the AER to adjust this value based on updated information that was not available when JGN submitted its revised proposal. More information on the rate of return can be found in our Rate of Return Fact Sheet.