evoenergy

Appendix 3.2: The Hon. John Middleton, AM KC legal opinion of the AER's draft decision

Revised 2026–31 access arrangement information

ACT and Queanbeyan-Palerang gas network access arrangement 2026–31

Submission to the Australian Energy Regulator

January 2026

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Legal Opinion

To	Megan Willcox General Manager, Economic Regulation Evoenergy	**Your reference**
From	The Hon. John Middleton, AM KC Senior Advisor	**Our reference** BRE/BRE/354593/41 AUM/1302340613.1
Date	13 January 2026	

The question

1 Evoenergy owns and operates the gas distribution network in the ACT and the Queanbeyan-Palerang region of NSW. Evoenergy's network is a 'scheme pipeline' for the purposes of the National Gas Law (**NGL**) and National Gas Rules (**NGR**), and Evoenergy is subject to economic regulation under the NGL and NGR.

2 On 30 June 2025, Evoenergy submitted its Access Arrangement proposal for the period of 1 July 2026 to 30 June 2031 (**2026 – 2031 Period**) to the AER. The AER released its draft decision on Evoenergy's Access Arrangement proposal on 28 November 2025 (**Draft Decision**).

3 Evoenergy is concerned with the AER's Draft Decision and has asked for a legal opinion as to the legality of the Draft Decision. In particular, Evoenergy has asked for a legal opinion on the legality of the following two aspects of the Draft Decision:

3.1 the AER's decision on accelerated depreciation, in particular:

(a) the decision to extend the economic lives of Evoenergy's medium pressure (**MP**) mains and high pressure (**HP**) mains beyond 2045, being the legislated date by which the ACT must reach net zero emissions; and

(b) the decision to calculate additional revenue for accelerated depreciation using a 'base' real network price increase limit of 4%; and

3.2 the fact that the AER seeks to minimise any risk borne by consumers under the Draft Decision, with various components of the Draft Decision shifting the majority of risk to Evoenergy.

Summary of opinion

The AER's Draft Decision regarding depreciation is unlawful

4 The AER's Draft Decision regarding depreciation, which extends the economic lives of Evoenergy's MP and HP mains beyond 2045, and allows for an additional amount of

accelerated depreciation calculated using a base real network price increase limit of 4%, is unlawful because:

4.1 the Draft Decision is not supported by any evidence, and is therefore invalid;

4.2 the Draft Decision regarding depreciation, and thus, Evoenergy's Access Arrangement, contravene rules 68B(1)(b) and 89(1) of the NGR, as the depreciation schedule is inconsistent with the criteria set out in rule 89(1);

4.3 the Draft Decision regarding depreciation, and thus, Evoenergy's Access Arrangement, are inconsistent with the National Gas Objective (**NGO**) and the revenue and pricing principles, and accordingly contravene section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR;

4.4 the AER has had regard to irrelevant considerations in making its Draft Decision, with the effect that the Draft Decision is an improper exercise of the power conferred by the NGL and NGR; and

4.5 the Draft Decision is unreasonable.

Various other components of the Draft Decision are unlawful

5 Various other components of the Draft Decision are unlawful because:

5.1 they are contrary to the scheme of the NGL and NGR incentives based economic regulatory regime;

5.2 they are inconsistent with the NGO and the revenue and pricing principles, and accordingly contravene section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR; and

5.3 they are unreasonable.

The legal framework

6 The legal framework governing the making of the AER's Draft Decision is primarily contained in the NGL and Parts 8 and 9 of the NGR. Each of the NGL and NGR set out a range of considerations that the AER must have regard to when making its decision on an access arrangement, and a range of the factors that the AER may have regard to.

7 Any decision the AER makes must be made within the confines of its powers as set out in the NGL and NGR. These powers, and their limits, are summarised below (as relevant).

Relevant NGL provisions

8 When making a final decision on Evoenergy's Access Arrangement, the AER will be 'exercising an economic regulatory function or power'.[1] In doing so, the AER must perform or exercise the economic regulatory function or power in a manner that is consistent with the National Gas Objective (**NGO**).[2] The NGO is to:

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1 See the definition of 'AER economic regulatory function or power' in section 2 of the NGL, which expressly includes a function or power exercised by the AER that relates to an applicable access arrangement decision.

2 NGL, section 28(1)(a).

> …promote efficient investment in, and efficient operation and use of, covered gas services for the long term interests of consumers of covered gas with respect to -
>
> (a) price, quality, safety, reliability and security of supply of covered gas; and
>
> (b) the achievement of targets set by a participating jurisdiction –
>
> (i) for reducing Australia's greenhouse gas emissions; or
>
> (ii) that are likely to contribute to reducing Australia's greenhouse gas emissions.

9 Paragraph (b) was introduced in 2023.

10 Additionally, the AER must take into account the revenue and pricing principles set out in section 24 of the NGL when it exercises a discretion in approving or making those parts of an access arrangement relating to a reference tariff.[3] The AER may take into account the revenue and pricing principles when performing or exercising any other economic regulatory function or power.[4]

11 The revenue and pricing principles are set out below:

> (1) The revenue and pricing principles that apply in relation to a pipeline service provided by means of a scheme pipeline are the principles set out in subjections (2) to (7).
>
> (2) A scheme pipeline service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs in—
>
> (a) providing reference services; and
>
> (b) complying with a regulatory obligation or requirement or making a regulatory payment.
>
> (3) A scheme pipeline service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides. The economic efficiency that should be promoted includes—
>
> (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
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> (b) the efficient provision of pipeline services; and
>
> (c) the efficient use of the pipeline.
>
> (4) Regard should be had to the capital base with respect to a pipeline adopted—
>
> (a) in any previous—
>
> (i) access arrangement decision; or
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> (ii) decision of a relevant Regulator under section 2 of the Gas Code;

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3 NGL, section 28(2)(a).

4 NGL, section 28(2)(b).

(b) in the Rules.

(5) A reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which that tariff relates.

(6) Regard should be had to the economic costs and risks of the potential for under and over investment by a scheme pipeline service provider in a pipeline with which the service provider provides pipeline services.

(7) Regard should be had to the economic costs and risks of the potential for under and over utilisation of a pipeline with which a scheme pipeline service provider provides pipeline services.

12 The NGO and the revenue and pricing principles are complementary and operate together; the long-term interests of consumers are served by the recovery by service providers of at least their efficient costs. A decision which is inconsistent with the revenue and pricing principles cannot be a decision that will, or is likely to, contribute to the achievement of the NGO.

13 This has been recognised by the Australian Competition Tribunal, including in *Re Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3.[5] While this decision was made in the context of the National Electricity Law (**NEL**), National Electricity Rules (**NER**), and the National Electricity Objective (**NEO**), it is similarly applicable to the NGO and the revenue and pricing principles in the NGL.[6]

Relevant NGR provisions

14 Parts 8 and 9 of the NGR govern access arrangements for scheme pipelines and price and revenue regulation for scheme pipelines, respectively.

Part 8 NGR: Access arrangements for scheme pipelines

15 Rule 68B of the NGR includes a requirement that the provisions of an access arrangement must be consistent with the NGO, and the NGR and any procedures made under the NGR.

68B General requirement for consistency

(1) The provisions of an access arrangement must be consistent with:

(a) the national gas objective; and

(b) these rules and Procedures as in force when the terms and conditions of the access arrangement are determined or revised;

(2) In deciding whether the non-tariff terms and conditions of an access arrangement are appropriate, the AER must have regard to the risk-sharing arrangements implicit in the reference tariff.

Part 9 NGR: Price and revenue regulation for scheme pipelines

16 Rule 76 of the NGR requires a scheme pipeline service provider's revenue to be determined using the building block approach, as follows:

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5 *Re Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3 at [15].

6 The Australian Competition Tribunal has observed that the revenue and pricing principles in the NEL are in similar terms to s 24(2) of the NGL, and has, on numerous occasions, considered the NGO and NEO together (see, for example, *Application by DBNGP (WA) Transmission Pty Ltd (No 3)* [2012] ACompT 14; *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1).

76 Total revenue

Total revenue is to be determined for each regulatory year of the access arrangement period using the building block approach in which the building blocks are:

(a) a return on the projected capital base for the year (See Divisions 4 and 5); and

(b) depreciation on the projected capital base for the year (See Division 6); and

(c) the estimated cost of corporate income tax for the year (See Division 5A); and

(d) increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency (See Division 9); and

(e) a forecast of operating expenditure for the year (See Division 7).

17 The balance of Part 9 of the NGR contains a range of provisions that relate to the different building block components set out in rule 76. Rules 88 and 89 relate to depreciation. In essence, the access arrangement is to contain a depreciation schedule, which should be designed having regard to specified depreciation criteria.

88 Depreciation schedule

(1) The depreciation schedule sets out the basis on which the pipeline assets constituting the capital base are to be depreciated for the purpose of determining a reference tariff.

(2) The depreciation schedule may consist of a number of separate schedules, each relating to a particular asset or class of assets.

89 Depreciation criteria

(1) The depreciation schedule should be designed:

(a) so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services; and

(b) so that each asset or group of assets is depreciated over the economic life of that asset or group of assets; and

(c) so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets; and

(d) so that (subject to the rules about capital redundancy), an asset is depreciated only once (ie that the amount by which the asset is depreciated over its economic life does not exceed the value of the asset at the time of its inclusion in the capital base (adjusted, if the accounting method approved by the AER permits, for inflation)); and

(e) so as to allow for the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.

(2) Compliance with subrule (1)(a) may involve deferral of a substantial proportion of the depreciation, particularly where:

(a) the present market for pipeline services is relatively immature; and

(b) the reference tariffs have been calculated on the assumption of significant market growth; and

(c) the pipeline has been designed and constructed so as to accommodate future growth in demand.

18 Rule 91 relates to operating expenditure (**opex**), and requires the AER's decision on opex to reflect the amount incurred by a prudent service provider acting efficiently and in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services in a manner consistent with the achievement of the NGO.

91 Criteria governing operating expenditure

(1) Operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services in a manner consistent with the achievement of the national gas objective.

(2) The forecast of required operating expenditure of a pipeline service provider that is included in the access arrangement must be for expenditure that is allocated between:

(a) reference services;

(b) other services provided by means of the scheme pipeline; and

(c) other services provided by means of non-scheme parts (if any) of the pipeline,

in accordance with rule 93.

19 Rule 92 provides that an access arrangement must include a mechanism (a reference tariff variation mechanism (**TVM**)) for variation of a reference tariff over the course of an access arrangement period. Rule 92(2) sets out how this requirement must be operationalised, as follows:

(2) Except to the extent that subrule (3) applies, the reference tariff variation mechanism must be designed to equalise (in terms of present values):

(a) forecast revenue from reference services for the access arrangement period; and

(b) the portion of total revenue allocated to reference services for the access arrangement period.

20 Rule 97 sets out the factors that the AER must have regard to when deciding whether a TVM is appropriate. These factors are set out below.

97 Mechanics of reference tariff variation

…

(3) in deciding whether a particular reference tariff variation mechanism is appropriate to a particular access arrangement, the AER must have regard to:

(a) the need for efficient tariff structures; and

(b) the possible effects of the reference tariff variation mechanism on administrative costs of the AER, the service provider, and users or potential users; and

(c) the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed reference tariff variation mechanism; and

(d) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and

(d1) the risk sharing arrangements implicit in the access arrangement; and

(e) any other relevant factor

…

21 Rule 98 governs incentive mechanisms. It provides that an access arrangement may include one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider. Any incentive mechanism must be consistent with the revenue and pricing principles.

98 Incentive mechanism

(1) An access arrangement may include (and the AER may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.

(2) An incentive mechanism may provide for carrying over increments for efficiency gains and decrements for losses of efficiency from one access arrangement period to the next.

(3) An incentive mechanism must be consistent with the revenue and pricing principles.

Australian Competition Tribunal decisions

22 The NGL and NGR have been considered extensively by the Australian Competition Tribunal. Previous Tribunal decisions provide guidance on two fundamental components of the legal framework, being:

22.1 the NGO and the revenue and pricing principles; and

22.2 the scheme of the NGL and NGR incentives-based economic regulatory regime.

The NGO and revenue and pricing principles

23 As noted above, the provisions of an access arrangement must be consistent with the NGO, and the AER must make its final decision in a manner that will or is likely to achieve the NGO.

24 The Australian Competition Tribunal has considered the objectives of the NGO on numerous occasions. In particular, the Tribunal has observed (in *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1 at [77]) that:

> The ultimate objective reflected in the NEO and NGO is to direct the manner in which the national electricity market and the national natural gas market are regulated, that is, in the long term interests of consumers of electricity and natural gas respectively with respect to the matters specified. The provisions proceed on the legislative premise that their long term interests are served through the promotion of efficient investment in, and efficient operation and use of, electricity and natural gas services. This promotion is to be done "for" the long term interests of consumers. It does not involve a balance as between efficient investment, operation and use on the one hand and the long term interest of consumers on the other. Rather, the necessary legislative premise

> is that the long term interests of consumers will be served by regulation that advances economic efficiency.

25 In short, the NGO does not require any balancing of the long term interests of consumers, on the one hand, and economic efficiency, on the other. Rather, the long term interests of consumers will be served by regulation that enhances economic efficiency.

26 The revenue and pricing principles recognise that economic efficiency will be promoted by service providers being able to recover at least their efficient costs.[7] This has been recognised by the Australian Competition Tribunal in *Application by EnergyAustralia and Others* [2009] ACompT8 at [77] – [78]:

> It might be asked why the NEL principles require that the regulated NSP be provided with the opportunity to recover at least its efficient costs. Why 'at least'? The issue of opportunity is critical to the answer. The regulatory framework does not guarantee recovery of costs, efficient or otherwise. Many events and circumstances, all characterised by various uncertainties, intervene between the ex ante regulatory setting of prices and the ex post assessment of whether costs were recovered. But if, as it were, the dice are loaded against the NSP at the outset by the regulator not providing the opportunity for it to recover its efficient costs (eg, by making insufficient provision for its operating costs or its cost of capital), then the NSP will not have the incentives to achieve the efficiency objectives, the achievement of which is the purpose of the regulatory regime.
>
> Thus, given that the regulatory setting of prices is determined prior to ascertaining the actual operating environment that will prevail during the regulatory control period, the regulatory framework may be said to err on the side of allowing at least the recovery of efficient costs. This is in the context of no adjustment generally being made after the event for changed circumstances.

27 As noted above, the NGO and the revenue and pricing principles are complementary and operate together. A decision which is inconsistent with the revenue and pricing principles cannot be a decision that will, or is likely to, contribute to the achievement of the NGO.

28 This has been recognised by the Australian Competition Tribunal on numerous occasions, one example being in *Re Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3 at [15], as follows:

> The national electricity objective provides the overarching economic objective for regulation under the Law: the promotion of efficient investment in the long term interests of consumers. Consumers will benefit in the long run if resources are used efficiently, i.e. resources are allocated to the delivery of goods and services in accordance with consumer preferences at least cost. As reflected in the revenue and pricing principles, this in turn requires prices to reflect the long run cost of supply and to support efficient investment, providing investors with a return which covers the opportunity cost of capital required to deliver the services.

29 Also in the *ElectraNet* decision, the Tribunal recognised that consumers' long term interests will not always be served by lower prices in the short term. A decision which results in higher prices can be consistent with the NGO and the revenue and pricing principles, particularly if such prices provide an adequate return on investment:[8]

> … consumers will benefit in the long run if resources are used efficiently, ie if investors receive a return on efficient investment which covers the opportunity cost of the capital required to deliver the services. While consumers might benefit today from the lowest possible prices which do not provide an adequate return on investment, such prices are not in their long term interest, contrary to what Dr Dwyer for ECCSA described as

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7 NGL, section 28(2)(a).

8 *Re Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3 at [251].

> the "legitimate expectations of consumers". If those prices were sustained, they would not generally support the allocation of sufficient resources, including capital, to maintain and increase the supply of the affected service in accordance with the value consumers place on it. This would be contrary to the promotion of efficient investment and the long term interest of consumers.

30 It is clear that the NGO and NEO are not concerned with the achievement of broader social or environmental objectives. In the Second Reading Speech of the Minister for Mineral Resources and Development (South Australia) for the *National Electricity (South Australia) National Electricity Law (Miscellaneous Amendments) Amendment Act 2007* (SA), referred to in the *PIAC* decision, the Minister observed that:[9]

> The purpose of the National Electricity Law is to establish a framework to ensure the efficient operation of the national electricity market, efficient investment in, and the effective regulation of electricity networks. As previously noted, the national electricity objective also guides the Australian Energy Market Commission and the Australian Energy Regulator in performing their functions. This should be guided by an objective of efficiency that is in the long term interests of consumers. Environmental and social objectives are better dealt with in other legislative instruments and policies which sit outside the National Electricity Law.

31 This has been affirmed by the Australian Competition Tribunal, which noted that, consistent with the legislative materials referred to above, social and environmental objectives should be a matter of separate policy of the legislature reflected in different ways than through the NEO.[10]

32 While the NGO and NEO were expressly amended in 2023 to include an emissions reduction objective, in consulting on these amendments, the Energy Ministers noted that, while social equity and affordability issues are important matters for future consideration, they were outside the scope of the present review process.[11] Explicit amendment is required in order for the NGO and NEO to extend to such considerations. Such amendment has not occurred.

NGL and NGR economic regulatory regime

33 As recognised by the AER in the Draft Decision, the NGL and NGR create an incentives based economic regulatory regime.[12]

34 For the NGL and NGR incentives based economic regulatory regime to work properly, service providers must be incentivised to undertake actions that lead to efficiency gains. This has been recognised by the Australian Competition Tribunal in the *EnergyAustralia* decision referred to above:[13]

> …if, as it were, the dice are loaded against the NSP at the outset by the regulator not providing the opportunity for it to recover its efficient costs (eg, by making insufficient provision for its operating costs or its cost of capital), then the NSP will not have the incentives to achieve the efficiency objectives, the achievement of which is the purpose of the regulatory regime.

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9 Legislative Council, South Australia, 16 October 2007, Hansard, page 883.

10 *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1 at [61].

11 Energy Ministers, *Information Paper: Incorporating an emissions reduction objective into the national energy objectives*, May 2023, page 7.

12 AER, *Attachment 3 – Operating expenditure, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 6.

13 *Application by EnergyAustralia and Others* [2009] ACompT 8 at [77] – [78].

35 These principles are codified in the NGL and NGR, which require that a network service provider be provided with the opportunity to recover at least its efficient costs, and effective incentives to promote economic efficiency in respect of its provision of reference services.

ACT net zero target

36 The ACT Government has set a legislative target to achieve net zero greenhouse gas emissions by 2045.[14] This legislative target is supported by:

36.1 legislated interim targets for 2025, 2030 and 2040, in the lead up to net zero in 2045;[15]

36.2 a ban on new gas connections (except in limited circumstances);[16]

36.3 an Integrated Energy Plan (**IEP**), which outlines the ACT Government's approach to achieving net zero by 2045.

37 In the IEP, the ACT Government observes that: [17]

37.1 Evoenergy's gas network will need to be decommissioned;

37.2 by 2030, Evoenergy will be providing visibility and early signals to the community of expected timing and phasing of gas network decommissioning;

37.3 by 2035 – 2045, sections of the gas network will be safely decommissioned; and

37.4 the ACT Government will develop policy and regulatory frameworks to support safe, efficient and equitable decommissioning of the gas network.

38 It is also worth noting that:

38.1 on 17 November 2025, the ACT Minister for Energy reconfirmed the Government's commitment to decommissioning the gas network by 2045, in the public hearing of the Standing Committee on Environment and Planning for its inquiry into the annual and financial reports for 2024 – 25;[18] and

38.2 the ACT Government has engaged engineering consulting firms to assess the future of Evoenergy's gas network, including GPA Engineering, which produced a report *Green Gas Alternatives for the ACT's Commercial and Industrial Sector*.[19] GPA has since prepared a further report, to be provided as part of Evoenergy's revised access arrangement proposal, which found that:[20]

(a) the ACT Government’s proposed phase-out of natural gas by 2045 establishes a clear end-of-life horizon for Evoenergy’s gas network. While a residual network configuration may be technically feasible, it would likely be

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14 *Climate Change and Greenhouse Gas Reductions Act 2010*, section 6.

15 *Climate Change and Greenhouse Gas Reduction (Interim Targets) Determination 2018*.

16 *Climate Change and Greenhouse Gas Reductions Act 2010*, section 13A.

17 ACT Government, *Integrated Energy Plan: Our pathway to electrification*, June 2024, pages 17, 19, 55.

18 Legislative Assembly for the Australian Capital Territory, Standing Committee on Environment and Planning, *Inquiry into Annual and Financial Reports 2024 – 25,* 17 November 2025, page 93.

19 GPA Engineering, *Green Gas Alternatives for the ACT's Commercial and Industrial Sector*, 1 August 2024.

20 GPA Engineering, *Feasibility of Evoenergy Gas Network Beyond 2045*, January 2026, page 6.

economically unsustainable under current market conditions and likely require significant external support to remain viable;

(b) studies consistently identified electrification as the most cost-effective decarbonisation pathway in the ACT, with green gas limited to niche applications that could be more efficiently delivered as bottled rLPG rather than through pipelines. Without consideration of the true comparative cost of these alternatives (including assessment of likely customer demand for rLPG), certainty on residual demand cannot be achieved;

(c) any residual network(s) would not include the entire network and asset base. The majority of assets would need to be decommissioned by 2045. At most, only a limited portion of the existing network could be considered for extension beyond 2045, and certainly not the full asset base; and

(d) delaying staged decommissioning would increase safety, environmental, and financial risks, whereas proactive planning aligned with the 2045 target is the best pathway to ensure cost efficiency and mitigate uncertainty.

AER Draft Decision

39 Relevant components of the AER's Draft Decision are summarised below.

Accelerated depreciation

40 Evoenergy's Access Arrangement proposal included $105 million (2025-2026) of accelerated depreciation to reduce stranded asset risk. Evoenergy's proposed $105 million reflected the following two components:[21]

40.1 $30 million, calculated using the straight line depreciation method and reduced economic lives of 19 years for the HP and MP mains, aligning with the ACT's net zero emissions target date of 2025; and

40.2 an additional $75 million, calculated using the 'Sum-of-the-Years' digits depreciation method. This is implemented by reallocating a fixed portion of its existing HP and MP pipelines asset class into a dedicated asset class in the roll forward model, with a remaining asset life of 5 years.

41 The AER has accepted Evoenergy's decision to apply accelerated depreciation to reduce stranded asset risk. However, the AER has not accepted Evoenergy's proposed accelerated depreciation amount of $105 million ($2025-26), and has determined a reduced amount of $47 million ($2025-26). This $47 million comprises two components:[22]

41.1 a baseline accelerated depreciation amount of $12 million under the straight line depreciation method. The AER did not accept Evoenergy's proposed reduced asset lives of 19 years to align with the ACT's net zero emissions target date. The AER has concluded that the economic lives of Evoenergy's HP and MP mains are 30 and 25 years respectively, both of which end after 2045; and

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21 AER, *Attachment 1 – Capital base, Regulatory Depreciation and corporate income tax, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 12.

22 As above, pages 13 and 14.

41.2 an additional incremental accelerated depreciation amount of $35 million, which is calculated by reducing the opening capital base of certain assets to achieve an overall base real network price increase limit of 4% per annum.

42 In making its decision to set the asset lives of Evoenergy's HP and MP mains to 30 and 25 years respectively, the AER noted: [23]

> In assessing Evoenergy's proposed expected economic life, we have considered the likelihood that Evoenergy's gas network will be decommissioned by the ACT's net-zero target date, informed by the ACT Government's current policy settings. We have also considered demand trends, customer behaviour and stakeholder submissions in forming our view.
>
> …
>
> However, we do not accept Evoenergy's proposal to reduce the expected economic life to 19 years for the MP and HP pipeline asset classes. While we consider the likelihood that Evoenergy's network will be decommissioned by 2045 to be high, we do not consider there is sufficient evidence to suggest a 100% likelihood of this outcome as suggested by Evoenergy's proposal.
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> …
>
> In addition, we consider any amount of accelerated depreciation, including from reduced asset lives, must be balanced against short-term price impacts. The accelerated depreciation from reducing the economic lives to align with 2045 alone will result in a material increase to network prices by over 6% per annum in real dollar terms, based on Evoenergy's proposed demand forecast for the 2026–31 period.
>
> Therefore, we consider a smaller reduction to the expected economic life relative to Evoenergy's proposed 19 years will provide a more measured approach that better reflects current policy settings and demand uncertainty, while balancing short-term price impacts.

43 In making its decision on additional accelerated depreciation, the AER noted:[24]

> However, any amount of accelerated depreciation must be balanced against price impacts and affordability. There is a real risk that adopting a policy of accelerating depreciation, without clearly defined limits, would be likely to result in large and repeated increases in future gas prices. This would not align with the long-term interests of customers, as it risks the use of the network (including the number of customers) declining faster than anticipated, which further increases the risk of asset stranding and of costs being borne by an even smaller number of customers in the future.
> …
>
> Our decision to allow accelerated depreciation is designed to ensure Evoenergy is not deterred from making efficient investment during the net zero transition. However, allowing accelerated depreciation must be balanced against price impacts and affordability, avoiding price shocks where possible, particularly for vulnerable customers and those facing challenges during the energy transition. As network prices continue to increase, there is a real risk that any further price increase from accelerated depreciation may cause the use of the network (including the number of customers) to decline faster than anticipated, which further increases the risk of asset stranding and of costs being borne by an even smaller number of customers in the future.
> …

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23 As above, pages 17 and 18.

24 As above, page 14.

> Our draft decision is to apply a 4.0% 'base' real price increase limit when determining the amount of accelerated depreciation. Setting this limit on price increases, in our judgment, best ensures the depreciation schedule will be adjusted consistent with the requirements of rule 89 of the NGR, in particular rule 89(1)(a).

44 The AER does not provide any economic evidence to support its conclusions that:

44.1 The economic lives of Evoenergy's HP and MP mains should be 30 and 25 years respectively. Rather, this decision is based on the AER's view that there is a lack of certainty that Evoenergy's gas network will be fully decommissioned by 2045. The AER's decision was also informed by its consideration of the short-term price impacts of the incremental depreciation resulting from the shortening of the economic lives of Evoenergy's assets, and not merely the lack of certainty over the timing of the cessation of operation of the gas network and its decommissioning. The AER states that:[25]

> We consider any amount of accelerated depreciation, including from reduced asset lives, must be balanced against short-term price impacts. The accelerated depreciation from reducing the economic lives to align with 2045 alone will result in a material increase to network prices by over 6% per annum in real dollar terms, based on Evoenergy's proposed demand forecast for the 2026-31 period. Therefore, we consider a smaller reduction to the expected economic life relative to Evoenergy's proposed 19 years will provide a more measured approach that better reflects current policy settings and demand uncertainty, while balancing short-term price impacts.

This could explain why the AER's decision on economic lives cannot be reconciled to any evidence pertaining to those lives that it refers to. If the AER had determined economic lives that ended in 2045, this would necessarily put rule 89(1)(b) and its 4% limit in direct conflict. The AER has taken short-term price impacts into account in setting a shorter reduction to the economic lives of Evoenergy's assets, which deliver a price increase of less than 4%. This would be an error of law, as short term price impacts have no relevance to rule 89(1)(b) or the AER's decision on economic lives for the purposes of compliance with that rule.

44.2 That a 4% base real network price increase limit is necessary to ensure that short term price shocks do not result in use of the network declining at a rate that increases the risk of asset stranding and of costs being borne by an even smaller number of customers in the future.

45 While the AER's decision contains limited discussion on how its proposed depreciation schedule meets the depreciation criteria in rule 89(1), the AER noted:[26]

> The straight-line depreciation method combined with a 'base' real price increase limit offers more flexibility, allowing the depreciation schedule (and in turn prices) to be adjusted in a way that better promotes efficient growth (including negative growth) in the market for reference services, consistent with NGR rule 89(1)(a). Under this approach, the immediate price impact of accelerated depreciation is limited when prices are already raising significantly due to declining demand or when other costs (such as interest rates) are high. This ensures better price stability and affordability, thereby promoting efficient use of reference services. Conversely, when prices are relatively stable and affordable or other costs are low (such as during a period of low interest rates), more accelerated depreciation can be applied. This helps offset some of the price impacts from accelerated depreciation and increases the likelihood of cost recovery, supporting incentives for efficient investment.

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25 As above, page 17.

26 As above, page 21.

TVM

46 The AER declined Evoenergy's proposal to move to a revenue cap TVM. A TVM is a mechanism for variation of a reference service tariff over the course of an access arrangement period.[27] During the 2021 – 2026 access arrangement period, Evoenergy was subject to a weighted average price cap TVM (**WAPC**).

47 In broad terms, a WAPC imposes a ceiling on the weighted average tariff a service provider can charge. It sets initial tariffs, and the maximum average adjustment for varying tariffs each year, based on a forecast of demand set prior to the commencement of the five year access arrangement period.[28] Under a WAPC, demand risk is allocated to the service provider with the result that, if actual demand is higher than forecast demand, the service provider retains the additional revenue this generates and customers pay more than the efficient price for services (and vice versa when demand is lower).[29]

48 In contrast, a revenue cap TVM limits the maximum annual revenue recovered by a service provider to a total amount set by the AER. Service providers can only recover their forecast efficient costs. Prices are adjusted annually to account for any differences between actual revenue recovered in prior years and the revenue allowance for those years.[30]

49 In its Draft Decision, the AER considered that Evoenergy should apply a TVM that is a hybrid of a WAPC and a revenue cap TVM. The AER refers to the hybrid TVM in its decision on Jemena Gas Network's access arrangement for the 2025 – 30 period, appearing to suggest that this model may be appropriate for Evoenergy. Under this mechanism, the AER would continue to assess Evoenergy's tariffs under the WAPC approach, but a revenue cap element would apply if actual volumes for a year are 5% lower or higher than forecast, with Evoenergy and consumers sharing the resultant under or over recovery on a 50/50 basis.

50 In making its decision, the AER noted:[31]

> Weighted average price cap regulation incentivises network service providers to grow the volume of gas (natural gas being a fossil fuel) carried by their networks. This is because networks retain any revenue earnt from actual volumes being higher than forecasts used to determine their network tariffs. Equally, gas networks incur costs if actual volumes are lower than forecasts. That is, weighted average price caps assign volume risk to networks.
>
> The main alternative approach, revenue cap regulation, does not provide the same incentive because network service providers can earn only their approved revenue – under or over revenue recoveries are trued-up over time. However, revenue cap regulation would create risk of tariff volatility from year to year due to the revenue true-ups, while weighted average price cap regulation provides for relatively stable tariffs. Revenue caps also assign volume risk to customers, in that the network is guaranteed to earn its target revenue, regardless of actual volumes compared to targets.
>
> In our draft decision, we consider that Evoenergy's proposed revenue cap would create the tariff volatility discussed above. A hybrid approach, with elements of both price cap and revenue cap regulation assigning volume risk to both customers and the NSP, can best reduce the incentive inherent in a pure price cap form of control to encourage gas consumption, while providing protection to consumers against large price increases if demand falls faster than forecasts.

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27 NGR, rule 92.

28 Evoenergy, *Access Arrangement Proposal 2026 – 2031, Attachment 9 – Tariff Variation Mechanism*, page 14.

29 As above, page 14.

30 As above, page 14.

31 AER, *Attachment 5 – Reference Services, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 22.

51 The AER notes that volume risk is assigned to both customers and the NSP. However, volume risk is only shared in the event that volumes are 5% higher or lower than forecast. If volumes are higher than forecast, but not more than 5% higher, Evoenergy will retain the benefit. Conversely, if volumes are lower than forecast, but not more than 5% lower, Evoenergy will be required to bear the cost of this variance.

52 The AER's Draft Decision does not comment on the fact that, in the context of the ACT policy and legislative settings, Evoenergy would appear to bear the greater risk (i.e. it is more likely that volumes will be between 0 – 5% lower than it is they will be between 0 – 5% higher).

Capital expenditure (capex) and CESS

53 The AER did not accept Evoenergy's capex forecast. In particular, the AER has materially reduced Evoenergy's network overheads capex (i.e. by around 19%). Additionally, the AER's constituent decision on the Capital Expenditure Sharing Scheme (**CESS**) determined that the CESS should only penalise overspends, without rewarding underspends.

54 In its Access Arrangement proposal, Evoenergy submitted that the CESS should not apply in the 2026 – 2031 period. Evoenergy considered that the CESS is no longer appropriate to apply going forward, due to the ACT Government's decision to phase out gas supply.[32] Evoenergy noted that, if it does not apply the CESS in the 2026 – 31 period, customers will receive a greater share of the benefit, although Evoenergy will still retain some reward through standard regulatory mechanisms (i.e. financing benefit).

55 In its Draft Decision, the AER decided to apply an "asymmetrical CESS which would require Evoenergy to forgo its rewards but maintains the incentive for it to incur capex efficiently by penalising any overspend."[33]

Opex

56 In its Access Arrangement proposal, Evoenergy removed government taxes and levies from its opex forecasts, and proposed instead to account for these costs through the TVM. Evoenergy considered that this was appropriate as these taxes and levies are outside of its control, and can be unpredictable and constitute a material proportion of its revenue requirement.[34] Accounting for these costs through the TVM would allow for Evoenergy to pass these costs directly onto customers, with neither Evoenergy nor customers bearing the risk of these costs varying from forecast.

57 In the 2021 – 2026 period, the Utilities Network Facilities Tax (**UNFT**) and the Energy Industry Levy (**EIL**) were forecast as category specific forecasts within opex, and subject to a true up through the TVM (i.e. to ensure that Evoenergy is recovering no more or less than its actual costs incurred as a result of these taxes and levies).

58 The AER did not accept Evoenergy's proposal, nor did it revert to the approach used in the 2021 – 2026 period. Rather, the AER has included forecasts for the UNFT and the EIL as 'step changes' in Evoenergy's opex forecast, noting that:[35]

> Historically, we have allowed government fees and taxes as category specific forecasts, combined with a true up mechanism. However, we changed our approach on the basis that providing a true-up in the tariff variation formula effectively funds these costs on a cost-of service basis. This is inconsistent with the incentive-based

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32 Evoenergy, *Access Arrangement Proposal 2026 – 31, Attachment 3: Capital Expenditure*, page 28.

33 AER, *Attachment 5 – Capital expenditure sharing scheme, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 5.

34 Evoenergy, *Access Arrangement Proposal 2026 – 31, Attachment 9: Tariff variation mechanism,* page 42.

35 AER, *Attachment 3 – Operating expenditure, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 19.

framework. Our current approach is to include government fees and taxes in opex. The AER's approach differs from the approach under the 2021 – 2026 period, where the UNFT and EIL were forecast as category specific forecasts and subject to a true up through the TVM. Under the AER's approach in the Draft Decision, these costs will not be subject to a true up through the TVM.

59 The AER proposed that Evoenergy include a tax change cost pass through event in its revised proposal, which would permit it to apply to the AER to pass through any change in these costs relative to forecast.

Demand forecast

60 The AER did not accept Evoenergy's demand forecasts for its Volume Individual and Volume Boundary customers (residential and most business customers) due to concerns with the forecasting method. The AER applied alternate demand forecasts prepared by its consultant (Frontier Economics) as a placeholder in its Draft Decision, which involve a lower rate of disconnections for residential customers and a slower decline in usage per customer than was forecast by Evoenergy.

Declining block tariff structure

61 In its Access Arrangement proposal, Evoenergy included a 'declining' block tariff structure for its 'volume individual' (**VI**) tariffs, which apply to gas transportation reference services supplied to almost all of its customers, under which customers would pay a fixed charge per year, together with a charge for each of four further consumption 'blocks' derived using marginal prices for each 'block' that decline as the customer's gas use per quarter increases. It did not propose any changes to its 'volume boundary' (**VB**) or demand capacity tariffs.

62 The AER did not accept this proposal, instead requiring the alignment of the price for the blocks in the VI tariff in the first year of the 2026-31 access arrangement period and the same change to Evoenergy's VB tariff, on the basis that this tariff structure promotes the use of gas in conflict with the emissions reduction element of the NGO. It also decided to gradually flatten Evoenergy's demand capacity tariff, which currently has two consumption 'blocks'. The AER requires Evoenergy to flatten its tariffs for volume customers, and give consideration to the transition path to a flatter demand customer tariff structure, so as to reduce the implicit reward for higher gas consumption.

HoustonKemp Report

63 Evoenergy has engaged Dale Yeats, Partner at HoustonKemp, to prepare a report on whether the AER's Draft Decision on depreciation complies with the requirements of the NGL and NGR, and to comment on the implications of the Draft Decision on Evoenergy's incentives to efficiently invest in its network.

64 The findings made in HoustonKemp's report are set out below.

Conclusion on depreciation

65 The AER’s decision not to accept Evoenergy’s proposed depreciation is based on its view that a higher price will drive a material reduction in demand. In HoustonKemp's opinion, this premise is:

65.1 inconsistent with the assumption on the price elasticity of demand on which the AER's own demand forecast is based, i.e., that the price elasticity of demand is equal to -0.05;

65.2 inconsistent with evidence in the economics literature and the ACT-specific research commissioned by Evoenergy and undertaken by CIE, which found that demand for gas is relatively unresponsive to changes in price; and

65.3 overlooks the ability and strong incentive for Evoenergy to respond to an unexpected increase in disconnections by decreasing price below the level approved by the AER.

66 In contrast, HoustonKemp's analysis is that Evoenergy's proposed approach to depreciation will not result in any material decline in demand. In comparison to Evoenergy's proposal, the AER's draft decision to adopt a 'base real price increase limit' approach with a 4% per annum limit on the change in network price (in constant dollar terms) acts:

66.1 to defer recovery of a material proportion of Evoenergy's efficient capital costs beyond 2031, at which point the AER forecasts connections and total usage for Evoenergy's VI tariff, as an example, will be 14 per cent and 18 per cent lower, respectively;

66.2 to create a perverse incentive for Evoenergy to trade-off efficient opex against the recovery of its capital costs when preparing a proposed access arrangement; and

66.3 to signal to Evoenergy that the upper limit on future price changes is very likely to be 4.0 per cent per annum in constant dollar terms over the remaining economic life of its assets, which Evoenergy estimates will result in it not recovering a significant amount of its efficient costs.

67 In HoustonKemp's opinion, the AER's Draft Decision on depreciation therefore does not afford Evoenergy a reasonable opportunity to recover at least its efficient costs. Contravention of this foundational principle of economic regulation acts to distort the incentives for Evoenergy to undertake efficient investment by creating perverse incentives:

67.1 not to undertake efficient investment in the network, owing to the likelihood it will not recover those efficient costs;

67.2 to favour investment in assets with relatively shorter economic lives, since the recovery of those costs is subject to relatively less risk; and

67.3 to favour opex over capex, since opex is recovered in the year it is incurred.

68 In HoustonKemp's opinion, the AER's Draft Decision on depreciation is inconsistent with the requirements of the depreciation criteria, the revenue and pricing principles and the NGO that promote efficient investment and the efficient operation of the network. Further, the resulting distortions to incentives for efficient investment exacerbate the risk of a deterioration in the quality, safety, reliability and security of the supply of gas services on Evoenergy's network, which is not in the long term interest of consumers.

Conclusion on ability to recover efficient costs

69 HoustonKemp also concludes that various other components of the AER's Draft Decision do not provide Evoenergy with the ability to recover at least its efficient costs, as follows:

69.1 the Draft Decision regarding the TVM leaves Evoenergy's opportunity to recover its efficient costs dependant on the AER's ability to accurately forecast demand for gas, which the AER acknowledges is uncertain and can be affected significantly by factors beyond Evoenergy's control;

69.2 the Draft Decision regarding forecast demand and Evoenergy's tariff structure may exacerbate the risk that the TVM acts to prevent Evoenergy from recovering its efficient costs;

69.3 the Draft Decision on the CESS does not provide a reasonable opportunity for Evoenergy to recover its costs and, when cost efficiencies are achieved in the early years of an access arrangement, may create a perverse incentive to over-spend capex towards the end of 2026-31; and

69.4 the Draft Decision on the treatment of UNFT and EIL is grounded in a flawed rationale and is not supported, as the AER suggests, with the revenue and pricing principle to provide effective incentives to improve economic efficiency.

70 These elements of the AER's decision, combined with its decision on depreciation, create pressure across-the-board on the opportunity for Evoenergy to recover at least its efficient costs and, in contrast to the requirements of the rules:

70.1 do not afford Evoenergy with a reasonable opportunity to recover at least its efficient costs; and

70.2 do not provide incentives for the efficient investment in and the efficient operation of Evoenergy's network.

Consideration

71 Evoenergy has asked for consideration to be given to the legality of the AER's approach in its Draft Decision, in respect of:

71.1 depreciation, in particular, the decisions to:

(a) extend the economic lives of Evoenergy's HP and MP mains beyond 2045; and

(b) impose a base real network price increase limit of 4% per annum; and

71.2 the fact that the AER seeks to minimise any risk borne by consumers under the Draft Decision, with various components of the Draft Decision shifting the majority of risk to Evoenergy**.**

Depreciation

72 There are five legal issues that arise for consideration in respect of the AER's decision on depreciation:

72.1 whether the AER's Draft Decision is invalid on the basis that the AER did not provide any evidence to support its conclusions on asset lives and the 4% base real network price increase limit;

72.2 whether the AER's Draft Decision contravenes rules 68B(1)(b) and 89(1) of the NGR, as it contains a depreciation schedule that is not designed to reflect the depreciation criteria;

72.3 whether the AER's Draft Decision contravenes section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR, on the basis that it is not consistent with the NGO and the revenue and pricing principles;

72.4 whether the AER's making of its Draft Decision is an improper exercise of the power conferred by the NGL and NGR, as the AER has regard to irrelevant considerations in making its Draft Decision; and

72.5 whether the AER's Draft Decision regarding depreciation is unreasonable.

Issue 1: whether the AER's Draft Decision is invalid on the basis it is not supported by any evidence

No evidence rule

73 It is well established that a decision is affected by error if the decision maker provides no evidence to justify their decision. The 'no evidence' ground of review was developed at common law. It has been codified as its own ground of review in section 5(1)(h) of the Administrative Decisions (Judicial Review) Act 1977 (Cth) (**ADJR Act**), which establishes a ground for reviewing certain administrative decisions on the grounds that "there was no evidence or other material to justify the making of the decision".

74 Additionally, section 5(1)(f) of the ADJR Act provides a ground of review when a decision involved an error of law, whether or not the error appears on the record of the decision. Section 5(1)(f) encompasses the common law ground of 'no evidence', regardless of whether the specific ground in section 5(1)(h) is made out.

75 Section 5(3) of the ADJR Act provides that:

> The ground specified in paragraph (1)(h) shall not be taken to be made out unless:
>
> (a) the person who made the decision was required by law to reach that decision only if a particular matter was established, and there was no evidence or other material (including facts of which he or she was entitled to take notice) from which he or she could reasonably be satisfied that the matter was established; or
>
> (b) the person who made the decision based the decision on the existence of a particular fact, and that fact did not exist.

76 For a ground to be established under section 5(3)(a) of the ADJR Act, it must be established that there is no evidence or other material from which the decision maker could reasonably be satisfied of a particular matter required by law to be established before the decision was reached.[36] It is enough to show an absence of evidence or material from which the decision-maker could reasonably be satisfied that the particular matter was established, that being a lesser burden than having to show an absence of evidence or material to support the decision.[37]

77 For a ground to be established under section 5(3)(b) of the ADJR Act, it must be established that:[38]

77.1 the decision maker found a 'particular fact';

77.2 the decision was 'based' on that fact; and

77.3 that the fact did not exist.

Economic lives of HP and MP mains

78 The AER's Draft Decision regarding depreciation is governed by, amongst other provisions, rule 89(1) of the NGR. Rule 89(1)(b) requires the AER to design the depreciation schedule so

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36 *Feltex Reidrubber Ltd v Minister for Industry and Commerce* ; 46 ALR 171 at pages 185 and 186; per Sheppard J; *Pharmacy Guild of Australia v Australian Community Pharmacy Authority* (1996) 70 FCR 46.

37 *Australian Broadcasting Tribunal v Bond* (1990) 170 CLR 321 at 358.

38 *Curragh Queensland Mining Ltd v Daniel* (1992) 34 FCR 212 at 220 per Black CJ; *Szelagowicz v Stocker* (1994) 35 ALD 16 at page 22; *Minister for Immigration and Multicultural Affairs v Rajamanikkam* (2002) 210 CLR 222; 190 ALR 402 at page 408 per Gleeson CJ, at page 414 per Gaudron and McHugh JJ.

that each group of assets is depreciated over the economic lives of the relevant assets. The AER found that the economic lives of Evoenergy's HP and MP mains were 30 and 25 years respectively, which extends the economic lives of these assets beyond 2045 (being the legislated date by which the ACT must reach net zero greenhouse gas emissions).

79 In the language of section 5(3)(a) of the ADJR Act, the AER is required by law to reach a decision on the depreciation of the relevant assets, which is dependent on it establishing the economic lives of those assets.

80 There is no evidence or other material from which the AER can be satisfied that the economic lives of Evoenergy's HP and MP mains are 30 and 25 years respectively. This is clear from the AER's statements that:

> While we consider the likelihood that Evoenergy's network will be decommissioned by 2045 to be high, we do not consider there is sufficient evidence to suggest a 100% likelihood of this outcome as suggested by Evoenergy's proposal.

81 While the AER notes that it is not satisfied with the evidence provided in Evoenergy's proposal, it does not provide any evidence of its own on which to justify its decision regarding the economic lives of the assets. Rather, the AER observes that:[39]

81.1 although the IEP has set an indicative timeline for decommissioning the gas network, there is still uncertainty as to what this would involve and how long it will take for the network to be decommissioned safely;

81.2 decommissioning the network safely is a complex task;

81.3 the actual rate of decline of the use of natural gas is uncertain; and

81.4 the ACT's policy environment is still evolving.

82 None of these observations justify the AER's decision to extend the economic lives of Evoenergy's assets beyond 2045. While these observations may be correct, they do not mean that Evoenergy's network will not be decommissioned by 2045. The ACT Government has set a legislated target for net zero emissions by 2045, and has expressed an intent to decommission Evoenergy's network by this date. None of the AER's observations operate to preclude this outcome from occurring.

83 Accordingly, the AER's Draft Decision regarding the economic lives of Evoenergy's assets is invalid on the basis that the AER has not provided any evidence to justify its decision.

4% base real network price increase limit

84 In making its decision to determine additional accelerated depreciation based on a 4% 'base real price increase limit', the AER noted that:

> …allowing accelerated depreciation must be balanced against price impacts and affordability, avoiding price shocks where possible, particularly for vulnerable customers and those facing challenges during the energy transition. As network prices continue to increase, there is a real risk that any further price increase from accelerated depreciation may cause the use of the network (including the number of customers) to decline faster than anticipated, which further increases the risk of asset stranding and of costs being borne by an even smaller number of customers in the future.

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39 AER, *Attachment 1 – Capital base, Regulatory Depreciation and corporate income tax, Draft Decision – Evoenergy (ACT) 2026 – 31*, page 17.

> The ACT Government and CCP33 commented that any price increase from accelerated depreciation should be carefully considered to avoid an unintended acceleration in disconnections that would further increase the cost burden on vulnerable customers. As such, we consider a 'base' real price increase approach remains the most balanced approach for determining the level of accelerated depreciation.
>
> Our draft decision is to apply a 4.0% 'base' real price increase limit when determining the amount of accelerated depreciation. Setting this limit on price increases, in our judgment, best ensures the depreciation schedule will be adjusted consistent with the requirements of rule 89 of the NGR, in particular rule 89(1)(a).

85 The Draft Decision included a table which set out the impacts on residential bills of the accelerated depreciation amount contained in each of Evoenergy's proposal and the AER's Draft Decision.

86 The AER's decision, to impose a 4% base network price increase limit, appears to be based on a conclusion that any price increases above this amount will cause the use of the network to decline materially and create an associated risk of asset stranding.

87 However, the AER does not provide any evidence to demonstrate this. In particular, the AER does not provide any evidence to demonstrate the impact that the various price increases will have on demand for gas and Evoenergy's network services.

88 I refer to the report by HoustonKemp, which, in contrast to the AER's decision, finds that:

88.1 the price elasticity of demand for gas consumption is relatively inelastic for residential customers;

88.2 the gas network price comprises approximately 30% of the total gas retail price; and

88.3 there is likely to be an immaterial difference in the impact on demand resulting from AER's proposed 4% limit and the depreciation amounts proposed by Evoenergy in its original and revised proposal.

89 In the language of section 5(3)(b) of the ADJR Act, the AER's Draft Decision regarding its 4% network price increase limit is based on a particular fact (that any price increase above 4% per annum is likely to result in a material decline in demand for gas), but this fact does not exist (as evidenced by HoustonKemp's report and the AER's lack of supporting material for its conclusion). The AER's Draft Decision is therefore invalid, on the basis it has provided no evidence to support its conclusion.

Issue 2: whether the AER's Draft Decision contravenes rule 89 of the NGR

90 Rule 89 of the NGR sets out the depreciation criteria. Rule 89(1) provides that 'the depreciation schedule <u>should</u> be designed' in accordance with five specified criteria. This language is important. The five criteria in rule 89(1)(a) – (e) are not simply considerations that the AER must have regard to. Rather, the depreciation schedule of an access arrangement <u>must</u> be designed in accordance with rule 89(1)(a) – (e).

91 The language in rule 89(1) does not allow for the AER to perform a balancing act between the different criteria in (a) – (e). An access arrangement will not comply with rule 89 if the depreciation schedule is designed to reflect one of these criteria at the expense of another; it must be designed in accordance with <u>all</u> of (a) – (e).

92 Rule 89(1)(a) requires the depreciation schedule to be designed 'so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services'.

93 The Australian Competition Tribunal has observed that:[40]

> It is uncontroversial that [rule 89(1)(a) and (e)] are best met by the depreciation methodology that most closely matches AR with long run marginal cost ('**LRMC**') associated with an incremental increase in services.

94 The Australian Competition Tribunal has also noted, in Application by APA GasNet Australia (Operations) Pty Limited (No 2) [2013] ACompT 8:[41]

> There is substantial agreement about what is required in terms of tariff paths to promote efficient growth in the market for reference services.
>
> The economic experts for both the AER and APA GasNet (PwC for APA GasNet and Frontier Economics for the AER) generally agreed that, subject to tariffs reflecting long-run marginal cost, recovery of any remaining costs should be so as to minimise distortion of demand. PwC states that efficient pricing entails ensuring that the marginal cost of consumption is signalled to consumers. To the extent that there are non-marginal (fixed) costs of supply, then these should be spread across consumers in a way that minimises distortion of consumption decisions. PwC states that "in other words, efficient pricing… essentially entails devising tariffs that minimise the demand distortion that results from having to recover non-marginal costs through increases in price above marginal cost". Frontier Economics similarly states that: "subject to reference tariffs reflecting the average LRMC of system usage, any remaining regulated revenues should be recovered in a way that minimises the impact on the demand for reference services".

95 It is clear, including from these decisions, that the objective in rule 89(1)(a) is best met by a depreciation methodology that:

95.1 matches average revenue with long run marginal cost associated with an incremental increase in services; and

95.2 subject to tariffs reflecting long run marginal cost, ensures the recovery of any remaining costs is so as to minimise any distortion of demand.

96 The AER appears to consider that its proposed approach to depreciation better meets the requirements of rule 89(1)(a) than Evoenergy's proposed depreciation schedule. The AER places great importance on its proposed depreciation schedule meeting the requirements of rule 89(1)(a), noting that:[42]

> Our draft decision is to apply a 4.0% 'base' real price increase limit when determining the amount of accelerated depreciation. Setting this limit on price increases, in our judgment, best ensures the depreciation schedule will be adjusted consistent with the requirements of rule 89 of the NGR, <u>in particular</u> rule 89(1)(a).

97 However, even if (contrary to the conclusions reached by HoustonKemp in its report) the AER is correct that its proposed depreciation schedule meets the requirements of rule 89(1)(a), it must also meet the requirements of (b) – (e). An access arrangement which meets the requirements of rule 89(1)(a), but not each of the other criteria in (b) – (e), will not be compliant with the NGR.

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40 *Application by ATCO Gas Australia Pty Ltd* [2016] ACompT 10 at [329].

41 *Application by APA GasNet Australia (Operations) Pty Limited (No 2)* [2013] ACompT 8 at [217]-[218].

42 AER, *Attachment 1 – Capital base, Regulatory Depreciation and corporate income tax, Draft Decision – Evoenergy (ACT) 2026 – 31* at page 27 (own emphasis added).

98 The Australian Competition Tribunal has observed that rule 89(1)(b) is "quite specific in stating that the depreciation schedule to be designed "so that each asset… is depreciated *over the economic life* of that asset or group of assets."[43]

99 The AER's Draft Decision does not comply with the requirements of rule 89(1)(b), as:

99.1 the AER's decision on the economic lives of Evoenergy's HP and MP mains is arbitrary and made without any evidentiary basis, for the reasons discussed above; and

99.2 the AER's decision will leave a material portion of Evoenergy's 2026-2027 opening capital base unrecovered by 2045, when Evoenergy's gas network will be decommissioned. This does not allow Evoenergy to recover the costs of these assets over their economic lives.

100 Rule 89(1)(c) requires the depreciation schedule to be designed 'so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets.' This must include, in the context of declining demand, a future reduction in economic life.

101 The AER's decision defers the recovery of costs, which, in the context of declining demand, operates to reduce flexibility to allow for a future reduction in asset lives. HoustonKemp's report observes that the AER's decision acts to signal to Evoenergy that the upper limit on future price changes is very likely to be 4.0 per cent per annum in constant dollar terms over the remaining economic life of its assets, which Evoenergy estimates will result in it not recovering a significant amount of its efficient costs.

102 It is noted that rule 89(2) allows for the deferral of depreciation where required for compliance with rule 89(1)(a), particularly in the case of an immature market. In any event, a deferral could not occur at the expense of compliance with the other provisions of rule 89(1), including (c).

103 For these reasons, the AER's Draft Decision contravenes rule 89 of the NGR, as the depreciation schedule is not designed in accordance with the depreciation criteria. As a result, it also contravenes rule 68B(1)(b) of the NGR, which requires the provisions of an access arrangement to be consistent with the provisions of the NGR.

Issue 3: whether the AER's Draft Decision contravenes section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR

104 Section 28(1)(a) of the NGL requires the AER to, in performing or exercising an AER economic regulatory function or power, perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the NGO. As established above, the AER's making of an access arrangement decision is an 'AER economic regulatory function or power'.

105 Further, section 68B(1)(a) of the NGR requires the provisions of an access arrangement to be consistent with the NGO.

106 Section 24 of the NGR sets out the revenue and pricing principles. Relevantly, the revenue and pricing principles provide that:

106.1 a scheme pipeline service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs in providing reference services; and

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43 *Application by DBNGP (WA) Transmission Pty Ltd (No 3)* [2012] ACompT 14 at [454].

106.2 a scheme pipeline service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides. The economic efficiency that should be promoted includes:

(a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and

(b) the efficient provision of pipeline services; and

(c) the efficient use of the pipeline.

107 In its Draft Decision, the AER noted that:[44]

> We consider that while section 24(2) of the NGL sets out the principle that networks be provided a '… reasonable opportunity to recover at least the efficient costs the service provider incurs…', it does not mean gas consumers must guarantee that the regulated businesses recover these costs without considering price affordability and stability. The revenue and pricing principles are matters we are required to take into account, but they are not binding in all circumstances. We balance them against other considerations under the NGL, NGO and NGR. By contrast, we must seek to promote the achievement of the NGO.

108 The AER gave great weight to the role of price affordability and stability when making its Draft Decision on depreciation. The AER's view was that accelerated depreciation must be balanced against short term price impacts and affordability, noting that:[45]

> Accelerated depreciation can help reduce stranded asset risk and promote efficient investment. However, it must be balanced against short-term price impacts and affordability. As the long-term demand for Evoenergy's network continues to decline, it becomes increasingly important to maintain price affordability and avoid price shocks by having the flexibility to reassess the level of accelerated depreciation over time. Further accelerated depreciation in an environment of declining demand and higher prices will exacerbate upward pressure on prices, potentially triggering an unintended acceleration in disconnections. This outcome would not align with the long-term interests of customers and further increases stranded asset risk for the network business.

109 The AER appears to consider that the NGO requires consideration of short-term price impacts and affordability, the risk of costs being borne by a smaller number of customers in the future, and the impact of any decision on vulnerable customers.

110 The AER's interpretation of the NGO, and the role of the revenue and pricing principles, is incorrect. As discussed above at paragraphs 24 and 25 the NGO does not require any balancing of the long term interests of consumers, on the one hand, and economic efficiency, on the other. Rather, the long term interests of consumers will be served by regulation that enhances economic efficiency.

111 If the AER takes the view that the dimensions of efficiency (i.e. investment and operation on the one hand, and use on the other) are in tension, and it has a discretion as to how to balance these, that will be an error. The reason for this, in part, is rule 89(1)(b), where compliance is required regardless of any consideration of efficient use/demand for reference services. However, whether this be so or not, Evoenergy's proposal for accelerated depreciation does not result in any material distortion in demand, so there is no work for rule 89(1)(a) to do, and the dimensions of efficiency in the NGO are not in tension.

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44 AER, *Attachment 1 – Capital base, regulatory depreciation and corporate income tax, Draft decision – Evoenergy (ACT) 2026 – 31,* page 26.

45 As above, page 26.

112 Any decision which enhances economic efficiency will serve the long term interests of consumers. There is no role in the NGO for considerations of social equity, such as short term affordability and the impact on vulnerable consumers. This has been recognised by the Australian Competition Tribunal and reiterated by the Energy Ministers in 2023.

113 Further, the Australian Competition Tribunal has recognised that a decision which is inconsistent with the revenue and pricing principles cannot be a decision that will or is likely to contribute to the achievement of the NEO (and thus, the NGO).[46] The AER is incorrect to distinguish between the roles of the revenue and pricing principles and the NGO; its decision must be consistent with the revenue and pricing principles in order for it to be consistent with the NGO.

114 As noted above, the two key revenue and pricing principles here are that service providers should be provided with the opportunity to recover at least their efficient costs, and with effective incentives in order to promote economic efficiency.

115 The Australian Competition Tribunal has recognised the importance of regulated NSPs being provided with the opportunity to recover at least their efficient costs, in the *EnergyAustralia* decision referred to above.

116 HoustonKemp's report finds that the AER's Draft Decision regarding depreciation does not provide Evoenergy with a reasonable opportunity to recover at least the efficient costs it incurs in providing reference services.

117 As a result of the AER's Draft Decision not affording Evoenergy a reasonable opportunity to recover its efficient costs, the AER's Draft Decision does not provide Evoenergy with effective incentives to promote economic efficiency with respect to the reference services Evoenergy provides. In particular, the Draft Decision distorts Evoenergy's incentives to undertake efficient investment in any pipeline with which Evoenergy provides reference services.

118 HoustonKemp observes that the Draft Decision distorts the incentives for Evoenergy to undertake efficient investment by creating perverse incentives:

118.1 not to undertake efficient investment in the network, owing to the likelihood it will not recover these efficient costs;

118.2 to favour investment in assets with relatively shorter economic lives, since the recovery of those costs is subject to relatively less risk;

118.3 to favour opex over capex, since opex is recovered in the year it is incurred.

119 It is clear, from the HoustonKemp report, that the AER's Draft Decision is inconsistent with the revenue and pricing principles, as it does not provide Evoenergy with a reasonable opportunity to recover at least the efficient costs it incurs in providing reference services, or effective incentives to promote economic efficiency with respect to the reference services Evoenergy provides.

120 The question is whether the Draft Decision provides Evoenergy with a reasonable opportunity to recover its efficient costs, and creates effective incentives to promote economic efficiency. For the reasons outlined in HoustonKemp's report, it is clear that the answer to this question is no.

121 Accordingly, consistent with the Australian Competition Tribunal's previous decisions, the AER's decision on depreciation cannot be a decision that will or is likely to contribute to the

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46 *Re Application by ElectraNet Pty Limited (No 3)* [2008] ACompT 3 at [15].

achievement of the NGO, in contravention of section 28(1)(a) of the NGL. It also follows from this conclusion that the provisions of Evoenergy's access arrangement cannot be consistent with the NGO, in contravention of rule 68B(1)(a) of the NGR.

Issue 4: whether the AER's making of its Draft Decision is an improper exercise of the power conferred by the NGL and NGR, as the AER has regard to irrelevant considerations in making its Draft Decision;

122 As discussed above, the AER has had regard to matters of social equity in making its Draft Decision on depreciation, including the impact of the Decision on vulnerable customers. The NGO does not permit the AER to have regard to such considerations, nor do any other provisions of the NGL and NGR.

123 The NGL and NGR set out a range of considerations the AER must have regard to, and a range of considerations the AER may have regard to. The impact of any decision on vulnerable customers is not one of these considerations.

124 Accordingly, the AER's making of its Draft Decision regarding depreciation is an improper exercise of the power conferred on it by the NGL and NGR, as the AER has had regard to irrelevant considerations in making its decision.

Issue 5: whether the AER's Draft Decision regarding depreciation is unreasonable.

125 For the reasons set out in HoustonKemp's report, and discussed above in issues 1 – 4, the AER's Draft Decision regarding depreciation is unreasonable.

Other components of the Draft Decision

126 HoustonKemp's report concludes that various other components of the Draft Decision do not afford Evoenergy with a reasonable opportunity to recover its efficient costs, and do not provide incentives for efficient investment in, and efficient operation of, Evoenergy's network. On the basis of this conclusion, the AER's Draft Decision is contrary to the scheme of the NGL and NGR economic regulatory regime, contravenes section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR, and is unreasonable.

CESS

127 The AER's Draft Decision is to apply an asymmetrical CESS, pursuant to which Evoenergy must forgo its rewards for underspending relative to forecast, but will remain subject to penalties for any overspend.

128 HoustonKemp observes that the consequence of penalising Evoenergy for spending more than the level of capex approved by the AER, but not rewarding it for spending less, is that the expected value of each dollar of capex is less than $1, and the AER's decision on the CESS therefore denies Evoenergy a reasonable opportunity to recover its efficient costs.

129 HoustonKemp also finds that the application of an asymmetric CESS means that, if Evoenergy is outperforming its approved capex during the early years of 2026-31, it faces no incentive to maintain that improvement in efficiency throughout the remainder of the access arrangement. Rather, the AER's decision may create a perverse incentive to overspend capex in later years of the period, so that, in aggregate, the capex allowance is fully spent over 2026-31. HoustonKemp observes that, in practice, this incentive would likely relate to investment in short term assets in those later years, given the uncertain future demand for gas and the implications of the AER's draft decision for the opportunity for Evoenergy to recover its efficient costs.

130 On the basis of HoustonKemp's conclusion regarding the CESS, the AER's decision to apply an asymmetrical CESS is contrary to the scheme of the NGL and NGR incentives based

economic regulatory regime. The AER's decision also contravenes section 28(1)(a) of the NGL, 68B(1)(a) and (b) of the NGR and 98(3) of the NGR, as it is inconsistent with the revenue and pricing principles.

TVM, demand forecast and flattening of tariff structure

131 The AER's Draft Decision is to apply a hybrid TVM, rather than the revenue cap TVM proposed by Evoenergy. The AER signals that the hybrid TVM will involve it continuing to assess Evoenergy's tariffs under the WAPC approach, but with a revenue cap element to apply if actual volumes for a year are 5% lower or higher than forecast. If this occurs, Evoenergy and consumers will share the resultant under or over recovery on a 50/50 basis.

132 HoustonKemp finds that such an approach makes Evoenergy's opportunity to recover at least its efficient costs dependent on the AER's ability to accurately forecast demand for gas. This places a great deal of risk on Evoenergy, in circumstances where, as the AER acknowledges, there is a great deal of uncertainty regarding future demand, and the rate of decline rests on factors largely beyond Evoenergy's control.

133 Similarly, the AER's demand forecast works with the assignment of volume risk under the TVM to further increase the risk that Evoenergy will be under-remunerated. The AER adopted a higher demand forecast than included in Evoenergy's proposal. HoustonKemp notes that, to the extent that the AER's demand forecast incorporates an upward bias, this will preclude Evoenergy's ability to recover its efficient costs. This is because, under the volume risk sharing arrangement in the Draft Decision, Evoenergy will not be compensated for differences between actual and forecast revenue up to a specified threshold and, even beyond that threshold, will be permitted to recover only a proportion of the difference.

134 HoustonKemp also finds that the AER's requirement that Evoenergy flatten its tariff structures can be expected to increase the effect on Evoenergy's actual revenue of any differences between forecast and actual demand for gas.

135 On the basis of HoustonKemp's report, the AER's decisions, in its Draft Decision, regarding the hybrid TVM, higher demand forecasts and flatter tariff structures, create an outcome where 'the dice are loaded against' Evoenergy from the outset, as Evoenergy has no expectation that it will recover its efficient costs. As observed by the Australian Competition Tribunal, this will result in Evoenergy not having any incentives to achieve the efficiency objectives of the NGL and NGR.

136 Such an outcome is contrary to the scheme of the NGL and NGR economic regulatory regime, contravenes section 28(1)(a) of the NGL and 68B(1)(a) of the NGR, due to inconsistency with the revenue and pricing principles, and thus, the NGO, and is unreasonable.

UNFT and EIL

137 HoustonKemp concludes that the AER's decision to include the UNFT and EIL in the opex forecast, without any true up under the TVM, lacks any substance and is not consistent with the revenue and pricing principle to promote effective incentives to improve efficiency.

138 HoustonKemp observes that the basis for the AER's decision is that excluding the UNFT and the EIL from the TVM true up mechanism is that it provides an incentive for Evoenergy to lower its costs. However, Evoenergy has no control over the UNFT or the EIL, and so no apparent ability to manage or reduce those costs. The AER, in assuming that Evoenergy has a degree of managerial control over these taxes, via its ability 'to work with the ACT Government to minimise the impact of these changes on its customers' (at pp 20-21 of Attachment 3) is without any proper basis. This would result in legal error. Further, the UNFT and the EIL is a material proportion of Evoenergy's costs and is difficult to forecast.

139 As a result, the AER's Draft Decision regarding the UNFT and the EIL does not provide Evoenergy with a reasonable opportunity to recover its efficient costs.

140 Accordingly, on the basis set out by HoustonKemp, the AER's Draft Decision is contrary to the scheme of the NGL and NGR economic regulatory regime, contravenes section 28(1)(a) of the NGL and rule 68B(1)(a) of the NGR, and is unreasonable.

Overall decision

141 Various individual components of the AER's Draft Decision are unlawful, on the basis of the conclusions in HoustonKemp's report. Together, these components produce an outcome where risk is unreasonably allocated to Evoenergy. Such a decision is manifestly inconsistent with the scheme of the NGL and NGR regime and is unreasonable.

The Hon. John Middleton, AM KC

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