



**DRAFT DECISION**  
**Multinet Gas**  
**Access arrangement**  
**2018 to 2022**

**Attachment 10 – Reference**  
**tariff setting**

July 2017

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## Note

This attachment forms part of the AER's draft decision on the access arrangement for Multinet Gas for 2018-22. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 - Services covered by the access arrangement

Attachment 2 - Capital base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

Attachment 13 - Demand

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## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
DRP	debt risk premium
ECM	(Opex) Efficiency Carryover Mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	Value of Imputation Credits
MRP	market risk premium
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	Tax asset base
UAFG	Unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

## 10 Reference tariff setting

This attachment outlines our assessment of the reference tariffs proposed by Multinet Gas (Multinet) against the requirements of the National Gas Rules (NGR). Our assessment focuses on the structure of reference tariffs and takes into account the revenue and pricing principles.<sup>1</sup>

### 10.1 Draft decision

We accept Multinet's proposed structure of reference tariffs for the 2018–22 access arrangement. We are satisfied the proposed structure of the reference tariffs complies with the requirements of the NGR.<sup>2</sup> Nevertheless, the quantum of Multinet's proposed reference tariffs must be amended to reflect the revised revenue allowance set out in this draft decision.

We accept Multinet's proposed fixed principle for the carryover of unrecovered pass through event costs to the 2023–27 access arrangement period.<sup>3</sup>

We do not accept Multinet's proposed fixed principle to allow the carryover, into the subsequent access arrangement period, of any under or over recovery of revenue.<sup>4</sup>

### 10.2 Multinet's proposal

Multinet's proposed reference tariffs for the 2018–22 access arrangement period are consistent with those in the current access arrangement.

Multinet proposed two new fixed principles:<sup>5</sup>

- to allow recovery of pass through event costs in the next access arrangement period if not fully recovered in the previous period.
- to account for revenue under or over recovery in the context of its proposed revenue cap tariff variation mechanism.

Multinet's proposed haulage reference tariffs are outlined in Table 10-1 and proposed ancillary reference services are outlined in Table 10-2.

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<sup>1</sup> NGL, ss. 24(2)-(7)

<sup>2</sup> NGR, rr. 93, 94.

<sup>3</sup> Multinet Gas - 22.3.1 - Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up - 20161215, p. 24, fixed principle (g).

<sup>4</sup> Multinet Gas - 22.3.1 - Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up - 20161215, p. 24, fixed principle (e).

<sup>5</sup> Multinet Gas - 22.3.1 - Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up - 20161215, p. 24.

**Table 10-1 Multinet's proposed initial tariff classes and tariff charge components**

Customer category	Tariff class	Tariff category	Charge components
<b>Residential</b>	Tariff V	Non-Yarra Valley Towns and non-Gippsland Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
	Tariff V	Yarra Valley Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
	Tariff V	Gippsland Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
<b>Non-residential</b>	Tariff V	Non-Yarra Valley Towns and non-Gippsland Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
	Tariff V	Yarra Valley Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
	Tariff V	Gippsland Towns	Fixed base charge Stepped variable usage charge, including seasonal pricing
	Tariff D	Non-Gippsland Towns	Stepped variable demand charge
	Tariff D	Gippsland Towns	Stepped variable demand charge
	Tariff L	All	Stepped variable usage charge, including seasonal pricing Demand charges

**Table 10-2 Multinet's proposed ancillary reference services**

Ancillary reference service
Meter Investigation – High Account Investigation between 8am and 4pm on a Business Day
Meter Disconnection – Use of locks & plugs between 8am and 4pm on a Business Day
Meter Removal – Various between 8am and 4pm on a Business Day
Reconnect between 8am and 4pm on a Business Day
Special Meter Reads between 8am and 4pm on a Business Day
Installation of a second service valve in a pit and disconnect gas supply

## 10.3 Assessment approach

In an access arrangement, a service provider is required to specify for each reference service the reference tariff and proposed approach to setting the reference tariffs.<sup>6</sup> This is done by:

- explaining how revenues and costs are allocated, including the relationship between costs and tariffs<sup>7</sup>
- defining the tariff classes<sup>8</sup>
- comparing the revenue to be raised by each reference tariff with the cost of providing each individual reference service<sup>9</sup>
- explaining and describing any pricing principles it employed.<sup>10</sup>

Following our assessment of proposed reference tariffs, if we do not accept them, we must determine the initial (i.e. 2018) reference tariffs to apply for each reference service.

In our assessment of the proposed reference tariffs, we reviewed Multinet's:

- access arrangement information<sup>11</sup>
- access arrangement proposal.<sup>12</sup>

We also had regard to submissions received in the course of our consultation on the proposed access arrangement.<sup>13</sup>

### Identifying the reference service

The NGR require service providers to specify a reference tariff for each reference service.<sup>14</sup> When undertaking our review, we first consider what is (or are) the reference service(s) for the purpose of the NGR. Our decision on what constitutes the reference service is set out in attachment 1.

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<sup>6</sup> NGR, rr. 48(1)(d)(i), 72(1)(j).

<sup>7</sup> NGR, rr. 72(1)(j)(i), 93(1)–(2).

<sup>8</sup> NGR, r. 94(1)–(2).

<sup>9</sup> NGR, r. 94(3).

<sup>10</sup> NGR, r. 72(1)(j)(ii)

<sup>11</sup> Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, pp. 149-158

<sup>12</sup> Multinet Gas - 22.3.1 - *Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up - 20161215*.

<sup>13</sup> NGR, r. 59.

<sup>14</sup> NGR, r. 48(1)(d)(i).

## Assessing the tariff setting method for the reference service

The reference tariffs for an access arrangement must be designed to meet the requirements of the NGR. Our discretion on tariff design is limited.<sup>15</sup>

We consider how the service provider intends to charge for reference services by:

1. Assessing how Multinet intends to allocate costs and revenues between reference services and other services. It must demonstrate that total revenue is allocated between reference and other services in the ratio in which costs are allocated between reference services and other services. Costs must also be allocated to the reference service and other services to which the cost is directly attributable.<sup>16</sup>
2. Assessing how Multinet grouped its customers into tariff classes. Multinet is required to group together customers for reference services on an economically efficient basis and to avoid unnecessary transaction costs.<sup>17</sup> We consider if the nature of the reference service (e.g. volume and demand tariff classes) is consistent with the need to group customers for reference services together on an economically efficient basis and avoid unnecessary transaction costs.
3. Assessing how:
  - (a) the expected average revenue of a tariff class compares with the stand alone cost and avoidable cost of providing the reference service to that tariff class
  - (b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
  - (c) whether the tariffs take into account the long run marginal costs of providing reference services
  - (d) whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.<sup>18</sup>

We have full discretion in assessing the proposed new fixed principles.<sup>19</sup> We have assessed them for consistency with the NGR, and have had regard to the revenue and pricing principles.<sup>20</sup>

For existing fixed principles that were approved before the commencement of the NGR, these are binding on the AER and Multinet for the period for which the principle is fixed and these may only be varied or revoked with Multinet's consent.<sup>21</sup>

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<sup>15</sup> NGR, r. 94(6).

<sup>16</sup> NGR, r. 93(2).

<sup>17</sup> NGR, r. 94(2).

<sup>18</sup> NGR, rr. 94(3)–(4).

<sup>19</sup> NGR, r. 99.

<sup>20</sup> NGL, s. 28(2); NGR, r. 100(1).

<sup>21</sup> NGR, r. 99.

### 10.3.1 Interrelationships

Multinet's tariffs have an interrelationship with the services it provides, our approved total revenue requirement for Multinet and the application of annual tariff variation mechanisms.

Multinet's haulage reference tariffs are adjusted annually by applying a weighted average price cap formula. Its haulage reference tariffs are derived from the total revenue requirement after demand for each tariff class is considered. This means the tariffs we determine (including the means of varying the tariffs from year to year) are the binding constraint across the 2018-22 access arrangement, rather than the total revenue requirement set out in our decision.

After the first year of the access arrangement period, tariffs for Multinet's haulage reference services and ancillary reference services are set by applying the tariff variation formula.

Our draft decision on:

- Multinet's total revenue requirement—is set out in the Overview
- the services Multinet will offer to customers over the 2018–22 access arrangement period are set out in attachment 1—Services covered by the access arrangement
- the annual tariff variation mechanisms are set out in attachment 11—Reference tariff variation mechanism.

## 10.4 Reasons for draft decision

We accept Multinet's proposed reference service tariff structure because we are satisfied that it complies with the NGR requirements.<sup>22</sup>

The tariff structure is consistent with that applied in the current access arrangement. However, we consider the quantum of the proposed initial reference tariffs must be amended to reflect our draft decision forecast demand and revenue allowance.

We accept Multinet's proposed fixed principle for the carryover of unrecovered pass through event costs to the following access arrangement period. We do not accept Multinet's proposed fixed principle for the carryover of revenue under or over recoveries into the following access arrangement period.

The remainder of this section sets out the reasons for our draft decision under the following headings:

- allocation of revenues and costs to reference tariffs
- establishment of tariff classes

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<sup>22</sup> NGR, rr. 94(6).

- tariff classes and revenue limits
- fixed principles.

### 10.4.1 Allocation of revenues and costs to reference tariffs

Multinet's proposal included information outlining its stand-alone costs, long run marginal costs and incremental costs. On reviewing this, we are satisfied Multinet's approach to allocating revenue and costs between reference services and non-reference services complies with the NGR for the following reasons:

- We are satisfied Multinet's proposed costs relating to its reference services do not include costs incurred (and recovered) from the provision of its non-reference services.
- Multinet has not allocated non-reference service revenue to a reference service because the underlying costs have not been included in Multinet's building block revenues.

### 10.4.2 Establishment of tariff classes

Multinet groups its customers by the nature of the haulage reference service (residential or non-residential categories, volume or demand tariffs) and classifies them by their location on the distribution network. We consider that these characteristics are likely to be the driver of costs within Multinet's gas distribution network. Therefore, using them to group customers into tariff classes is appropriate. We note Multinet's proposed tariff classes are consistent with the tariff classes in the current access arrangement.

Based on the above reasons, we are satisfied that the proposed tariff classes are consistent with the requirements of the NGR.<sup>23</sup>

### 10.4.3 Tariff classes and revenue limits

We have assessed Multinet's tariff classes and revenue limits against the following NGR considerations.<sup>24</sup>

- (a) the expected average revenue of a tariff class compares with the stand-alone cost and avoidable cost of providing the reference service to that tariff class
- (b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
- (c) whether the tariffs take into account the long run marginal costs of reference services

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<sup>23</sup> NGR, rr. 94(1), (2).

<sup>24</sup> NGR, r. 94.

(d) whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.

## Stand-alone and avoidable costs

We are satisfied that Multinet's proposed reference tariffs are consistent with the NGR requirements because the expected revenue to be recovered lies on or between:

- an upper bound representing the stand-alone cost of providing the reference service to customers who belong to that tariff class
- a lower bound representing the avoidable cost of not providing the reference service to those customers.

We had regard to the quantitative material Multinet submitted to us which indicated the above criteria were met.<sup>25</sup>

We consider Multinet's definitions of avoidable and stand-alone costs for the tariff classes are acceptable for assessing compliance with the NGR.<sup>26</sup> We have also reviewed the methodology applied by Multinet to demonstrate that for each tariff, the expected tariff revenue lies on or between the avoidable and standalone costs. Again, this is comparable to the analysis we have undertaken for other energy businesses over a number of years.

## Transaction costs

We are satisfied that Multinet's proposed reference tariffs take into account transaction costs associated with the tariff and the need to avoid them where possible.<sup>27</sup> We consider the continuation of the current access arrangement tariff classes and tariff structures will minimise any additional transaction costs across access arrangement periods and thereby avoiding their unnecessary imposition.

## Long run marginal cost

Multinet submitted that it used the Average Incremental Cost approach to calculate long run marginal cost (LRMC) by tariff class. Multinet further submitted that, because its system-wide forecast of demand growth is negative, using a system-wide long run marginal cost estimate "may lead to unintended consequences (namely a negative LRMC)".<sup>28</sup>

For the above reason Multinet estimated LRMC with reference to those network regions for which it forecasts augmentation capex in the 2018–22 access arrangement

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<sup>25</sup> Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 151.

<sup>26</sup> Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, pp. 150-1.

<sup>27</sup> NGR, rr. 94(2), 94(4).

<sup>28</sup> Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 156.

period.<sup>29</sup> Multinet noted that, for those network regions, it allocated augmentation capex to peak period tariff parameters. For network regions without augmentation capex, Multinet submitted that peak LRMC equates to the off-peak charge which reflects the additional opex required to deliver an extra gigajoule of gas.

We consider Multinet's approach is generally consistent with that applied by other gas distribution networks. Moreover, we observe that the calculated values of LRMC are sensitive to the assumptions made around a number of different variables. As such, these provide a guide when assessing price levels and structures, and we accept that Multinet's tariffs have taken LRMC into account as far as possible given regional variations in forecast growth.

## Response to price signals

Multinet submitted that its proposed reference tariff structures are unchanged from those in its current access arrangement.<sup>30</sup> Also, that its tariffs are currently structured to allow end-use customers to respond to price signals.

We are satisfied that in proposing its reference tariffs Multinet has had regard to whether customers are able, or likely, to respond to price signals. Multinet's existing price signals are well known to its customers and allow them to respond to prices by adjusting their demand.

### 10.4.4 Fixed principles

Multinet proposed the following fixed principles that relate to tariff setting,<sup>31</sup> which we have considered as follows;

Fixed principle (a) relates to the form of regulation:

The regulator will use incentive based regulation adopting a CPIX<sup>32</sup> approach and not rate of return regulation. The fixed principle will apply until the end of the sixth access arrangement period.<sup>33</sup>

We require Multinet to change this fixed principle so that it will apply until the end of the fixed period currently stated which is the fifth access arrangement period (2018–22 access arrangement period). The application of this fixed principle in subsequent access arrangement periods is more appropriately considered as part of our consultation on Multinet's proposals for those periods. Should Multinet propose this

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<sup>29</sup> Eastern, Korumburra, Yarra Glen, South Melbourne.

<sup>30</sup> Multinet, *2018 to 2022 Access Arrangement Information*, December 2016, p. 157.

<sup>31</sup> Multinet Gas - 22.3.1 - *Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up* - 20161215, p. 23.

<sup>32</sup> We consider Multinet's discussion of this proposed fixed principle incorporated a typographical error in that the CPI-X formula was incorrectly written as "CPIX".

<sup>33</sup> Multinet Gas - 22.3.1 - *Access Arrangement Part B Reference Tariff and Reference Tariff Policy - Mark up* - 20161215, p. 23.

principle at the time of the next review, we will consider it at that point in time. We therefore require Multinet to amend its access arrangement to provide that the principle in clause 7.2(a) is a fixed principle for the 2018–23 access arrangement period only.

Fixed principle (e) relates to carrying over revenue under or over recoveries to the next access arrangement period, as part of Multinet's proposed revenue cap tariff variation mechanism, and which is to apply until the end of the seventh access arrangement period. We do not accept Multinet's fixed principle (e). This is because we do not accept Multinet's proposed revenue cap reference tariff variation mechanism. Our reasons for retaining the current weighted average price cap are set out in attachment 11. Under a price cap, the service provider is permitted to retain any revenue over recovery from a given regulatory year. Equally, the service provider will forego any under recovery observed in a given regulatory year. Therefore, fixed principle (e) is not required.

Fixed principle (g) relates to carrying over pass through event costs to the next access arrangement period<sup>34</sup> and which is to apply for 30 years.

We accept Multinet's new fixed principle (g) for managing pass through event costs. This addresses a specific issue that can arise at the end of an access arrangement period. While uncommon, it is possible for a pass through event to be determined to have occurred near the end of an access arrangement period such that related costs are unable to be recovered in the same period. Multinet's proposed fixed principle allows for haulage reference tariffs in the next access arrangement period to be adjusted to recover (or return to customers<sup>35</sup>) any unrecovered (unreturned) revenues attributable to the pass through event. We have approved clauses of similar effect in previous access arrangements<sup>36</sup> and we have no concerns with the substance of Multinet's proposal, with one qualification: Multinet's proposal that the fixed principle apply for 30 years. We do not approve this aspect of this fixed principle for the same reason as we have set out in other access arrangements on the basis that any fixed principles for later access arrangement periods are appropriately considered together with other revisions to apply in those periods.<sup>37</sup> We require this principle to be fixed until the end of the fifth access arrangement period.

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<sup>34</sup> This fixed principle is labelled (g) in Multinet's access arrangement but should be labelled (f).

<sup>35</sup> A pass through event may relate to a reduction in costs incurred by the NSP, meaning customers benefit from a reduction in revenues recovered by the NSP through tariffs.

<sup>36</sup> AER, *Final Decision: ActewAGL Distribution Access Arrangement 2016-22* - Attachment 11, May 2016, p. 11-10, AER, *Final Decision: Jemena Gas Networks 2015–20*, Attachment 11 – Reference tariff variation mechanism, p. 11-27.

<sup>37</sup> AER, *Final Decision: Jemena Gas Networks 2015–20*, Attachment 11 – Reference tariff variation mechanism, p. 11-27.

## 10.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable:

**Table 10.3 Multinet's reference tariff revisions**

Revision	Amendment
Revision 10.1	Amend the quantum of reference tariffs to reflect our draft decision on total revenue.
Revision 10.2	Amend the proposed access arrangement to specify that proposed fixed principle (a) will apply only to the 2018-22 access arrangement period.
Revision 10.3	Amend the proposed access arrangement to remove fixed principle (e).
Revision 10.4	Amend the proposed access arrangement to specify that proposed fixed principle (g) will apply only to the 2018-22 access arrangement period.