



DRAFT DECISION

Evoenergy

Access Arrangement

2021 to 2026

Overview

November 2020

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AER reference: 65197

Invitation for submissions

In response to our draft decision, Evoenergy has the opportunity to submit a revised proposal for its upcoming 2021–26 access arrangement period by **13 January 2021**.

Submissions on both our draft decision and Evoenergy’s revised proposal are invited from interested stakeholders by **17 February 2021**. We will consider and respond to all submissions received by that date in our final decision. Subject to stakeholder interest, we will also consider holding a public forum following submission of the revised proposal.

Submissions should be sent to: Evoenergy2021@aer.gov.au

Alternatively, submissions can be sent to:

Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested.

Parties wishing to submit confidential information should:

- (1) clearly identify the information that is the subject of the confidentiality claim
- (2) provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website.¹

¹ For further information regarding our use and disclosure of information provided to us, see the *ACCC/AER Information Policy* (June 2014), which is available on our website: <https://www.aer.gov.au/publications/corporate-documents/acc-and-aer-information-policy-collection-and-disclosure-of-information>

Note

This Overview forms part of the AER's draft decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the draft decision.

Our revisions are reflected in, *Draft decision – Evoenergy access arrangement 2021–26 – Approved Access Arrangement – November 2020*, which gives effect to this draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

Contents

Executive summary	5
1 Our draft decision.....	11
1.1 How our draft decision would affect gas bills	11
1.2 What is driving revenue?	13
1.3 Key differences between draft decision and proposal	16
1.4 Evoenergy’s consumer engagement	16
2 Reference services and tariffs.....	22
2.1 Services covered by the access arrangement	22
2.2 Reference tariff setting and variation mechanism	23
2.3 Forecast demand	24
3 Total revenue requirement.....	26
3.1 The building block approach	26
3.2 Draft decision on total revenue	27
3.3 Revenue smoothing and tariffs	29
4 Key elements of our draft decision on revenue.....	33
4.1 Capital base.....	33
4.2 Rate of return and value of imputation credits.....	35
4.3 Regulatory depreciation.....	37
4.4 Capital expenditure.....	41
4.5 Operating expenditure.....	42
4.6 Revenue adjustments	44
4.7 Corporate income tax	45
5 Incentive schemes to apply for 2021–26	47
5.1 Efficiency carryover mechanism.....	47
5.2 Capital expenditure sharing scheme	47
6 Non-tariff components	48
A Shortened forms	49
B List of submissions	50

Executive summary

The Australian Energy Regulator (AER) regulates gas transmission and distribution networks in all Australian jurisdictions except Western Australia. As part of this process, a regulated gas network business must periodically apply to us for a ruling on network tariffs which, in turn, influence the expected amount of revenue it will recover from consumers for using its network. The National Gas Law and Rules (NGL and NGR) provide the regulatory framework governing gas transmission and distribution networks. Our work under this framework is guided by the National Gas Objective (NGO).² We use our insights and expertise to determine how much money the network business can recover.

We are currently doing this for Evoenergy for the 2021–26 access arrangement period which runs from 1 July 2021 to 30 June 2026 (2021–26 period).³

Evoenergy provides natural gas distribution services to approximately 150,000 homes and businesses across Canberra, Greater Queanbeyan and Bungendore, of which around 90 per cent of consumers are located in the ACT and 10 per cent in NSW. Around 98 per cent of Evoenergy's consumers are residential consumers.

We note that the unprecedented changes to the economic environment as a result of COVID-19 will have wide ranging impacts which may cause aspects of Evoenergy's proposal to differ at the revised proposal stage. We base this draft decision on current information and best forecasts that can reasonably be made, but acknowledge that some aspects of Evoenergy's proposal may need to change.

This draft decision allows Evoenergy to set gas network tariffs which are expected to result in the recovery of \$311.9 million (\$ nominal) in revenue in the 2021–26 period from consumers, who are likely to benefit from bill reductions in the first year.

The revenue we allow Evoenergy forms the distribution network component of retail gas bills, making up 28 per cent of a typical residential bill and 22 per cent for small businesses.⁴ Other key components of the bill include wholesale gas, transmission and retail costs. While we do not regulate retail prices, we estimate that if this draft decision is implemented, compared to current levels, average annual bills for Evoenergy's consumers would:⁵

- decrease by \$26 (2.1 per cent) for residential consumers and \$232 (1.7 per cent) for small business consumers in the first year⁶
- increase by \$8 (0.6 per cent) for residential consumers and \$69 (0.5 per cent) for small business consumers in each of the next four years of the 2021–26 period.⁷

² NGL, s. 23.

³ Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, June 2020.

⁴ Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 27.

⁵ As at 30 June 2021.

⁶ As at 30 June 2022.

⁷ As at 30 June of each of the last four years of the 2021–26 period.

By the end of the 2021–26 period, bills for residential and small business consumers will have increased by \$5 (0.4 per cent) and \$44 (0.3 per cent), respectively.⁸

The key themes of this draft decision are:

- ensuring consumers pay no more than they need for safe and reliable gas services
- significant improvements in Evoenergy’s consumer engagement approach
- response to jurisdictional emissions reduction targets.

We have had regard to a range of sources in making this draft decision, including Evoenergy’s proposal, submissions received, and additional analysis undertaken and published by us.

Evoenergy’s proposal has been developed against the backdrop of the ACT Government’s *Climate Change Strategy 2019–25*, including the legislated 2045 net zero greenhouse gas emissions target. How these policy settings impact on Evoenergy’s future network planning and consumers is a key issue for stakeholders in this review.

Evoenergy has put forward a well-informed proposal, underpinned by significant improvements to its consumer engagement approach. Our draft decision largely accepts Evoenergy’s proposal and it now has the opportunity to respond to our draft decision and stakeholder feedback in its revised proposal.

Our draft decision broadly approves Evoenergy’s forecasts for key expenditure items, including operating expenditure (opex), and represents an overall revenue reduction of \$3.1 million (1.0 per cent) compared to Evoenergy’s proposal for the 2021–26 period. The reduction is driven by the lower rate of return we have used to calculate the return on capital, and we do not expect this to be an area of contention going forward as we apply a binding instrument to our decisions. We also accept Evoenergy’s proposal for reductions to the standard asset lives (accelerated depreciation) for new pipeline assets located in the ACT, but not for assets located in NSW, reflecting the different environmental policy settings in those jurisdictions. However, we seek further information from Evoenergy in its revised proposal on certain aspects of capital expenditure (capex) and the degree to which gas demand is forecast to fall over the 2021–26 period as this flows through to the prices consumers pay for consuming gas.

Overall, subject to receipt of the additional information on capex and gas demand that we are seeking in Evoenergy’s revised proposal, we are satisfied that our draft decision on Evoenergy’s 2021–26 proposal is likely to be in the long term interests of consumers and, if implemented in our final decision, consumers will be better off, now and in the future.

⁸ Compares 30 June 2026 (for the 2021–26 period) to 30 June 2021 (for the 2016–21 period).

Ensuring consumers pay no more than they need for safe and reliable gas services

Ensuring consumers pay no more than they need for safe and reliable gas services that they want is a cornerstone of the access arrangement decision process. This involves us assessing whether Evoenergy's 2021–26 proposal represents a reasonable and realistic forecast of how much money it needs for the safe and reliable operation of its gas distribution network. Additionally, we have engaged directly with Evoenergy representatives to discuss and seek further information on aspects of its proposal.

Evoenergy informs us that consumers' key concern is energy affordability and fairness, together with environmental sustainability, responsible transition, and a safe and reliable gas service.⁹ Evoenergy responded to these concerns by putting forward a proposal that includes a small precautionary cost increase for reductions to the standard asset lives of its pipeline assets, but still results in relatively stable bills over the 2021–26 period. It prioritised bill reductions for consumers in the first year of the period, thereafter limiting bill increases to the inflation rate.

We have assessed Evoenergy's proposal at the component level to satisfy ourselves of the robustness of proposed expenditures, as well as more holistically to confirm its alignment with Evoenergy's business priorities and jurisdictional policy settings. Subject to receipt of the additional information on capex and demand that we are seeking in Evoenergy's revised proposal, and given the small overall revenue difference between what Evoenergy proposed and our draft decision, we consider Evoenergy's proposal achieves positive outcomes for consumers.

Significant improvements in Evoenergy's consumer engagement approach

We commend Evoenergy on the significant and targeted improvements it has made to its consumer engagement approach for this review.

The Consumer Challenge Panel (CCP24) noted:¹⁰

“CCP24 has observed that the GN21 Plan has been underpinned by a broad consumer and stakeholder engagement strategy. The engagement activities that we observed were well-managed and well-facilitated, and genuinely sought to elicit perspectives from a diverse range of consumers and stakeholders. CCP24 have observed a significant 'step-up' in Evoenergy's engagement compared with previous regulatory reviews.”

Evoenergy meaningfully engaged with consumers through its existing community relationships and additional channels across the ACT, Queanbeyan and Bungendore.

⁹ Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 14.

¹⁰ CCP24, *Advice to the Australian Energy Regulatory on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 4.

It also effectively leveraged the expertise of its Energy Consumer Reference Council (ECRC) via regular updates on its proposal's development at ECRC meetings.¹¹

Evoenergy's proposal shows that it tailored its engagement approach to the knowledge requirements of its stakeholders by:

- having regard to the development stage of its proposal and the complexity of issues
- varying its engagement approach according to purpose (such as briefing key stakeholders on its finalised proposal prior to lodgement)
- working collaboratively with stakeholders on substantive matters with potentially lasting effects over several access arrangement periods (such as its Citizens' Jury).

The centrepiece of Evoenergy's engagement program was its Citizens' Jury, where it sought to gather consumer expectations and views on the future of its gas network. This ambitious, innovative and targeted engagement initiative was praised by stakeholders. We applaud Evoenergy for this initiative and in reflecting the Jury's recommendations in its 2021–26 proposal.

We acknowledge that Evoenergy pivoted responsively to online engagement with consumers in response to the COVID-19 pandemic, forcing it to truncate and re-imagine some of its planned in-person engagement. Evoenergy's asset stranding workshop utilised innovative collaborative software to deepen its discussion with consumers and highlight likely bill impacts under different depreciation scenarios.

Section 1.4 details further consideration of Evoenergy's consumer engagement program and our framework for assessing consumer engagement. It sets out the range of considerations that we think can clearly demonstrate whether consumers have been genuinely engaged in the development of the proposal.¹² While stakeholders have highlighted Evoenergy's significantly improved consumer engagement in this review, submissions suggest there is scope for Evoenergy to make greater use of the consumer engagement factors set out in section 1.4.

Response to jurisdictional emissions reduction targets

The future of natural gas is a live issue, particularly as renewable energy becomes cheaper and is increasingly becoming the choice of consumers. Whilst ACT and NSW consumers are still demanding gas and Evoenergy continues to connect consumers and support its network operations, gas networks across Australia are facing an evolving landscape with growing support for reducing carbon emissions by moving away from natural gas use for homes and businesses. This is occurring at varying speeds in different regions, driven primarily by jurisdictional government policy.

¹¹ Information on Evoenergy's ECRC is available here: <https://www.evoenergy.com.au/consumer-engagement-program/energy-consumer-reference-council>

¹² See Table 7, AER, *Draft decision, Jemena distribution determination 2021–26*, September 2020, p. 43.

This issue of uncertainty was considered by CCP24:¹³

“Evoenergy, along with other gas distribution network businesses, faces fundamental questions about the future of the gas network, driven by jurisdictional governments moving towards net zero emissions policies in a timeframe considerably less than the asset lives of a large part of the business’s asset base. Specifically, in the case of Evoenergy where the gas network spans two jurisdictions, the ACT Government has legislated for net zero emissions for the ACT by 2045. In NSW however, the Government has set a net zero emissions by 2050 policy objective that is yet to be established in legislation.”

Some network businesses, such as Evoenergy, are responding to uncertainties regarding the future of natural gas by conducting research into renewable gases, as well as seeking to recoup investments in long-lived network assets from consumers over a shorter time horizon to mitigate against asset stranding risk.

In its 2021–26 proposal, Evoenergy proposed reductions to the current standard asset lives for new pipeline assets to address potential cost recovery uncertainties caused by the ACT Government’s legislated 2045 net zero greenhouse gas emissions target. Evoenergy noted the ACT Government’s *Climate Change Strategy 2019–25* requiring the phasing out of natural gas use in the ACT and its replacement by renewable electricity.¹⁴ Evoenergy considers its proposal is an early, precautionary measure against rising bills as the result of declining gas consumer numbers. It submitted that accelerated depreciation of the assets will reduce the risk that, in the event of network closure, consumers who find it difficult or not feasible to move away from gas will be left to pay an unfair share of costs.¹⁵

There are a variety of views from stakeholders on these matters, but a common concern is the implication for future prices for consumers. Therefore, there may be a case for some precautionary steps to be taken sooner rather than later.

Based on our assessment of the information before us at this point in time, our draft decision accepts Evoenergy’s 2021–26 proposal for reductions to the standard asset lives for new pipeline assets located in the ACT, but not for new pipeline assets located in NSW, as set out in section 4.3.

We have considered the issues raised by Evoenergy which affect gas usage in its network. Evoenergy has considered the impact of the ACT Government’s climate change policies more holistically, with reductions proposed to its capex and demand forecasts in the ACT, along with reductions to asset lives, contributing to a 5.5 per cent real reduction in its asset base by the end of the 2021–26 period. Given the ACT Government’s climate change policies towards future natural gas use in the ACT and Evoenergy’s proposal to reduce network expansion in the ACT, we consider that shorter standard asset lives for the 2021–26 period could reduce potential asset stranding risk. The ACT Government has made a clear policy directive to significantly

¹³ CCP24, *Advice to the Australian Energy Regulatory on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 3.

¹⁴ Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 1.

¹⁵ *Ibid.*, p. iv.

reduce or eliminate natural gas consumption in the ACT by 2045, which goes beyond setting a net zero greenhouse gas emissions target. Based on the current evidence available to us, we consider there is a likelihood of the usage of Evoenergy's gas network declining, and therefore a greater likelihood that its ACT pipelines will not reach the end of their technical lives.

However, we do not consider that reduced asset lives are warranted for capex associated with NSW expansion, given that Evoenergy has a positive consumer growth outlook for this region and the ACT Government's climate change policies to curtail gas consumption do not apply to this region. It is not clear at this point in time whether Evoenergy would cease connecting new consumers in NSW if the ACT Government decided to move to full electrification in the ACT. Further, we note Evoenergy's capex and demand proposals are 'business as usual' in NSW. We consider it is appropriate to maintain the longer standard lives for pipeline assets being built in NSW as currently there is insufficient evidence to conclude that the economic lives of these assets would be shorter than their technical lives.

We consider our draft decision is a prudent, responsible and precautionary first step to protect the long term interests of Evoenergy's gas consumers from asset stranding risk. We will adapt our approach in future access arrangement reviews for the key considerations and changing circumstances that are relevant for each jurisdiction.

Our draft decision takes account of the views from stakeholder submissions, including the CCP24 who support Evoenergy's proposed steps for managing asset stranding risk and would like to see further stakeholder engagement on the future of gas. To this end, and in recognition of the importance of the gas market and our role in determining network access arrangements, we have elevated consideration of future gas market issues in our strategic priorities list. We are currently considering how the AER could advance this discussion with consumers, industry, market bodies and government stakeholders.

Next steps

Evoenergy now has the opportunity to consider our draft decision. It must submit its revised proposal to us by **13 January 2021**.

Interested stakeholders are invited to make submissions on both our draft decision and Evoenergy's revised proposal (once submitted) by **17 February 2021**.

We will make our final decision by **30 April 2021**.

1 Our draft decision

Our draft decision allows Evoenergy to set gas network tariffs which are expected to result in the recovery of \$311.9 million (\$ nominal, smoothed) in revenue from consumers from 1 July 2021 to 30 June 2026.

Evoenergy is regulated using a price cap.¹⁶ Incentives are provided to it to reduce costs, improve service quality and undertake efficient investments.

Gas pipelines that are subject to full regulation, like Evoenergy's, are regulated by us under an approved access arrangement.¹⁷ An access arrangement specifies certain pipeline services (reference services) and the price and non-price terms and conditions on which those reference services will be offered over a five-year period.

To approve an access arrangement, we make regulatory decisions on the network tariffs that pipeline operators, like Evoenergy, can charge users of its reference services.

For this draft decision, our assessment is based on the access arrangement proposal that Evoenergy submitted to us on 26 June 2020.¹⁸ Evoenergy's proposal sets out its view of its expected costs, demand and revenues for the 2021–26 period.

1.1 How our draft decision would affect gas bills

Gas distribution network tariffs that will be set by reference to our final decision are one contributor to consumers' total retail gas bills. Key contributors are:

- the cost of purchasing gas (the wholesale energy cost)
- the cost of the pipelines used to transport the gas (the transmission and distribution networks), and other infrastructure such as metering costs
- the retailer's costs and profit margin.

Each of these costs contribute to the retail prices charged to consumers by their chosen retailer.

¹⁶ This is a weighted average price cap (WAPC) tariff basket form of price control. This approach is consistent with other gas distributors and Evoenergy's current period access arrangement. See Attachment 10 for more information.

¹⁷ The NGL provides for different types of regulation to apply to gas pipelines, based on competition and significance criteria. A 'full regulation' pipeline must periodically submit an access arrangement to the AER, setting out pricing for a reference service sought by a significant part of the market. 'Light regulation' pipelines are not subject to upfront price regulation. The light regulation model is a negotiate-arbitrate approach, placing greater emphasis on commercial negotiation and information disclosure. The AER plays a role only if dispute resolution mechanisms are triggered.

¹⁸ Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, June 2020.

Our draft decision on Evoenergy affects the component of the bill relating to gas distribution pipelines. For consumers on Evoenergy's network, distribution charges account for approximately:

- 28 per cent of an average residential consumer's annual gas bill
- 22 per cent of an average small business consumer's annual gas bill.

We estimate the expected bill impact by varying the distribution charges in accordance with our draft decision, while holding all other components constant. This approach isolates the effect of our draft decision on distribution tariffs only. However, this does not imply that other components of the bill will remain unchanged across the access arrangement period.

Table 1 shows the estimated average annual impact of our draft decision, if implemented, for the 2021–26 period on retail gas bills for consumers on Evoenergy's network compared with Evoenergy's proposal (\$ nominal).

While we do not regulate retail prices, we estimate that if this draft decision is implemented, compared to current levels, average annual bills for Evoenergy's consumers would:¹⁹

- decrease by \$26 (2.1 per cent) for residential consumers and \$232 (1.7 per cent) for small business consumers in the first year²⁰
- increase by \$8 (0.6 per cent) for residential consumers and \$69 (0.5 per cent) for small business consumers in each of the next four years of the 2021–26 period.²¹

By the end of the 2021–26 period, bills for residential and small business consumers will have increased by \$5 (0.4 per cent) and \$44 (0.3 per cent), respectively.²² This compares to increases of \$26 (2.1 per cent) and \$232 (1.7 per cent) for residential consumers and small business consumers, respectively, if we were to accept Evoenergy's proposal in full.

¹⁹ As at 30 June 2021.

²⁰ As at 30 June 2022.

²¹ As at 30 June of each of the last four years of the 2021–26 period.

²² Compares 30 June 2026 (for the 2021–26 period) to 30 June 2021 (for the 2016–21 period).

Table 1 AER’s estimated impact of our draft decision and Evoenergy’s proposal on average annual gas bills for the 2021–26 period (\$ nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
AER’s draft decision						
Residential annual bill ^a	1,224 ^a	1,198	1,205	1,213	1,221	1,229
Annual change ^c		-26 (-2.1%)	7 (0.6%)	8 (0.6%)	8 (0.6%)	8 (0.6%)
Small business annual bill ^b	13,527 ^b	13,295	13,362	13,430	13,500	13,571
Annual change ^c		-232 (-1.7%)	67 (0.5%)	68 (0.5%)	70 (0.5%)	72 (0.5%)
Evoenergy’s proposal						
Residential annual bill ^a	1,224 ^a	1,217	1,225	1,233	1,241	1,249
Annual change ^c		-7 (-0.6%)	8 (0.6%)	8 (0.7%)	8 (0.7%)	8 (0.7%)
Small business annual bill ^b	13,527 ^b	13,463	13,535	13,608	13,683	13,759
Annual change ^c		-64 (-0.5%)	71 (0.5%)	73 (0.5%)	75 (0.6%)	77 (0.6%)

Source: AER analysis; Evoenergy, *RIN 10 Workbook 4 Bill Impacts*, June 2020.

- (a) Annual bill for 2020–21 reflects the average annual consumption of 28 GJ for Evoenergy’s residential consumers.
- (b) Annual bill for 2020–21 reflects the average annual consumption of 469 GJ for Evoenergy’s small business consumers.
- (c) Annual change amounts and percentages are indicative. They are derived by varying the network tariff contribution to the 2020–21 bill amounts in proportion to the change in the tariff path. Actual bill impacts will vary depending on gas consumption and tariff class.

1.2 What is driving revenue?

The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like-for-like basis. To do this, we use ‘real’ values based on a common year, which have been adjusted for the impact of inflation (\$2020–21).²³

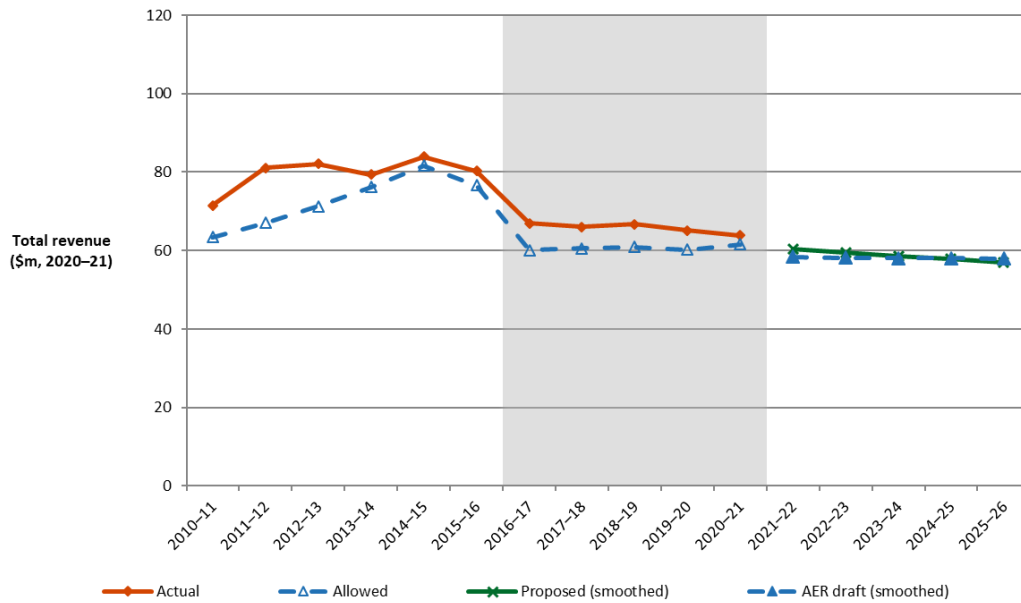
Figure 1 shows our draft decision for Evoenergy’s smoothed revenue for the 2021–26 period and its allowed revenue over the years between 2010–21.

This draft decision approves total revenue for the 2021–26 period that is \$33.5 million (10.3 per cent) lower than we approved in our 2016–21 decision.²⁴

²³ That is, 30 June 2021 dollar terms based on Evoenergy’s estimated actual revenue for 2020–21.

²⁴ The comparison of total revenue between 2021–26 and 2016–21 periods is based on unsmoothed revenue. In nominal dollar terms, our draft decision total revenue for the 2021–26 period is \$6.8 million (2.1 per cent) lower than total revenue approved for the 2016–21 period.

Figure 1 Revenue over time (\$ million, 2020–21)



Source: AER analysis.

Figure 2 shows the key drivers for the change in Evoenergy’s approved revenue from the 2016–21 period compared to what we expect in the 2021–26 period. It shows that our draft decision provides for decreases in the building blocks for:

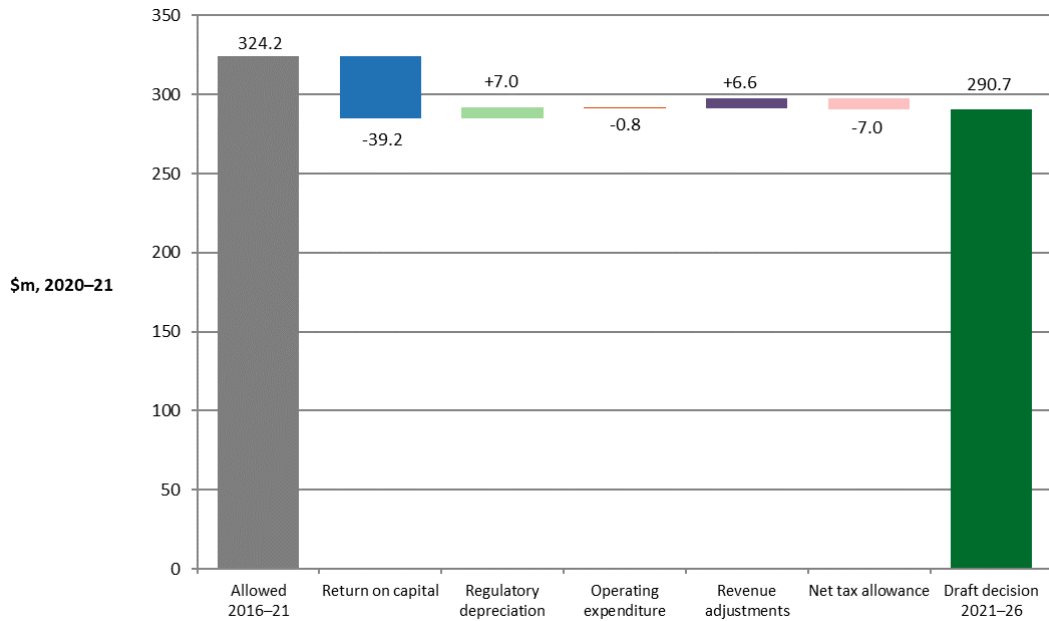
- return on capital, which is \$39.2 million (33.3 per cent) lower than 2016–21, driven by decreases in the nominal weighted average cost of capital (WACC) from 6.01 to 4.60 per cent in the first year of the 2016–21 and 2021–26 periods, respectively
- corporate income tax, which is \$7.0 million (83.9 per cent) lower than 2016–21, driven by the lower return on equity and higher gamma, as per the 2018 Rate of Return Instrument (Instrument) and application of our 2018 tax review²⁵

Figure 2 also shows our draft decision provides for increases in the building blocks for:

- regulatory depreciation, which is \$7.0 million (20.4 per cent) higher than 2016–21, driven by an increase in expenditure on short-life metering assets in the 2016–21 and 2021–26 periods
- revenue adjustments, which are \$6.6 million (83.2 per cent) higher than 2016–21, driven by an increase in the efficiency carryover mechanism (ECM) amount.

²⁵ AER, *Final report: Review of regulatory tax approach*, December 2018.

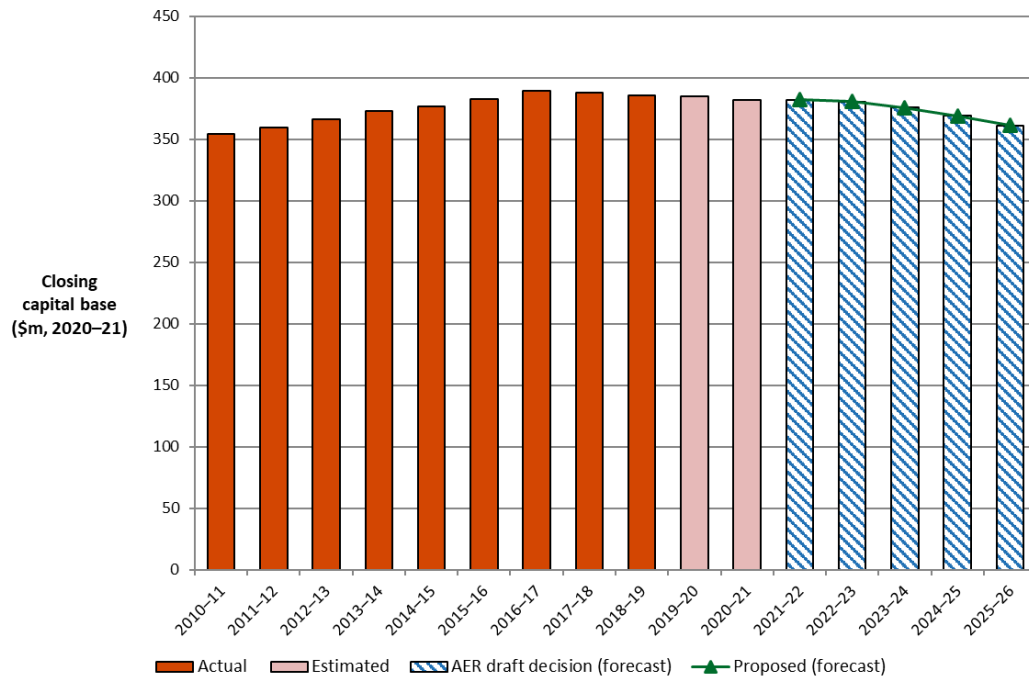
Figure 2 AER’s draft decision for the 2021–26 period and Evoenergy’s 2016–21 allowed building block costs (\$ million, 2020–21)



Source: AER analysis.

Figure 3 compares our draft decision on Evoenergy’s forecast capital base, to Evoenergy’s actual and proposed forecast capital base. It shows that Evoenergy’s capital base is forecast to decrease by 5.5 per cent by the end of the 2021–26 period.

Figure 3 Value of Evoenergy’s capital base over time (\$ million, 2020–21)



Source: AER analysis.

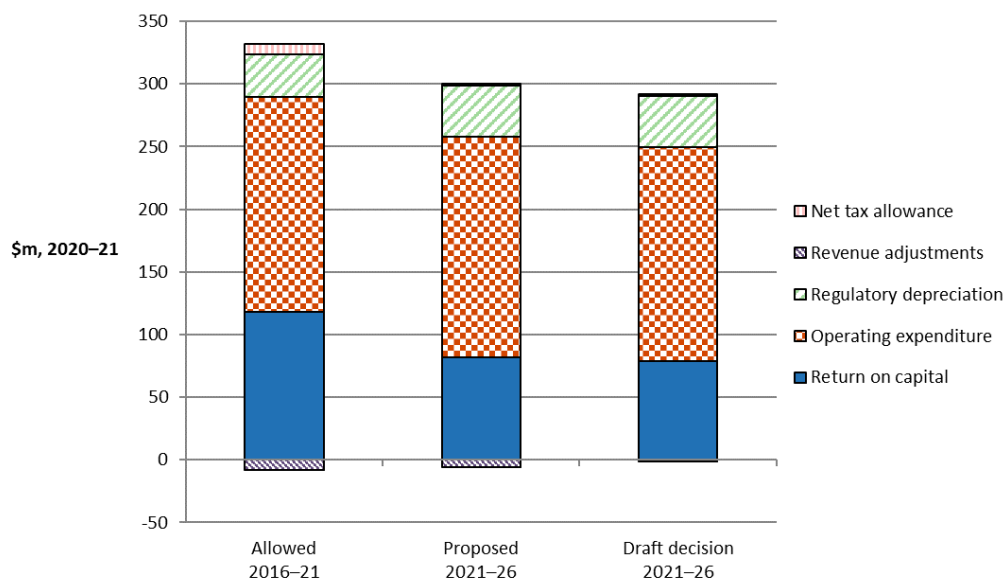
1.3 Key differences between draft decision and proposal

Evoenergy proposes total forecast revenue of \$314.9 million for the 2021–26 period.²⁶ Our draft decision of \$311.9 million allows \$3.1 million (1.0 per cent) less revenue than Evoenergy seeks to recover through its proposal.

Figure 4 compares the building block revenue from our draft decision to Evoenergy’s proposal for the 2021–26 period, and to approved revenue for the 2016–21 period.

The biggest contributor to the difference between our draft decision revenue and Evoenergy’s proposal is the current rate of return (and, therefore, the return on capital). Although Evoenergy has applied the 2018 Instrument and proposes a 4.68 per cent rate of return, currently the risk free rate and cost of debt is lower than at the time of its proposal, leading to a rate of return of 4.60 per cent. Consequently, the allowance for the return on capital building block is \$3.3 million (3.7 per cent) lower than proposed.

Figure 4 AER’s draft decision on components of total revenue (\$ million, 2020–21)



Source: AER analysis.

1.4 Evoenergy’s consumer engagement

Consumer engagement helps network businesses determine how best to provide services that align with consumers’ long term interests. Consumer engagement in this context is about Evoenergy working openly and collaboratively with its gas consumers and providing opportunities for their views and preferences to be heard and to

²⁶ Evoenergy, *Appendix 4.2 PTRM*, June 2020.

influence Evoenergy's decisions. The Rules also require us to consider the extent to which elements of Evoenergy's proposal address relevant concerns identified during its engagement with consumers.

In the regulatory process, stronger consumer engagement can help us test network businesses' expenditure proposals, and can raise alternative views on matters such as service priorities, capex and opex proposals, and tariff structures.

Evoenergy's consumer engagement in the preparation of its 2021–26 proposal has been well received by stakeholders, although submissions suggest there is scope for Evoenergy to make greater use of the consumer engagement factors we describe below. Consumer groups noted a significant improvement in the quality of Evoenergy's engagement compared to its previous reviews. Retailers' comments were also generally positive, although for some, not all issues could be resolved fully (specifically, Evoenergy's Reference Service Agreement (RSA)).²⁷

We use a range of considerations to demonstrate whether consumers have been genuinely engaged in the development of Evoenergy's proposal. As set out below, these include the nature of engagement, breadth and depth of engagement, clearly evidenced impact, and assessment of outcomes.²⁸

Nature of engagement

Overall, we consider that Evoenergy's consumer engagement was genuine, independent and consumer focused. In preparing its draft plan, Evoenergy engaged with a diverse group of stakeholders using existing community relationships and additional channels across the ACT, Queanbeyan and Bungendore. This included using its Energy Consumer Reference Council (ECRC)²⁹ to identify and include consumer and stakeholder groups in its engagement program planning.³⁰

Evoenergy tailored its consumer engagement approach to suit its stakeholders (such as household consumer, small to medium businesses, government, and energy retailers), having regard to the development stage of its proposal and the complexity of issues being discussed, enabling them to contribute to shaping the proposal.

Evoenergy's consumer engagement strategy comprised six phases and a range of engagement activities, including providing written feedback, online surveys, community roadshows, one-on-one consultations and deep dives.

²⁷ See Attachment 11 for further information.

²⁸ See Table 7; AER, *draft decision, Jemena distribution determination 2021–26, Overview*, September 2020, p. 43.

²⁹ Information on Evoenergy's ECRC is available here: <https://www.evoenergy.com.au/consumer-engagement-program/energy-consumer-reference-council>

³⁰ Evoenergy, *Attachment 1, Consumer engagement, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 1-1

Evoenergy also partnered with the ACT Council of Social Service (ACTCOSS) so that vulnerable consumers could contribute to its proposal.³¹ ACTCOSS submitted:³²

“We welcome Evoenergy’s commitment to work with stakeholders to understand and consider the needs of vulnerable customers and what they can do to help as they develop their transition roadmap.”

The centrepiece of Evoenergy’s engagement program, its Citizens’ Jury, was representative of the diverse community with which Evoenergy engages. The Jury’s 28 members were selected via an independent recruitment process and deliberated over the following question over two weekends in October and November 2019:³³

“The ACT Government has legislated for net zero greenhouse gas emission by 2045. Evoenergy is committed to transform the gas network to meeting this target. As part of this transition, what are our consumers expectations of the service provided to them?”

The Jury received expert presentations to inform their understanding of local, national and international issues relating to gas. In its initial phase, the Jury deliberated for more than 750 hours, gathering consumers’ expectations and views on the future of Evoenergy’s gas network.³⁴ The Jury’s final recommendations report was used to inform Evoenergy’s proposal.³⁵

The COVID-19 pandemic also saw Evoenergy adapt its consumer engagement approach by using collaborative software to host an asset stranding workshop to help consumers understand the potential impact on bills under different asset depreciation scenarios.

Our Consumer Challenge Panel (CCP24) submitted the following comments in respect of Evoenergy’s consumer engagement in developing its proposal:³⁶

“Evoenergy has developed a comprehensive Consumer and Stakeholder Engagement Strategy...and is ongoing...”

[CCP24] observed a significant ‘step-up’ in Evoenergy’s engagement...[and] consider that the engagement has been genuine and well-organised, and care has been taken to shape the program to suit the specific geographic and demographic characteristics of Evoenergy’s customer base. A variety of engagement tools was utilised ranging from an innovative Citizens’ Jury process to community ‘pop-up’ sessions.”

³¹ Ibid., pp. 1–5.

³² ACTCOSS, *Submission: Evoenergy’s gas network 2021–26 access arrangement proposal to the Australian Energy Regulator*, August 2020, p. 7.

³³ Evoenergy’s Citizens’ Jury comprised a cross-section of the ACT community (representing owners, tenants, landlords, business operator, concession card holders, Aboriginal and Torres Strait Islander and Culturally & Linguistically Diverse members).

³⁴ Evoenergy, *Appendix 1.1 – Promotion and engagement tools, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 2.

³⁵ Evoenergy, *Gas network consultation program*, is available here <https://www.evoenergy.com.au/about-us/about-our-network/gas-five-year-plan/gas-network-consultation-program>

³⁶ CCP24, *Advice to the Australian Energy Regulator on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, pp. 6–9.

Breadth and depth of engagement

We consider that Evoenergy’s consumer engagement was appropriately broad and it tailored its approach where necessary.

In submissions received, stakeholders noted Evoenergy’s extensive stakeholder engagement to consider the future of its gas network based on information from a variety of viewpoints. For instance, Evoenergy’s Citizens’ Jury, call for stakeholder submissions on its draft plan, hosting community roadshows on its proposal, and hosting deep dive sessions on complex subject matter such as asset stranding and depreciation.

Energy Consumers Australia (ECA) acknowledged the:³⁷

“...commitment by Evoenergy...to engage with consumers and advocacy groups, and the efforts made so far to find the right balance between affordability and transitioning to the future energy system.”

Evoenergy’s second phase of consumer engagement provided an opportunity for stakeholders, including its Citizens’ Jury, to provide feedback on elements of its draft plan, allowing participants to provide a position. In addition, a number of deep dives were undertaken to allow further deliberation on aspects of the Evoenergy’s proposal – initially to establish the capital expenditure sharing scheme (CESS) and performance measures, and more recently on stranded asset risk.

Clearly evidenced impact

We consider that Evoenergy is committed to including consumers in its decisions.

A phased approach to engagement allowed Evoenergy to understand consumer values and concerns to help shape its proposal. Consumer feedback is reflected in Evoenergy’s proposal for the following four themes: environmental sustainability; responsible transition; safe and reliable service; and affordability and fairness:³⁸

“Environmental sustainability, as embodied in the ACT Government’s climate change policy leading to net zero greenhouse gas emissions from activities in the ACT by 2045, has widespread support in the community...

As well as incorporating elements...under environmental sustainability for acting consistently with the ACT climate change strategy, responsible transition also involves a least cost and orderly transition to net zero emissions...

Many consumers will continue to use gas during the transition to net zero emissions, and Evoenergy needs to maintain a reliable service and to ensure absolutely that the network remains safe for them, network technicians, and the general community...

³⁷ Energy Consumers Australia, *Evoenergy and Australian Gas Networks (SA) Gas access arrangement proposals 2021–25 submission*, August 2020, p. 5.

³⁸ Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 14.

Consumers are concerned about the high price of gas services and note the need to ensure that Evoenergy’s network prices promote affordability wherever possible.”

We also note that members of Evoenergy’s leadership team participated in engagement activities and were present to accept advice from stakeholders.

While stakeholders have commended Evoenergy on its consumer engagement and for incorporating many consumer views and priorities into its 2021–26 proposal, there are some areas that Evoenergy could continue to explore with consumers. For example:

- engaging with stakeholders on a detailed analysis, as opposed to high level engagement, in managing the transitional impacts as the ACT moves toward the legislated 2045 net zero greenhouse gas emissions target
- consideration of engagement activities that allow a range of ACT and NSW stakeholders across Evoenergy’s network to participate and collaborate,³⁹ with a focus on initiatives that promote consumer affordability and cost competitiveness.⁴⁰

ACTCOSS submitted:⁴¹

“...further work is needed now – as a critical part of the GN21 plan – to better understand and consider the needs of vulnerable consumers.

ACTCOSS recommends that Evoenergy’s GN21 plan be informed by an evidence base on vulnerable gas consumers that can provide insights into: which customers are vulnerable; what makes these customers vulnerable; the impact of the GN21 plan on vulnerable customers; and what specific measures Evoenergy could include in the GN21 plan to support vulnerable customers and improve their circumstances.”

CCP24 submitted similar remarks, particularly in relation to the impact of the move towards net zero emissions and tariff structures:⁴²

“Evoenergy is actively considering further engagement on these topics in the form of deep dives involving a range of customer and stakeholder representatives. CCP24 encourages Evoenergy to continue progressing these activities.”

Assessment of outcomes

Once we have considered the nature, scope and impact of the consumer engagement, our final step is to consider whether the outcome, as presented by Evoenergy in its proposal, is in the long term interests of consumers.

³⁹ CCP24, *Advice to the AER on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 11.

⁴⁰ Energy Consumers Australia, *Evoenergy and Australian Gas Networks (SA) Gas access arrangement proposals 2021–26 submission*, August 2020 - TRAC Partners Technical Report on Evoenergy’s 2021–26 access arrangement proposal, slides 9–10.

⁴¹ ACTCOSS, *Submission: Evoenergy’s gas network 2021–26 access arrangement proposal to the Australian Energy Regulator*, August 2020, p. 13.

⁴² CCP24, *Advice to the AER on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 11.

We do this undertaking our standard process. That is, we compare expenditures proposed by Evoenergy with those our established models and approaches suggest represent alternative estimates. If Evoenergy's proposal aligns with or is below our estimates, we are able to have greater confidence that the results of the consumer engagement are in the long term interests of consumers.

As set out in section 4.5, our draft decision approves Evoenergy's opex proposal. We have asked Evoenergy to provide additional information before we can accept its capex proposal, as set out in section 4.4.

2 Reference services and tariffs

This section summarises our 2021–26 draft decision on the services covered by Evoenergy’s access arrangement, the reference tariff setting and variation mechanism, and forecast demand.

2.1 Services covered by the access arrangement

The access arrangement must specify the pipeline services Evoenergy proposes to be reference services having regard to the reference service factors.⁴³ For each reference service, including services ancillary to the reference services, the access arrangement specifies the reference tariff and the other terms and conditions on which these services will be provided.⁴⁴

Evoenergy is to provide access to its reference services on the terms set out in its access arrangement, but may negotiate alternative terms and conditions at alternative prices with users. Evoenergy may also offer other non-reference services (negotiated services) which are not subject to regulation under the access arrangement. We may be called upon to determine the tariff and other conditions of access to services if an access dispute arises.⁴⁵

Evoenergy’s proposed reference service for the 2021–26 period is largely the same as its reference service for the 2016–21 period, and includes:

- haulage services (transportation of gas, meter reading and associated data activities, and ancillary activities such as disconnections, special meter reading, as may be requested by a user).

Evoenergy proposes to offer two additional non-reference services:

- interconnection service
- negotiated service.

Our draft decision approves Evoenergy’s reference service proposal for the 2021–26 period.

Evoenergy’s reference service proposal is consistent with the reference service proposal it submitted on 28 June 2019, as required under the Rules. At that time, we assessed Evoenergy’s proposal against Rules requirements, including the reference service factors. We consulted publically, but did not receive any submissions. We published our decision on the proposal on 25 November 2019.⁴⁶

⁴³ NGR, modified rr. 48(1)(c) and 47A(15).

⁴⁴ NGR, modified r. 48(1)(e).

⁴⁵ NGL, Chapter 6.

⁴⁶ AER, *Final Decision, Evoenergy Gas Distribution Determination 2021 to 2026, Reference Service*, November 2019.

2.2 Reference tariff setting and variation mechanism

Our draft decision includes decisions on the structure and levels of Evoenergy's reference tariffs (reference tariff setting) and the mechanism by which those tariffs can vary over the access arrangement period (reference tariff variation mechanism).

Reference tariff setting requires Evoenergy to explain how it allocates revenues and costs between reference services and other services, and how it determines different tariffs. This involves setting and applying the formula by which Evoenergy can recover its costs.

For the 2021–26 period, Evoenergy proposes to retain its declining block tariff structure, but simplify tariff classes and categories. It also proposes to improve the cost reflectivity of ancillary charges.

We accept Evoenergy's proposed changes to its reference tariff classes, tariff categories and ancillary charges for the 2021–26 period. We are satisfied the proposed structure of the reference tariffs complies with NGR requirements, and the declining block tariff structure is consistent with the price cap form of control. As part of a separate discussion with stakeholders on future gas market issues, there may be merit in reviewing the consistency of declining tariff block structures which promote natural gas consumption, with jurisdictional policy settings that are aimed at curbing natural gas consumption.

The reference tariff variation mechanism:

- permits building block revenues to be recovered smoothly over the access arrangement period, subject to any differences between forecast/actual demand
- accounts for actual inflation
- accommodates other reference tariff adjustments that may be required, such as for an approved cost pass through event
- sets administrative procedures for the approval of any proposed changes to reference tariffs

Evoenergy proposes to retain the current method for varying reference tariffs, including the weighted average price cap form of control, with some minor amendments.

We accept most of Evoenergy's proposed reference tariff variation mechanism for the 2021–26 period. We consider that some elements of Evoenergy's proposal are not consistent with the Rules. In particular, we do not accept:

- the proposed amendment to the consumer price index (CPI) measure
- the proposal to vary reference tariffs during a financial year to apply at a date prior to the start of the next financial year
- all of Evoenergy's proposed pass through event definitions.

Our draft decision updates the cost pass through events that will apply to Evoenergy in the 2021–26 period. We have accepted the cost pass through events proposed by

Evoenergy, with some definitional adjustments, and they are consistent with those we approved previously for 2016–21 period.

2.3 Forecast demand

Under a weighted average price cap, demand is an important input into the derivation of Evoenergy’s reference tariffs. In simple terms, tariffs are determined by dividing cost (forecast revenue) by total demand (GJ/day per consumer for each tariff class). This means that a decrease in forecast demand leads to an increase in tariffs, and vice versa. Forecast demand also affects forecasts for opex and capex (new connections) which inform our decision on the total revenue requirement.

Our draft decision is to not accept Evoenergy’s proposed demand forecast for individual volume consumers (Tariff VI) for the 2021–26 period. We have provided an alternative forecast as a placeholder, as set out in Table 2. Specifically, we do not accept the following aspects pending further information, analysis and updates to the latest source data:

- Evoenergy’s post-model adjustment to increase the incremental impact of the ACT Energy Efficiency Improvement Scheme (EEIS) from 2.8 per cent (as forecast by Evoenergy’s consultant, The Centre for International Economics (CIE)) to 10 per cent by 2025–26
- Evoenergy’s post-model adjustment to triple the rate of permanent disconnections (abolishments) from CIE’s forecast by 2025–26.

Table 2 AER’s draft decision on Evoenergy’s forecast demand (Tariff VI) for the 2021–26 period

	2021–22	2022–23	2023–24	2024–25	2025–26
Residential and Commercial Connections ^a	152,990	154,594	156,116	157,700	159,354
Total Residential and Commercial Demand (TJ)	6,448	6,388	6,340	6,314	6,255

Source: AER analysis using CIE demand forecasting model.
 (a) Closing connections including suspended connections.

Our draft decision is to accept the following aspects of Evoenergy’s demand forecast for the 2021–26 period, which we consider reasonable:

- the base model, which has been derived by CIE and takes into account of weather normalisation, price elasticity, historical trends and projections in line with the Australian Energy Market Operator’s (AEMO) demand forecasting approach
- Evoenergy’s input assumption to exclude four ACT postcodes from its connection forecast, on the basis these greenfield development areas are likely to be the first to cease connection to the gas network driven by existing ACT Government policy
- Evoenergy’s proposed demand forecast for volume boundary consumers (Tariff VB)

- Evoenergy’s proposed demand forecast for industrial and large government consumers (Tariff D).

Evoenergy’s proposed demand forecasts represent:

- A decrease in total residential and commercial gas demand of 2.65 per cent per year over the 2021–26 period, which is lower than the 3.06 per cent per year decrease for the 2016–21 period. This is due to forecast reductions in consumption per connection of 3.39 per cent per year being partially offset by net consumer growth of 0.76 per cent per year.⁴⁷ This compares to our alternative demand forecasts which represent a decrease in total residential and commercial gas demand of 0.76 per cent per year, and an increase in net consumer growth of 1.02 per cent per year, over the 2021–26 period.
- A decrease in industrial and large government demand of 0.04 per cent per year over the 2021–26 period, compared to an increase of 0.87 per cent per year over the 2016–21 period.

⁴⁷ This compares to a reduction in consumption per connection of 4.85 per cent per year, and a growth in net consumer connections of 1.91 per cent, in the 2016–21 period.

3 Total revenue requirement

The total revenue requirement is a forecast of the efficient cost of providing gas distribution services over the 2021–26 period. We determine annual revenue, and the total revenue requirement, in nominal terms. To do this, we take into account expected future inflation to determine nominal price levels in future periods. Our draft decision uses 10-year inflation expectations to convert revenues to nominal values.

Tariffs are derived from the total revenue requirement after consideration of demand for each tariff category. Our 2021–26 draft decision is that Evoenergy will continue to operate under a weighted average tariff cap. This means the tariffs we determine (including the means of varying the tariffs from year-to-year) are the binding constraint across the 2021–26 period, rather than the total revenue requirement set in our decision.⁴⁸

Tariffs are adjusted each year using ‘X factors’ (the percentage changes in real weighted average tariffs from year-to-year) as explained further in section 3.3.

3.1 The building block approach

We employ a building block approach to determine Evoenergy’s total revenue requirement. That is, we base the total revenue requirement on our estimate of the efficient costs that Evoenergy is likely to incur in providing its reference services. The building block costs, as shown in Figure 5, include:⁴⁹

- return on the projected capital base (or return on capital) – to compensate investors for the opportunity cost of funds invested in the business⁵⁰
- depreciation of the projected capital base (or return of capital) – to return the initial investment to investors over time⁵¹
- forecast opex – the operating, maintenance and other non-capital expenses incurred in the provision of network services
- revenue adjustments – including revenue increments/decrements resulting from the application of incentive schemes
- estimated cost of corporate income tax.

We use an incentive approach where, once regulated revenues are set for a five-year period, networks that keep actual costs below the regulatory forecast of costs retain

⁴⁸ Where 2021–26 actual demand varies from the 2021–26 demand forecast, Evoenergy’s actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, Evoenergy’s actual revenue will be above forecast revenue, and vice versa.

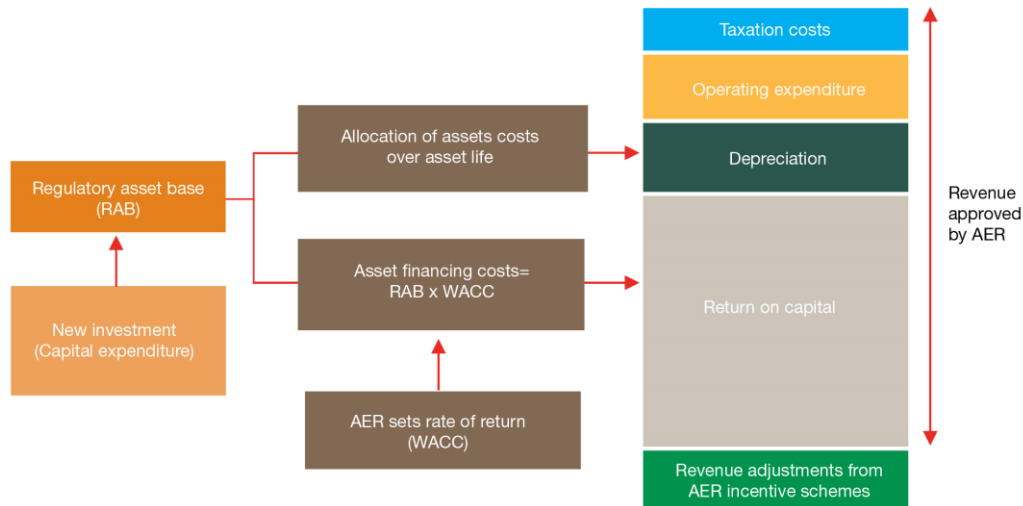
⁴⁹ NGR, r. 76.

⁵⁰ Note that forecast capex approved in our decision affects the projected size of the capital base and, therefore, the revenue generated from the return on capital and depreciation building blocks

⁵¹ Ibid.

part of the benefit. This incentive framework is a foundation of our regulatory approach and promotes the delivery of the National Gas Objective (NGO). Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

Figure 5 The building block approach to determining total revenue



Our 2021–26 draft decision for Evoenergy, by building block, is summarised in the next section, including high-level reasons and analysis.

3.2 Draft decision on total revenue

Our draft decision sets out a number of amendments to the building block inputs which make up Evoenergy’s total revenue requirement proposal of \$314.9 million (\$ nominal, smoothed). We expand on these in section 4.

Based on our assessment of the building block costs,⁵² our draft decision determines a lower total revenue requirement of \$311.9 million (\$ nominal, smoothed).⁵³

It follows that our draft decision requires amendments to the 4.4 per cent reduction in real tariffs that Evoenergy is proposing for 2021–22. However, we accept Evoenergy’s proposed tariff path, which provides for constant real tariffs throughout 2022–26.

As a result of our lower total revenue requirement and higher demand forecast compared to what Evoenergy is proposing, our draft decision is for a larger real decrease in weighted average tariffs of 9.8 per cent in 2021–22, followed by constant real tariffs in the remaining four years of the 2021–26 period. Section 3.3 discusses our approach to revenue smoothing and tariffs.

⁵² Using the building block approach set out in the NGR, r. 76.

⁵³ This is calculated by smoothing the unsmoothed building block revenue for the 2021–26 period, as set in this decision.

Table 3 sets out our draft decision on Evoenergy’s total revenue requirement (by building block) for each year of the 2021–26 period, the total revenue after equalisation (smoothing), and the X factors for use in the tariff variation mechanism.

Table 3 AER’s draft decision on Evoenergy’s smoothed total revenue and X factors for the 2021–26 period (\$ million, nominal)

Building block	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	17.6	17.3	17.0	16.4	15.8	84.1
Regulatory depreciation	6.5	7.9	9.0	10.0	11.0	44.4
Operating expenditure	33.7	35.9	36.1	37.8	40.0	183.7
Revenue adjustments	0.5	–1.4	–0.1	–0.5	0.0	–1.4
Net tax allowance	0.3	0.3	0.3	0.3	0.3	1.4
Building block revenue – unsmoothed	58.7	60.1	62.2	64.0	67.2	312.2
Building block revenue – smoothed	59.7	61.0	62.3	63.8	65.1	311.9
X factors ^a	9.77%	0.00%	0.00%	0.00%	0.00%	n/a
Inflation forecast	2.37%	2.37%	2.37%	2.37%	2.37%	n/a
Nominal price change ^b	–7.63%	2.37%	2.37%	2.37%	2.37%	n/a

Source: AER analysis.

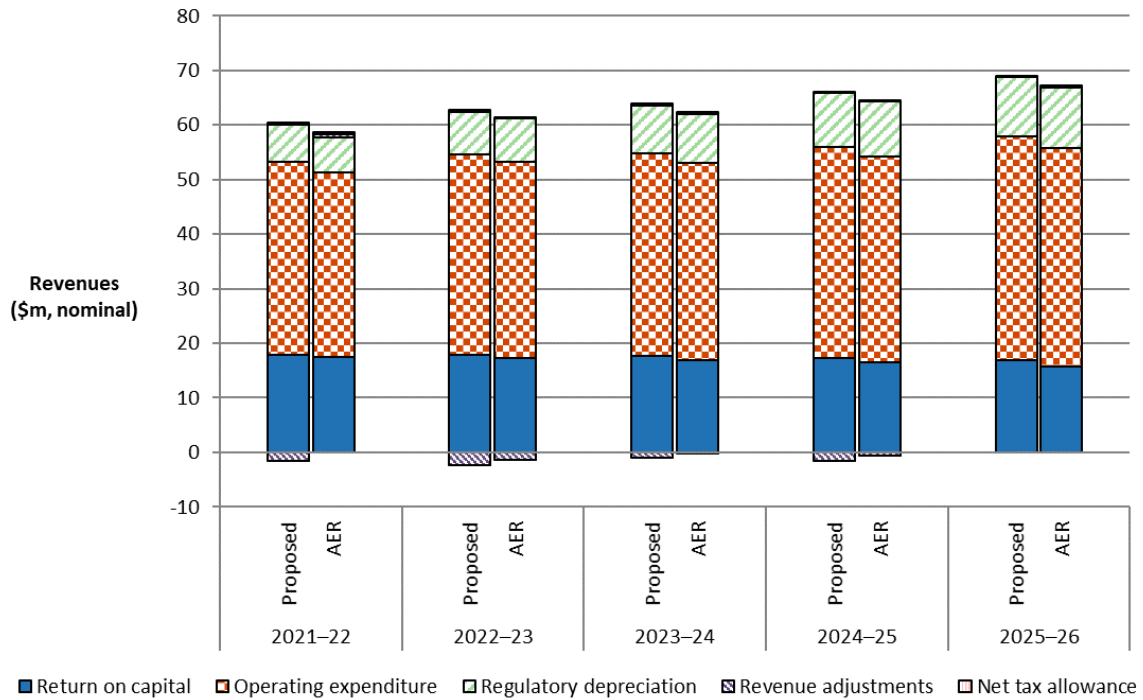
n/a: not applicable.

(a) Under the CPI–X form of control, a positive X factor is a decrease in price (and, therefore, in revenue). The X factor for 2021–22 is indicative only. Our decision establishes 2021–22 tariffs directly, rather than referencing a change from 2020–21 tariffs.

(b) The formula for a nominal price change under the CPI–X form of control is: $[(1+CPI)*(1-X \text{ factor})]-1$.

Figure 6 shows the effect of our draft decision adjustments to Evoenergy’s proposed building blocks for the 2021–26 period. It shows reductions to the proposed building blocks for the return on capital, depreciation and tax.

Figure 6 AER’s draft decision and Evoenergy’s proposed building block revenue (unsmoothed) (\$ million, nominal)



Source: AER analysis.

Note: Revenue adjustments includes the efficiency carryover mechanism (ECM).

3.3 Revenue smoothing and tariffs

After our assessment of Evoenergy’s total building block revenue (unsmoothed), we determine the forecast revenue profile (smoothed) across the 2021–26 period.⁵⁴

Evoenergy operates under a weighted average price cap as its tariff variation mechanism. This means we must determine the weighted average tariff change each year such that the net present value (NPV) of unsmoothed and smoothed revenue is equal across the 2021–26 period.⁵⁵ This weighted average tariff change is known as the ‘X factor’.

As part of the annual reference tariff variation process, we combine the X factors we have determined in our decision with actual inflation to create reference tariffs for the coming year. This means that the average prices paid by consumers, and therefore the revenues received by Evoenergy, change with the X factor plus actual inflation.⁵⁶

⁵⁴ This process of smoothing revenues is described in the NGR as ‘revenue equalisation’. See NGR, r. 92.

⁵⁵ See Attachment 10 for information on the mechanics of the tariff variation mechanism.

⁵⁶ Under the CPI–X form of control, a positive X factor represents a decrease in price (and, therefore, in revenue). Conversely, a negative X factor represents an increase in price (and, therefore, in revenue).

Table 4 presents our draft decision X factors compared to Evoenergy's proposal.

Table 4 Weighted average tariff change (X factors) across the 2021–26 period — AER's draft decision and Evoenergy's proposal

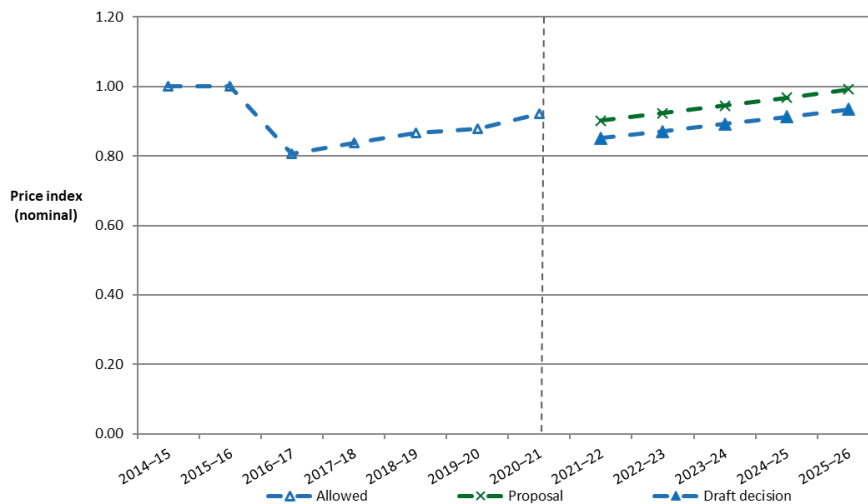
	2021–22	2022–23	2023–24	2024–25	2025–26
AER's draft decision					
X factor ^a	9.77%	0.00%	0.00%	0.00%	0.00%
Nominal price change	-7.63%	2.37%	2.37%	2.37%	2.37%
Evoenergy's proposal					
X factor ^a	4.40%	0.00%	0.00%	0.00%	0.00%
Nominal price change	-2.11%	2.40%	2.40%	2.40%	2.40%

Source: AER analysis; Evoenergy, *Appendix 4.2 PTRM*, June 2020.

(a) Under the CPI-X form of control, a positive X factor is a decrease in price (and, therefore, in revenue). For example, in the table above, an X factor of 0 per cent in 2022–23 means a constant real price for this year; after consideration of inflation, this becomes a nominal price increase of 2.37 per cent. The X factor for 2021–22 is indicative only. The draft decision establishes 2021–22 tariffs directly, rather than referencing a change from 2020–21 tariffs.

Figure 7 shows indicative tariff paths for Evoenergy's reference services across the 2021–26 period. It compares Evoenergy's proposed tariff path with that approved previously for the 2016–21 period, and with this draft decision.⁵⁷ This provides a broad, overall indication of the average movement in tariffs across the 2021–26 period.

Figure 7 Indicative reference tariff paths for Evoenergy's reference services from 2016 to 2026 (nominal index)



Source: AER analysis; Evoenergy, *Appendix 4.2 PTRM*, June 2020.

⁵⁷ The tariff path for 2016–26 uses actual inflation outcomes for 2016–20, and expected inflation for 2020–26.

Evoenergy's proposed tariff path for the 2021–26 period is for an initial decrease of 2.1 per cent (\$ nominal) in 2021–22, followed by increases of 2.4 per cent in each of the remaining four years of the 2021–26 period.⁵⁸

Our draft decision provides for lower forecast smoothed revenue than Evoenergy's proposal, in line with our amendments to total unsmoothed revenue. Our draft decision also provides for higher forecast demand for the 2021–26 period as described in section 3.3. As such, a decrease of 7.6 per cent to tariffs is required in the first year (2021–22) of the 2021–26 period to reflect the change in smoothed revenue from the 2016–21 period, which is followed by increases of 2.4 per cent in each of the remaining four years of the 2021–26 period.

In choosing the smoothing profile, we have balanced a number of competing objectives:

- equalising (in NPV terms) unsmoothed and smoothed revenue
- providing price signals that reflect the underlying efficient costs
- minimising variability in tariffs in 2020–21 and within the 2021–26 period
- minimising the likelihood of variability in tariffs at the start of the 2026–31 period
- recognising stakeholder preferences for a particular tariff path.

Each of these points is discussed in turn.

First, we are satisfied that our tariff path for Evoenergy's 2021–26 period achieves revenue equalisation, as required under the Rules.⁵⁹ As we have reduced the unsmoothed revenue proposed by Evoenergy, we have set the tariff path so that it adjusts the smoothed revenue downward to equalise with the unsmoothed building block costs.

Second, and related to the first point, our smoothing allows closer alignment of tariffs and costs. This aids the achievement of the NGO and the revenue and pricing principles (RPP), including through providing a price signal that facilitates efficient use of natural gas services.⁶⁰ Our tariff path shows a larger decrease in the first year of the 2021–26 period, reflecting the lower unsmoothed building block costs and higher demand forecast compared to Evoenergy's proposal.

Third, in setting the tariff path, we aim to minimise tariff volatility in 2020–21 and within the 2021–26 period. Our chosen tariff path reflects this objective, but also reflects the consideration we must give to other competing objectives. For instance, setting a flat tariff path from 2020–21 would better minimise within-period volatility, but would not achieve revenue equalisation.

⁵⁸ Evoenergy's proposed nominal tariff path reflects its proposed expected inflation of 2.40 per cent.

⁵⁹ NGR, r. 92(2). The revenue equalisation occurs in NPV terms, discounting the yearly cash flows at the rate of return to reflect the time value of money.

⁶⁰ NGL, ss. 23 and 24.

Fourth, in setting the tariff path, we also aim to minimise the likelihood of tariff volatility between the 2021–26 and 2026–31 periods. We do not know with certainty what Evoenergy’s efficient costs will be in 2026–27, or across the 2026–31 period more generally. The unsmoothed building block costs for 2025–26 (the last year of the 2021–26 period) are the best available proxy. Hence, this objective requires minimising the divergence between smoothed and unsmoothed revenues for 2025–26. If there are no significant changes in forecast costs from 2025–26 to 2026–27, this final year divergence provides an estimate of the size of the tariff change at the start of the 2026–31 period. For this draft decision, this final year divergence is 3 per cent, which is within our preferred target range of +/-3 per cent. We note that if there are significant changes in costs at the start of the 2026–31 period, this might increase or decrease the required tariff change at that time.

Finally, our tariff path is consistent with Evoenergy’s proposed tariff path of an initial decrease to tariffs in the first year, followed by constant tariffs in real terms in the remaining years, of the 2021–26 period. We note that this tariff path is supported by ACTCOSS.⁶¹ Other stakeholders did not raise any concerns with the proposed profile.

We are satisfied that our tariff path reflects a balanced consideration of competing objectives. We will review this smoothing profile for the final decision, if necessary.

⁶¹ ACTCOSS, *Submission: Evoenergy’s gas network 2021–26 access arrangement proposal to the AER*, August 2020, p. 7.

4 Key elements of our draft decision on revenue

The components of our draft decision include the building blocks we use to determine the revenue that Evoenergy may recover from its users. The following sections summarise our revenue decision by building block. The Attachments to this draft decision provide a more detailed explanation of our analysis and findings.

4.1 Capital base

The capital base roll forward accounts for the value of Evoenergy's regulated assets over the access arrangement period. The opening value of the capital base is used to determine the return on capital and return of capital (depreciation) building blocks. To calculate the capital base for a regulatory year within an access arrangement period, the opening value of the capital base is rolled forward by indexing it for inflation, adding any conforming capex, and subtracting depreciation and other possible factors (such as disposals or consumer contributions).⁶² Following this process, we also arrive at a closing value of the capital base at the end of each regulatory year of an access arrangement period.

We are required to make a decision on Evoenergy's opening capital base as at 1 July 2021 for the 2021–26 period, and Evoenergy's projected capital base for the 2021–26 period.

For this draft decision, we determine an opening capital base of \$381.9 million (\$ nominal) as at 1 July 2021, which is \$0.4 million (0.1 per cent) lower than Evoenergy's proposed opening capital base of \$382.3 million.⁶³ This reduction is made because we have amended Evoenergy's proposed roll forward model (RFM) to update the actual capex and CPI inputs for 2014–15. Table 5 summarises our draft decision on the roll forward of Evoenergy's capital base during the 2016–21 period.

We determine a projected closing capital base of \$405.7 million (\$ nominal) as at 30 June 2026, which is \$0.8 million (0.2 per cent) lower than Evoenergy's proposed closing capital base of \$406.6 million.⁶⁴ Our draft decision reflects the updated opening capital base as at 1 July 2021, and our decisions on the expected inflation rate (section 4.2.3) and forecast depreciation (section 4.3) and forecast capex (section 4.4). Table 6 sets out the projected roll forward of the capital base for the 2021–26 period.

We accept Evoenergy's proposal to establish the opening capital base as at 1 July 2026 using the approved depreciation schedules based on forecast capex over the 2021–26 period.⁶⁵ These depreciation schedules will be adjusted for actual inflation

⁶² The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

⁶³ Evoenergy, *Appendix 4.1 RFM*, June 2020.

⁶⁴ Evoenergy, *Appendix 4.2 PTRM (Public)*, June 2020.

⁶⁵ Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang regional gas distribution network 1 July 2021 – 30 June 2026*, June 2020, p. 15.

outcomes over this period. Attachment 2 sets out detailed reasons for our draft decision on Evoenergy's capital base.

Table 5 AER's draft decision on Evoenergy's capital base roll forward for the 2016–21 period (\$ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20 ^a	2020–21 ^b
Opening capital base	338.4	349.7	361.1	366.9	371.4	377.0
Net capex ^c	17.4	19.6	13.2	13.3	15.1	15.1
Indexation of capital base ^d	5.7	5.2	6.9	6.5	6.8	7.5
Less: straight-line depreciation ^e	11.8	13.4	14.3	15.3	16.3	17.3
Interim closing capital base	349.7	361.1	366.9	371.4	377.0	382.3
Difference between estimated and actual capex in 2014–15 capex						–0.3
Return on difference for 2014–15 capex						–0.0 ^f
Closing capital base as at 30 June 2021						381.9

Source: AER analysis.

- (a) Based on estimated capex provided by Evoenergy. We will update the capital base roll forward for actual capex in the final decision.
- (b) Based on estimated capex provided by Evoenergy. We expect to update the capital base roll forward with a revised capex estimate in the final decision, and true-up the capital base for actual capex at the next access arrangement review.
- (c) Net of disposals and capital contributions, and adjusted for actual CPI. The 2015–16 capex is included in the roll forward period as it was an interval of delay.
- (d) We will update the capital base roll forward for actual CPI for 2020–21 in the final decision.
- (e) Adjusted for actual CPI. Based on forecast capex.
- (f) This reflects a small negative value.

Table 6 AER's draft decision on Evoenergy's projected capital base roll forward for the 2021–26 period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening capital base	381.9	391.0	398.7	402.9	405.0
Net capex ^a	15.6	15.6	13.1	12.1	11.8
Indexation of opening capital base	9.1	9.3	9.5	9.6	9.6
Less: straight-line depreciation	15.6	17.2	18.4	19.6	20.7
Closing capital base	391.0	398.7	402.9	405.0	405.7

Source: AER analysis.

- (a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the capital base for revenue modelling.

4.2 Rate of return and value of imputation credits

The return each business is to receive on its capital base (the ‘return on capital’) is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the capital base.

We estimate the rate of return by combining the returns of two sources of funds for investment – equity and debt. The allowed rate of return provides the business with a return on capital to service the interest rate on its loans and give a return on equity to investors.

An accurate estimate of the rate of return is necessary to promote efficient prices in the long term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Conversely, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

We are required by the National Gas Law (NGL) to apply a rate of return instrument – the current 2018 Rate of Return Instrument (Instrument) – to estimate an allowed rate of return.⁶⁶

We have applied the Instrument and estimate a placeholder allowed rate of return of 4.60 per cent (nominal vanilla), which will be updated for our final decision on the averaging periods. Evoenergy’s proposal adopted the Instrument.⁶⁷

Our calculated rate of return, as set out in Table 7, would apply to the first year of the 2021–26 period. A different rate of return would apply for the remaining regulatory years of the period. This is because we will update the return on debt component of the rate of return each year, in accordance with the Instrument, to use a 10-year trailing average portfolio return on debt that is rolled-forward each year. Hence, only 10 per cent of the return on debt is calculated from the most recent averaging period, with 90 per cent from prior periods.

Our draft decision accepts Evoenergy’s proposed risk free rate averaging period⁶⁸ and debt averaging periods because they comply with the conditions set out in the Instrument.⁶⁹

⁶⁶ NGL, Chapter 2, Part 1, division 1A, AER, *Rate of Return Instrument*, December 2018, available here <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-instrument-2018/final-decision>

⁶⁷ Evoenergy, *Attachment 5 – Rate of return, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–2026*, June 2020, p. 5-2.

⁶⁸ This is also known as the return on equity averaging period.

⁶⁹ AER, *Rate of Return Instrument*, December 2018, cl. 7–8, 23–25, 36.

Table 7 AER’s draft decision on Evoenergy’s rate of return (% nominal)

	AER final decision (2016–21)	Evoenergy’s Proposal (2021–26)	AER draft decision (2021–26)	Allowed return over the access arrangement period
Nominal risk free rate	2.57%	1.00%	0.91% ^a	
Market risk premium	6.50%	6.10%	6.10%	
Equity beta	0.7	0.6	0.6	
Return on equity (nominal post–tax)	7.10%	4.66%	4.57%	Constant (%)
Return on debt (nominal pre–tax)	5.31% ^b	4.69%	4.62% ^a	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	6.03%	4.68%	4.60%	Updated annually for return on debt
Expected inflation	2.18%	2.40%	2.37%	Constant (%)

Source: AER analysis; Evoenergy, *Attachment 4 – Capital base and depreciation, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020; Evoenergy, *Attachment 5 – Rate of return, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020.

^a Calculated using a placeholder averaging period of 20 business days ending 31 August 2020.

^b Applies to the first year of the 2016–2021 access arrangement period.

4.2.1 Debt and equity raising costs

In addition to providing for the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity. We include debt raising costs in the opex forecast because these are regular and ongoing costs. We include equity raising costs in the capex forecast because these costs are only incurred once and would be associated with funding the particular capital investments.

For debt raising costs, our draft decision is to accept the method used in Evoenergy’s proposal which uses an annual rate of 8.46 basis points per annum (bppa).⁷⁰ We have considered this annual rate and found that our alternative benchmark estimate (9.42 bppa) is not materially different from Evoenergy’s proposal.

Evoenergy proposed to use our benchmark approach to estimate equity raising costs.⁷¹ We have updated our estimate for this access arrangement period based on the benchmark approach using updated inputs. This results in zero (\$2020–21) equity raising costs.

⁷⁰ Evoenergy, *Appendix 4.2 PTRM*, June 2020.

⁷¹ Evoenergy, *Attachment 5 – Rate of return, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 5-3.

4.2.2 Imputation credits

Our draft decision applies a value of imputation credits (gamma) of 0.585, as set out in the 2018 Instrument.⁷² Evoenergy's proposal adopts the Instrument for gamma.⁷³

4.2.3 Expected Inflation

Evoenergy proposes to apply our current approach for estimating expected inflation. Our draft decision estimate of expected inflation is 2.37 per cent for the 2021–26 period.

We are currently undertaking a review into the treatment of inflation in our regulatory framework, including the method likely to result in the best estimate of expected inflation. The final outcomes of this review are expected in December 2020. If we consider that a different method for estimating expected inflation should be adopted, we intend to commence the consultation process under the NGR for amending the post-tax revenue model (PTRM). We expect to apply amendments to the PTRM (if any) in our final decision for Evoenergy, unless a rule change proposal is required.

Whilst our inflation review is ongoing, we have modelled the potential outcome on Evoenergy's total revenue and consumers' retail gas bills from applying a lower expected inflation rate of 1.87 per cent (as per our inflation review draft position). As an indicative estimate only, this has the effect of increasing our draft decision total revenue for Evoenergy by \$6.6 million (2.1 per cent) for the 2021–26 period, and for average annual bills for residential and small business consumers to be \$4 (0.3 per cent) and \$36 (0.3 per cent) higher by the end of the 2021–26 period, respectively, than estimated under this draft decision and set out at section 1.1.

Further information regarding our draft decision on Evoenergy's allowed rate of return, expected inflation, debt and equity raising costs is set out in Attachment 3.

4.3 Regulatory depreciation

We use regulatory depreciation to model the nominal asset values over the 2016–21 period and set the depreciation building block as part of calculating the total revenue for Evoenergy. The depreciation amount is the net total of real straight-line depreciation (negative) and annual inflation indexation (positive) on the projected capital base.

We are required to make a decision on Evoenergy's proposed:⁷⁴

- depreciation on the projected capital base

⁷² AER, *Rate of Return Instrument*, December 2018, cl. 27.

⁷³ Evoenergy, *Appendix 4.2 PTRM*, June 2020.

⁷⁴ NGR, rr. 59, 72, 76, 88, 89.

- depreciation schedule, which sets out the basis on which the depreciation is calculated.

Attachment 4 sets out our draft decision on Evoenergy's annual regulatory depreciation amount for the 2021–26 period. It also details our consideration of specific matters that affect the estimate of regulatory depreciation, including the:

- standard asset lives for depreciating new assets associated with forecast capex, including the proposed shortening of standard lives for new pipeline assets⁷⁵
- remaining asset lives for depreciating existing assets in the opening capital base.

We determine a regulatory depreciation amount of \$44.4 million (\$ nominal) for Evoenergy for the 2021–26 period, which is \$0.3 million (0.8 per cent) higher than the \$44.0 million proposed by Evoenergy.⁷⁶ The difference is primarily driven by our lower expected inflation rate for the 2021–26 period.

The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation of the capital base. The straight-line depreciation is impacted by our decision on Evoenergy's opening capital base as at 1 July 2021 (section 4.1), forecast capex (section 4.4) and asset lives. Our draft decision straight-line depreciation for Evoenergy is \$0.2 million lower than proposed, and is mainly due to our updates to the opening capital base.

The indexation on the capital base is impacted by our decision on Evoenergy's opening capital base (section 4.1), forecast capex (section 4.4) and the expected inflation rate (section 4.2.3). Our draft decision indexation on Evoenergy's projected capital base is \$0.6 million lower than proposed, and is largely due to our lower expected inflation rate for the 2021–26 period of 2.37 per cent per annum compared to Evoenergy's proposed 2.40 per cent per annum. The decrease in indexation has more than offset the decrease in straight-line depreciation (since indexation is deducted from the straight-line depreciation).

In coming to our decision on Evoenergy's straight-line depreciation:

- We accept Evoenergy's proposed straight-line method to calculate regulatory depreciation.
- We accept Evoenergy's proposed weighted average method to calculate the remaining asset lives as at 1 July 2021 for depreciating its existing assets. In accepting this method, we have updated the proposed remaining asset lives as at 1 July 2021 due to the input changes we made to Evoenergy's proposed RFM.
- We partially accept Evoenergy's proposal to reduce its standard asset lives (accelerated depreciation) associated with new assets for its high-pressure (HP) mains, medium-pressure (MP) mains, and MP services (pipeline) asset classes. While we accept Evoenergy's proposed shorter standard asset lives for new

⁷⁵ The term 'standard asset life' may also be referred to as 'economic life'.

⁷⁶ Evoenergy, *Appendix 4.2 PTRM (Public)*, June 2020.

pipeline assets in the ACT region, we do not consider the reduced standard lives should be applied to the NSW region.

Evoenergy proposed to reduce the current standard asset lives for its asset classes associated with its pipeline assets.⁷⁷ Evoenergy's key reason for doing so is to address potential cost recovery uncertainties caused by the ACT Government's legislated 2045 net zero greenhouse gas emissions target. Evoenergy noted that in September 2019, the ACT Government published its *Climate Change Strategy 2019–25* requiring the phasing out of natural gas use in the ACT and its replacement by renewable electricity.⁷⁸

Evoenergy stated that its proposal for accelerated depreciation of new, long-lived assets is an early, precautionary measure against rising bills as the result of declining gas consumer numbers. It submitted that accelerated depreciation will reduce the risk that, in the event of network closure, consumers who find it difficult or unfeasible to move away from gas will be left to pay an unfair share of costs.⁷⁹

Our draft decision is to:

- accept Evoenergy's proposed shorter standard asset lives for pipeline assets in the ACT region
- not accept Evoenergy's proposed shorter standard asset lives for pipeline assets in the NSW region; accordingly, we have created three new asset classes for pipeline assets located in the NSW region of Evoenergy's gas network and maintained the longer standard asset lives for these new asset classes.

In assessing Evoenergy's proposal, we have considered the issues raised by Evoenergy which affect gas usage in its network. Given ACT Government's climate change policies towards future natural gas use in the ACT and Evoenergy's proposal to reduce network expansion in the ACT, we consider that shorter standard asset lives for the 2021–26 period could reduce potential asset stranding risk. The ACT Government has made a clear policy directive to significantly reduce or eliminate natural gas consumption in the ACT by 2045, which goes beyond setting a net zero emissions target. Based on the current evidence available to us, we consider there is a likelihood of the usage of Evoenergy's gas network declining due to the ACT Government's policies directed at reducing gas consumption by consumers. Therefore, we consider Evoenergy faces a greater likelihood that its ACT pipelines would not reach the end of their technical lives due to the combination of the policies aimed at curtailing natural gas use in the ACT.

We accept that Evoenergy has considered the impact of the ACT Government's climate change policies more holistically with step changes proposed to its capex and

⁷⁷ Evoenergy, *Attachment 4 – Capital base and depreciation, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 8.

⁷⁸ Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 1.

⁷⁹ *Ibid.*, p. iv.

demand forecasts in the ACT, along with reductions to asset lives. We note that Evoenergy has proposed zero connections in 'greenfield' areas and reduced connections in 'brownfield' areas of the ACT for the 2021–26 period. Therefore, Evoenergy's forecast market expansion capex for the upcoming period is nearly half the amount of actual market expansion capex for the current period. As a result of these actions, Evoenergy's capital base is expected to decline by 5.5 per cent by the end of the 2021–26 period in real terms.

While we consider there is a possibility that the pipeline assets would not reach the end of their technical lives, there is currently not enough evidence to say that all assets would be stranded by 2045. This is because the ACT Government is still considering a transition towards renewable gas to achieve net zero emissions from gas use, which would allow Evoenergy to use its pipelines beyond 2045 to transport renewable gas. We consider the reasonable approach under the current climate change policies in the ACT is to assign asset lives which are longer than the 2045 target but shorter than the technical lives of the assets.

Therefore, we consider that Evoenergy's proposed shorter standard asset lives of 30 years for the MP mains and MP services (reduced from 50 years), and 50 years for HP mains (reduced from 80 years) are reasonable for the purposes of depreciating new pipeline assets over the 2021–26 period in the ACT region. We expect to have more policy clarity from the ACT Government at the next access arrangement review to re-assess the asset lives for the 2026–31 period.

However, we do not consider that reduced asset lives are warranted for capex associated with NSW expansion, given that Evoenergy has a positive consumer growth outlook for this region and the ACT Government's climate change policies to curtail gas consumption do not apply to this region. It is not clear at this point in time whether Evoenergy would cease connecting new consumers in NSW if the ACT Government decides to move to full electrification in the ACT. Further, we note Evoenergy's capex and demand proposals are 'business as usual' in regard to NSW. Therefore, we consider it is appropriate to maintain the longer standard lives for pipeline assets being built in NSW as currently there is insufficient evidence provided by Evoenergy to conclude that the economic lives of these assets would be shorter than their technical lives.

We are satisfied that our draft decision is consistent with the NGR's depreciation criteria and is in the long term interests of consumers, in accordance with the NGO and RPP. Table 8 sets out our draft decision on Evoenergy's forecast regulatory depreciation for the 2021–26 period.

Table 8 AER's draft decision on Evoenergy's forecast regulatory depreciation for the 2021–26 period (\$ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Straight-line depreciation	15.6	17.2	18.4	19.6	20.7	91.4
Less: indexation on opening capital base	9.1	9.3	9.5	9.6	9.6	47.0
Regulatory depreciation	6.5	7.9	9.0	10.0	11.0	44.4

Source: AER analysis.

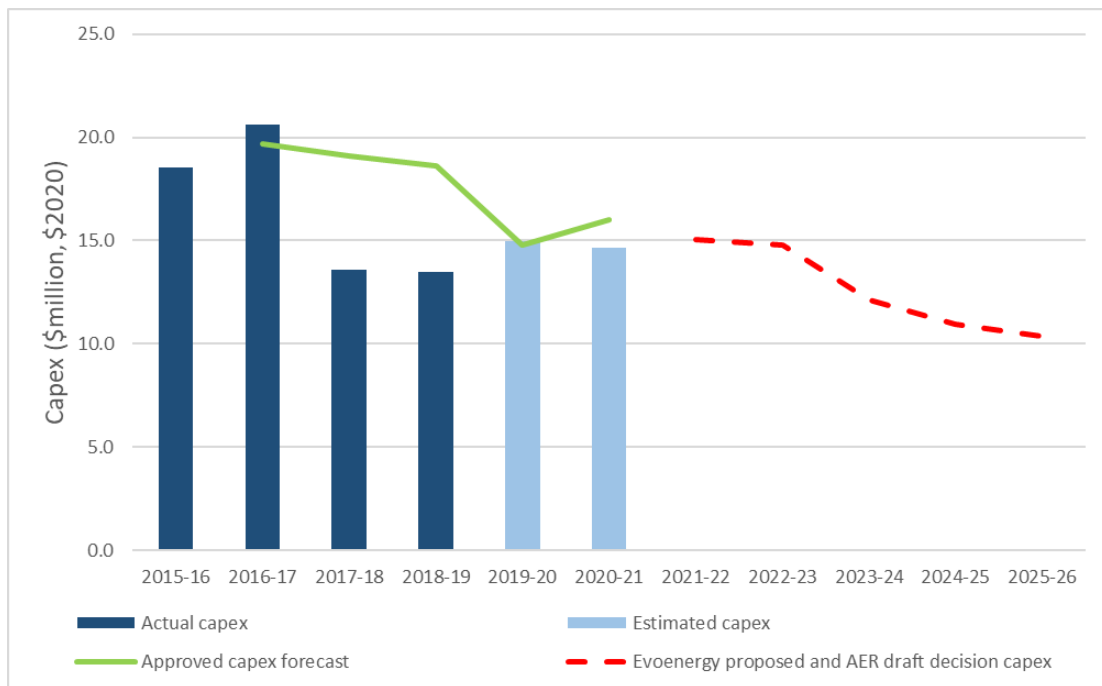
4.4 Capital expenditure

Capital expenditure (capex) refers to the capital costs and expenditure incurred in the provision of pipeline services.⁸⁰ This investment mostly relates to assets with long lives. Evoenergy recovers the costs of these assets through the return on capital and depreciation building blocks. In this way, Evoenergy recovers the financing cost and depreciation associated with these assets over the expected life of these assets.

Our draft decision includes an assessment of Evoenergy’s actual capex in the 2016–21 period (which forms part of its opening capital base)⁸¹ and its forecast capex for the 2021–26 period (which forms part of its projected capital base).⁸²

Figure 8 compares Evoenergy’s past and proposed forecast capex, and the forecasts approved by us in our previous 2016–21 decision and this 2021–26 draft decision.

Figure 8 AER’s draft decision and Evoenergy’s past and proposed capex (\$ million, 2020–21)



Source: AER analysis.

4.4.1 Conforming capex for the 2016–21 period

Evoenergy expects to spend less than the 2016–21 period capex forecast we approved previously for each capex category, except for capacity development where it expects to spend the full amount.

⁸⁰ NGR, r. 69.

⁸¹ NGR, r. 77.

⁸² NGR, r. 78(b).

In this draft decision, we approve \$66.0 million (\$2020–21) of total net capex for Evoenergy as conforming capex under the NGR, subject to Evoenergy providing additional information on its investment in the Ginninderry development.⁸³ We will review Evoenergy’s actual capex for 2019–20 in our 2021–26 final decision, and actual capex for 2020–21 in Evoenergy’s 2026–31 access arrangement review.

4.4.2 Conforming capex for the 2021–26 period

Evoenergy proposes forecast net capex of \$66.3 million (\$2020–21) for the 2021–26 period, which is \$13.8 million (17.9 per cent) lower than its actual net capex for the 2016–21 period.⁸⁴ Our draft decision approves Evoenergy’s forecast net capex of \$66.3 million as a placeholder for the 2021–26 period. We are seeking additional information from Evoenergy in its revised proposal on its proposed market expansion capex in brownfield developments, and how this interacts more broadly with ACT Government policy. Table 9 presents our draft decision for forecast capex by category.

Table 9 AER’s draft decision and Evoenergy’s proposal for forecast capex for the 2021–26 period (\$ million, 2020–21)

Category	Evoenergy’s Proposal	AER’s Draft Decision	Difference
Market expansion (Connections)	24.8	24.8	0.0
Stay-in-business - meter renewal (Meter replacement)	22.2	22.2	0.0
Capacity development (Augmentation)	0.9	0.9	0.0
Stay-in-business - network renewal (Facilities and pipes)	12.2	12.2	0.0
Non-system (Other)	-	-	0.0
Overhead	3.6	3.6	0.0
GROSS TOTAL	63.8	63.8	0.0
Contribution	0.5	0.5	0.0
NET TOTAL	66.3	66.3	0.0

Source: AER analysis. Totals may not sum due to rounding.

4.5 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses, incurred in the provision of pipeline services. Forecast opex is one of the building blocks we use to determine a service provider’s total revenue requirement.

⁸³ NGR, r. 79(1). We have assessed conforming capex for 2015–16, 2016–17, 2017–18 and 2018–19. We have not assessed 2019–20 and 2020–21 as they are estimated capex.

⁸⁴ Evoenergy’s capex for 2019–20 and 2020–21 is based on an estimate only.

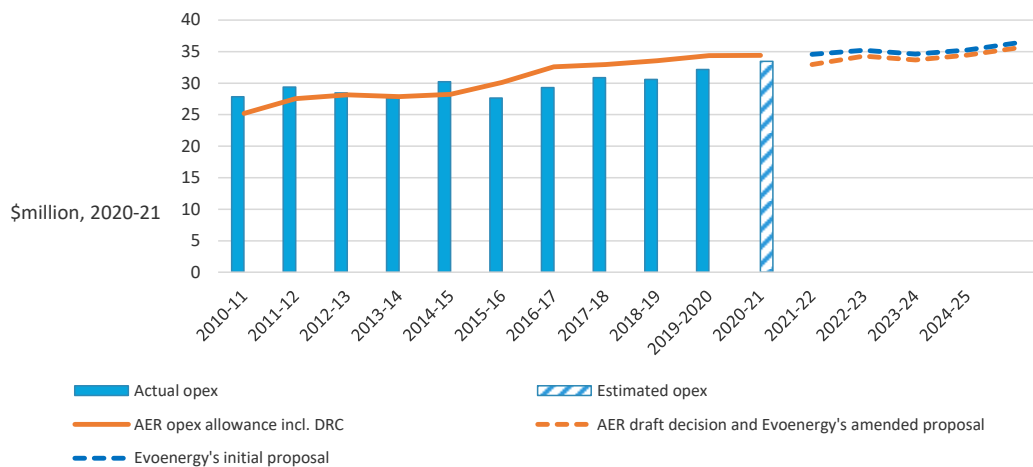
Our draft decision is to not accept Evoenergy’s initial total opex forecast proposal⁸⁵ of \$176.1 million (\$2020–21), but to accept its amended proposal of \$171.0 million for the 2021–26 period.⁸⁶ Evoenergy amended its initial proposal to update for actual audited 2019–20 opex which had become available post lodgement.

Our alternative estimate of forecast opex is \$0.2 million, or 0.1 per cent, higher than Evoenergy’s amended proposal. We are satisfied Evoenergy’s amended proposal of forecast opex meets the opex criteria⁸⁷ and the requirements for forecasts and estimates.⁸⁸

We have not included some aspects of Evoenergy’s proposal in our alternative estimate, such as the labour price index (WPI) forecast from BIS Oxford Economics, which we consider do not reflect a realistic expectation of labour prices as it was produced at the onset of the COVID-19 pandemic. However, this is offset by other factors, with the result that, overall, there is no difference between our alternative estimate and Evoenergy’s amended proposal.

Figure 9 compares the opex forecast we approve in this draft decision to Evoenergy’s initial proposal, and the forecasts we approved for 2010–21 compared to Evoenergy’s actual opex in that period.

Figure 9 AER’s draft decision compared to Evoenergy’s past and proposed opex (\$ million, 2020–21)



Source: Evoenergy, *Annual RIN (various years)*; Evoenergy, *Proposed reset RIN - RIN 3 Workbook 1 Forecast Consolidated*, June 2020; AER, *Final Decision – ActewAGL Distribution access arrangement 2016–21 – Revenue forecast model – RFM PTRM*, May 2016; AER, *Final Decision – ActewAGL (ACT, Queanbeyan and Palerang) Access arrangement 2010-15, PTRM after appeal*, September 2010; Evoenergy, *Response to AER IR003 Attachment 1 Evoenergy gas network 2021-26 revised opex model*, 1 October 2020; AER analysis.

Note: Includes debt raising costs, UAG, utilities network facility tax, energy industry levy, IT access utilisation fee.

⁸⁵ Submitted as part of its 2021–22 proposal on 26 June 2020, including debt raising costs. Evoenergy, *Attachment 2 – Operating expenditure, Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, pp. 2-7 and 2-8.

⁸⁶ Submitted on 1 October 2020 to update for audited 2019–20 actual opex, including debt raising costs. Evoenergy, *Response to AER IR003 Attachment 1 Evoenergy gas network 2021-26 revised opex model*, 1 October 2020.

⁸⁷ NGR, r. 91.

⁸⁸ NGR, r. 74.

Table 10 sets out our draft decision (Evoenergy's amended forecast opex), our alternative opex estimate and Evoenergy's initial proposal.

Table 10 AER's draft decision and Evoenergy's proposal for forecast total opex for the 2021–26 period (\$ million, 2020–21)

	Evoenergy's Initial Proposal (1)	AER's Draft Decision / Evoenergy's Amended Proposal (2)	AER's Alternative Opex Estimate (3)	Difference (3)–(2)
Based on reported opex in 2019–20	167.1	160.9	160.1	–0.8
Base year adjustments	–54.3	–53.7	–50.8	2.9
2019–20 to 2020–21 increment	0.1	0.1	0.1	–
Output growth	2.1	2.0	2.0	–
Price growth	1.6	1.5	0.3	–1.2
Productivity growth	–1.7	–1.6	–1.6	–
Step changes	2.3	2.3	2.1	–0.2
Category specific forecasts	57.9	58.5	57.9	–0.6
Total opex (excluding debt raising costs)	175.1	170.0	170.1	0.1
Debt raising costs	1.0	1.0	1.1	0.1
Total opex (including debt raising costs)	176.1	171.0	171.2	0.2

Source: Evoenergy, *2021–26 Access Arrangement Proposal – Attachment 6.2 – Opex Model*, June 2020; Evoenergy, *Response to AER Information request 03 – Opex Model*, 1 October 2020; AER analysis.

Note: Numbers may not add up to total due to rounding.

4.6 Revenue adjustments

We have applied one revenue adjustment to Evoenergy's revenue for the 2021–26 period, as presented below.

4.6.1 Efficiency carryover mechanism for the 2016–21 period

An efficiency carryover mechanism (ECM) is intended to provide a continuous incentive for service providers to pursue efficiency improvements in opex, and provide for a fair sharing of these between service providers and network users.

Our draft decision is to approve a carryover amount totalling –\$1.3 million (\$2020–21) from application of the ECM in the 2016–21 period. This is \$3.7 million more than Evoenergy's amended proposal of –\$5.0 million.⁸⁹

⁸⁹ Submitted on 1 October 2020. Evoenergy, *Response to AER information request 14 – ECM Model*, 1 October 2020.

Our calculated carryover amounts differ from Evoenergy’s amended carryover amounts because we have used audited 2019–20 opex, used different inflation figures to convert amounts into 2020–21 dollars, removed movements in provisions, and included insurance and superannuation costs.

Table 11 shows our draft decision on the carryover amounts Evoenergy accrued during the 2016–21 period.

Table 11 AER’s draft decision on carryover amounts compared to Evoenergy’s proposal for the 2021–26 period (\$ million, 2020–21)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
AER’s draft decision	0.5	–1.3	–0.1	–0.5	0.0	–1.3
Evoenergy’s proposed carryover (as at 1 October 2020)	–0.4	–2.3	–0.9	–1.3	0.0	–5.0
Difference	1.0	1.0	0.8	0.9	0.0	3.7

Source: Evoenergy, *Response to AER information request 14 – ECM Model*, 1 October 2020; AER analysis.
 Note: Numbers may not add up due to rounding.

4.7 Corporate income tax

Our determination of the total revenue for Evoenergy includes the estimated cost of corporate income tax for the 2021–26 period.⁹⁰ Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our PTRM. This allows Evoenergy to recover the estimated cost of corporate income tax during the 2021–26 period.

We accept Evoenergy’s proposed approach to calculate its forecast cost of corporate income tax. Evoenergy has used our PTRM for gas pipeline service providers which implemented the findings from our 2018 tax review.⁹¹

We determine an estimated cost of corporate income tax of \$1.4 million (\$ nominal) for Evoenergy in the 2021–26 period, which is \$0.1 million less than proposed. The difference is primarily driven by our adjustments to the return on capital and the regulatory depreciation building blocks, which affect revenues and, in turn, impact the tax calculation.

Further, we determine an opening tax asset base (TAB) value of \$260.3 million (\$ nominal) for Evoenergy as at 1 July 2021. While we accept Evoenergy’s proposed method to establish the opening TAB, we reduced the proposed opening TAB value by \$0.2 million due to minor corrections to 2014–15 actual capex inputs in the RFM.

⁹⁰ NGR, r. 76(c).

⁹¹ AER, *Final report: Review of regulatory tax approach*, December 2018.

We accept Evoenergy’s proposed standard tax asset lives for all of its existing asset classes as they are broadly consistent with the tax asset lives prescribed by the Australian Tax Office’s (ATO) taxation ruling 2020/3.⁹² As discussed in section 4.3, we have created three new asset classes for pipeline assets located in the NSW region of Evoenergy’s gas network.⁹³ We have applied the same standard tax asset life of 20 years to these new asset classes as that of the existing pipeline asset classes for tax depreciation purposes.

We also accept Evoenergy’s proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2021. This method is a continuation of the approved approach used in the 2016–21 period and applies the approach as set out in our RFM.

Table 12 sets out our draft decision on the estimated cost of corporate income tax for Evoenergy for the 2021–26 period. Further detail is included in Attachment 7.

Table 12 AER’s draft decision on Evoenergy’s cost of corporate income tax for the 2021–26 period (\$ million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Tax payable	0.8	0.7	0.6	0.6	0.7	3.5
Less: value of imputation credits	0.5	0.4	0.4	0.4	0.4	2.0
Net corporate income tax	0.3	0.3	0.3	0.3	0.3	1.4

Source: AER analysis.

⁹² ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181.

⁹³ These are presented as ‘HP Mains – MSW’, ‘MP Mains – NSW’ and ‘MP Services – NSW’ in the draft decision PTRM.

5 Incentive schemes to apply for 2021–26

Our incentives schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If network businesses reduce their costs to below our forecast of efficient costs, the savings are shared with their consumers in future access arrangement periods.

This draft decision determines that two incentive schemes will apply to Evoenergy for the 2021–26 period, as presented below.

5.1 Efficiency carryover mechanism

As noted in section 4.6.2, an efficiency carryover mechanism (ECM) is intended to provide a continuous incentive for service providers to pursue efficiency improvements in opex, and provide for a fair sharing of these between service providers and network users.

Our draft decision is to approve the application of an ECM to Evoenergy in the 2021–26 period. We have made minor amendments to Evoenergy’s proposed ECM in this draft decision to be consistent with version 2 of the efficiency benefit sharing scheme (EBSS) for electricity service providers and other gas distribution businesses.⁹⁴

Attachment 8 sets out our ECM draft decision in detail, including our revisions to Evoenergy’s proposed ECM.

5.2 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex.

Evoenergy proposes to introduce a CESS to cover the 2021–26 period.⁹⁵ This incentive scheme currently does not exist for Evoenergy.

Our draft decision approves the application of a CESS that excludes connections capex in the 2021–26 period.⁹⁶ Attachment 12 provides further information on our draft decision on CESS for Evoenergy.

⁹⁴ AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013.

⁹⁵ Evoenergy, *Access arrangement information – Attachment 9, Incentive schemes*, June 2020.

⁹⁶ The operation of the CESS is set out in Evoenergy’s *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, Section 4, p. 9.

6 Non-tariff components

Collectively, the non-tariff components of an access arrangement are:

- the terms and conditions for the supply of reference services (or Reference Service Agreement (RSA))
- queuing requirements – a process or mechanism for establishing an order of priority between prospective users of spare and/or developable capacity
- extension and expansion requirements – the method for determining whether an extension or expansion is a part of the covered pipeline and the effect this will have on tariffs
- capacity trading requirements – the arrangements for users to assign contracted capacity and change delivery and receipt points
- change of receipt or delivery point by the user – the process or mechanism for changing a user's receipt or delivery point
- a review submission date and a revision commencement date – in this case, Evoenergy's proposed dates being 30 June 2025 and 1 July 2026, respectively.

Our draft decision approves Evoenergy's proposed amendments for the non-tariff components of its 2021–26 proposal, with the exception of two items relating to its RSA⁹⁷ which we do not expect to be an issue at the revised proposal stage, as set out in Attachment 11. We will confirm our position on these items in our final decision.

We note that the RSA remains subject to a continuous improvement process, whereby it is formally reviewed and amended at each access arrangement review. This does not prevent Evoenergy from continuing discussions with individual parties to work through their specific issues and circumstances.

We encourage Evoenergy and stakeholders to continue to engage on issues relating to gas quality specification, retailer-requested disconnections by Evoenergy and the liability and indemnity regime after our decision, potentially at an industry working group level. For example, this work could be coordinated by Energy Networks Australia (ENA), or prioritised and advanced by one of AEMO's industry working groups.

Our expectation is for Evoenergy to continue to work with retailers following our decision, particularly in relation to performance standards applicable to Evoenergy, to help retailers to better manage their businesses and consumers' expectations.

⁹⁷ Evoenergy, *Reference Service Agreement, Evoenergy's gas distribution network, 1 July 2021 – 30 June 2026*, June 2020.

A Shortened forms

Shortened form	Extended form
ACTCOSS	ACT Council of Social Service
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ATO	Australian Tax Office
bppa	Basis points per annum
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
CCP / CCP24	Consumer Challenge Panel, sub-panel 24
CIE	Centre for International Economics
CPI	Consumer price index
EBSS	Efficiency benefit sharing scheme
ECA	Energy Consumers Australia
ECM	Efficiency carryover mechanism
EEIS	Energy Efficiency Improvement Scheme
ENA	Energy Networks Australia
HP	High-pressure
Instrument / 2018 Instrument	2018 Rate of Return Instrument
JGN	Jemena Gas Networks (NSW) Ltd
MP	Medium-pressure
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NPV	Net Present Value
Opex	Operating expenditure
PTRM	Post-tax revenue model
RFM	Roll forward model
RPP	Revenue and pricing principles
RSA	Reference Service Agreement
TAB	Tax asset base
UAG	Unaccounted for gas
WPI	Wage Price Index

B List of submissions

This draft decision has been made with regard to submissions received from the following stakeholders on Evoenergy's 2021–26 access arrangement proposal.

Stakeholder	Date
ACT Council of Social Service (ACTCOSS)	13 August 2020
ActewAGL	10 August 2020
Conservation Council ACT Region	10 August 2020
Consumer Challenge Panel (CCP24)	10 August 2020
EnergyAustralia	10 August 2020
Energy Consumers Australia (ECA)	11 August 2020
Origin Energy	10 August 2020