DRAFT DECISION

Jemena
Distribution Determination
2021 to 2026

Overview

September 2020

AUSTRALIAN ENERGY REGULATOR

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Executive summary

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate energy networks in all jurisdictions except Western Australia. We set a maximum revenue that network businesses are allowed to recover from consumers in providing network services.

Jemena owns and operates one of the five electricity distribution network service providers in Victoria and services over 324,000 households, 27,300 small business and 1500 large business consumers in the north-west greater Melbourne area. On 31 January 2020, Jemena submitted its proposal for the five year regulatory control period commencing 1 July 2021.

This draft decision sets out the amount of money Jemena can collect from electricity consumers for using its network in the 2021–26 regulatory control period.

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 Jemena's proposal to differ at the revised proposal stage. We base this draft determination on current information and best forecasts that can reasonably be made, but acknowledge that some proposals may need to change.

Jemena can recover $1273.3 million ($ nominal) from its consumers in the 2021–26 regulatory control period. This is 10.0 per cent lower than the revenue allowed for in our 2016–20 final decision and leads to lower network charges for Jemena's consumers from the beginning of the next regulatory control period.

The total revenue allowed in our draft decision is $106.3 million (or 7.7 per cent) less than the $1379.6 million ($ nominal) proposed by Jemena.

The revenue we allow forms the distribution network component of retail electricity bills, making up about 25 per cent of a standard residential bill (32 per cent for small businesses).

We estimate that if this draft decision is implemented, compared to current charges, distribution network charges in the first year of the 2021–26 regulatory control period will drop by $61 (3.8 per cent) for residential consumers and by $221 (3.5 per cent) for small business consumers. Thereafter, charges will decrease by an average of $3 (0.2 per cent) and $17 (0.3 per cent) each year over the remaining four years of the regulatory period for residential and small business consumers respectively.

We estimate these bill impacts by calculating the average revenue per unit of energy charged to customers under our determination. We have adopted standard assumptions about the amount of energy used by customers and hold all other bill components constant.

These estimates may vary between our draft and final determinations following additional information provided in response to our draft decision. Further changes may

occur during the subsequent annual pricing process. These changes may increase or decrease customer bills.

Customers' final bills may differ from the draft determination estimates because, for example:

- revised capital expenditure (capex) and operating expenditure (opex) estimates may be made in the final determination
- energy consumption forecasts may change
- the structure of tariffs may vary from the simple assumption of a constant amount for each unit of energy used
- a different rate of return may be made in the final determination reflecting updated market data
- the return on debt will be updated in each of years 2 to 5 of the 2021−26 regulatory control period
- revenue adjustments may be required to ensure compliance with the revenue cap
- penalties and rewards from the incentive schemes may be subtracted from or added to revenue
- adjustments to revenue may be required as a result of the transition in 2021 from a calendar to a financial basis for this determination. We expect that a true-up will be needed during the 2021−26 regulatory control period
- our forthcoming decision on the approach to estimating expected inflation will apply to the final determination
- approved network charges will include transmission charges and possible jurisdictional scheme charges.

In making this draft decision we have had regard to a range of sources including Jemena's proposal, submissions received, as well as analysis undertaken and published by us.

Jemena has often been a leader in consumer engagement approaches and its regulatory proposal reflects the feedback it received through this engagement.

Our draft decision finds that Jemena's proposal is not in the long-term interests of consumers. This finding is mainly driven by a significant difference between what Jemena proposes and what we consider to be levels of opex required over the next five years. Our draft decision allows for sufficient revenue to replace ageing infrastructure and to operate Jemena's network in a safe and reliable manner in the long-term interests of consumers.

Based on the information currently before us, we are satisfied that our draft decision on Jemena's 2021–26 regulatory proposal is in the long-term interests of consumers. Jemena now has the opportunity to consider our draft decision, the latest economic data, engage with its consumers and put forward a revised proposal with updated information.

In making this draft decision, we note the following key themes:

- Jemena's engagement with consumers
- ensuring consumers pay no more than necessary for safe and reliable services
- facilitating the emergence of distributed energy resources
- network tariff reform proceeding in Victoria.

Jemena's engagement with consumers

All five Victorian distributors made a concentrated effort to improve engagement with their consumers and strive to better capture the diversity of their preferences. While each distributor approached this differently, all published an early draft of their regulatory proposal to gauge consumer views. We were encouraged to see these efforts to understand consumer preferences before the proposal has been finalised.

We were also encouraged to see the distributors coordinate their engagement on tariff structure statements in acknowledgement of the Victorian context and challenges advocates and representatives can face in finding resources to engage. The distributors collaborated on a series of forums to develop principles for their tariff strategies for small users as a basis to develop structures. Participating stakeholders included consumer representatives and advocates, community groups, the Victorian Government, and retailers. The consistent use of language and structured, focused points of engagement were noted in the generally supportive submissions we received from stakeholders.

From the outset, Jemena set a strategic objective of operating at the “collaborate” level of engagement in the IAP2 spectrum.[1] In doing so, it aimed to demonstrate a ‘customer-centric’ focus by developing its regulatory proposal around the preferences of its consumers. To accomplish this Jemena engaged widely during the planning phase and developed individualised engagement approaches for each consumer cohort. For residential consumers, a deliberative process called a ‘People’s Panel’ was adopted, which became a key part of Jemena’s engagement strategy. The People’s Panel was selected as a representative sample of the demographic profile of residential consumers within Jemena's distribution area. The engagement sessions were designed to be iterative, building the capacity of ‘everyday citizens’ to participate, develop and agree on a robust set of recommendations.[2]

Through this engagement, consumers told Jemena that affordability, reliability and sustainability were key concerns. Jemena’s People’s Panel delivered a set of 25 recommendations, 13 of which related to topics that were subsequently included in Jemena’s regulatory proposal. The remaining 12 recommendations were for Jemena to

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1 See: https://iap2.org.au/wp-content/uploads/2020/01/2018_IAP2_Spectrum.pdf.

2 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 12.

improve customer service issues and address issues such as carbon emissions.[3] Members of Jemena's Board and senior management were on hand to accept the recommendations and after reviewing them, accepted every one.[4] Jemena also committed to implement a range of customer service improvements,[5] as well as committing to increased feed-in of solar and other renewables into the grid. We found the themes from the broader engagement, along with the recommendations from the People's Panel reflected in the regulatory proposal.

After developing its draft plan, Jemena reconvened the People's Panel to show how its input affected Jemena's decisions and to test if those views were accurately reflected. It also sought further feedback from the People's Panel on its preferences issues including the price path, a customer service incentive scheme (CSIS) and tariff options. Following feedback from the People's Panel that good customer service is an expectation that consumers should not have to pay more for, Jemena chose to withdraw from proposing a CSIS.[6] In the final evaluation of Jemena's draft plan, 92 per cent of People's Panel participants were either 'comfortable' or 'very comfortable' that the plan sufficiently considered the long-term interests of consumers. The other 8 per cent were 'unsure'.[7] Jemena also canvassed feedback from its Customer Council who raised issues of putting downward pressure on costs and prices, but found the draft plan was adequately 'customer-centric'.[8]

While we consider that Jemena's consumer engagement was effective and the proposal reflects the consumers' input, stakeholders questioned the efficiency of Jemena's opex forecast.[9] Nor was the Consumer Challenge Panel (CCP17) convinced that Jemena's selection of the base year for opex was compelling or efficient.[10] But CCP17 expressed overall comfort in Jemena's capex proposal, supporting initiatives to keep prices 'in check' and not over-invest in reliability or new assets before they are needed.[11] While we placed weight on Jemena's good consumer engagement and consumers' support for elements of the proposal that were directly influenced by

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3 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, pp. 20-22.

4 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 23.

5 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal*, *Overview*, January 2020, p. 57.

6 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-04, Reconvening the Jemena People's panel*, January 2020, p. 9.

7 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-04, Reconvening the Jemena People's panel*, Appendix B, January 2020, p.25.

8 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-06, Customer Council's feedback on Jemena's 2021–25 EDPR,* January 2020, p. 13.

9 ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26*,June 2020, pp. 16 & 26.

10 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 45.

11 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p.80.

consumers, we were not convinced as to the quality of engagement on the issue of efficiency. To address this concern, we made an opex efficiency adjustment.

Ensuring consumers pay no more than necessary

Ensuring consumers pay no more than necessary for safe and reliable electricity is a cornerstone of the regulatory determination process. We must assess whether a business' proposal is a reasonable and realistic forecast of how much money it needs for the safe and reliable operation of the network. It also involves encouraging distributors to explore how they can provide better services at lower cost through a range of incentive schemes.

Our draft decision opex forecast is $76.8 million ($2021–21) or 13.3 per cent below what Jemena proposed as the efficient amount of opex required over the next five years.

Jemena's proposed opex forecast is 29.6 per cent higher than its opex in the 2016–20 regulatory period.[12] We tested Jemena's opex using our benchmarking techniques, and other analysis, and concluded that its historical opex, as well as opex in the base year (2018), sits outside the band consider to be efficient. Therefore, we consider Jemena has room to reduce its base opex and transition to an efficient level over the 2021–26 regulatory control period. As a result, we made an efficiency adjustment. Whilst Jemena offered to hand back to consumers savings of $20.2 million ($2020–21) (via a lower opex forecast) resulting from its business transformation work in 2019,[13] we instead applied an efficiency adjustment which over the next regulatory control period reduces Jemena's proposed opex by $44.9 million.

The adjustment allows a transition to efficient costs and time for Jemena's management to implement programs to reduce costs to efficient levels over the regulatory control period. We consider our decision allows for prudent, practicably achievable, efficient costs that will enable Jemena to safely provide reliable services.

Our opex forecast is a further $19.9 million lower than what Jemena proposed as we have taken into account the unforeseen impact of COVID-19 on economic conditions. In particular, the resultant lower wage price growth and customer and maximum demand forecasts over the next regulatory control period.

We consider Jemena's proposed step up in opex for bushfire liability insurance over the 2021–26 regulatory control period is prudent and efficient. We therefore, included Jemena's proposed step change for insurance premium costs ($28.2 million) in our estimate of opex over the next five years. However, we did not allow a number of Jemena's other proposed step changes, which we did not consider justified. Under the regulatory framework, we generally include step changes only if we are satisfied they

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12 After adjusting for cost allocation method changes, on a like for like basis this increase is 15.6 per cent.

13 Jemena, *Response to Information request 52*, 27 July 2020, p. 2..

relate to efficient costs associated with new regulatory obligations or capex/opex trade-offs, which are not already captured in base opex or through our trend forecast.

Our forecast capex in this draft decision of $602.3 million ($2020–21) is $24.8 million (or 4.0 per cent) lower than Jemena's proposed $ 627.1 million. Jemena's proposed net capex forecast is 9 per cent higher than for the 2016–20 regulatory control period spend. Our top-down and bottom-up category analysis taken together found the capex proposal in aggregate to be prudent and efficient—subject to adjustments we made to Jemena's forecast new connections and real escalations to account for the unforeseen economic changes due to COVID-19. Since submitting its proposal, Jemena reduced its capex relating to bushfire risk obligations, namely its forecast amount for Rapid earth fault current limiters (REFCL). We adopted this reduced amount for our draft decision, subject to further assessment before our final decision.

Facilitating the emergence of distributed energy resources

As noted in the Issues Paper, facilitating the transition of the energy system is a key theme for this Victorian regulatory determination process. Various mechanisms can play a part, such as expenditure to physically accommodate greater exports, demand management initiatives and more cost reflective network tariffs to incentivise the efficient location of distributed energy resources (DER) to optimise use of the networks. We consider this work so important that we have made incentivising networks to become platforms for energy services a strategic objective in our regulation of networks. But it is imperative that these mechanisms are coordinated to ensure a coherent approach.

DER is no longer a marginal technology. This pattern will strengthen over the regulatory period with the Victorian Government’s Solar Homes Program supporting the installation of 700,000 solar PV systems (for around one in four households) between 2018–19 and 2027–28. Networks are also preparing for the electric vehicle (EV) market and supporting charging infrastructure. While less developed than solar PV or battery storage systems, the EV market has the potential to provide significant network support.

We support Jemena facilitating solar PV growth on its network, particularly in the context of the Victorian Government’s Solar Homes Program, and have provided for this in our draft decision. Our decision provides for the Solar Homes Program while ensuring allowances are prudent. Whilst we had concerns about Jemena's DER capex proposal, overall we consider that its proposed expenditure on DER integration is a proportionate step in responding to increasing DER penetration.

We also note that Jemena’s tariff strategy was not been well linked to its DER strategy. We encourage a more unified approach in its revised proposal.

Network tariff reform proceeding in Victoria

We are encouraged by the Victorian distributors’ efforts to progress network tariff reform in the 2021–26 regulatory control period. The distributors took on guidance from our 2017 decision and worked with customers to develop a unified approach for

residential and small business customers in Victoria. This enabled distributors to move from opt-in to opt-out assignment to cost reflective network tariffs and allowed them to target the charging structures at periods of network constraints. They are also exploring pricing arrangements for DER such as electric vehicles and battery storage. Their efforts to explore appropriate price signals, including by considering stakeholder perspectives, indicate they are on the right track.

But we recommend the distributors build on this progress in their revised proposals. For small users, we advise the distributors to explore reassigning customers on legacy cost reflective tariffs to the new time of use and demand tariffs. Doing so would simplify the suite of network tariffs, improve the targeting of price signals for customers, and increase the magnitude of the customer base retailers are managing these signals for. For large users, distributors should offer choice of tariff structure, given those customers are more likely and able to face and respond to network tariff structures than smaller users. While the standard large user tariffs proposed are consistent with industry practice, offering optional tariffs would improve the matching of network tariffs to forward-looking costs at a more disaggregated level. Greater choice would also help emerging technologies to efficiently integrate into, and support the operation of the network.

Finally, distributors could do more to help customers understand the linkages between tariff strategies, tariff trials, DER and broader expenditure proposals. Linking tariff strategies for each tariff class with information and initiatives relating to demand management is also encouraged.

Change to the regulatory control period

In April 2019, the Victorian Minister for Energy, Environment and Climate Change indicated her intention to change the timing of the regulatory control period for electricity distribution networks from a calendar year basis to a financial year basis. We prepared this decision on the basis that the Victorian Government will enact legislation to change the commencement date of the next regulatory control period from 1 January 2021 to 1 July 2021.

The National Energy Legislation Amendment Bill 2020 (the Bill) currently before the Victorian parliament, provides for an extension of the current regulatory control period (1 January 2016 to 31 December 2020) by 6 months. Unfortunately, external factors such as COVID-19 lockdown prevented the passage of the legislation and related Orders in Council prior to release of this decision. In a letter to the AER on 2 September 2020, the Minister reaffirmed the Victorian Government's commitment to change electricity and gas network regulatory periods from a calendar to financial year basis. The AER will publish its draft decisions for the five businesses for the next regulatory control period on this basis. It should be noted the draft decision was prepared under the expectation the legislation would be in place.

We separately assessed the total allowed revenue for Jemena for the six month period from 1 January 2021 to 30 June 2021, based on the trend-forward approach outlined in our letter to the Victorian distributors in November 2019, our April 2020 Issues Paper, and the application of the 2018 Rate of Return instrument to the six month period. We

set out our final approach to this assessment in a letter to Jemena in August 2020.[14] Due to the delay in the passage of the legislation, we will not formally make a revenue decision for the relevant six-month period at this time.

We expect that the legislation and related Orders in Council, once in effect, will provide for a pricing proposal for the six month period. We will continue to work with distributors and the Victorian government to ensure any effects of this delay are minimised. We will provide further communication on the timing of the publication of our final decision for the six month period and the expected timing of our assessment of network tariffs shortly.

What are the next steps?

Jemena now has the opportunity to consider our draft decision and submit its revised proposal and supporting material in December 2020.[15]

We will make our final determination by 30 April 2021.

Detailed explanations of factors informing our draft decision can be found in the overview section and attachments to this draft determination.

[14] AER letter to distributors August 2020, https://www.aer.gov.au/system/files/AER - Correspondence to Jemena - Victorian EDPR and the six-month extension - 17 August 2020.pdf

[15] The numbers in this draft determination may change in the final determination.

Invitation for submissions

In response to our draft decision, Jemena now has the opportunity to submit a revised proposal for its next regulatory control period (2021–26) by 3 December 2020. Submissions on our draft decision and Jemena's revised proposal are invited from interested stakeholders by 8January 2021. We will consider and respond to all submissions received by that date in our final determination.

Submissions should be sent to: VIC2021-26@aer.gov.au

Alternatively, submissions can be sent to:

Kami Kaur
General Manager, A/g
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

(3) all non-confidential submissions will be placed on our website.[16]

[16] 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/accc-and-aer-information-policy-collection-and-disclosure-of-information.

Review timeline

The key milestones for our review of Jemena's regulatory proposal are set out below:

Milestone	Date
Jemena submitted its proposal	31 January 2020
AER issues paper published	30 March 2020
Virtual public forum on Jemena's proposal held e	22 April 2020
Submissions on AER's issues paper and Jemena's proposal closed	3 June 2020
AER draft decision published	30 September 2020
Public forum on draft decision	15 October 2020
Jemena submits revised proposal	3 December 2020
Submissions on draft decision and revised proposal due	8 January 2021
AER final decision to be published	30 April 2021

Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Jemena for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset 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 benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

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1 Our draft decision

Our draft decision would allow Jemena to recover a total revenue of $1273.3 million ($ nominal) from its consumers from 1 July 2021 to 30 June 2026.

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

Our draft decision for Jemena determines the total revenue it can recover from consumers for the provision of common distribution services (standard control services (SCS)). This forms the basis of Jemena's distribution tariffs for the 2021–26 regulatory control period. Jemena's Tariff Structure Statement (TSS) sets out the tariff structure through which it will recover its regulated revenue for SCS from consumers.

Jemena also provides alternative control services (ACS), the costs of which are recovered only from users of those services, through a capped price on the individual service. These costs are considered separately to our building block determination.[17] Our draft decision sets out the prices Jemena is allowed to charge consumers for the provision of ACS: ancillary network services, public lighting and metering. Jemena has not proposed to provide any services on a negotiated basis in the 2021–26 regulatory control period.[18]

We have taken Jemena's consumer engagement into account in developing our draft decision. More information is provided in section 3.

1.1 What's driving revenue?

Revenue is driven by changes in real costs and inflation. We assess costs (such as capital and operating expenditure) in real terms (using 2020–21 as a common year) to reveal the underlying cost trends over a number of years or regulatory control periods. The numbers presented in this overview are in real 2020–21 dollars unless otherwise noted. Some aspects of our decision are presented in nominal terms to be consistent with the NER and to enable consumers to see the full impact of our determination inclusive of expected inflation.

The total revenue allowance in this 2021–26 draft decision is 10.0 per cent lower than the allowed revenue provided for in our 2016–20 final decision. Figure 1 shows real revenue decreases from 2020 levels by 10.6 per cent in the first year of the next regulatory control period. After that, Jemena's revenue decreases by 2.5 percent per year.

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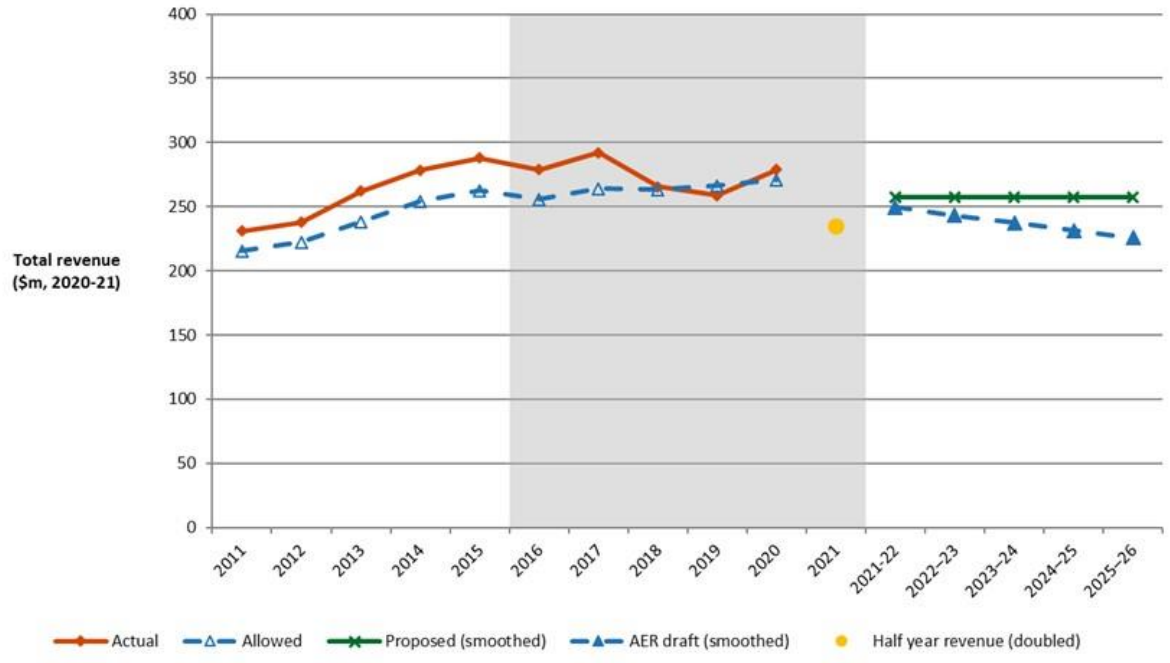
17 We discuss alternative control services in Attachment 16 to this draft decision.

18 Our distribution determination for Jemena includes an approved negotiating framework and negotiated distribution service criteria, as required by the NER. Because Jemena has not included any negotiated services in its proposal, these elements of our determination will be inactive for the 2021–26 regulatory control period.

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



Source: AER analysis, smoothed revenue.

Figure 2 highlights the key drivers of Jemena's allowed revenue from the 2016–20 for the 2021–26 regulatory control period. It illustrates that the largest driver of change is the return on capital building block. The nominal weighted average cost of capital (WACC) has decreased from around 6.37 per cent in the 2016–20 regulatory control period to 4.67 per cent for the 2021–26 regulatory control period.[19] Other reductions include:

- Regulatory depreciation due to lower amount of forecast capex.
- Corporate tax amount, due to changes in our regulatory tax approach (following our 2018 tax review) and the 2018 rate of return instrument.[20]

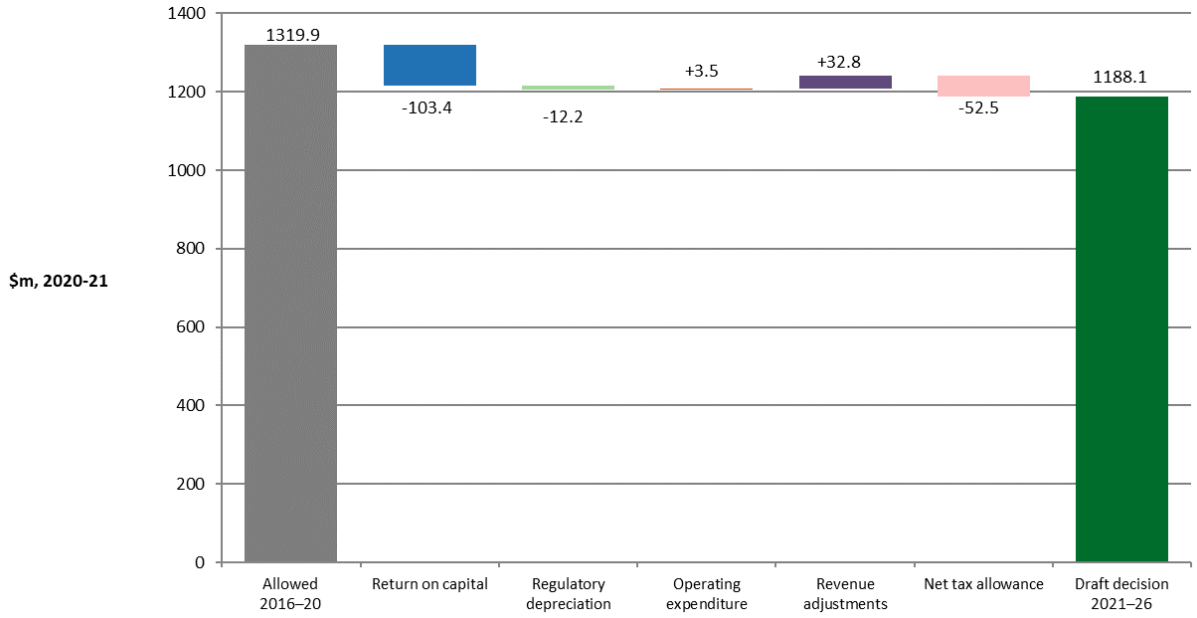
The increase in the revenue adjustment is largely driven by positive incentive scheme payments over the 2021–26 regulatory control period, compared to negative efficiency benefit sharing scheme (EBSS) payments and no capital expenditure sharing scheme (CESS) payments over the 2016–20 regulatory control period. [21]

[19] The WACC is a nominal WACC unless stated otherwise. The real WACC is impacted to a similar degree. Please see section 2.2 for further details.

[20] Please see section 2.6 for further details.

[21] Please see section 2.7 for further details

Figure 2 Change in revenue from 2016–20 to 2021–26 ($ million, 2020–21)



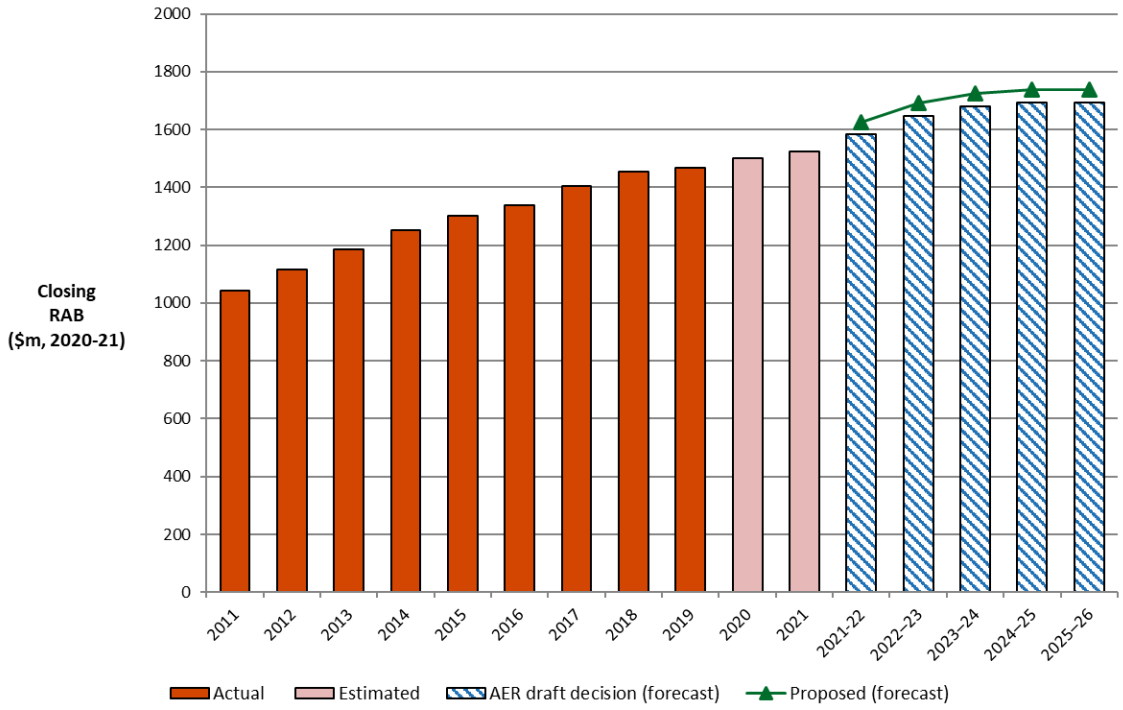
Source: AER analysis.

Note: Revenue adjustments include increments or decrements accrued under incentives schemes such as the CESS, EBSS, shared asset adjustments, and DMIAM.

Figure 3 compares our draft decision forecast regulatory asset base (RAB) to Jemena's proposed and actual RAB. This shows that Jemena's RAB is forecast to increase by around 11.1 per cent in value over the 2021–26 regulatory control period, compared to a 15.3 per cent increase in the current 2016–20 regulatory control period.[22] This difference is mainly driven by lower forecast capex for the 2021–26 regulatory control period compared to capex incurred (and estimated) in the 2016–20 regulatory control period.

[22] Please see section 2.1 for further details.

Figure 3 Value of Jemena's RAB over time ($ million, 2020–21)



Source: AER analysis.

1.2 Key differences between our draft decision and Jemena's proposal

Our draft decision has determined total revenues of $1273.3 million ($ nominal) for the 2021–26 regulatory period. This is $106.3 million or 7.7 per cent lower than Jemena's proposed $1379.6 million.

The biggest contributor to the difference between our draft decision revenue and Jemena's proposal is the operating expenditures. We consider Jemena's opex forecast inefficient and therefore our substitute opex forecast of $499.8 million ($2020–21) is $76.8m or 13.3 per cent lower than Jemena's proposed $576.6 million.

While Jemena applied the 2018 rate of return instrument and proposed a 4.80 per cent rate of return, the risk free rate and cost of debt are now both lower than at the time of submitting its proposal. As a result of this and the lower forecast RAB discussed below, the revenue for the cost of capital component is lower by $30.4 million ($ nominal) compared to Jemena's proposal.

We have largely accepted Jemena's proposed capex forecast subject to adjustments driven by the unexpected economic changes due to COVID-19. Our substitute total net capex forecast is $24.8 million ($2020–21) or 4.0 per cent lower than the proposal. This leads to a lower forecast RAB than Jemena's proposal. The lower forecast RAB also contributes to our lower draft decision revenues through a lower return on capital and regulatory depreciation allowance.

1.3 Expected impact of our draft decision on electricity bills

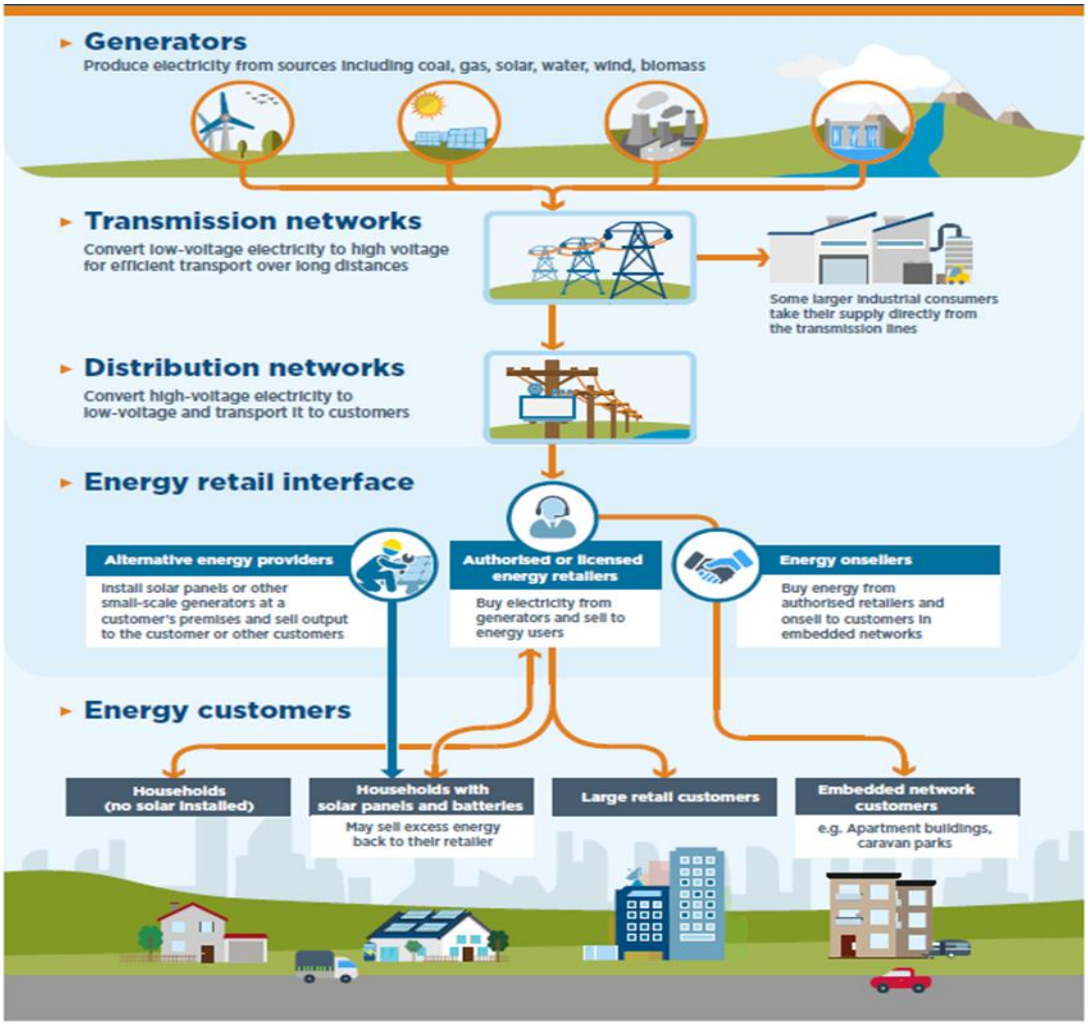
Jemena's distribution network SCS charges make up about 25 per cent of the total residential and 32 per cent of the small business retail electricity bills paid by consumers in Jemena's area.[23] Our decision also covers charges for revenue-capped metering services (that form a part of ACS) and these costs are included in this estimated bill impact analysis.[24] Other components of the electricity bill include wholesale electricity costs, retail costs and environmental policy costs.

Figure 4 illustrates the different components of the electricity supply chain. Each of these costs contributes to the retail prices charged to consumers by their chosen electricity retailer.

[23] Jemena, *Response to AER information request #040*, 06 July 2020.

[24] The metering costs referenced in the estimated bill impact analysis refer only to the revenue-capped type 5 and 6 (including. smart metering) services, and do not include any other price-capped metering services. For more information on metering services, see Attachment 16 – Alternative control services.

Figure 4 Electricity supply chain



Source: AER, State of the Energy Market, December 2018, p. 28.

For this draft decision, we have estimated average distribution price impacts flowing from our revenue determination. These prices are indicative and will vary for a number of reasons. For example, any change in forecast demand will affect annual price updates. We have also not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue

Table 1 shows the estimated average annual impacts of our draft decision on electricity bills for residential and small business customers for the 2021–26 regulatory control period. We estimate these impacts, while holding all other components constant. This approach isolates the effect of our draft decision on distribution network tariffs from

other bill components. However, this does not imply that other components will remain unchanged across the regulatory control period.[25]

The final bill impact is likely to be affected by our final decision on any revisions made by Jemena, changes in consumption, the return on debt, cost pass throughs, adjustments for under or over recovery and incentive schemes. The final outcome of our inflation review later this years and the Victorian Government's legislation on the 6 month extension period will also change the final bill impact. We note that due to the economic uncertainties and concurrent review of our methodology for estimating expected inflation there is potential for a larger-than-normal change between the draft and final decisions.

Under the draft decision we estimate that compared to current charges, the distribution network charges ($ nominal) in Jemena's area:

- for an average residential consumer would:
    - reduce by $61 (3.8 per cent) in the first year of the 2021–26 regulatory control period
    - decrease on average by $3 (0.2 per cent) for each of the remaining four years of the 2021–26 regulatory control period.
- for an average small business consumer would:
    - reduce by $221 (3.5 per cent) in the first year of the 2021–26 regulatory control period
    - decrease on average by $17 (0.3 per cent) for each of the remaining four years of the 2021–26 regulatory control period.

Table 1 Estimated contribution to annual electricity bills for the 2021–26 regulatory control period ($ nominal)

	2020	2021–22	2022–23	2023–24	2024–25	2025–26
AER draft decision						
Residential annual bill	1597[a]	1536	1531	1530	1528	1526
Annual change[c]		–61 (–3.8%)	–5 (–0.3%)	–2 (–0.1%)	–2 (–0.1%)	–2 (–0.1%)
Standard control services		–37	–6	–2	–2	–3
Metering		–24	1	1	1	1
Small business annual bill	6399[b]	6178	6148	6136	6123	6110
Annual change[c]		–221 (–3.5%)	–29 (–0.5%)	–12 (–0.2%)	–13 (–0.2%)	–13 (–0.2%)

[25] It also assumes that actual energy consumption will equal the forecast adopted in our final decision. Since Jemena operates under a revenue cap, changes in energy consumption will also affect annual electricity bills across the 2021–26 regulatory control period.

	2020	2021–22	2022–23	2023–24	2024–25	2025–26
Standard control services		–197	–30	–13	–13	–14
Metering		–24	1	1	1	1
Jemena proposal						
Residential annual bill	1597[a]	1555	1558	1565	1572	1578
Annual change[c]		–43 (–2.7%)	3 (0.2%)	7 (0.4%)	7 (0.4%)	7 (0.4%)
Standard control services		–27	3	6	6	6
Metering		–16	1	1	1	1
Small business annual bill	6399[b]	6241	6256	6289	6323	6356
Annual change[c]		–158 (–2.5%)	15 (0.2%)	33 (0.5%)	34 (0.5%)	33 (0.5%)
Standard control services		–142	14	33	33	32
Metering		–16	1	1	1	1

Source: AER analysis; Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 76.

(a) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and reflects the average consumption of 4000 kWh for residential customers in Victoria. This is then indexed by CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.

(b) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and reflects the average consumption of 20000 kWh for small business customers in Victoria. This is then indexed by CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.

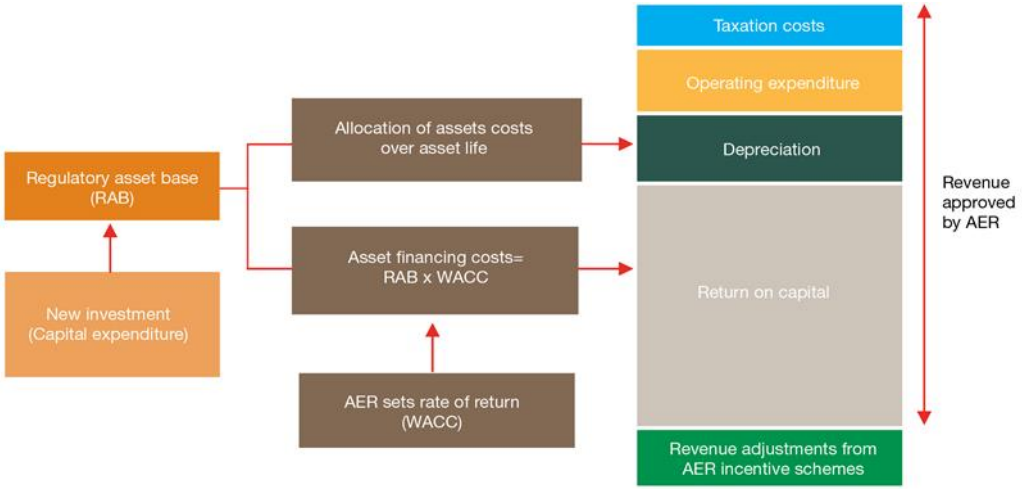
(c) Annual change amounts and percentages are indicative. They are derived by varying the distribution component of the 2020 bill amounts in proportion to yearly expected revenue divided by forecast energy as provided by Jemena. Actual bill impacts will vary depending on electricity consumption and tariff class.

2 Key components of our draft decision on revenue

The total revenue Jemena proposed reflects its forecast of the efficient cost of providing network services over the 2021–26 regulatory control period. Jemena's proposal, and our assessment of it under the National Electricity Law and Rules (NEL and NER), are based on a 'building block' approach to determining a total revenue allowance (see Figure 5) which looks at six cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business) (section 2.2)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time) (section 2.3)
- capex — the capital expenditure incurred in the provision of network services — mostly relates to assets with long lives, the cost of which are recovered over several regulatory control periods. The forecast capex approved in our decisions directly affects the projected size of the RAB and therefore the revenue generated from the return on capital and depreciation building blocks (section 2.4)
- opex—the operating, maintenance and other non-capital expenses incurred in the provision of network services (section 2.5)
- the estimated cost of corporate income tax (section 2.6)
- revenue adjustments, including revenue increments or decrements resulting from the application of incentive schemes, such as the EBSS and CESS that applied to Jemena for the 2016–20 regulatory control period and the Demand Management Innovation Allowance Mechanism (DMIAM) allowance for 2021–26 (section 2.7).

Figure 5 The building block model to forecast network revenue



Source: AER, *State of the Energy Market, December* 2018, p. 28.

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 part of the benefit. This incentive framework is a foundation of the regulatory framework, which aims to promote the NEO. Network businesses 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.

Our draft decision on Jemena's distribution revenues for the 2021–26 regulatory control period is set out in Table 2.

Table 2 AER's draft decision on Jemena's revenues for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	71.2	73.1	74.8	75.2	74.6	368.8
Regulatory depreciation[a]	47.0	52.4	54.9	58.7	61.1	274.1
Operating expenditure[b]	105.3	106.3	107.6	108.1	108.9	536.1
Revenue adjustments[c]	18.2	14.9	13.5	10.6	10.8	68.0
Net tax allowance	5.3	5.4	4.4	6.4	6.4	27.8
Annual revenue requirement (unsmoothed)	247.0	252.1	255.2	259.0	261.7	1274.9
Annual expected revenue (smoothed)	**255.3**	**255.0**	**254.7**	**254.3**	**254.0**	**1273.3**
X factor[d]	n/a[e]	2.45%	2.45%	2.45%	2.45%	n/a

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).

(b) Includes debt raising costs.

(c) Includes revenue adjustments from EBSS, CESS, shared asset adjustments and DMIAM.

(d) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(e) Jemena is not required to apply an X factor for 2020–21 because we set the 2020–21 expected revenue in this decision. The expected revenue for 2021–22 is around 10.6 per cent lower than the approved total annual revenue for 2020 in real terms, or 8.5 per cent lower in nominal terms after taking into account the escalation by half year CPI to allow comparison of the revenue from 1 July 2021 onwards.

In the sections below we discuss each component of our draft decision on Jemena's revenue building blocks for the 2021–26 regulatory control period.

2.1 Regulatory asset base

The RAB is the value of assets used by Jemena to provide regulated distribution services. The value of the RAB substantially impacts Jemena's revenue requirement,

and the price consumers ultimately pay. This makes it a key issue for many stakeholders. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determination.

As part of our decision on Jemena's revenue for 2021–26, we make a decision on its opening RAB as at 1 July 2021. We use the RAB at the start of each regulatory year to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

We determine an opening RAB value of $1524.4 million ($ nominal) as at 1 July 2021 for Jemena. This value is $26.7 million (or 1.7 per cent) lower than Jemena's proposed opening RAB of $1551.1 million ($ nominal) as at 1 July 2021.[26] While we largely accept the proposed methodology for calculating the opening RAB, we made the following revisions to Jemena's proposed inputs to the roll forward model (RFM):

- removed the 'Metering' asset class as the assets have effectively been fully depreciated.[27] There is also no new capex allocated to this asset class during the 2021–26 regulatory control period
- amended 2016 lagged actual CPI to reflect June on June rather than September on September. This is consistent with the CPI method listed in the control mechanism for the 2016–20 regulatory control period
- amended the 2016 equity raising costs to reflect the amended 2016 CPI
- updated the following inputs as newer information has become available since Jemena submitted its proposal:
    - actual capex for 2019 reported in the annual RIN for that year
    - actual inflation for the 6 month period of 1 January to 30 June 2021, reflecting the lagged CPI series
    - forecast inputs for inflation, nominal WACC, equity raising costs and depreciation for the 6 month period of 1 January to 30 June 2021.

To determine the opening RAB as at 1 July 2021, we have rolled forward the RAB over the 2016–20 regulatory control period and a further roll forward for six months (the 1 January to 30 June period)[28] to arrive at a closing RAB at 30 June 2021 in accordance with our RFM. This roll forward process includes an adjustment at the end

[26] Jemena, *JEN – Att 07-17 SCS RFM CY16-HY21 – 20200131 – Public,* January 2020.

[27] It has an opening value of less than $0.01 as at 1 July 2021.

[28] The additional roll forward for 6 months is due to the decision by the Victorian government to change the timing of the annual Victorian electricity network price changes to financial year basis from calendar year basis. This change means the current regulatory control period of 2016–20 is extended by 6 months and the next regulatory control period will commence on 1 July 2021.

of the 2016–20 regulatory control period to account for the difference between actual 2015 capex and the estimate approved in the 2016–20 determination.[29]

Table 3 sets out the roll forward of Jemena's RAB over the 2016–21 period.

Table 3 AER's draft decision on Jemena's RAB for the 2016–21 period ($ million, nominal)

	2016	2017	2018	2019	2020[a]	2021[b]
Opening RAB	1186.8	1238.2	1312.5	1386.1	1428.4	1483.4
Capital expenditure[c]	115.9	134.7	128.4	100.2	126.1	61.6
Inflation indexation on opening RAB	17.9	12.7	25.4	28.8	22.8	18.1
Less: straight-line depreciation[d]	82.4	73.0	80.2	86.7	93.7	38.8
Interim closing RAB	1238.2	1312.5	1386.1	1428.4	1483.7	1524.4
Difference between estimated and actual capex in 2015					–0.2	
Return on difference for 2015 capex					–0.1	
Closing RAB as at 31 December 2020					1483.4	
Closing RAB as at 30 June 2021						**1524.4**

Source: AER analysis.

(a) Based on estimated capex provided by Jemena. We expect to update the RAB roll forward for actual capex in the final decision.

(b) The half year period of 1 January to 30 June 2021. Based on estimated capex provided by Jemena. We expect to update the RAB roll forward with a revised capex estimate in the final decision, and true-up the RAB for actual capex at the next reset

(c) Net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.

(d) Adjusted for actual CPI. Based on forecast capex.

We determine a forecast closing RAB value as at 30 June 2026 of $1903.7 million ($ nominal) for Jemena. This is $49.1 million or 2.5 per cent lower than Jemena' proposed closing RAB value of $1952.8 million ($ nominal).[30] Our draft decision on the forecast closing RAB value reflects the amended opening RAB as at 1 July 2021, and our draft decisions on the expected inflation rate (attachment 3), forecast depreciation (attachment 4) and forecast capex (attachment 5).[31] The major driver of the difference

[29] The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2016–20 determination.

[30] Jemena, *JEN – Att 07-15 SCS PTRM FY22–26 – 20200131 – Public*, January 2020.

[31] Capex enters the RAB net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Therefore, our draft decision on the forecast RAB also reflects our modifications to the rate of return for the 2021–26 regulatory control period (attachment 3).

in the closing RAB has been our draft decision to reduce Jemena's proposed forecast capex by $27.2 million ($ nominal) or 4.0 per cent.

Table 4 sets out our draft decision on the forecast RAB values for Jemena over the 2021–26 regulatory control period.

Table 4 AER's draft decision on Jemena's RAB for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening RAB	1524.4	1622.1	1724.5	1802.2	1860.1
Capital expenditure[a]	144.8	154.7	132.7	116.6	104.7
Inflation indexation on opening RAB	36.2	38.5	40.9	42.8	44.2
Less: straight-line depreciation	83.2	90.9	95.9	101.5	105.2
Closing RAB	**1622.1**	**1724.5**	**1802.2**	**1860.1**	**1903.7**

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 RAB for revenue modelling.

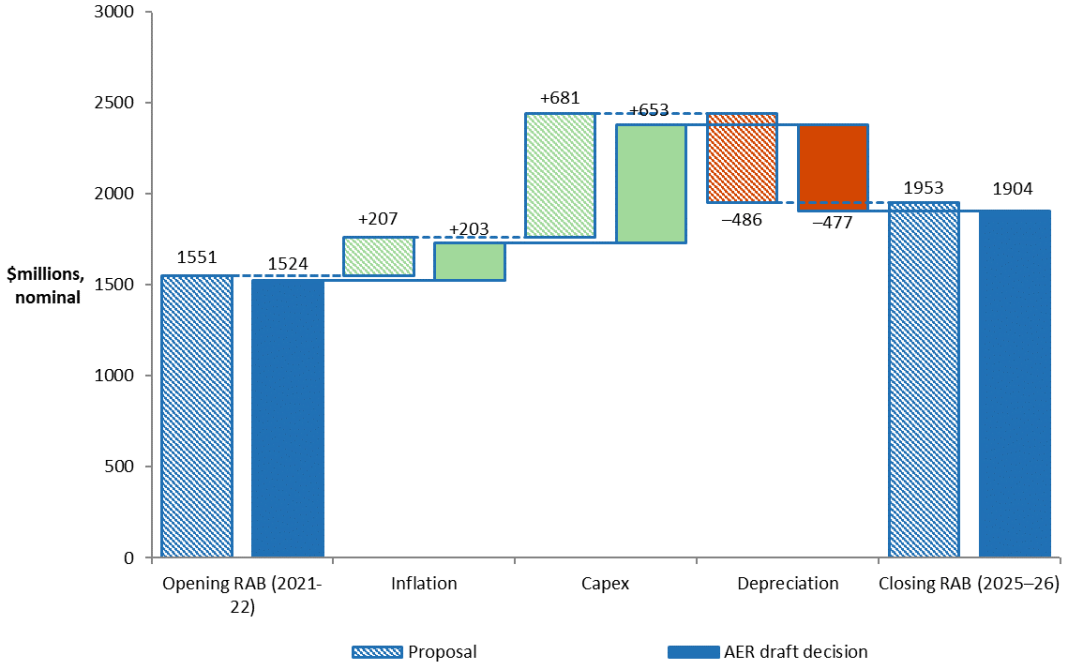
We accept Jemena's proposal that the forecast depreciation approach is to be used to establish the opening RAB at the commencement of the 2026–31 regulatory control period.[32] We consider this approach is consistent with our *Framework and approach* paper.[33] It is also consistent with the capital expenditure incentive objective in that it will provide sufficient incentives for Jemena to achieve capex efficiency gains over the 2021–26 regulatory control period.

Figure 6 shows Jemena's proposal and our draft decision RAB over the 2021–26 regulatory control period.

[32] NER, cl. 6.12.1(18). Jemena, *Regulatory proposal*, January 2020, p. 148.

[33] AER, *Final framework and approach for AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 12.

Figure 6 Jemena's proposal and AER's draft decision RAB ($ million, nominal)



Source: AER analysis.

Further detail on our draft decision regarding the RAB is set out in attachment 2.

2.2 Rate of return and value of imputation credits

The return each business is to receive on its RAB (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 RAB.

We estimate the rate of return by combining the returns of the 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 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.

The Victorian Government is intending to move the Victorian electricity distribution network service providers from a calendar year regulatory period to a financial year regulatory period.[34] This entails a 6 month extension to the current regulatory period (2016–20) through to June 2021 then a 5 year regulatory control period starting on 1 July 2021.[35]

We are required by the National Electricity Law (NEL) to apply a rate of return instrument—the current 2018 Rate of Return Instrument (2018 Instrument)—to estimate an allowed rate of return.[36] However, the 2018 Instrument was developed on the basis of consecutive 12-month regulatory years, and does not contemplate an intervening 6 month extension period when moving from calendar years to financial years. This is important for the calculation of the trailing average portfolio return on debt under the Instrument. The 2018 Instrument also did not contemplate the nomination of averaging periods for a 6 month extension period.

The Victorian Government intends to enact the change to a financial year regulatory period through the National Energy Legislation Amendment (NELA) Bill. By the time of this draft decision, the Bill has not been passed. In a letter to the AER on 2 September 2020, the Minister reaffirmed the Victorian Government's commitment to change electricity and gas network regulatory periods from a calendar to financial year basis. We anticipate that we will be able to apply a modified 2018 instrument in the final decision on this basis.[37]

Subject to the passing of the NELA Bill and relevant Orders in Council, application of a modified 2018 Instrument in this draft decision would estimate a placeholder allowed rate of return of 4.67 per cent (nominal vanilla) which will be updated for our final decision on the averaging periods.[38] We note Jemena's regulatory proposal also accepted the application of these modifications to the 2018 Instrument.[39]

Our calculated rate of return, in Table 5, will apply to the first year of the 2021–26 regulatory control period. A different rate of return will apply for the remaining regulatory years of the period. This is because we will update the return on debt

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34 Victorian Government, *Letter re: Intention to change the timing of annual Victorian network price changes*, April 2019, available at https://www.aer.gov.au/system/files/VIC%20DELWP%20letter%20to%20AER%20re%20intention%20to%20change%20the%20timing%20of%20annual%20Victorian%20network%20price%20changes%20-%20April%202019_0.pdf

35 The 6 month extension period was labelled as the 'mini-year' when we consulted on modifications to the 2018 Rate of Return Instrument.

36 NEL, Part 3, division 1B. AER, *Rate of return instrument*, December 2018, available at https://www.aer.gov.au/networks-pipelines/guidelinesschemes-models-reviews/rate-of-return-guideline-2018/final-decision

37 Hon Lily D'Ambrosio MP, *Letter re: Reaffirming commitment to change the timing of Victorian network pricing*, 2 September 2020.

38 See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision. NGL, Chapter 2, Part 1, division 1A; NEL, Part 3, division 1B.

39 Jemena, *2021–26 Electricity distribution price review, Regulatory proposal, Attachment 07-02*, *Rate of Return* January 2020, p. 9.

component of the rate of return each year in accordance with a modified 2018 instrument to use a 10-year trailing average portfolio return on debt that is rolled-forward each year.

Subject to the passing of the NELA Bill and relevant Orders in Council, our draft decision is to accept Jemena's proposed risk free rate averaging period[40] and debt averaging periods because they would comply with conditions proposed for a modified 2018 instrument.[41]

Table 5 Draft decision on Jemena's rate of return (% nominal)

	AER final decision (2016–20)	Jemena proposal (2021–26)	AER draft decision (2021–26)	Allowed return over regulatory control period
Nominal risk free rate	2.93%	1.04%	0.90%[a]	
Market risk premium	6.5%	6.1%	6.1%	
Equity beta	0.7	0.6	0.6	
Return on equity (nominal post–tax)	7.5%	4.70%	4.56%	Constant (%)
Return on debt (nominal pre–tax)	5.62%	4.87%	4.74%[b]	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	6.37%	4.80%	4.67%	Updated annually for return on debt
Expected inflation	2.32%	2.37%	2.37%	Constant (%)

Source: AER analysis; Jemena, *2021–26 Electricity distribution price review, Regulatory proposal, Attachment 07-02 Rate of Return*, January 2020, pp. 6-11.

[a,b] Calculated using a placeholder averaging period.

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.

[40] This is also known as the return on equity averaging period.

[41] See AER, *Rate of return instrument*, December 2018, cll. 7–8, 23–25, 36; Parliament of Victoria, *National energy legislation amendment bill 2020*, June 2020; and AER, *Draft decision, Jemena draft determination 2021 to 2026, Attachment 3—Rate of return confidential appendix A: Equity and debt averaging periods*, September 2020.

Our draft decision is to accept the method used in Jemena's proposal which uses an annual rate of 8.78 basis points per annum (bppa).[42] We have considered this annual rate and found that our alternative benchmark estimate (8.2 basis points) is not materially different from Jemena's proposal.

We accept Jemena's proposal to use our approach to estimate equity raising costs.[43] Using this approach, Jemena forecasts $4.22 million of equity raising costs.[44] We have updated our estimate for this regulatory control period based on the benchmark approach using updated inputs. This results in $3.81 million ($2020–21) equity raising costs.

Imputation credits

Subject to the passing of the NELA Bill and relevant Orders in Council, our draft decision is to apply a gamma of 0.585 as provided in the 2018 Instrument.[45] Jemena's proposal has adopted a value of 0.585 which is consistent with this.[46]

Inflation

Jemena proposed to apply our current approach to estimate expected inflation. Our draft decision estimate of expected inflation is 2.37 per cent for the regulatory control period.[47] Each Victorian distributor's proposal noted concerns with our current approach to estimating expected inflation. 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, with a draft position to be published in early October. The draft position will provide guidance on the potential impact of alternative methods of estimating expected inflation. If we consider a different method for estimating expected inflation should be adopted, we intend to commence the consultation process under the NER for amending the PTRM. We expect to apply amendments to the PTRM (if any) in our final determination for each of the Victorian distributors in April 2021, unless a rule change proposal is required.

2.3 Regulatory depreciation (return of capital)

Regulatory depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (return of capital). Jemena invests

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42 Jemena, *2021–26 Electricity distribution price review, Regulatory proposal, Attachment 06-01, Standard Control Services – Operating expenditure*, January 2020, p. 27.

43 Jemena, *2021–26 Electricity distribution price review, Regulatory proposal, Attachment 005-01, Forecast capital expenditure*, January 2020, p. xiii

44 Jemena, *JEN - Att 07-15 SCS PTRM FY22–26 - 20200131 - Public - 24 Feb 20*.

45 See AER, *Rate of return instrument*, December 2018; Parliament of Victoria, *National energy legislation amendment bill 2020*, June 2020.

46 Jemena, *2021–26 Electricity distribution price review, Regulatory proposal, Attachment 07-02*, January 2020, p. 6.

47 Jemena Electricity Networks, *Jemena Electricity Networks Vic Ltd - 2021–26 Electricity Distribution Price Review Regulatory Proposal - Attachment 07-02 - Rate of Return*, January 2020, p.11.

capital in large assets to provide electricity network services to its consumers. The costs of these assets are recovered over the asset's useful life, which in many cases can be 50 or more years. This means only a small part of the cost of such assets are recovered from consumers upfront or in any year. The greater proportion is recovered over time through the depreciation allowance. The regulatory depreciation allowance is the net total of the straight-line depreciation less the inflation indexation adjustment of the RAB.

Our draft decision on Jemena's revenue for 2021–26 includes a regulatory depreciation amount of $274.1 million ($ nominal). This is $4.9 million (1.7 per cent) lower than Jemena's proposal.

We adopt the same approach to regulatory depreciation as Jemena. For some asset classes we have amended the proposed standard asset lives which determine how quickly an asset class is removed from the RAB.[48] We accept Jemena's proposal to apply the year-by-year tracking approach, subject to minor changes to its depreciation tracking model.

We have also made determinations on other components of Jemena's proposal, which affect the RAB and in turn impacts the forecast regulatory depreciation. Reductions to the opening RAB (attachment 2) and forecast capex (attachment 5) lead to a $9.1 million reduction to straight-line depreciation. Offsetting this, our draft decision on the indexation of the RAB is $4.2 million lower than the proposal. This is largely due to the lower forecast.

Further detail on our draft decision regarding depreciation is set out in attachment 4.

2.4 Capital expenditure

Capex—the capital costs and expenditure incurred to provide network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. Capex is added to Jemena's RAB, which is used to determine the return on capital and return of capital (regulatory depreciation) building block allowances. All else being equal, higher forecast capex will lead to a higher projected RAB value and higher return on capital and regulatory depreciation allowances.

Our draft decision on Jemena's revenue includes a total net capex forecast of $602.3 million ($2020–21) for the 2021–26 regulatory control period. This is 4.0 per cent lower than Jemena's capex forecast of $627.1 million.

Our draft decision allows for a capex forecast that is broadly in line with current period spend.[49] We consider that this capex forecast is prudent and efficient, and sufficient for

[48] We have amended the standard lives for the 'Non-network - other' and 'Equity raising costs' asset classes.

[49] We took account of the materially greater forecast in REFCL over the forecast period ($35 million) relative to its allowance of $6 million in the current period.

Jemena to maintain its services level given that it has performed well on a number of network health indicators over the current period.

In making our draft decision, we have used updated information to take into account changes in economic conditions. For example, we have used updated housing data from the Housing Industry Association (HIA) to develop our forecast connections and labour price growth was calculated consistent with the approach used in our opex decision (see section 2.5).

We typically analyse a distributor's total capex forecast from a top-down[50] perspective. This top-down review forms the starting point of our capex assessment to determine whether further detailed analysis is required, but is also used throughout our review process to test the results of our bottom-up assessment. We apply both top-down and bottom-up reviews so that our decision is fully informed. From both reviews, we are generally satisfied that Jemena's forecast reasonably reflects the capex criteria after accounting for adjustments to connections, REFCL augex and real cost escalation.

Stakeholders showed support for Jemena's consumer engagement and capital program design and were reasonably comfortable with its forecast capex proposal.[51] [52] [53] We placed appropriate weight on Jemena's consumer engagement and its consumers' support for the capex proposal in deciding whether the proposed forecast is prudent and efficient.[54]

Figure 7 illustrates the change in Jemena's capex over time. Jemena's forecast is a 9 per cent increase from its historical actual capex over the 2016–20 regulatory period. It also underspent its current regulatory period allowance by 21 per cent.

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50 A top down analysis focusses on overall trends and adjustments rather than a bottom-up analysis which focusses on aggregating category specific drivers.

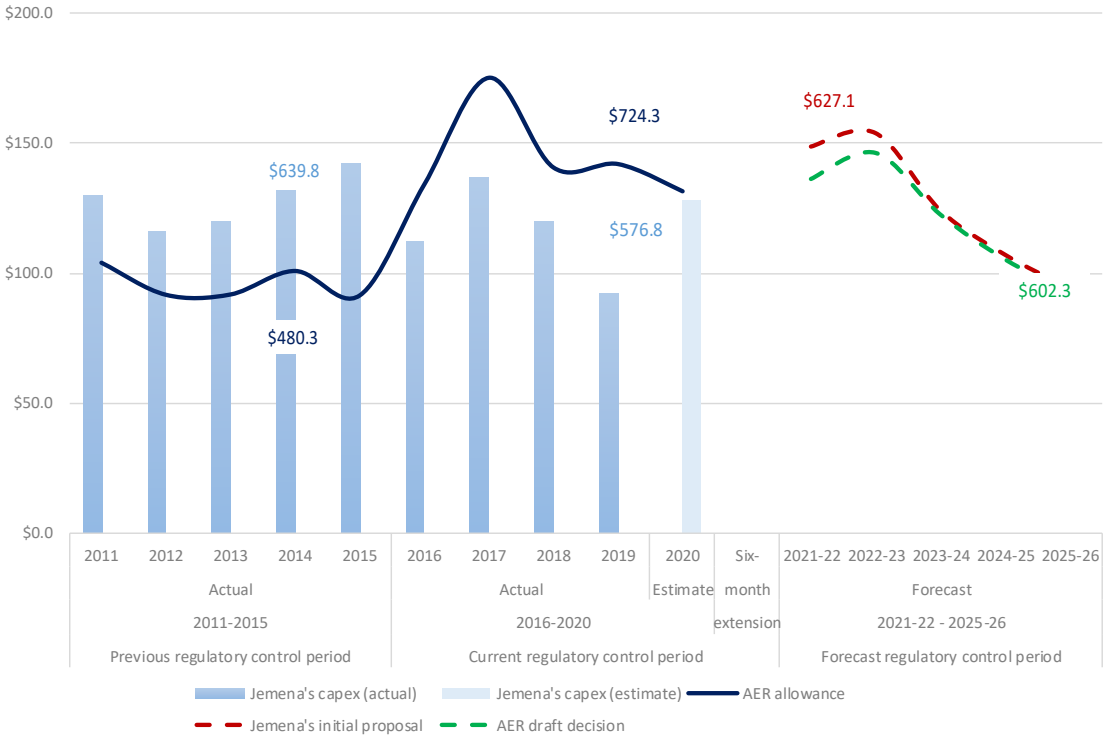
51 A significant component of Jemena's customer engagement approach involved the People's Panel, comprising 43 people from Jemena's customer base. The People's Panel produced five recommendations relating to capex, which are: maintaining the current number of outages and length of outages, improving channels of customer service, enabling DER and investing in smart technology. The last two informed Jemena's Future Grid program.

52 CCP17, *Advice to the AER on the Victorian electricity distributors' regulatory proposals 2021–26,* June 2020, pp. 23 and 80.

53 Spencer and Co, *Report to ECA on Victorian 2021–26 regulatory proposals*, June 2020, pp. 9, 12 and 18.

54 NER, cl.6.5.7(e)(5A)

Figure 7 AER's draft decision on total forecast capex ($ million, 2020–21)



Source: Jemena's initial proposal and AER analysis.

Note: The capex figures reported refer to five-year totals over a regulatory control period. The 2020 estimate has been included in this chart for indicative purposes. We have not used this estimate in our trend comparison.

We undertook a targeted bottom-up review which focused on some drivers of capex that have increased relative to current period capex. While this bottom-up review found no other material issues to support further adjustments, our draft decision identifies areas we expect more quantitative evidence to support Jemena's projects and programs that it should look to address not just for the purposes of future revenue reviews but in the usual course of operating its business.

In determining whether Jemena's total capex forecast is prudent and efficient, we also note the following:

- With the capital expenditure sharing scheme applying in the current period, we place weight on Jemena's forecast capex being a moderate 9 per cent increase relative to its current period spend. Further, Jemena's forecast capex is 2 per cent higher than its longer term capex trend, going back to the start of the 2011–15 regulatory control period. The drivers of the increase are DER integration capex and REFCL. Jemena's 2019 net capex is lower due to a one off gifting of assets which increased its capital contributions by $15 million for that year.[55]

[55] Jemena, *Information request 039*, June 2020, p. 2.

- Jemena's expected underspend in the current period is approximately 21 per cent. Of the Victorian distributors, Jemena provided the most comprehensive and transparent information in identifying the drivers of its capex underspend and deferrals.[56]
- Jemena's material underspend also highlights that it can manage and maintain its network at a more efficient level. During the current period, Jemena improved its network reliability and reduced fire starts, reflecting it can effectively manage risk on its network. This provides us with confidence that Jemena's current period spend is a reasonable forecast to address its network requirements over the RCP. We are therefore satisfied that our substitute estimate which is in line with current period spend will provide Jemena with sufficient funding to meet its capex objectives under the NER.
- Jemena did not provide detail on a formal top-down challenge or adjustment to its forecast, but indicated it employed combinations of bottom-up and top-down methodologies in developing the forecast.[57]
- In response to the initial proposal, most stakeholders were supportive of investment by networks to integrate a greater level of PV export. [58] However, several stakeholders raised concerns with using the feed-in tariff as the basis for the value of DER and the likelihood of negative pool prices in Victoria based on the Queensland and South Australian experience.[59] More specifically, the VCO called for a standard approach for valuing exported generation that reflects the expected changes in the value of DER exports over time.[60]
- Similar concerns about a lack of consistency across distributors in valuing the benefits associated with investing in DER integration were raised in response to the AER's consultation paper on Assessing DER Integration Expenditure.[61] In response, the AER and ARENA commissioned the value of DER (VaDER) study earlier this year.[62] CSIRO and Cutler-Merz were engaged to conduct a study into potential methodologies for valuing DER and have extensively engaged with stakeholders, including Jemena, as part of the study.

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56 Jemena, *2021–26 Regulatory proposal – attachment 05-02 – historical capital expenditure,* January 2020; Jemena, *Information request 012*, May 2020.

57 Jemena, *2021–26 Regulatory proposal – attachment 05-01 – forecast capital expenditure*, January 2020, p. B-3.

58 Victorian Community Organisations, *2021–26 Victorian EDPR,* May 2020, p.4, Local Government Response, *2021–26 Victorian EDPR, May 2020,* p.30, Origin Energy, *Submission to Victorian electricity distributors' regulatory proposals,* June 2020, p.3, Vector Limited, *2021–26 Victorian EDPR,* June 2020, p.4, DELWP, *Victorian Government submission on the electricity distribution price review 2021–26,* May 2020, p. 2.

59 Energy Australia, *Victorian electricity distribution determinations 2021–26 regulatory proposal*, June 2020, p. 14; CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals,* June 2020, p. 106; Energy Users' Association of Australia, *Submission: AusNet Services EDPR 2021–26*, June 2020, pp. 11–12.

60 Victorian Community Organisations, *2021–26 Victorian EDPR,* May 2020, p. 10.

61 See: https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/assessing-distributed-energy-resources-integration-expenditure/initiation.

62 See: https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/assessing-distributed-energy-resources-integration-expenditure/consultation

- The final report of the VaDER study is due to the AER in early October 2020, which will help to address some of the stakeholder concerns outlined above. We will publish the final report as soon as practicable. We will then consider the report's recommendations and formally implement them as we consider appropriate as part of the AER's DER integration expenditure guideline, now due for completion in 2021. Given the extensive stakeholder engagement in forming the VaDER study's recommendations, we anticipate that consumers will expect Victorian distributors to prepare their revised proposals in the spirit of these recommendations.

We are expecting updated information relating to Jemena's Rapid Earth Fault Current Limiter (REFCL) capex, which is not yet available. We also expect Jemena to reflect updated economic conditions in its revised proposal for real cost escalations, connections and demand forecasts.

We have set out the reasons for our draft decision on capex in more detail in attachment 5.

2.5 Operating expenditure

Opex is the forecast of operating, maintenance and other non-capital costs incurred in the provision of standard control services. Forecast opex is one of the building blocks we use to determine Jemena's total regulated revenue requirement.

We are not satisfied that Jemena's opex forecast is prudent and efficient. Our draft decision is to include our alternative total opex forecast of $499.8 million ($2020–21) in Jemena's allowed revenue for the 2021–26 regulatory control period.[63] This is $76.8 million, or 13.3 per cent, lower than Jemena's total opex forecast of $576.6 million ($2020–21).[64]

Figure 8 shows Jemena's actual opex and our previous approved forecast in the current regulatory control period along with its proposed opex for the next regulatory control period and our draft decision. Jemena's opex forecast for the 2021–26 regulatory control period was 29.6 per cent higher than its actual and estimated opex in the 2016–20 regulatory control period.[65] Our draft decision is 12.3 per cent higher than Jemena's actual and estimated opex in the current regulatory control period.[66]

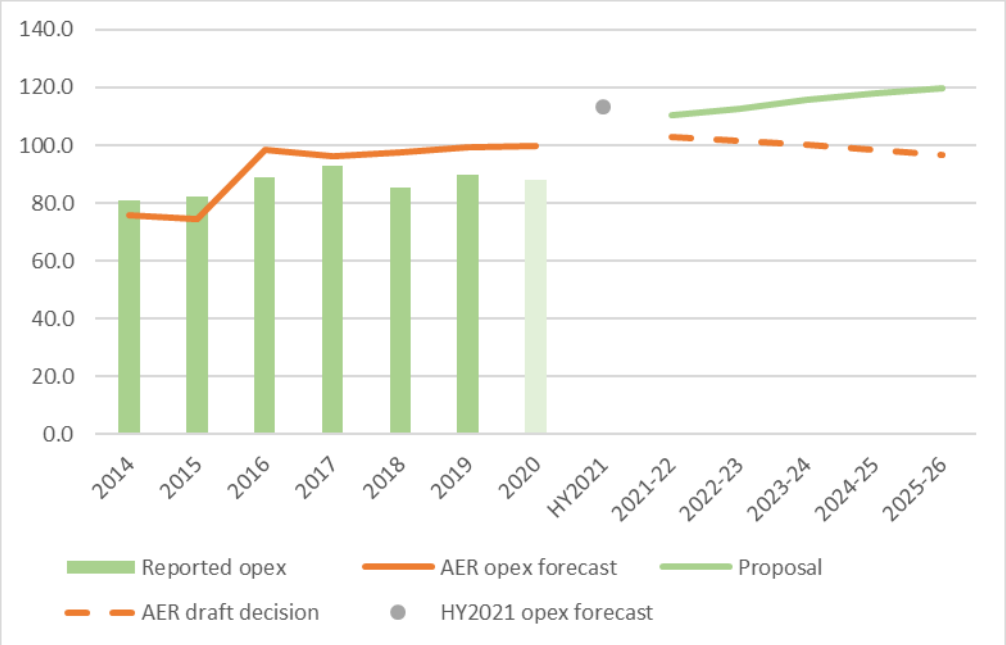
[63] Including debt raising costs.

[64] Including debt raising costs.

[65] On a like for like basis, after removing the adjustment for the expensing of corporate overheads which does not begin until 1 January 2021, this is 12.3 per cent.

[66] On a like for like basis, after removing the adjustment for the expensing of corporate overheads our draft decision is 1 per cent lower than the actual and estimated opex in the 2016-20 regulatory control period.

Figure 8 Jemena's opex over time ($ million, 2020–21)



Source: Jemena, IR001 – RIN 5 - *Workbook 1 - Regulatory determination – Public – 10 March 20; Jemena,* Economic Benchmarking RIN response 2019; *JEN – Att 06-04 SCS Opex Model FY22–26 – Public - 25 Feb 20*; AER analysis.

Note: We have not included in the 2020 estimate the expensing of corporate overheads under Jemena's new CAM, as this does not occur until 1 January 2021.

Table 6 sets out Jemena's proposal, including updates it submitted, our alternative estimate for the draft decision and the key differences. The updates it submitted include a proposed reduction to its proposal of $20.2 million ($2020–21) via a negative step change to hand back the results of its 2019 transformation program more quickly.

Table 6 Comparison of Jemena's proposal and our draft decision on opex ($ million, 2020–21)

	Jemena's Proposal	Updated proposal	AER draft decision	Difference
Base (reported opex in 2018)	427.8	427.8	422.5	-5.3
Efficiency adjustment	0.0	0.0	-44.9	-44.9
Base year adjustments	62.1	0.0	0.0	-62.1
Final year increment	12.5	83.7	79.2	66.7
Trend: Output growth	23.2	19.6	11.6	-11.6
Trend: Real price growth	10.7	9.2	0.8	-9.8
Trend: Productivity growth	-7.4	-7.5	-5.8	1.6
Step changes	42.4	21.3	32.4	-10.0
Category specific forecasts	1.0	0.9	0.1	-1.0

	Jemena's Proposal	Updated proposal	AER draft decision	Difference
Total opex (excluding debt raising costs)	572.2	554.9	495.8	-76.4
Debt raising costs	4.4	4.3	4.0	-0.4
Total opex (including debt raising costs)	576.6	559.3	499.8	-76.8
Percentage difference to proposal				-13.3%

Source: JEN – *Att 06-04 SCS Opex Model FY22–26 – Public* - 25 Feb 20; AER analysis.

Notes: Numbers may not add up to totals due to rounding. The difference is between Jemena's proposal and our draft. Jemena updated its proposal to incorporate its proposed base adjustment for the expensing of corporate overheads into the calculation of its final year increment (as this will occur from 1 January 2021). It also added a negative step change to hand back the results of its 2019 transformation program more quickly, and withdrew its proposed step change in relation to transitional return on debt alignment costs. See section 6.2.

Category specific forecasts reflect the net change

The following key factors have contributed to our lower alternative total opex forecast:

- From our assessment of revealed costs, a range of benchmarking techniques and our analysis of its category costs we consider that Jemena's opex has been relatively inefficient over time and in the 2018 base year. Given this, we have made an efficiency adjustment to Jemena's base year opex. While we consider base year opex should be 15 per cent lower, we also consider that it will take time and involve costs for management to implement the required programs over the next regulatory control period to transition to efficient costs. Given this, we have used a glide path to reduce opex by 3 per cent per annum, resulting in cumulative a reduction of 15 per cent in the last year of the five year regulatory control period. We consider that this provides for the prudent, practicably achievable, efficient costs that will enable Jemena to maintain the quality, reliability, security and safety of services. This means our alternative estimate is $44.9 million ($2020–21) lower than Jemena's initial proposal. Taking into account Jemena's update to reduce its opex forecast by $20.2 million (and hand back the results of its 2019 transformation program more quickly), means our efficiency adjustment is $24.7 million ($2020–21) more than Jemena included in its updated proposal.
- Our forecast rate of change by which we trend opex forward over the next five years is on average 0.6 per cent each year. This is lower than Jemena's proposed 1.4 per cent per year on average. This is primarily driven by our lower output and price growth forecasts, which in large part reflect the impacts of COVID-19 on wage price growth and reliance on AEMO's maximum demand forecasts. This lowers our alterative estimate compared to Jemena's proposal by $19.8 million ($2020–21).
- With the exception of forecasting labour price growth, we have used our standard approach to trend opex forward over the next five years. For labour price growth, we have used a forecast prepared by Deloitte Access Economics rather than the standard approach of averaging two forecasts as this is the only forecast available which factors in the impacts of COVID-19. For the final decision we will reconsider

updating the rate of change forecast using our standard approach provided the necessary forecasts are available.

- We generally only include step changes where we are satisfied there are efficient costs associated with new regulatory obligations or capex/opex trade-offs and these costs are not already captured in base opex or through our trend forecast. We consider Jemena's proposed step up in opex required for bushfire liability insurance over the 2021–26 regulatory control period is prudent and efficient and have included an increase in costs for this of $28.2 million ($2020–21) in our alternative estimate. However, we have not included some step changes proposed by Jemena as we did not consider there is sufficient evidence to demonstrate the proposed costs are efficient (the future grid program and EPA regulation changes) or are driven by material new obligations (financial year RIN step change). This lowers our alternative estimate compared to Jemena's proposal by $10.0 million ($2020–21).

In making our draft decision we have taken into account Jemena's consumer engagement, including its People's Panel, and the feedback we have received from other stakeholders.

Jemena's consumer consultation appears to have been mainly high level and focused on total opex. Noting the importance of affordability to customers, and maintaining safe and reliable services, it stated that it is committed to delivering initiatives aimed at reducing costs now and into the future. In our assessment we have not been convinced that its opex proposal is efficient and passes lower costs on to consumers in the next regulatory control period. In addition, while over 90 per cent of its People Panel were comfortable that Jemena's draft plan (including the opex proposal) sufficiently considers their long-term interests, we could not clearly see how Jemena had engaged with its customers in relation to specific components of its proposal. In contrast, we received feedback from a number of stakeholders who had concerns with specific aspects of Jemena's proposal. This included the efficiency of Jemena's base year opex, the trend forecasts in light of COVID-19 impacts and the quantum of proposed step changes.

We have set out the reasons for our draft decision on opex in more detail in attachment 6. Our opex model, which calculates our alternative estimate of opex, is available on our website.

2.6 Corporate income tax

We determine an estimated cost of corporate income tax of $27.8 million ($ nominal) for Jemena in the 2021–26 regulatory control period. This represents a decrease of $2.7 million compared to Jemena's proposal of $30.6 million ($ nominal).

The key reasons for the decrease is due to our:

- reduction to the return on equity, which is influenced by our adjustments on other building block components (attachments 2, 3 and 5)
- reduction to regulatory depreciation (attachment 4)

- reduction to customer contributions (attachment 5).

Further, in this draft decision we have made an update to the proposed opening tax asset base (TAB) as at 1 July 2021 for actual capex.

We accept Jemena's proposed standard tax asset lives for its asset classes, with the exception of the 'Non network – IT' and 'Non network – other' asset classes. The proposed standard tax asset lives are broadly consistent with the tax asset lives prescribed by the Commissioner for taxation in Australian Tax Office (ATO) taxation ruling 2020/3 and/or are the same as the approved standard tax asset lives for the 2016–20 regulatory control period.

We also accept Jemena'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 2016–20 regulatory control period and applies the approach as set out in our RFM.

Our adjustments to the return on capital (attachments 2, 3 and 5) and the regulatory depreciation (attachment 4) building blocks affect revenues, which in turn impacts the tax calculation. The changes affecting revenues are discussed in attachment 1.

Further detail on our draft decision regarding the corporate income tax is set out in attachment 7.

2.7 Revenue adjustments

Our draft decision on Jemena's total revenue also included a number of adjustments:

- EBSS — Jemena accrued EBSS carryovers totalling $25.0 million ($ 2020–21).[67] This is $1.2 million higher than $23.8 million proposed and mainly reflects that, to correctly apply the scheme, we did not exclude some cost categories which Jemena had mistakenly left out.[68] When we last made regulatory decisions for Jemena we decided to apply the EBSS during the 2016–20 regulatory control period. It is intended to provide a continuous incentive for distributors to pursue efficiency improvements in opex, and provide for a fair sharing of these between distributors and network users. While Jemena has achieved some efficiency gains during the current regulatory control period, as reflected in its EBSS carryovers, we have nonetheless found its base opex to be inefficient (see section 2.5). So, while Jemena has made efficiency gains relative to our opex forecast in the current regulatory control period, they have not been sufficient for its base opex to be found relatively efficient, based on the currently available benchmarking analysis. The accrued EBSS carryover amount of $25.0 million added to Jemena's allowed revenue rewards Jemena for those opex reductions achieved during the 2016–20 regulatory period. Network users benefit from lower opex forecasts in the 2021–26 regulatory control period.

[67] Includes accrued EBSS carryovers for the half year 2021 period.

[68] Includes accrued EBSS carryovers for the half year 2021 period.

- CESS — Jemena has accrued rewards under the CESS we applied in the current 2016–20 regulatory control period to incentivise Jemena to undertake efficient capex throughout the period. The CESS rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex. In the 2016–20 period, Jemena out-performed our capex forecast, and our draft decision is to approve a CESS revenue increment amount of $38.3 million ($2020–21). This is more than Jemena's initially proposed $30.2 million mainly due to us updating its estimated 2019 capex spend with the actual amount.[69]
- Shared assets — Distributors, such as Jemena, may use assets to provide both the SCS we regulate and unregulated services. These assets are called 'shared assets'. If the revenue from shared assets is material, ten per cent of the unregulated revenues that a distributor earns from shared assets will be used to reduce the distributor's revenue for SCS. For this draft decision, we determine a revenue adjustment of $1.5 million ($2020–21) to be shared with customers across the 2021–26 regulatory control period.
- Demand management innovation allowance mechanism (DMIAM) — an allowance of $1.96 million ($2020–21) has been applied to Jemena over the 2021–26 regulatory control period. The DMIAM aims to encourage distribution businesses to find investments that are lower cost alternatives to investing in network solutions.

Section 4 sets out our draft decision on the incentive schemes that might apply to Jemena over the next regulatory control period

[69] Jemena initially proposed $25.6 million ($2020–21), but subsequently found an error in its calculations and re-forecast a new CESS payment of $30.2 million.

3 Jemena's consumer engagement

The National Electricity Objective focuses our work on the long-term interest of consumers[70] and we think including consumers in the development of proposals is the best way to deliver this. Genuine, high quality engagement with consumers helps distributors better understand consumers' preferences and experiences and tailor their proposals to align with consumers' long-term interests. The Rules also require us to consider the extent to which elements of the proposals address relevant concerns identified during the distributor's engagement with consumers.[71]

We value the work of the distributors to constructively engage with consumers when preparing their draft proposals. They all acknowledged the diversity within their consumer base in terms of the manner in which they engage with the network, as well as the linguistic, cultural and demographic characteristics that influence this engagement. The interactions between the distributors' senior management (including board members) and the engagement initiatives also suggested the distributors were keen to hear what their consumers had to say.

We used the results of each distributor's consumer engagement to inform our draft decisions. High quality consumer engagement can take a range of forms and we encourage distributors to consider which approach best suits them and consumers in their network. The best approach to take may depend on the nature of a distributor's consumer base and the issues of importance to those consumers.

Regardless of the approach taken, we believe that proposals which have been developed with the influence of consumers, and their preferences, are more likely to be in the long-term interests of consumers than those which have not. Taking this into account, the elements outlined in Table 7 represent a range of considerations that we think can clearly demonstrate whether consumers have been genuinely engaged in the development of the proposals.

The elements of consumer engagement which informed how we viewed this engagement and the weight we were able to place on the outcomes in our consideration of the regulatory proposal are summarised in Table 7. The rest of this section discusses our assessment of each distributor's engagement against this framework. These elements are intended to show how our thinking has evolved since our 2013 Consumer Engagement Guideline but are not intended to provide a fixed view. Our framework will continue to evolve as distributors' models of consumer engagement mature over time.

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70 NEL, s. 16(1)(a).

71 NER, cl. 6.5.6(e)(5A) and 6.5.7(e)(5A).

Table 7 Framework for considering consumer engagement

Element	Weight determined by
Nature of engagement	• Consumers partner in forming the proposal rather than asked for feedback on distributor's proposal • Relevant skills and experience of the consumers, representatives, and advocates • Consumers provided with impartial support to engage with energy sector issues • Sincerity of engagement with consumers • Independence of consumers and their funding • Multiple channels used to engage with a range of consumers across a distributor's customer base
Breadth and depth	• Clear identification of topics for engagement and how these will feed into the regulatory proposal • Consumers consulted on broad range of topics • Consumers able to influence topics for engagement • Consumers encouraged to test the assumptions and strategies underpinning the proposal • Consumers were able to access and resource independent research and engagement
Clearly evidenced impact	• Proposal clearly tied to expressed views of consumers • High level of business engagement, e.g. consumers given access to the distributor's CEO and/or board • Distributors responding to consumer views rather than just recording them • Impact of engagement can be clearly identified • Submissions on proposal show consumers feel the impact is consistent with their expectations

Proof point	• Reasonable opex and capex allowances proposed
	  ○ In line with, or lower than, historical expenditure
	  ○ In line with, or lower than, our top down analysis of appropriate expenditure
	  ○ If not in line with top down, can be explained through bottom up category analysis

Nature of engagement

Overall we consider that Jemena's consumer engagement was genuine and collaborative. From the outset, in the development of its regulatory proposal, Jemena has strived to operate at the “collaborate” level of engagement in the IAP2 spectrum.[72] Jemena has demonstrated an overarching engagement strategy which identified customer cohorts, engagement objectives, engagement processes and priorities for each phase of the engagement, as well as priorities for each customer cohort, consistent with the collaborate level on the IAP2 spectrum.[73] We have not undertaken a formal audit against the IAP2 spectrum. However, from the information provided it would appear that Jemena’s proposal is broadly consistent with the collaborate or empower end of the spectrum.

Jemena commenced its engagement in November 2017 with a series of 13 focus groups for residential and business customers, as well as speaking to local councils and retailers. The aim of this engagement was to seek input from participants on the design phase of the regulatory proposal, and to gain an understanding as to how to make the engagement process as effective as possible.[74] In consultation with its Customer Council, Jemena planned the structure and content of its engagement approach, which included a draft plan and the formation of the People’s Panel, a deliberative process, which became a key part of Jemena’s engagement strategy. The People's Panel was a group of 43 Jemena residential customers, selected to represent the demographic profile of Jemena's distribution area.[75]

The design of the People’s Panel was underpinned by a set of principles to enable this set of “everyday citizens” to develop and agree on a robust set of recommendations to deliver outcomes that could be trusted by the broader community.[76] Jemena’s People’s Panel consumer engagement approach was recognised by the ENA / ECA Consumer Engagement Awards in 2019, with Jemena winning the award for its consumer engagement work in both the New South Wales gas network and in Victoria, for the People’s Panel approach.[77]

Through its engagement process, Jemena realised that its customers are not homogenous and that each customer type has its own set of priorities and engagement requirements. For example, initiatives like the People’s Panel were not effective for

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72 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 1. See also: https://iap2.org.au/wp-content/uploads/2020/01/2018_IAP2_Spectrum.pdf

73 See Jemena, *2021–26* Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement, January 2020, pp. 6-12.

74 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 13.

75 Jemena, *2021–26* Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, *Our customer, stakeholder and community engagement*, January 2020, p. 16.

76 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 12.

77 ENA, *Consumer engagement report*, 2020 report, pp 22-30.

small business customers, which responded to a survey approach instead.[78] Large businesses were engaged through the regular account management process.[79]

This improved and professional consumer engagement process is reflected in CCP17's advice to us on Jemena's regulatory proposal. We tasked CCP17 specifically with advising us on the effectiveness of Jemena's engagement activities with consumers and how this was reflected in the development of its proposal.

CCP17 observed that "Jemena is at the forefront of both development and application of consumer engagement approaches. They maintained engagement, with some ebbs and flows, for 2½ years and innovated with the People's Panel".[80] CCP17 also noted that the diversity of engagement conducted by Jemena, in addition to the People's Panel, over a two and a half year period, was "as significant as the People's Panel process, as good as that was".[81] The diversity of Jemena's engagement included surveys for small businesses, small group sessions with large customers, regular forums, and workshops for local councils, one-on-one engagement with retailers and deep dives for the AER, CCP and the CCC.[82]

Breadth and Depth

Overall, we consider that Jemena's consumer engagement was broad, covering a range of topics across a diverse customer cohort. We consider the depth of engagement a challenge for Jemena, particularly in relation to the People's Panel. While the People's Panel covered a broad range of topics, Jemena faced the challenge of building the capacity of everyday citizens to be able to engage in the complex topics Jemena wanted feedback on.[83]

To assist its People's Panel in building its capacity to engage, Jemena provided presentations from its own technical experts as well as independent industry experts, including energy retailers, customer advocacy groups and other energy distributors. Jemena also provided a cost model of pricing implications of all options over time, so that participants could gage the cost impacts of their recommendations. In addition, all participants were provided with personal bill impacts under different electricity pricing structures using Smart Meter data.[84] This enabled the People's Panel to test the

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78 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 27.

79 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 28.

80 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 23.

81 CCP17*, Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26* p. 23.

82 Jemena, *2021–26* Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, *Our customer, stakeholder and community engagement*, January 2020, pp. 27-33.

83 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 13.

84 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-02, Community consultation report,* January 2020, p. 15.

assumptions, underlying any options put forward, and provided participants with insights into how their recommendations would impact them personally.

As a result of its diverse engagement, Jemena identified three key themes to be addressed by its regulatory proposal which align directly with the energy trilemma of Affordability, Reliability and Sustainability.[85] In response, Jemena devised its proposal around these key themes, endeavouring to deliver what its customers want in a "balanced and cost-effective way".[86]

Of the identified themes, stakeholders were intently focussed on affordability. For example, Energy Australia submitted that affordability is a key concern for its customers.[87] Reducing network changes to ensure affordability was the first recommendation of the joint Victorian Community Organisations (VCO) submission.[88] The Victorian Department of Environment, Land, Water and Planning (DELWP) submitted that "Affordability for consumers is the overarching outcome required of the 2021–26 electricity distribution pricing review process".[89] ECA emphasised that "Affordability continues to be energy consumers' number one priority."[90] The ECA submission noted that Jemena's opex proposal is 20 per cent above actual spend in the current period.[91] Several stakeholders expressed concerns with the efficiency of Jemena's opex and suggested we should evaluate its opex efficiency and make an adjustment.[92]

The VCO compared the result of engagement across all five Victorian distributors and noted varying results in key areas – such as the value of reliability, safety and affordability. They also noted that all distributor's programs demonstrated benefits to customers, especially in terms of new or changed programs or processes developed in direct response to customer feedback.[93]

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85 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 10.

86 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Overview*, January 2020, p. v.

87 Energy Australia, *Submission on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, p. 6.

88 VCO, *Submission on the VIC EDPR 2021–26 Proposals,* May 2020, p. 3.

89 DEWLP*, Submission on the Victorian Electricity Distribution Regulatory Proposal 2021–26*, June 2020, p. 2.

90 ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, p. 4.

91 ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, pp. 16, 26.

92 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*, June 2020, p. 45; Origin Energy, *Submission from Origin Energy regarding DNSP proposals*, June 2020, p. 4; Victorian Community Organisations (VCO) which include St Vincent's de Paul Society, Brotherhood of St Laurence and Consumer Action Law Centre, *Submission on 2021–26 Victorian distributors Regulatory Proposals*, January 2020. p. 56.

93 Victorian Community Organisations, *Submission on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26,* May 2020, p.14.

Clearly evidenced impact

We find the themes from the broader engagement, along with the recommendations from the People's Panel reflected throughout the regulatory proposal. It is clear that Jemena is committed to including consumers in its decisions. For example, members of Jemena's senior leadership team actively participated in engagement activities and were on hand to personally accept the advice of the People's Panel, and after reviewing that advice, agreed to accept all 25 recommendations.[94]

The People's Panel produced two main sets of advice, the first involved suggestions and proposals made during the sessions and the second was the set of 25 recommendations to go to the Jemena Board. Thirteen of the recommendations were for Jemena's specific action, to be implemented in the draft plan, and a further 12 issues were beyond Jemena's direct control but issues it could advocate about.[95]

Five of the thirteen recommendations that Jemena agreed to implement were for non-network expenditure designed to improve the customer experience and customer service levels. This includes improving the ease of access and energy consumption information available, tailoring usage information to account for different pricing structures, improving the channels of customer service to include mobile apps, sending SMS messages for unplanned outages, and advising customers regarding planned outages.[96]

These priorities, along with its acceptance of all 25 recommendations made by the People's Panel, forms the basis of Jemena's 2021–26 regulatory proposal.[97] The implementation of the People's Panel recommendations into the draft proposal demonstrates Jemena's commitment to allow consumers to influence its decisions and incorporate their preferences to the highest possible extent.

Jemena published its draft proposal in early January 2019 for customer consultation, reconvening the People's Panel to show how its input affected Jemena's decisions and to test to see if those views were accurately reflected. Jemena also sought input from the People's Panel on several final decisions relating to its regulatory proposal.

The response to the draft proposal was positive, with 92 per cent of participants either 'comfortable' or 'very comfortable' that the draft plan reflected customer's long-term interests.[98] As a result, Jemena did not make significant changes to the proposal apart from some changes to reflect new or updated information.[99] Jemena also canvassed

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94 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 13.

95 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 22.

96 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Overview*, January 2020, p. 57.

97 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-01, Our customer, stakeholder and community engagement*, January 2020, p. 36.

98 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Overview,* January 2020, p. vi

99 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Overview,* January 2020, p. vi

feedback from its Customer Council who raised some issues to do with putting downward pressure on costs and prices, but found that overall the draft plan adequately addresses the energy trilemma and was 'customer-centric'.[100]

One change that was made in response to the People's Panel feedback on its draft proposal was a decision to withdraw from proposing a customer service incentive scheme (CSIS). The scheme did not get the support Jemena anticipated from the Panel, with only 46 per cent in favour of its implementation. The message Jemena received was that customers expect good customer service to be included in the base price of distribution services.[101] While CCP17 expressed support for the CSIS, it also respects Jemena's decision not to proceed based on it taking customer's views into account.[102] [103]

Stakeholders were generally comfortable regarding the level of Jemena's total capex forecast, particularly elements of the proposal that had been the subject of consumer engagement.[104] For example, CCP17 cited consumer's support for the initiatives to keep prices 'in check' and not over-investing in reliability or new assets before they are needed.[105] However, stakeholders raised concerns regarding the efficiency of Jemena's proposed opex forecast, including the efficiency of its base year. [106] While we acknowledge that Jemena has invested in its transformation program to reduce its opex and offered some resulting cost savings to consumers, it is not clear how consumers have engaged in the efficiency of Jemena's base year opex.

We find that Jemena's consumer engagement has set out with purpose and intent to ensure that the views of consumers were included in the development of its regulatory proposal. Jemena achieved this using a range of engagement strategies and a willingness to try new approaches in order to involve the full diversity of customer segments, from low income households through to large customers and energy retailers. Further, as observed by CCP17, Jemena has been innovative and attempted

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100 Jemena, *2021–26 Electricity Distribution Price Review Regulatory Proposal, Attachment 02-06, Customer Council's feedback on Jemena's 2021–25 EDPR,* January 2020, p. 13.; Jemena, 2021–26 *Electricity Distribution Price Review Regulatory Proposal, Attachment 02-02, Community consultation report, January 2020, p. 43.*

101 Jemena, *2021–26* Electricity Distribution Price Review Regulatory Proposal, *Overview*, January 2020, p. 24.

102 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 36.

103 See also ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, p. 17.

104 See ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26,* June 2020, p. 12.; CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 80.

105 CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 80

106 ECA*, Submission and Attachment 1 and 2 on the Victorian Electricity Distribution Regulatory Proposal 2021–26*, June 2020, pp. 16 & 26.; Victorian Community Organisations, *Submission on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26,* May 2020, p.60.; CCP17, *Advice to the AER on the Victorian Electricity Distributors' Regulatory Proposals for the Regulatory Determination 2021–26*. p. 45.

to make to make engagement ‘fun’ which is a challenge in the energy space.[107] We agree with CCP17’s overall assessment, that Jemena’s claim to be operating at or near the IAP2 level of 'collaborate' is “real in practice as well as aspiration”.[108]

Proof point

We accept that the revenue proposal submitted by Jemena was developed in collaboration with its consumers and reflects the feedback received, with some elements of the proposal, such as capex evidently influenced by consumers. As noted in our AusNet Services overview, we consider that consumer engagement should inform rather than determine our decision. As a result, we have applied appropriate weight to aspects of the proposal that address the concerns of consumers,[109] and ensured that our draft decision meets the Rules criteria.[110] Accordingly, we have assessed all the material and evidence before us to be satisfied that our determination is likely to contribute to the NEO to the greatest extent.[111]

As outlined in section 2.4, our assessment found that Jemena’s proposed capex proposal was clearly influenced by its commitment to consumer affordability. Its capex forecast is 2 per cent above its trend from 2011. While Jemena’s proposed capex is nine per cent above its actual and estimated expenditure in the current regulatory period, the main drivers are investments for bush fire risk mitigation and Jemena's expenditure to facilitate increasing DER penetration, which was also influenced by consumers.[112]

Jemena's opex forecast was 29.6 per cent higher than its actual and estimated opex for the 2016–20 period.[113] As outlined in section 2.5, our draft decision alternative estimate of total opex is 12.3 percent higher (on a like for like basis, is 1.0 per cent lower) than Jemena's actual and estimated opex in the current regulatory control period.[114] We could not clearly see how Jemena’s consumers had engaged on the efficiency of the proposed opex forecast and our assessment found that Jemena’s opex has been relatively inefficient over time and in the 2018 base year.

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107 CCP17, *Advice to the AER on the Victorian Electricity Distributors’ Regulatory Proposals for the Regulatory Determination 2021–26*. p. 24.

108 CCP17, *Advice to the AER on the Victorian Electricity Distributors’ Regulatory Proposals for the Regulatory Determination 2021–26*. p. 24.

109 NER, cl. 6.5.6(e)(5A) and 6.5.7(e)(5A).

110 NER, cll. 6.5.7(c) & 6.5.6(c)

111 NEL, s 16(1)(a) and (d).

112 CCP17, *Advice to the AER on the Victorian Electricity Distributors’ Regulatory Proposals for the Regulatory Determination 2021–26*. p. 24.

113 After adjusting for cost allocation method changes (which will come into effect on 1 January 2021), on a like for like basis this increase is 15.6 per cent.

114 Like for like comparison is after removing the adjustment for expensing of corporate overheads in the next regulatory control period.

4 Incentive schemes

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. These schemes provide important balancing incentives under the revenue determination we've discussed in section 2, to encourage Jemena to pursue expenditure efficiencies and demand side alternatives while maintaining the reliability and overall performance of its network.

The incentive schemes that might apply to an electricity distribution network as part of our decision are:

- the EBSS
- the CESS
- the service target performance incentive scheme (STPIS)
- the CSIS
- the demand management incentive scheme (DMIS) and allowance (DMIAM)
- the f-factor scheme.

Once we make our decision on Jemena's revenue cap, it has an incentive to provide services at the lowest possible cost, because its returns are determined by its actual costs of providing services. Our incentive 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 networks reduce costs to below our forecast of efficient costs, the savings are shared with its consumers in future regulatory periods through a lower opex allowance and a lower RAB.

We understand the strong concerns of stakeholders, that the CESS not only rewards efficiency gains but also over forecasting and deferral of capex. The current CESS guideline includes protections against material deferrals that have been triggered for some elements of Powercor's proposal[115] but not for Jemena. Protection against over forecasting of capex lies in the rigorous assessment of proposed capex.

The DMIS and the DMIAM provide businesses an incentive to undertake efficient expenditure on non-network options relating to demand management research and development in demand management projects that have the potential to reduce long-term network costs.

The STPIS balances a business' incentive to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to

[115] AER, *Draft Decision, Powercor Distribution Determination 2021–26, Attachment 9 Capital Expenditure Sharing Scheme*, September 2020.

businesses to maintain and improve service performance and not by simply cutting costs at the expense of service quality. Once improvements are made, the benchmark performance targets will be tightened in future years.

To accompany the STPIS we have established the CSIS to try and capture how well the distributor is meeting customer preferences. The intention is for this to replace the 0.5 per cent of revenue tied to the telephone answering parameter under the STPIS. As a new small scale incentive scheme, it is up to the distributor to formally propose to us how they intend to apply the scheme. As noted earlier in section 1.4, after consulting consumers, Jemena chose to withdraw from proposing a CSIS.

Our draft decision is that each of the CESS, STPIS, DMIS, and DMIAM should apply to Jemena for the 2021–26 regulatory control period.

Our draft decision is not to apply the EBSS for Jemena in the 2021–26 regulatory control period. Consistent with the Victorian distributors' framework and approach, we only apply the EBSS if the opex forecast for the following regulatory control period (2026–31) is based on the distributor's revealed cost. As our opex assessment for Jemena has determined its revealed costs in the base year are inefficient, and Jemena's proposal has not shown it will be at an efficient level of opex by the end of the 2021–26 regulatory control period, we cannot be satisfied that we would use revealed costs to forecast opex in the following period. Uncertainty about whether or not revealed costs will be used to forecasts costs in the following period means consumers could pay the costs of the EBSS without getting the benefits inherent in the revealed cost approach.

Our draft decision also includes how the f-factor scheme is applied to Jemena in the next regulatory control period. The f-factor scheme is prescribed by the Victorian Government's "f-factor scheme order 2016" to reduce the risk of fire starts by network assets.[116] We will continue to adopt our current approach to give effect of the outcomes of the scheme as an "I-factor" component within the price control formula.

We discuss our draft decisions on each incentive scheme in attachments 8 to 11. Our draft decision on the f-factor scheme is discussed in attachment A.

[116] *Victoria Government Gazette, G 51*, 22 December 2016, p. 3239.

5 Tariff structure statement

The requirement on distributors to prepare a tariff structure statement arises following significant reforms to the rules governing distribution network pricing. The purpose of the reforms is to empower customers to make informed choices by:

- providing better price signals to retailers to reflect what it costs to use the networks to supply electricity at different times
- transitioning to greater cost reflectivity while engaging with customers, customer representatives, and retailers to consider the impacts of tariff changes on customers
- managing future expectations for retailers, energy service providers and customers by providing guidance on distributors' tariff strategy.

It is important to note that distributors charge retailers for the network services provided to end-customers. There is no obligation on retailers or energy service providers to pass the network tariff structure through to their end-customers. The structure of retail offers should be determined by retailers responding to consumer preferences and competitive pressures.

Network tariff reform aims to help distributors charge retailers in a manner which more closely reflects the cost of providing electricity network capacity to their end customers. Retailers can then decide how best to manage these price signals which may include "insurance-style" flat rate offers and non-price measures such as well targeted demand management initiatives. If customers are well placed to respond to these price signals, retailers may pass through the structures and reward customers for helping to manage the commercial risk.[117] But at present, it is more common for retailers to pass through the cost reflective network tariff structures to large business customers, than for residential or small business customers.

The tariff structure statement must set out a number of matters. These include tariff classes, proposed tariffs and the structures and charging parameters, and the approach to setting tariff levels in each year of the regulatory control period. [118] The policies and procedures it will use to assign customers to tariffs, or reassign customers from one tariff to another must also be outlined.

In this determination we decide the structure of tariffs that will form the basis of annual pricing proposals throughout the regulatory control period.[119] We are also required to decide the policies and procedures for assigning or re-assigning customers to tariff classes.[120] While an indicative pricing schedule must accompany the tariff structure

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117 See our recently published Retailer Engagement Report on the Network Tariff Reform webpage

118 NER, cl. 6.18.1A.

119 NER, cl. 6.12.1(14A).

120 NER, cl. 6.12.1(17).

statement, the tariff levels for each tariff for each year of the 2021–26 regulatory control period are not set as part of this determination.[121]

Tariffs for the regulatory year commencing 1 July 2021 will be subject to a separate approval process in May 2021, after we have made our final revenue determination in April 2021. Tariffs for the next four years will also be approved on an annual basis.[122]

We commend the Victorian distributors for their work to engage with stakeholders in a series of forums to help develop a state-wide proposal for the small user components of their TSSs. Similar to our recent decisions on we have given weight to both the involvement of consumers in developing these proposals, as well as the supportive submissions we have received.[123] In forming our views for this draft decision we have also taken into account the Victorian Department of Environment, Land, Water & Planning's submission which strongly encourages us to broadly accept these elements.[124]

Our draft decision broadly supports the direction of these proposals. Particularly as the distributors have generally met the expectations we set out in our final decision for the first round of TSS (2017–20). At that time we encouraged the Victorian distributors to move from opt-in to opt-out tariff assignment to cost reflective tariffs to increase the pace at which network tariff reform progresses. We also urged the Victorian networks to refine their tariff structures to include more targeted peak period charging windows. The Victorian distributors have also generally adopted strategies we have encouraged within our determinations for other networks, such as discounting their cost reflective tariffs relative to the flat rate option.[125]

However, we have concerns that some aspects of the proposed TSS do not comply with the pricing principles set out in the NER.[126] We require:

- greater clarity around the interlinkages between distributed energy initiatives, including tariff trials, and the tariff strategies for the 2021–26 regulatory period
- consideration of interactions between emerging distributed energy technologies, such as batteries and electric vehicles, and proposed tariff structures
- refining the charging windows for large user tariffs to more closely reflect periods of network constraint for each distributor
- responses to large businesses' requests for greater choice in network tariff structures as large users generally have network structures passed through.

In attachment 19 we have therefore set out a series of changes that we consider necessary for us to approve the Victorian distributors' TSS proposals.

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121 NER, cl. 6.8.2(d)(1).

122 NER, cll. 6.18.2 and 6.18.8.

123 For example, see our Final Decision for SA Power Network's TSS for the 2020–25 regulatory control period

124 DELWP, Submission on Tariff Structure for the Victorian Electricity Distribution Proposal 2021–26, June 2020

125 For example see our Final Decision for Essential Energy's TSS for the 2019–24 regulatory control period

126 NER, cl. 6.18.5.

6 The National Electricity Law and Rules

The NEL and NER provide the regulatory framework governing electricity distribution networks. Our work under this framework is guided by the National Electricity Objective (NEO):[127]

> "…to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.[128] The focus of the NEO is on promoting efficient investment in, and operation and use of, electricity services (rather than assets) in the long-term interests of consumers.[129] This is not delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision.[130]

Electricity determinations are complex decisions. In most cases, the provisions of the NER do not point to a single answer, either for our decision as a whole or in respect of particular components. They require us to exercise our regulatory judgement. Where there are choices to be made among several plausible alternatives, we have selected what we are satisfied would result in an overall decision that is likely to contribute to the achievement of the NEO to the greatest degree.[131]

Our distribution determinations are predicated on a number of constituent decisions that we are required to make.[132] These are set out in appendix A and the relevant attachments. In coming to a decision that contribute to the achievement of the NEO, we have considered interrelationships of the constituent components of our draft decision in the relevant attachments. Examples include:

- underlying drivers and context which are likely to affect many constituent components of our decision. For example, forecast demand affects the efficient levels of capex and opex in the regulatory control period (see attachment 5 and 6).
- direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the benchmark

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127 NEL, s. 7.

128 NEL, section 16(1)(a)

129 This is also the view of the Australian Energy Markets Commission (the AEMC). See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

130 Hansard, *SA House of Assembly,* 26 September 2013, p. 7173. See also the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 7–8.

131 NEL, s. 16(1)(d).

132 NER, 6.12.1

efficient entity's debt to equity ratio has a direct effect on the cost of equity, the cost of debt, and the overall vanilla rate of return (see attachments 3 and 7).

- trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa (see attachments 5 and 6).

In general, we consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service that they value at least cost in the long run.[133] A decision that places too much emphasis on short term considerations may not lead to the best overall outcomes for consumers once the longer term implications of that decision are taken into account.[134]

There may be a range of economically efficient decisions that we could make in a revenue determination, each with different implications for the long-term interests of consumers.[135] A particular economically efficient outcome may nevertheless not be in the long-term interests of consumers, depending on how prices are structured and risks allocated within the market.[136] There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree than others would. For example, we consider that:

- the long-term interests of consumers would not be advanced if we encourage overinvestment which results in prices so high that consumers are unwilling or unable to efficiently use the network.[137]
- equally, the long-term interests of consumers would not be advanced if allowed revenues result in prices so low that investors do not invest to sufficiently maintain the appropriate quality and level of service, and where consumers are making more use of the network than is sustainable leading to safety, security and reliability concerns.[138]

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133 Hansard, *SA House of Assembly,* 9 February 2005, p. 1452.

134 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 6–7.

135 *Re Michael: Ex parte Epic Energy* [2002] WASCA 231 at [143].

136 See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

137 NEL, s. 7A(7).

138 NEL, s. 7A(6).

A Constituent decisions

Our draft decision on Jemena's distribution determination for the 2021–26 regulatory control period includes the following constituent components:

Constituent decision
In accordance with clause 6.12.1(1) of the NER, the AER's draft decision is that the classification of services set out in Attachment 13 will apply to Jemena for the 2021–26 regulatory control period.
In accordance with clause 6.12.1(2)(i) of the NER, the AER's draft decision is not to approve the annual revenue requirement set out in Jemena building block proposal. Our draft decision on Jemena's annual revenue requirement for each year of the 2021–26 regulatory control period is set out in attachment 1 of the draft decision.
In accordance with clause 6.12.1(2)(ii) of the NER, the AER's draft decision is to approve Jemena' proposal that the regulatory control period will commence on 1 July 2021. Also in accordance with clause 6.12.1(2)(ii) of the NER, the AER's draft decision is to approve Jemena's proposal that the length of the regulatory control period will be 5 years from 1 July 2021 to 30 June 2026.
The AER did not receive a request for an asset exemption under clause 6.4.B.1 (a) (1) and therefore has not made a decision in accordance with clause 6.12.1(2A) of the NER.
In accordance with clause 6.12.1(3)(ii) and acting in accordance with clause 6.5.7(d) of the NER, the AER's draft decision is not to accept Jemena's proposed total forecast capital expenditure of $627.1 million ($2020–21). Our draft decision therefore includes a substitute estimate of Jemena' total forecast capex for the 2021–26 regulatory control period of $602.3 million ($2020–21). The reasons for our draft decision are set out in attachment 5.
In accordance with clause 6.12.1(4)(ii) and acting in accordance with clause 6.5.6(d) of the NER, the AER's draft decision is to not accept Jemena's proposed total forecast operating expenditure, inclusive of debt raising costs and exclusive of DMIAM of $576.6 million ($2020–21). Our draft decision therefore includes a substitute estimate of Jemena total forecast opex for the 2021–26 regulatory control period of $499.8 million ($2020–21) including debt raising costs and exclusive of DMIAM. This is discussed in attachment 6 of the draft decision. The reasons for our draft decision are set out in attachment 6 of the draft decision.
Jemena did not propose any contingent projects and therefore the AER has not made a decision under clause 6.12.1(4A) of the NER.
In accordance with clause 6.12.1(5) of the NER and the 2018 Rate of Return Instrument (to be modified subject to the passing of relevant Victorian legislation), the AER's draft decision is that the allowed rate of return for the 2021–22 regulatory year is 4.67 per cent (nominal vanilla) as set out in attachment 3 of the draft decision. The rate of return for the remaining regulatory years 2022–26 will be updated annually because our decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.
In accordance with clause 6.12.1(5A) of the NER and the 2018 Rate of Return Instrument (to be

modified subject to the passing of relevant Victorian legislation), the AER's draft decision on the value of imputation credits as referred to in clause 6.5.3 is to adopt a value of 0.585. This is discussed in section 2.2 of this draft decision overview.

In accordance with clause 6.12.1(6) of the NER, the AER's draft decision on Jemena's regulatory asset base as at 1 July 2021 in accordance with clause 6.5.1 and schedule 6.2 is $1524.4 million ($ nominal). This is discussed in attachment 2 of the draft decision.

In accordance with clause 6.12.1(7) of the NER, the AER's draft decision is to not accept Jemena's proposed corporate income tax of $30.6 million ($ nominal). Our draft decision on the estimate of Jemena's corporate income tax is $27.8 million ($ nominal). This is discussed in attachment 7 of the draft decision.

In accordance with clause 6.12.1(8) of the NER, the AER's draft decision is to not approve the depreciation schedules submitted by Jemena. Our draft decision substitutes alternative depreciation schedules that accord with clause 6.5.5(b) and this is discussed in attachment 4 of the draft decision.

In accordance with clause 6.12.1(9) of the NER the AER makes the following draft decisions on how any applicable efficiency benefit sharing scheme (EBSS), capital expenditure sharing scheme (CESS), service target performance incentive scheme (STPIS), demand management incentive scheme (DMIS), demand management innovation allowance mechanism (DMIAM) or small scale incentive scheme (customer service incentive scheme) is to apply:

- We will not apply the EBSS to Jemena in the 2021–26 regulatory control period. This is discussed in attachment 8 of the draft decision.
- We will apply the CESS as set out in version 1 of the Capital Expenditure Incentives Guideline to Jemena in the 2021–26 regulatory control period. This is discussed in attachment 9 of the draft decision.
- We will apply our Service Target Performance Incentive Scheme (STPIS) to Jemena for the 2021–26 regulatory control period. This is discussed in attachment 10 of the draft decision.
- We will apply the DMIS and DMIAM to Jemena for the 2021–26 regulatory control period. This is discussed in attachment 11 of the draft decision.
- We will not apply the CSIS as Jemena withdrew its proposed scheme.

In accordance with clause 6.12.1(10) of the NER, the AER's draft decision is that all other appropriate amounts, values and inputs are as set out in this draft determination including attachments.

In accordance with clause 6.12.1(11) of the NER and our framework and approach paper, the AER's draft decision on the form of control mechanisms (including the X factor) for standard control services is a revenue cap. The revenue cap for Jemena for any given regulatory year is the total annual revenue calculated using the formula in attachment 14 which includes any adjustment required to move the DUoS unders and overs account to zero. This is discussed in attachment 14 of the draft decision.

In accordance with clause 6.12.1(12) of the NER and our framework and approach paper, the AER's draft decision on the form of the control mechanism for alternative control services is to

Constituent decision

apply a revenue caps for type 5 and 6 metering (including smart metering) services and price caps for all other services. The revenue cap for Jemena's type 5 and 6 metering (including smart metering) services for any given regulatory year is the total annual revenue for type 5 and 6 (inc. smart metering) services calculated using the formula in attachment 14, which includes any adjustment required to move the metering unders and overs account to zero. This is discussed in attachment 14 of the draft decision.

In accordance with clause 6.12.1(13) of the NER, to demonstrate compliance with its distribution determination, the AER's draft decision is that Jemena must maintain a DUoS unders and overs account and a metering unders and overs account. It must provide information on these accounts to us in its annual pricing proposal. This is discussed in attachment 14 of the draft decision.

In accordance with clause 6.12.1(14) of the NER the AER's draft decision is to apply the following nominated pass through events to Jemena for the 2021–26 regulatory control period in accordance with clause 6.5.10:

- Terrorism event
- Insurance coverage event
- Natural disaster event
- Insurer credit risk event
- Retailer insolvency event

These events have the definitions set out in Attachment 15 of the draft decision.

In accordance with clause 6.12.1(14A) of the NER, the AER's draft decision is to not approve the tariff structure statement proposed by Jemena. This is discussed in attachment 19 of the draft decision.

In accordance with clause 6.12.1(15) of the NER, the AER's draft decision is that the negotiating framework as proposed by Jemena will apply for the 2021–26 regulatory control period. This is discussed in attachment 17 of the draft decision.

In accordance with clause 6.12.1(16) of the NER, the AER's draft decision is to apply the negotiated distribution services criteria published in February 2020 to Jemena. This is discussed in attachment 17 of the draft decision.

In accordance with clause 6.12.1(17) of the NER, the AER's draft decision on the procedures for assigning retail customers to tariff classes for Jemena is set out in attachment 19 of the draft decision.

In accordance with clause 6.12.1(18) of the NER, the AER's draft decision is that the depreciation approach based on forecast capex (forecast depreciation) is to be used to establish the RAB at the commencement of Jemena's regulatory control period as at 1 July 2026. This is discussed in attachment 2 of the draft decision.

In accordance with clause 6.12.1(19) of the NER, the AER's draft decision on how Jemena is to report to the AER on its recovery of designated pricing proposal charges is to set this out in its annual pricing proposal. The method to account for the under and over recovery of designated

Constituent decision
pricing proposal charges is discussed in attachment 14 of the draft decision.
In accordance with clause 6.12.1(20) of the NER, the AER's draft decision is to require Jemena to maintain a jurisdictional scheme unders and overs account. It must provide information on this account to us in its annual pricing proposal as set out in attachment 14 of the draft decision.
In accordance with clause 6.12.1(21) of the NER, the AER's draft decision is to not approve the connection policy proposed by Jemena. Our draft decision is to amend Jemena's proposed connection policy as set out in attachment 18 of the draft decision.
In accordance with section 16C of the National Electricity (Victoria) Act 2005, the NEL, the NER and the "f-factor scheme order 2016",[139] the AER's draft decision is to apply the f-factor incentive payments/penalties as a part of the "I-factor" adjustment to the annual revenue requirement calculation formula.

[139] http://www.gazette.vic.gov.au/gazette/Gazettes2016/GG2016G051.pdf, Victoria Government Gazette, G 51 22 December 2016, p. 3239.

B List of submissions

We received 21 submissions in response to Jemena's revenue proposal. These are listed below.

Submission from	Date received
AGL Energy Limited	3 June 2020
CCP17	10 June 2020
Department of Environment, Land, Water & Planning	2 June 2020
Department of Environment, Land, Water & Planning – specific submission on TSS	2 June 2020
Electric Vehicle Council	3 June 2020
EnergyAustralia	3 June 2020
Energy Consumers Australia	16 June 2020
Energy Safe Victoria	3 June 2020
Energy Users' Association of Australia	10 June 2020
Evie Networks	3 June 2020 and 17 August 2020
Local Government Response (prepared by Eastern Alliance for Greenhouse Action)	27 May 2020
Origin Energy	2 June 2020
Red Energy / Lumo Energy	19 June 2020
Vector Limited	3 June 2020
Victorian Community Organisations (prepared by Brotherhood of St Laurence, Renew, Victorian Council of Social Service)	3 June 2020
Allan Campbell	1 June 2020
Bernie Free	2 June 2020
Oonagh Kilpatrick	3 June 2020
Sarah Campbell	3 June 2020
Wannon Branch United Dairy Farmers	3 June 2020

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ATO	Australian Tax Office
augex	augmentation expenditure
CAM	cost allocation method
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP 17	Consumer Challenge Panel, sub-panel 17
CESS	capital expenditure sharing scheme
CoS	classification of service
CPI	consumer price index
DRP	debt risk premium
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
distributor	distribution network service provider
DSO	distribution system operator
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ECA	Energy Consumers Australia
ERP	equity risk premium
F&A	framework and approach
MRP	market risk premium
NEL	National Electricity Law
NEM	National Electricity Market

Shortened form	Extended form
NEO	National Electricity Objective
NER or the rules	National Electricity Rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
Pricing Order	electricity pricing order
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TSS	tariff structure statements
VCO	Victorian Community Organisations
WACC	weighted average cost of capital