



Draft Decision

Jemena Gas Networks (NSW) Ltd 2015–20 Access Arrangement

January 2019

© Commonwealth of Australia 2019

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications,
Australian Competition and Consumer Commission,
GPO Box 3131,
Canberra ACT 2601
or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585165

Email: AERInquiry@aer.gov.au

AER Reference: 62669

Invitation for submissions

Interested parties are invited to make submissions on this draft decision by 15 February 2019.

Submissions should be sent to: JGNremittal2015-20@aer.gov.au

Alternatively, submissions can be sent to:

Mr Sebastian Roberts
General Manager, Transmission & Gas
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:

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

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

¹ <https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information>

Contents

Invitation for submissions	iii
1 Executive Summary	6
1.1 .Next steps.....	9
1.2 .Remade decisions for NSW and ACT electricity distribution businesses	10
1.3 .Structure of this document	10
2 Our remade draft decision	11
3 JGN’s Proposal.....	14
4 Stakeholders’ views on the Proposal	16
4.1 .Energy Consumers Australia.....	16
4.2 .Public Interest Advocacy Centre	17
4.3 .St Vincent de Paul Society Victoria.....	18
4.4 .Consumer Challenge Panel	18
5 Reasons for our remade draft decision	21
5.1 .Our approach	21
5.1.1 The novel circumstances we face.....	21
5.1.2 Assessing the overall decision	22
5.2 .Assessment of JGN’s Proposal.....	23
5.3 .Remaking the market expansion capex and return on debt constituent decisions.....	27
5.3.1 Capital expenditure constituent decision	27
5.3.2 Return on debt constituent decision	35
5.4 .Other aspects of the 2015 final decision to be varied	43
5.4.1 Reference tariff variation mechanism	43
5.4.2 Annual Variation Notice submission date	44
Appendix A.....	45

Background on our remade draft decision	45
The remittal task – remaking our 2015 final decision for JGN	45
Enforceable undertakings provided by JGN.....	46

1 Executive Summary

The Australian Energy Regulator (AER) regulates energy networks under national energy market legislation and rules. Our network regulatory functions, which relate to electricity and gas networks in all Australian states and territories, except Western Australia, include setting the amount of revenue that monopoly network businesses can recover from customers for using networks (electricity poles and wires and gas pipelines) that transport energy.

The National Gas Law (NGL) and Rules (NGR) provide the regulatory framework governing gas networks. Our work under this framework is guided by the National Gas Objective (NGO):²

“...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

This is our remade draft decision on the access arrangement for the NSW gas distributor, Jemena Gas Networks (NSW) Ltd (JGN), for the 2015–20 access arrangement period, commencing 1 July 2015 to 30 June 2020. We set out the issues we have considered, our conclusions, and our reasons for why we are satisfied our decision, on the basis of the information before us, contributes to the achievement of the NGO to the greatest degree.

If this remade draft decision becomes our final decision, it will provide consumers with tariff stability and predictability and will provide for further reductions in gas distribution reference tariffs over the remainder of the 2015–20 access arrangement period.³ Our remade draft decision is to accept JGN’s Proposal. We determine JGN can recover total revenues of \$2,246.6 million (\$ nominal) from consumers over the five-year 2015–20 access arrangement period.⁴

Our remade draft decision will result in a revenue allowance of \$17.6 million (\$ nominal) above the revenue we approved in our 2015 final decision after incorporating updated information.⁵ In conjunction with our draft decision adjustment determination, this will lead to \$169 million (\$2019–20) at 30 June 2020 being returned to consumers in the 2020–25 access arrangement period.⁶

² NGL, s. 23.

³ After the Australian Competition Tribunal set aside our 2015 final decision on JGN’s 2015–20 access arrangement, the absence of a final 2015–20 access arrangement meant that for the regulatory years 2016-17, 2017-18 and 2018-19, JGN’s tariffs have been set using enforceable undertakings submitted to us by JGN under section 230A of the NGL. For example, see AER, *Open letter to stakeholders – Gas distribution reference tariffs in NSW from 1 July 2018*, 21 March 2018.

⁴ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018. In consultation with JGN, we will continue to update the revenue amount for any new information until our final decision is made.

⁵ This revenue increase, compared to the 2015 final decision, is due to the annual updates for return on debt and \$21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

⁶ The \$169 million (\$ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

In February 2015, JGN was seeking \$2,605.2 million (\$ nominal) in revenue for the 2015–20 access arrangement period, but we approved a revenue allowance of \$2,229 million (\$ nominal) in our June 2015 final decision (or \$376.2 million less than what JGN proposed). In response, JGN sought limited merits review of our decision by the Australian Competition Tribunal (Tribunal), which set aside our 2015 final decision.

Our remade draft decision has been informed by our analysis, supported by a series of stakeholder engagement processes that have occurred since the second-half of 2017 involving interested stakeholders, including consumer groups and JGN. The purpose of these discussions has been to identify and develop a common position on key matters that, in turn, could be put to us for consideration as being in the long-term interests of consumers.

There are a number of factors behind our decision to accept JGN's Proposal, including:

- we are satisfied it is likely to contribute to the achievement of the NGO to the greatest degree and is in the long-term interests of consumers
- it is broadly consistent with our forecasts of capital expenditure (capex) and the cost of debt in light of the information before us now
- it is supported by key consumer groups following consultation undertaken by JGN
- it will promote price certainty and stability for consumers
- it will provide a reasonably timely and certain resolution of JGN's access arrangement for the 2015–20 period, which will benefit both consumers and JGN.

We have had to remake our decision following the outcome of limited merits and judicial review processes relating to our 2015 final decision. The Tribunal remitted our decision to us, specifically requiring that we remake our decision in relation to JGN's market expansion capex forecast and the rate of return on debt with respect to the trailing average approach, and otherwise vary the access arrangement as set out in our 2015 final decision as we consider appropriate.⁷

To address pricing uncertainty during the period that the review processes were on foot, we accepted enforceable undertakings from JGN. These undertakings kept gas distribution reference tariffs constant in nominal terms in 2016-17, followed by reductions of an average of 7 per cent, and 5.4 per cent in real terms in 2017-18 and 2018-19, respectively. Under these undertakings and under our draft decision adjustment determination, we estimate that JGN will recover \$169 million (\$2019–20) at 30 June 2020 during the 2015–20 access arrangement period above the revenue we approve in this remittal decision.

On 31 October 2018, JGN submitted a Proposal to us to resolve all outstanding issues relating to the decision we need to remake.⁸ It is a total revenue proposal for \$2,246.6 million (\$, nominal) for the five-year 2015–20 access arrangement period. This amount is \$17.6 million (\$ nominal) above what we approved in our 2015 final decision after

⁷ *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*. See Appendix A for background on our remade decision.

⁸ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

incorporating updated information.⁹ This contrasts with the \$100 million in revenue at issue (the key elements of our 2015 final decision that were disputed were approximately \$92 million in return on debt and \$8 million in capex).

JGN's Proposal is based on:

- our 2015 final decision, including the constituent decisions we made on capex and the rate of return (including the cost of debt)
- the revenue that JGN has recovered thus far for the 2015–20 access arrangement period, with \$169 million (\$2019–20) at 30 June 2020 to be returned to customers in the 2020–25 access arrangement period.¹⁰

We have remade our 2015 final decision in accordance with the NGL and NGR. Among other things, this means we have taken into account the revenue and pricing principles (RPP) and are satisfied that the remade decision is likely to contribute to the achievement of the NGO to the greatest degree.

It is important to draw attention to the novel circumstances that we have faced in remaking this decision. These circumstances materially differ to what we faced when we made our 2015 final decision, and what we would generally face in making an access arrangement decision. As a result, it is likely that this remade decision will have limited precedent value.

Specifically, we are remaking this decision at a time:

- That is almost four years into the applicable five-year 2015–20 access arrangement period.
- When we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes.
- When we have information on JGN's actual performance for the first three years of the five-year 2015–20 access arrangement and updated forecasts for the remaining two years.
- When we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on JGN, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt.
- When our remade decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision (recognising that this prospect is to some extent alleviated by the rule made by the Australian Energy Market Commission (AEMC) on 30 August 2018 that allows us to let JGN recover any additional revenues that result from our remade decision across both the 2015–20 and 2020–25 access arrangement periods).¹¹

⁹ This revenue increase compared to the 2015 final decision is due to the annual updates for return on debt and \$21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

¹⁰ The \$169 million (\$ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

¹¹ AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule, 30 August 2018*; AEMC, *National Gas Amendment (Cross period revenue smoothing) Rule 2018 No. 2*, commencing 6 September 2018.

- When there is support from a range of consumer groups that JGN's Proposal is in the long-term interests of consumers.

The novel circumstances we find ourselves in also heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.¹²

JGN has engaged with key energy consumers groups to inform its Proposal, including Energy Consumers Australia, Public Interest Advocacy Centre, St Vincent de Paul Society Victoria and the AER Consumer Challenge Panel. The general consensus of these stakeholders is that JGN's Proposal is in the long-term interests of its consumers (see section 4).¹³

In light of the circumstances we are faced with, and the information before us, our remade draft decision is to accept JGN's Proposal for the 2015–20 access arrangement period. We are satisfied that this will result in a remade decision that is likely to contribute to the achievement of the NGO to the greatest degree and is in the long-term interests of consumers.

1.1 Next steps

Subject to stakeholder submissions received in response to this remade draft decision, we expect to publish our remade final decision on 28 February 2019, as per Table 1-1.

Table 1-1 Indicative timeline for finalising JGN's 2015–20 access arrangement

Determination process	Indicative date
AER publishes remade draft decision for consultation	24 January 2019
Stakeholder submissions on remade draft decision close	15 February 2019
AER publishes remade final decision	28 February 2019

¹² Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

¹³ Stakeholders' written advice on JGN's Proposal is published on the AER's website. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20-remittal/proposal>

1.2 Remade decisions for NSW and ACT electricity distribution businesses

Over the past year, we have released remade decisions for several NSW and ACT electricity distribution businesses for the 2014-19 regulatory control period, including Essential Energy¹⁴, Endeavour Energy¹⁵, Evoenergy¹⁶ and Ausgrid¹⁷. The remittal proposals, stakeholders' submissions and our decisions for these businesses are available on our website. The JGN remittal is the last of the set aside 2015 decisions we must remake.

1.3 Structure of this document

This document is structured as follows:

- Section 2 presents our remade draft decision for JGN
- Section 3 presents JGN's Proposal
- Section 4 presents stakeholders' views on JGN's Proposal
- Section 5 presents the reasons for our remade draft decision
- Appendix A presents background to our remade draft decision

¹⁴ AER, *Final Decision Essential Energy 2014-19 electricity distribution determination*, May 2018.

¹⁵ AER, *Final Decision Endeavour Energy 2014-19 electricity distribution determination*, September 2018.

¹⁶ AER, *Final Decision Evoenergy 2014-19 electricity distribution determination*, November 2018.

¹⁷ AER, *Final Decision Ausgrid 2014-19 electricity distribution determination*, January 2019.

2 Our remade draft decision

Our remade draft decision, after remaking the constituent decisions for capex and the rate of return, and amending the tariff variation mechanism for pass throughs¹⁸ JGN has not yet recovered in the 2015–20 access arrangement period, is to accept JGN's Proposal.¹⁹

If this remade draft decision becomes our final decision, this means JGN can recover estimated total revenues of \$2,246.6 million (\$ nominal) from consumers over the 2015–20 access arrangement period. This outcome is \$17.6 million (\$ nominal) above the revenue allowance we set for JGN in our 2015 final decision after incorporating updated information.²⁰ We determine that \$169 million (\$2019–20) at 30 June 2020 will be returned to customers in subsequent regulatory years from 2020-21

²¹

We are satisfied that this remade draft decision, taking into account the RPP, is likely to contribute to the achievement of the NGO to the greatest degree.²² Figure 2-1 illustrates our remade decision in terms of total revenue.

The distribution network component of customers' gas bills were set by our 2015 final decision and following the Tribunal's decision, by interim pricing measures (enforceable undertakings) in 2016-17, 2017-18 and 2018-19. The enforceable undertakings from JGN addressed pricing uncertainties arising from the limited merits and judicial review processes.

At the time of our 2015 final decision, we expected the average annual gas bill in 2015-16 to fall by around 9.2 per cent for both residential customers (or \$96) and small business customers (or \$462) in the 2015–20 access arrangement period.²³

In accordance with the enforceable undertakings we accepted from JGN for the 2016-17 to 2018-19 regulatory years, gas distribution reference tariffs were kept constant in nominal terms in 2016-17, reduced by an average of 7 per cent in real terms in 2017-18, and reduced by an average of 5.4 per cent in real terms in 2018-19. Under JGN's Proposal, tariffs for 2019-20 are expected to reduce by an average of 5.4 per cent in real terms.

As this remade draft decision, in conjunction with our draft decision adjustment determination, will lead to \$169 million (\$2019–20) at 30 June 2020 being returned to consumers in the 2020–25 access arrangement period. Holding everything else constant, we would expect this to put downward pressure on the tariffs faced by JGN's customers.

¹⁸ Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

¹⁹ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

²⁰ This revenue increase compared to the 2015 final decision is due to the annual updates for return on debt and \$21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

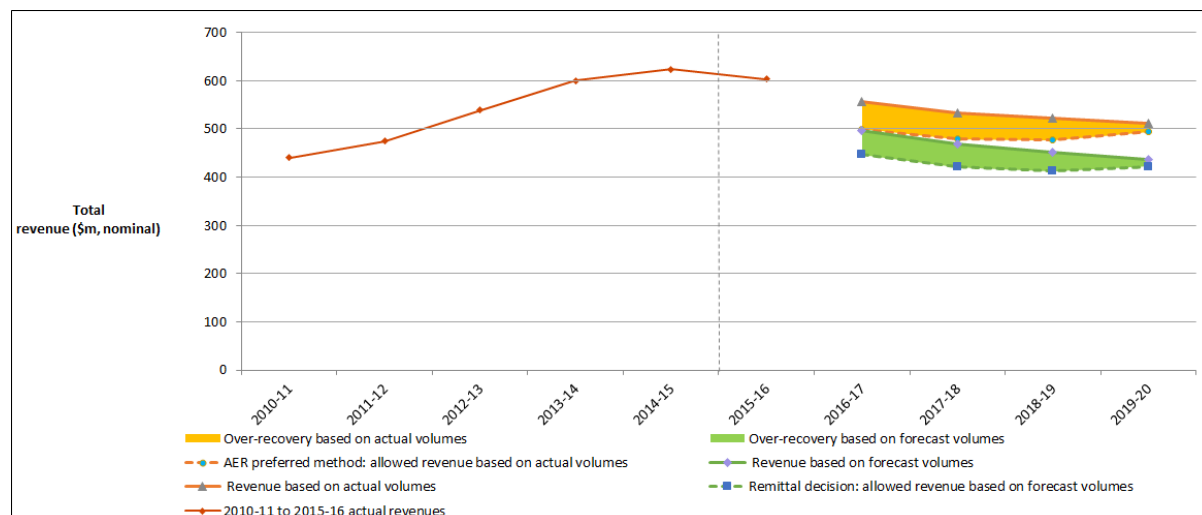
²¹ The \$169 million (\$ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

²² NGL, s. 23(1)(b)(iii).

²³ AER, *Final decision: JGN 2015–20 - Fact Sheet*, June 2015.

Figure 2-1 shows how the \$169 million (\$2019–20) at 30 June 2020 to be returned to customers was calculated based on forecast volumes and is represented by the green area.²⁴

Figure 2-1 JGN’s past total revenue and the assessment of recovered revenue (\$million, nominal)



Source: AER analysis.

At the same time as releasing this remade draft decision, we have also released a separate draft adjustment determination for JGN that has relevance to revenues recovered for both 2015–20 and 2020–25 access arrangement periods.²⁵ Under the NGR, we are required to make an adjustment determination in order to ensure JGN recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process.²⁶ The draft adjustment determination relates to revenue requirements from reference services that JGN must smooth between the 2015–20 and 2020–25 access arrangement periods to ensure this outcome. Our draft adjustment determination includes an adjustment amount of \$169 million (\$ as at 30 June 2020) for the 2019-20 regulatory year and an offsetting subsequent adjustment amount of \$169 million (\$ as at 30 June 2020) to be applied to the next (2020–25) access arrangement period.

Without a smoothing mechanism, JGN would potentially be required to apply the \$169 million (\$ as at 30 June 2020) downward revenue adjustment in the final year of the 2015–20 access arrangement period. This could lead to price fluctuations for JGN’s customers. Figure 2-2 shows that our remade draft decision would result in a 32 per cent reduction to average prices in the 2019-20 regulatory year compared to the 2018-19 regulatory year, if there was no smoothing mechanism in place. Depending on JGN’s revenue requirements for the 2020–25 access arrangement period, there is also potential for

²⁴ The AER’s preferred approach calculated \$178 million in recovered revenues to be returned to JGN customers based on actual volumes. In terms of Figure 2-1 it reflects the area between the solid and dashed yellow lines.

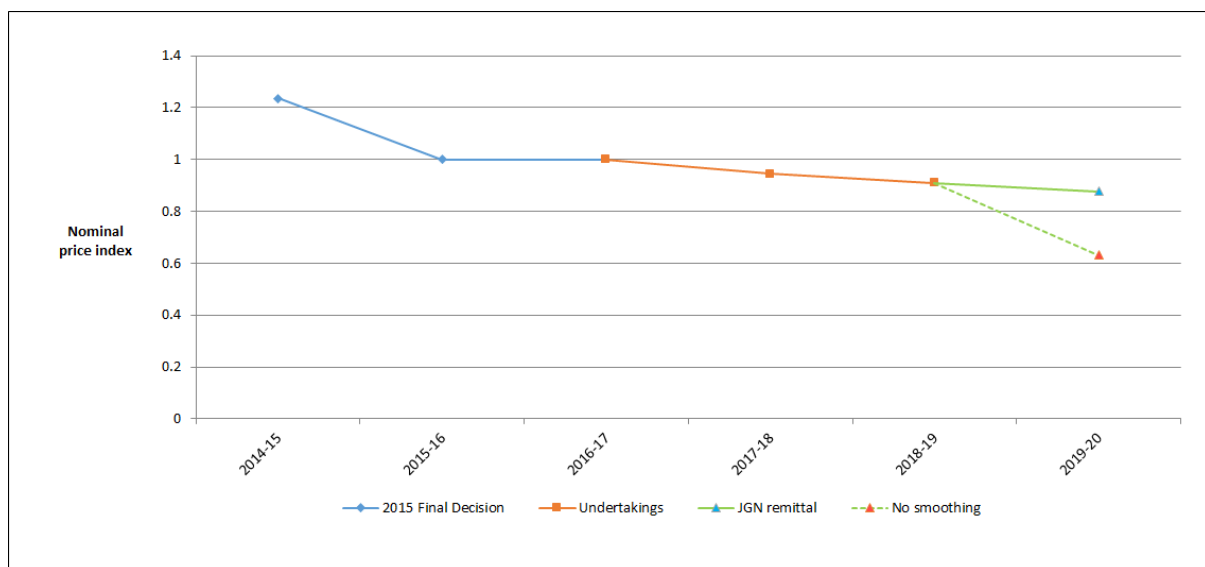
²⁵ AER, *Draft decision, JGN adjustment determination*, January 2019.

²⁶ NGR, Schedule 1, Part 11.

a large rebound or increase in average prices from 2019-20 to 2020-21 (the first regulatory year of the 2020–25 access arrangement period).

We consider such large fluctuations in average prices, even if they are one-off, are not consistent with the NGO. Such large fluctuations may lead customers to incorrectly assume they will continue into the future. Customers may then make inefficient investment decisions based on these assumptions. Adding the adjustment amount to the revenue allocated to the 2019–20 regulatory year in our remade draft decision ensures a consistent price path with JGN’s Proposal.²⁷ Further, applying the subsequent adjustment amount in the 2020–25 access arrangement period is consistent with JGN’s Proposal to return \$169 million (in net present value) to customers.²⁸

Figure 2-2 Nominal price index with, and without, revenue smoothing



Source: AER analysis.

²⁷ JGN, *Remittal model - Forecast volume scenario - PUBLIC*, 20 November 2018.

²⁸ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 5.

3 JGN's Proposal

On 31 October 2018, we received JGN's Proposal for the remaking of its access arrangement for the 2015–20 access arrangement period.²⁹

It is a total revenue proposal – that is, it is not directly presented in terms of the building block components as was the case in its initial and revised regulatory proposals which preceded our June 2015 final decision. As JGN notes in its Proposal:³⁰

“We have sought an overall outcome that is acceptable to all stakeholders. It is best considered as a package rather than being viewed separately as isolated individual items.”

Key aspects of JGN's Proposal are summarised below:³¹

“Our proposal follows a series of consultations...held with consumer groups, JGN's Customer Council, the Consumer Challenge Panel (CCP) 10, and the AER...

...the items remitted back to the AER were:

- market expansion capital expenditure...
- the cost of debt...

After the Tribunal set aside the 2015 FD, the absence of a final 2015 Access Arrangement decision meant that for the regulatory years 2016/17 (RY17), 2017/18 (RY18), and 2018/19 (RY19), JGN's prices have been set using Enforceable Undertakings... A consequence of these interim arrangements is that prices effected for RY17 through the Enforceable Undertaking were higher in July 2016 than prices envisaged for that regulatory year under the 2015 FD. This has continued through RY18 and RY19. As a result, and despite some reductions in network charges in 2017 and 2018, we expect to collect \$169M (\$2020) in revenues above what would have occurred had a remade decision been in place during that period.

Relevant to the calculation of over-recovery is the weighted average price cap (WAPC) form of control under which JGN is regulated. Under a WAPC, JGN is subject to demand forecasting risk. Where actual demand turns out to be higher or lower than forecast volumes, JGN receives higher or lower revenue than the AER's allowance. This provides JGN with the incentive to outperform the demand forecast accepted by the AER in the 2015 FD. This incentive is aligned to customers' interests as it spreads our fixed costs over more customers in the long run. JGN's demand forecast is reviewed and approved by the AER as part of a regulatory determination...

We wish to demonstrate our commitment to delivering on our customers' desire for affordable, reliable, and sustainable gas services. To drive towards this, and as part of an expedited resolution to the remittal, JGN's proposal adopts the 2015 FD, including the application of a transition to the trailing average cost of debt for 2015–20 (consistent with JGN's acceptance of the same methodology as part of the 2018 Rate of Return Guideline review process that the AER is in the process of conducting), with adjustments to account for:

²⁹ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

³⁰ Ibid.

³¹ Ibid.

- An additional allowance of...\$21M (\$2020) for market expansion capex compared with the 2015 FD...
- An update to the tariff variation mechanism in JGN's 2015–20 AA...to provide for the adjustment of RY20 tariffs to include those positive and negative cost pass through items not yet given effect due to the Enforceable Undertakings being in place in each of RY17, RY18 and RY19...
- A reduction of \$169M in revenue for the 2015–20 access arrangement period...to recognise that, for RY17 to RY19, prices were higher than they would have been if the remade final decision had been in place from RY16. This forecast...is based on a method that is consistent with JGN's form of control, the WAPC, whereby AER approved volume forecasts are used to set revenues.

We also recognise that the AER has forecast an alternative revenue adjustment of \$178M (\$2020) which is \$9M (\$2020) higher than JGN's calculation. We have tested these potential outcomes with stakeholders, and consider that the forecast of \$169M (\$2020) is consistent with the WAPC and achieves a result that is within an acceptable range to ensure an expedited resolution to the remittal. Stakeholders also considered that the \$9M (\$2020) benefit retained by JGN is reasonable in the context of the outstanding matters being considered as part of our remittal.

This proposal will continue to deliver lower network charges from 1 July 2019...

AER acceptance of this Proposal will finally resolve the remittal matters in full, thereby providing certainty to customers regarding their current and future prices...

JGN's acceptance of the AER's:

- approach to the cost of debt avoids a potential maximum \$107M increase in network costs
- proposal for additional market expansion capex avoids up to \$93M of capex allowance, which would otherwise have been added to the regulatory asset base and earn a return on this investment and recover the return of capital (depreciation)...

The Proposal enables the AER to consider the appropriate mechanisms to reduce JGN's future revenues by \$169M and return this amount to customers...

Customers avoid year on year price volatility and maintain annual tariff variation certainty via:

- having the cross period smoothing rule change now in place, which allows for the AER to approve steady price decreases for RY20 and for those to continue into the next period
- the processing of JGN's positive and negative cost pass throughs (not given effect through Enforceable Undertakings over RY17 to RY19) in a way that maintains AER oversight of these changes."

JGN engaged with consumer groups on a near-final version of its Proposal prior to submitting its finalised Proposal to the AER. The next section summarises stakeholders' comments on JGN's Proposal.

4 Stakeholders' views on the Proposal

Following early discussions between JGN and our staff on the key aspects of the decisions the Tribunal has required us to remake, JGN engaged with consumer groups on a near-final version of its Proposal. Subsequently, the following consumer groups issued letters expressing their views on JGN's Proposal:

- Energy Consumers Australia (ECA)
- Public Interest Advocacy Centre (PIAC)
- St Vincent de Paul Society Victoria (SVDP)
- AER Consumer Challenge Panel, Sub-panel 10 (CCP10)

The general consensus of these consumer groups is that JGN's Proposal for the 2015–20 access arrangement period is in the long-term interests of its customers. The letters in their entirety are available on our website, excerpts from which are provided below.

4.1 Energy Consumers Australia

In its letter on JGN's Proposal, ECA submitted:³²

"I write to express Energy Consumer Australia's support for the proposal for the remittal of Jemena Gas Networks' (JGN) 2015–20 determination (the Proposal)...

In forming our view of the Proposal, we have considered whether, as a package, the Proposal is in the long-term interests of consumers served. We understand that you have also consulted with the Public Interest Advocacy Centre (PIAC); the St Vincent de Paul Society; JGN's Customer Council; Consumer Challenge Panel 10; and the AER.

Our understanding is that JGN will propose to the AER:

1. That it adopts the 2015 Final Determination, including the application of a transition to the trailing average cost of debt for 2015–20 (consistent with JGN's acceptance of the same methodology as part of the 2018 Rate of Return Guideline review process)
2. An additional allowance of \$21 million for market expansion capital expenditure
3. Returning \$169 million (\$2020) in revenue to consumers. This reflects the revenue amount that would have been recovered by JGN had a remade decision been in place during that period, as forecast by JGN. We understand that...the proposed \$169 million is \$9 million less than the AER's forecast revenue adjustment of \$178 million. JGN believes that its forecast (\$169 million) is more consistent with the weighted average price cap and is within an acceptable range to ensure an expedited resolution to the remittal. We believe that the proposed \$169 million is capable of acceptance as on balance, the benefit outweighs further uncertainty for consumers from a protracted remittal process.

In our view, on balance, the benefits of the Proposal outweigh the costs and are in the long-term interests of consumers.

We understand that consumers will benefit from:

³² Energy Consumers Australia, *Proposal for the remittal of Jemena Gas Networks' determination*, 31 October 2018.

- the resolution of the proposed price path, with JGN agreeing not to re-open the issues arising from the Federal Court decision;
- the significant reduction in market expansion capital expenditure being sought by JGN (which was originally proposed to be \$114 million over and above the AER's original decision); and
- no real price increases over the 2019-24 period because of this proposal, and the work undertaken to smooth prices for consumers...

Separate to the Proposal, we understand that the AER is reviewing how costs for the 2015–20 period are to be recovered from consumers via the 'tariff variation mechanism'. We would encourage the AER to work with JGN to deliver a smooth price outcome for consumers."

4.2 Public Interest Advocacy Centre

In its letter on JGN's Proposal, PIAC submitted:³³

"PIAC supports JGN's proposal to accept the AER's most recent positions on cost of debt and market expansion capex, and retain \$9m above the AER's estimate of over-recovered revenue...

PIAC supports the approach JGN has taken to stakeholder engagement about the remitted 2015–20 access arrangement decisions. JGN has engaged with the AER, Consumer Challenge Panel, its Customer Council and consumer advocates in making its remittal proposal. This built on JGN's 2018 consumer engagement program for its 2020-25 access arrangement proposal, which PIAC considers has been positive.

However, we note the resolution of the JGN access arrangement has not been as timely as the NSW electricity distribution business remittals...

JGN proposes to:

- Accept the AER's 2015 position on cost of debt, including application of a transition to trailing average cost of debt;
- Accept the AER's most recent position on market expansion capex, allowing an additional \$21m; and
- Estimate the final 2016/17-2018/19 over-recovery at \$169m (rather than the \$178m AER estimate).

In PIAC's view, the approval of JGN's proposal is in the long-term interests of consumers. By not pursuing the positions it took in 2015, JGN will ensure their customers do not face the increase in bills associated with the full allowances originally sought.

The certainty that flows from the resolution of this process, and particularly the removal of the potential for judicial review of the AER's re-made decision by JGN, is also in consumers' interests.

On balance, PIAC considers it reasonable for JGN to recover \$9m above the AER's over-recovery estimate on that basis that:

- It appears to be a lower cost than the revenue forgone by JGN on market capex and cost of debt;
- It is consistent with 'uplifts' in the NSW electricity distribution remittal outcomes; and

³³ Public Interest Advocacy Centre, *Jemena Gas Network Remittal Proposal*, 1 November 2018.

- The AER has accepted this position.”

4.3 St Vincent de Paul Society Victoria

In its letter on JGN’s Proposal, SVDP submitted:³⁴

“SVDP supports JGN’s proposal to:

- Accept the AER’s 2015 position on cost of debt, including application of a transition to trailing average cost of debt;
- Accept the AER’s most recent position on market expansion capex, allowing an additional \$21m; and
- Estimate the final 2016/17-2018/19 over-recovery at \$169m (rather than the \$178m AER estimate).

Given the above and on balance SVDP considers it reasonable for JGN to recover \$9m above the AER’s over-recovery estimate...

SVDP notes and supports JGN’s engagement strategy for its 2015–20 remittal proposal which has included the AER, Consumer Challenge Panel, its Customer Council and consumer advocates in developing this proposal.

By not pursuing the positions it took in 2015, JGN will ensure their customers do not face the increase in bills associated with the full allowances originally sought. In addition, the removal of the potential for judicial review of the AER’s re-made decision by JGN, is also in consumers’ interests.”

4.4 Consumer Challenge Panel

The AER established the CCP in July 2013 to assist us to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to us to better balance the range of views considered as part of our decisions.

In its letter on JGN’s Proposal, CCP10 submitted:³⁵

“The two remitted issues were Market Expansion (ME) capex...and the cost of debt... A third issue has arisen as a result of the delays in finalising the revenue allowance being the collection of revenue from consumers pursuant to a series of ‘placeholder’ revenues being agreed, while the other matters were resolved.

The proposal from JGN in summary form is:

1. transition to the trailing average cost of debt methodology for 2015–20,
2. an additional \$21 million (real) for ME capex is allowed, above the original 2015 Access Arrangement decision,
3. an update to the tariff variation mechanism for the pass through that is not yet given effect and
4. a reduction in revenue of \$169 million for the total 2015–20 Access Arrangement period.

³⁴ St Vincent de Paul Society Victoria, *Jemena Gas Network Remittal Proposal*, 31 October 2018.

³⁵ Consumer Challenge Panel, *Jemena Gas Networks (JGN) 2015–20 Access Arrangement remittal proposal*, 1 November 2018.

The transition to a trailing average debt methodology effectively resolves the dispute regarding cost of debt issues.

An allowance of an additional \$21 million (real) for market expansion for the 2015–20 period resolves the dispute regarding ME capex.

An acceptance of a reduced revenue of \$169 million for 2015–20 from what has been collected resolves the placeholder issue, though we provide some comments about how this can be implemented in the following paragraphs...

The proposal from JGN to resolve the three issues arising from the remitted decisions is considered to be reasonable by CCP10 and acceptance of the proposal would be in the long-term interest of consumers...

JGN has engaged actively with CCP10 in seeking to finalise the remitted decisions...

We are aware that along with CCP10, JGN has also maintained regular contact and communication with PIAC, ECA and St Vincent de Paul Society as prominent consumer voices.

While engagement with CCP10 has been regular through email and telephone conversations, particularly once the pace of the process picked up from midyear, there has been a series of more formal processes of engagement that we summarise in the table below.

Consultations with JGN and CCP10	Dates
AER hosted a roundtable meeting to consider ME capex – CCP10 participated with JGN and AER	18 th January 2018
CCP10 responds to AER “Debt paper”	23 rd February 2018
JGN briefing of CCP10, and other consumer Groups	8 th August 2018
Draft proposal forwarded to CCP10 by JGN and discussed by email and phone	19 th September 2018
Teleconference – JGN and CCP10	4 th October 2018

The ongoing engagement and discussion has been very constructive throughout the process, a further reason for CCP10 being confident in our support of this proposal...

JGN’s proposal is consistent with the recent cost of debt decisions...

We...support the proposal for cross period revenue smoothing so that bill impacts for customers are as consistent as possible over an extended period of time...

CCP10 believes that the JGN proposal is in the long-term interest of their customers. The proposal involves JGN increasing their ME capex by a modest \$21 million and returning \$169 million of consumers’ money, consumers will benefit from:

- the certainty provided by the resolution of the proposed price path, with cross period smoothing;
- the removal of the risk for consumers from the re-opening of the contentious issues from the Federal Court decision, particularly in regard to debt costs;
- the return of \$169 million to consumers over the regulatory periods to 2025;

- ongoing focus on consumer engagement, building on the relationships that we observe have been strengthened by the discussions and transparency associated with developing this proposal; and
- a further demonstrable example of 'AER 2.0' being effectively applied.

It is our opinion that the benefits of this proposal significantly outweigh the costs (including ME capex increase), in aggregate, for consumers from this proposal...

CCP10 commends JGN for taking this opportunity to resolve the 2015–20 Access Arrangement. Consumers were not well served by the regulatory impasse between the AER and the NSW/ACT businesses around the 2014-19 determinations and the 2015–20 Access Arrangement.

We also commend the consumer groups on their willingness to engage with JGN for this remittal process and the 'good faith' that they have demonstrated, and which has been responded to very constructively by JGN."

5 Reasons for our remade draft decision

Our reasons for arriving at our position in this remade draft decision are set out below. The steps we took to arrive at our position are:

- remake the constituent decisions for market expansion capex and the return on debt in accordance with the Tribunal's directions and reasons (as clarified by the Full Federal Court (Court))
- identify any other aspects of our June 2015 final decision that may be appropriate to vary, as a consequence of remaking the constituent decisions for market expansion capex and the return on debt
- consider JGN's Proposal, as well as consumer groups' letters on the Proposal
- of all the possible outcomes available, decide whether we are satisfied that the position we have arrived at, taking into account the RPP, is likely to contribute to the achievement of the NGO to the greatest degree³⁶

5.1 Our approach

As is the case with making any Access Arrangement decision, there may be several possible overall decisions that will, or are likely to, contribute to the achievement of the NGO. In these circumstances, the NGL directs us to make the decision that we are satisfied will, or is likely to, contribute to the achievement of the NGO to the greatest degree.³⁷

Determining whether any particular decision will, or is likely to, contribute to achieving the NGO is a matter of regulatory judgment which involves assessing the decision as a whole, having regard to stakeholder views, taking into account the RPP and complying with the specific requirements of the NGR. Implicit in this task is recognising that an access arrangement decision is more than just the sum of its component parts as determined in accordance with Part 8 of the NGR.

5.1.1 The novel circumstances we face

The approach we have applied in remaking this draft decision has necessarily been influenced by the novel circumstances that we face now. These are novel circumstances because they materially differ from those we faced when we made our 2015 final decision, and what we would generally face in making an access arrangement decision. As a result, it is likely that this remade draft decision will have limited precedent value.

Specifically, we are making this remade draft decision at a time:

- that is almost four years into the applicable five-year 2015–20 access arrangement period

³⁶ NGL, s. 23(1)(b)(iii).

³⁷ Ibid.

- when we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes
- when we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on JGN, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt
- when we have information on JGN's actual performance for the first three years of the five-year 2015–20 access arrangement period and updated forecasts for the remaining two years
- when our decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision³⁸
- when there is support from a range of consumer groups that JGN's Proposal is in the long-term interests of consumers.

5.1.2 Assessing the overall decision

Ultimately, assessing whether this remade draft decision achieves the NGO to the greatest degree involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of JGN's network that is in the long-term interests of consumers. This involves us balancing the various, and at times competing, factors referred to in the NGO. We must also take into account the RPP in determining how the NGO may be achieved to the greatest degree.³⁹

This is the same approach that we applied in making our 2015 final decision. As we stated in that decision:⁴⁰

"Energy Ministers have provided us with a substantial body of explanatory material that guides our understanding of the NGO. The long-term interests of consumers are not delivered by any one of the NGO's factors in isolation, but rather by balancing them in reaching a regulatory decision..."

The NGL and NGR aim to remedy the absence of competition by providing that we, as regulator, make decisions that are in the long-term interests of consumers. In particular, we might need to require the service providers to offer their services at a different price than they would choose themselves. By its nature, this process will involve exercising regulatory judgement to balance the NGO's various factors.

It is important to recognise that there are a number of plausible outcomes that may contribute to the achievement of the NGO. The nature of decisions under the NGR is such that there may be a range of economically efficient decisions, with different implications for the long-term interests of consumers. At the same time, however, there are a range of outcomes that are

³⁸ Recognising that this prospect is to some extent alleviated by the rule made by the AEMC on 30 August 2018 that allows us to let JGN recover any additional revenues that result from our remade decision across both the 2015–20 and 2020–25 access arrangement periods. See AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule, 30 August 2018*; AEMC, *National Gas Amendment (Cross period revenue smoothing) Rule 2018 No. 2*, commencing 6 September 2018.

³⁹ NGL, s. 23(1)(b)(iii).

⁴⁰ AER, *Final decision, JGN Access Arrangement 2015–20, Overview*, June 2015, pp. 45-47.

unlikely to advance the NGO to a satisfactory extent. For example, we do not consider that the NGO would be advanced if allowed revenues encourage over-investment and result in prices so high that consumers are unwilling or unable to efficiently use the network. This could have significant longer term pricing implications for those consumers who continue to use network services. Equally, we do not consider the NGO would be advanced if allowed revenues result in prices so low that investors are unwilling to invest as required to adequately maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable. This could create longer term problems in the network and could have adverse consequences for safety, security and reliability of the network.”

This approach was also affirmed by the Tribunal in its reasons of 26 February 2016.⁴¹

“The ultimate objective reflected in the NEO [National Electricity Objective] and NGO [National Gas Objective] is to direct the manner in which the national electricity market and the national natural gas market are regulated, that is, in the long-term interests of consumers of electricity and natural gas respectively with respect to the matters specified. The provisions proceed on the legislative premise that their long-term interests are served through the promotion of efficient investment in, and efficient operation and use of, electricity and natural gas services. This promotion is to be done ‘for’ the long-term interests of consumers. It does not involve a balance as between efficient investment, operation and use on the one hand and the long-term interest of consumers on the other. Rather, the necessary legislative premise is that the long-term interests of consumers will be served by regulation that advances economic efficiency.”

In considering whether this remade draft decision is likely to contribute to the achievement of the NGO to the greatest degree, in respect of our assessment of JGN’s Proposal, we note that there are potentially a range of possible outcomes that may meet the Tribunal’s directions.

5.2 Assessment of JGN’s Proposal

As set out in section 3, JGN’s Proposal for a revenue forecast for the 2015–20 access arrangement period is summarised as follows:⁴²

“...as part of an expedited resolution to the remittal, JGN’s proposal adopts the 2015 FD, including the application of a transition to the trailing average cost of debt for 2015–20...with adjustments to account for:

- An additional allowance of...\$21M (\$2020) for market expansion capex...
- An update to the tariff variation mechanism in JGN’s 2015–20 AA...
- A reduction of \$169M in revenue for the 2015–20 access arrangement period...”

In light of the circumstances we are faced with, and the information before us, we are satisfied that accepting JGN’s Proposal will result in an outcome that is likely to contribute to the achievement of the NGO to the greatest degree.

Key reasons for our decision to accept JGN’s Proposal are outlined below.

⁴¹ *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1, [77].

⁴² JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

First, remaking the capital expenditure and cost of debt constituent decisions reveals a result that is broadly consistent with revenue that we arrived at in our 2015 final decision. This is discussed in sections 5.31 and 5.3.2, respectively. This result aligns with JGN's Proposal to accept our 2015 final decision, including the application of a transition to the trailing average cost of debt for 2015–20. We note that recent Tribunal and Court processes have clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt. A revenue neutral transition from the on-the-day approach to a trailing average approach is appropriate and consistent with the achievement of the allowed rate of return objective (ARORO) and will contribute to achieving the NGO.

Second, the novel circumstances we find ourselves in heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.⁴³ Resolving the uncertainty created by the limited merits and judicial review processes in a timely manner, by expediting this remittal process where possible compared to an extended timeframe of potentially up to 18 months for a regular determination process, is supported by several consumer groups and JGN (particularly in light of its 2020-25 access arrangement draft proposal on which it is engaging stakeholders).⁴⁴ At the same time, PIAC notes that resolution of JGN's remittal has not been as timely as resolution of the NSW electricity distribution business remittals.⁴⁵ We note that unlike the 2014-19 electricity distribution remittals which take effect from the start of the next (2019-24) regulatory control period, JGN's Proposal to resolve its remittal will take effect from the final year of the current (2015-20) access arrangement period.

If this remade draft decision becomes our final decision, it will resolve this uncertainty and addresses the crucial issue of price stability, which informs consumers of their budgetary and investment decisions on the use of electricity services. Price stability, or minimising price volatility, is also in the long-term interests of consumers and is one of the primary reasons we accepted the enforceable undertakings that JGN gave to us to govern prices for the 2016–17, 2017–18 and 2018–19 regulatory years.⁴⁶ It is also one of the primary reasons that, on 30 August 2018, the AEMC made a rule to avoid significant retail price fluctuations following the remaking of our decision. The rule enables us to allow JGN to recover/return any revenue discrepancies that result from our remade decision to/from its customers in a smoothed manner across access arrangement periods.⁴⁷

To that end, we agree with the following statement of the AEMC in its rule determination:⁴⁸

“Consumers may experience a price variation of a large magnitude over the three regulatory years from 2018/19 to 2020/21. This may arise from the delay in the finalisation of the remade

⁴³ Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

⁴⁴ Section 4 of this decision summarises the views of consumer groups (ECA, PIAC, SVDP and CCP10) regarding their support for expediting the JGN 2015–20 remittal decision.

⁴⁵ Public Interest Advocacy Centre, *Jemena Gas Network Remittal Proposal*, 1 November 2018.

⁴⁶ For example, see AER, *Open letter to stakeholders – Gas distribution reference tariffs in NSW from 1 July 2018*, 21 March 2018.

⁴⁷ AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule, 30 August 2018*; AEMC, *National Gas Amendment (Cross period revenue smoothing) Rule 2018 No. 2*, commencing 6 September 2018.

⁴⁸ AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule, 30 August 2018*, p.ii.

2015 decision and may lead some of JGN's customers to make decisions on their investment and use of natural gas services that in the long term are inefficient.

A process that allows revenue recovery to be shifted between the current and subsequent access arrangement periods in order to minimise network price volatility would lead to more stable network prices that would allow consumers to make better informed decisions. The Commission considered that this is in the long term interests of consumers.”

Third, we consider that, given the circumstances for this decision, a downward revenue adjustment of \$9 million (\$2019–20) as at 30 June 2020 to the \$178 million (\$2019-20) as at 30 June 2020 in recovered revenues we calculated to be returned to JGN customers based on actual volumes for the 2015–20 access arrangement period is likely to contribute to the achievement of the NGO to the greatest degree. We note this outcome is also supported by consumer groups. JGN also notes that:⁴⁹

“We also recognise that the AER has forecast an alternative revenue adjustment of \$178M (\$2020) which is \$9M (\$2020) higher than JGN's calculation. We have tested these potential outcomes with stakeholders, and consider that the forecast of \$169M (\$2020) is consistent with the WAPC and achieves a result that is within an acceptable range to ensure an expedited resolution to the remittal. Stakeholders also considered that the \$9M (\$2020) benefit retained by JGN is reasonable in the context of the outstanding matters being considered as part of our remittal.

This proposal will continue to deliver lower network charges from 1 July 2019...

AER acceptance of this Proposal will finally resolve the remittal matters in full, thereby providing certainty to customers regarding their current and future prices...”

In coming to this revenue adjustment, we have considered the following factors:

- It represents an outcome that quantifies and appropriately balances the risk and uncertainty of a protracted decision process faced by affected stakeholders, including consumers. This is in the context where stakeholders have stated a clear preference for us to remake the decision in a timely manner and to resolve uncertainty in light of the circumstances described above.
- It provides greater certainty and price stability for customers for the remainder of this and over the next access arrangement period.

We have given weight to the expressions of support from ECA, PIAC, SVDP and CCP10 in respect of JGN's Proposal, as set out in section 4. Notably, given the circumstances, each of these stakeholders considers that this revenue adjustment results in an outcome that is in the long-term interests of JGN's customers.⁵⁰

⁴⁹ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

⁵⁰ Energy Consumers Australia, *Proposal for the remittal of Jemena Gas Networks' determination*, 31 October 2018; Public Interest Advocacy Centre, *Jemena Gas Network Remittal Proposal*, 1 November 2018; St Vincent de Paul Society Victoria, *Jemena Gas Network Remittal Proposal*, 31 October 2018; Consumer Challenge Panel, *Jemena Gas Networks (JGN) 2015–20 Access Arrangement remittal proposal*, 1 November 2018.

For example, CCP10 stated:⁵¹

“CCP10 believes that the JGN proposal is in the long-term interest of their customers. The proposal involves JGN increasing their ME capex by a modest \$21 million and returning \$169 million of consumers’ money, consumers will benefit from:

- the certainty provided by the resolution of the proposed price path, with cross period smoothing;
- the removal of the risk for consumers from the re-opening of the contentious issues from the Federal Court decision, particularly in regard to debt costs;
- the return of \$169 million to consumers over the regulatory periods to 2025;
- ongoing focus on consumer engagement, building on the relationships that we observe have been strengthened by the discussions and transparency associated with developing this proposal; and
- a further demonstrable example of ‘AER 2.0’ being effectively applied.

It is our opinion that the benefits of this proposal significantly outweigh the costs (including ME capex increase), in aggregate, for consumers from this proposal...”

Our position on JGN’s proposed amendments to the tariff variation mechanism for pass throughs⁵² it has not yet recovered in the 2015–20 access arrangement period is presented in section 5.4.1.

Overall, we consider that JGN’s Proposal, which is \$358.6 million (\$ nominal) less than what it proposed in its February 2015 revised access arrangement proposal, represents an efficient level of expenditure necessary for it to provide safe and reliable natural gas services to its consumers. As we discussed in section 5.1.2, the approach we have applied in this remade draft decision involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of JGN’s network that is in the long-term interests of consumers. In other words, the long-term interests of consumers are served by us identifying how the level of natural gas services delivered by JGN so far during the 2015–20 access arrangement period may be done at least cost to the consumer.

⁵¹ Consumer Challenge Panel, *Jemena Gas Networks (JGN) 2015–20 Access Arrangement remittal proposal*, 1 November 2018.

⁵² Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

5.3 Remaking the market expansion capex and return on debt constituent decisions

The Tribunal's directions that we are to comply with in remaking our decision for JGN are as follows:⁵³

- “(a) the AER is to make the constituent decision on debt having regard to the position of Jemena Gas Networks (NSW) Ltd in its Revised Regulatory Proposal concerning the trailing average approach in accordance with the reasons for this determination;
- ...
- (c) the AER is to make the constituent decision on capital expenditure in accordance with the reasons for determination, including by reference to the current and ongoing contractual rates known, and accepted by the AER to be, prudent and efficient; and
- (d) the AER is to consider, and to the extent to which it considers appropriate, to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 28(1)(b) of the National Gas Law in the light of such variations as are made to the Final Decision by reason of (a)–(c) hereof.”

The rules in the NGR and provisions in the NGL that govern our assessment of capex and debt remain unchanged on remittal.

In the following sections, we set out our remade constituent decisions for market expansion capex and the cost of debt.⁵⁴

5.3.1 Capital expenditure constituent decision

This section discusses our draft decision on JGN's capex for the 2015–20 access arrangement period, made in accordance with the Tribunal's orders.

5.3.1.1 The Tribunal's decision

On 3 March 2016, the Tribunal handed down its decision.⁵⁵ The Tribunal's concerns with our 2015 final decision on JGN's capex for 2015–20 specifically referred to our assessment of Market Expansion (ME) capex.

ME capex, also known as connections capex, refers to capex associated with the connection of new customers to the distributor's gas network. Gas distribution businesses have a regulatory obligation to connect residential and commercial/industrial customers to the distribution network upon request. Capex associated with connecting customers to the distribution network generally includes the cost of new mains where required, gas service

⁵³ *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*. Note direction (b) is omitted following the Court's decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80, [738]–[784].

⁵⁴ At the same time as releasing this remade draft decision, we have released a separate draft adjustment determination for JGN that has relevance to both 2015–20 and 2020–25 access arrangement periods. See AER, *Draft decision, JGN adjustment determination*, January 2019.

⁵⁵ Australian Competition Tribunal, *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5*, 3 March 2016, p. 2.

pipe from the mains to the meter (services), and the meter. As connecting customers is a regulatory obligation, we consider that ME capex is justifiable under r. 79(2)(c)(iii) of the NGR.

We allowed ME capex of \$285.6 million (unescalated direct costs, \$2014–15) in our 2015 final decision. This was \$82.4 million (or 22 per cent) lower than JGN's February 2015 revised proposal of \$368.0 million (unescalated direct costs, \$2014–15).⁵⁶ In making our 2015 final decision, we were not satisfied that the model used by JGN to arrive at its ME capex forecast produced the best estimate. We used an alternative model to arrive at our ME capex estimate.

The ME capex approved in our 2015 final decision is around 22 per cent lower than JGN's proposed ME capex, driven by:

- our estimate of forecast new connections, which was lower than JGN's forecast
- the application of historical unit rates rather than the unit rates contained in JGN's connections model
- not including JGN's proposed additional expenditure for non-routine connections.⁵⁷

In June 2015, JGN sought review by the Tribunal of our "ME capex decision, by which the AER:

- did not approve the ME capex forecast produced through the use of the JGN unit rate derivation model...and
- instead approved its own proposal to adopt an ME capex forecast...produced by its own, alternative model."⁵⁸

The Tribunal found that our 2015 final decision to use an alternative model to arrive at our ME capex estimate was not in error.⁵⁹ However, the Tribunal determined that we were not entitled "to give no real weight to the acknowledged change in contractual arrangements after 1 July 2013."⁶⁰ It considered that "it is appropriate for the AER to have the opportunity to reconsider its ME capex."⁶¹

⁵⁶ AER, *Final decision—Jemena Gas Networks (NSW) Ltd access arrangement 2015–20, Attachment 6: Capital expenditure*, June 2015, p. 6-9.

⁵⁷ *Ibid*, p. 6-22.

⁵⁸ JGN, *Jemena Gas Network submissions on framework issues, return on debt and market expansion capital expenditure*, August 2015, [257].

⁵⁹ Australian Competition Tribunal, *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5*, 3 March 2016, [165].

⁶⁰ *Ibid*, [177].

⁶¹ *Ibid*, [187].

5.3.1.2 JGN's proposal

JGN has proposed an additional allowance of \$21 million (unescalated costs, \$2019–20) for ME capex compared with our 2015 final decision. JGN notes this is “consistent with the outcome reached by the AER and CCP10”⁶², in reference to the roundtable meeting held on 18 January 2018 between JGN, CCP10 and the AER where we outlined our preferred approach to remaking the ME capex decision.⁶³

5.3.1.3 Our draft decision

Our remade decision for ME capex and the constituent decision on capex is presented below. In coming to our position, we worked extensively with JGN to understand its assumptions and worked through any issues as they arose. We provided JGN with the opportunity to give feedback on our ME capex model to ensure that our methodology was transparent. For example, on 18 January 2018 we hosted a roundtable meeting with JGN and CCP10, the purpose of which was to share each party's views and to explain how we have arrived at our preliminary remade ME capex decision.⁶⁴ At the meeting, we put forward our preliminary estimate for our remade decision on ME capex. JGN noted that it had reviewed our model and agreed that it implemented our preferred approach. Our ME capex model forms the basis for JGN's proposed uplift to ME capex for this remittal.

Market expansion capital expenditure draft decision

We accept JGN's proposed uplift to ME capex of \$21 million (unescalated direct costs, \$2019–20) for the 2015–20 access arrangement period, compared with our 2015 final decision.⁶⁵

As summarised in Table 5-1, this brings JGN's allowance for ME capex to \$344.5 million (unescalated direct costs, \$2019–20), representing a 6 per cent increase from our 2015 final decision of \$323.9 million (unescalated direct costs, \$2019–20). We consider JGN's proposed ME capex as conforming capex for the 2015–20 access arrangement period and include this amount in our remade decision.⁶⁶

The increase in ME capex compared with our 2015 final decision reflects an adjustment to the contractor rates which form a part of the historical unit rates used to estimate JGN's ME capex requirement for 2015–20. Our remade decision gives full weight to JGN's contractual arrangements after 1 July 2013, in accordance with the Tribunal's decision. Furthermore, it represents the best possible forecast in the circumstances, conforms to the capex criteria and is likely to contribute to the achievement of the NGO.⁶⁷

⁶² JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 4.

⁶³ AER, *AER presentation – JGN capex remittal roundtable – 18 January 2018*, 18 January 2018.

⁶⁴ Presentations made by JGN, CCP10 and AER at the 18 January 2018 roundtable meeting are available on the AER website. See <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20-remittal/initiation>

⁶⁵ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 4.

⁶⁶ NGR, r. 79(1).

⁶⁷ NGR, rr. 74 and 79; and NGL, s. 28(1).

In remaking our decision, we also had regard to new information available and consequently made adjustments to our treatment of non-routine connections, Metreteks and meter data loggers, and corrected two minor modelling errors. These are discussed in section 5.3.1.4.1.

Our remade decision on capex impacts JGN's revenue requirement for the 2015–20 access arrangement period and consequently its tariffs for reference services. We have adjusted these aspects of the access arrangement accordingly. This capex decision does not affect any other constituent components of the 2015–20 access arrangement final decision.⁶⁸

Table 5-1 JGN remade draft decision on ME capex for 2015–20 compared to set aside 2015 final decision (unescalated direct costs, \$million, 2019–20)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
2015 final decision	71.3	68.0	64.8	61.5	58.3	323.9
Remade draft decision	75.8	72.4	68.9	65.4	62.0	344.5
Difference	4.5	4.3	4.1	3.9	3.7	20.6
Percentage difference (%)	6	6	6	6	6	6

Source: AER analysis.

Notes: (a) Excluding AER material and labour escalation adjustments.

(b) Totals may not add due to rounding.

Constituent decision on capital expenditure

Our remade draft decision for JGN allows \$1,107.5 million (escalated costs, \$2019–20) for net total capital expenditure (capex). This is an increase of \$21.9 million⁶⁹, or 2 per cent, from our 2015 final decision of \$1,085.6 million (escalated, \$2019–20). Our remade draft decision for capex by category is shown in Table 5-2.

⁶⁸ NGL, s. 28(1)(b)(ii).

⁶⁹ This figure includes the effect of cost escalation, which is consistent with our 2015 final decision model.

Table 5-2 JGN remade draft decision on capex for 2015–20 (escalated costs, \$million, 2019–20)

Category	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Connections/Market expansion	76.5	73.4	70.3	67.3	64.3	351.7 [^]
Augmentation/Growth capacity	19.5	19.8	24.6	19.5	13.9	97.3
Mains and service renewal	13.9	18.0	14.0	9.7	11.0	66.7
Facilities renewal and upgrade	25.3	21.3	22.6	23.1	18.6	110.8
SCADA	1.5	3.0	3.1	2.4	0.8	10.9
Meter renewal and upgrade	33.7	35.3	35.9	34.4	31.7	171.0
Government authority work	0.6	0.6	0.6	0.6	0.6	2.9
IT	48.2	34.5	37.2	20.8	12.0	152.7
Other - non-distribution	8.2	3.6	4.5	8.3	5.3	30.0
TPC/FEED	-	-	-	-	-	-
Overheads	27.6	27.1	27.6	27.0	26.3	135.5
GROSS TOTAL CAPITAL EXPENDITURE	256.7	237.0	240.4	213.0	184.6	1,131.6
Contributions	6.2	4.7	4.2	4.1	4.0	23.1
Asset disposals	0.1	0.1	0.2	0.3	0.2	0.9
NET TOTAL CAPITAL EXPENDITURE	250.4	232.3	236.0	208.5	180.4	1,107.5

Source: AER analysis.

Note: Totals do not add up as JGN claimed confidentiality over mines subsidence and related party margin expenditure.

[^]This table presents our remade draft decision in escalated cost terms. The cost escalators are consistent with the ME capex final decision model.

5.3.1.4 Methodology and reasons for our draft decision

Components of ME capex

The majority of ME capex relates to connecting residential and smaller commercial and industrial customers to the network (Tariff V connections). ME capex also includes larger commercial and industrial customer connections (Tariff D connections) and major market expansion projects (MME projects).⁷⁰ The Tribunal's orders to adjust the ME capex contractor rates only relate to Tariff V connections.

⁷⁰ JGN defines Tariff V customers as those consuming less than 10TJ of gas per year, and Tariff D customers as those consuming more than 10TJ of gas per year.

Methodology

To arrive at our remade decision for ME capex, we calculated JGN's Tariff V ME capex by multiplying Tariff V historical unit rates with mains/services/meters volumes per connection and forecast number of connections. This approach is consistent with the methodology we used in our 2015 final decision. Unlike that decision, we have adjusted the historical Tariff V unit rates to account for the current and ongoing contractor rates. When calculating the Tariff V unit rates, we had regard to additional material not available at the time of the 2015 final decision. No changes were made to the Tariff D or MME projects allowances from our 2015 final decision, as JGN did not dispute these elements of ME capex.

Historical cost approach

We have used the historical cost approach in remaking our decision, giving consideration to the past performance of a gas business. Under the ex-ante regime, gas businesses are rewarded for spending less capex than allowed by the regulator. This incentive enables us to place some reliance on the historical costs of a gas business when reviewing its forecast capex. We used historical costs and mains/services/meters volumes per connection as an indicator of efficient costs and volumes for JGN's ME capex. This is the same approach that we adopted for our assessment of ME capex in our 2015 final decision.

The historical cost approach is an accepted industry practice. Many gas businesses, including JGN, have used this approach as a basis to forecast expenditure proposals. We have also used this approach previously in our assessment of access arrangement proposals for the Victorian gas businesses.

Current and ongoing contractor rates

In accordance with the Tribunal's directions, we have had regard to JGN's current and ongoing contractor rates in remaking our decision on ME capex. The disputed contractor rates specifically related to contractor work for Tariff V mains and services. These components make up the majority of Tariff V connections expenditure.

In July 2013, Zinfra Pty Ltd⁷¹ was awarded JGN's southern region contract with the condition that pricing was to match or better the Northern Region tender outcomes (for the same scope of works).⁷² We reviewed the tender documents, the tender assessment and the decision to award the four contracts. In our 2015 draft decision, we noted that:

"We are satisfied that this was a competitive tender process. As it was a competitive tender price, we are satisfied that the unit rates established in the contracts reflect competitive unit rates prevailing in the market. On this basis we are satisfied that the unit rates drawn from these contracts which form the basis of estimates used in JGN's proposed capex are efficient [under NGR r. 71(1)]."⁷³

⁷¹ Zinfra is owned by JGN's ultimate Australian holding company, SGSP (Australia) Assets Pty Ltd, and is therefore a related party to JGN.

⁷² JGN, *Jemena Gas Network submissions on framework issues, return on debt and market expansion capital expenditure*, [284(b)].

⁷³ AER, *Draft decision—Jemena Gas Networks (NSW) Ltd access arrangement 2015–20, Attachment 6: Capital expenditure*, November 2014, p. 6-47.

Consequently, to fulfil the Tribunal’s directions we have adjusted the Tariff V unit rates in our remade decision to reflect the difference between the current and ongoing contractor rates, and the rates that were used for the 2015 final decision (being the average contractor rates over the five years to 2013–14).⁷⁴

5.3.1.4.1 Adjustments to Tariff V ME capex allowance for the remade decision

This section sets out our approach to adjusting Tariff V ME capex for this remade decision.

Tariff V adjustments

Tariff V connections expenditure makes up over 90 per cent of total ME capex and over 99 per cent of the total number of new connections. Our estimate of Tariff V connections expenditure is based on a five-year (2009–10 to 2013–14) historical average of Tariff V connections unit rates and mains/services/meters volumes per connection. The contractor component of the five-year average unit rates were adjusted to reflect the current and ongoing contractor rates.

To calculate the total Tariff V connections expenditure for each customer category, we multiplied the forecast number of new connections by the five-year average unit rates and mains/services/meters volumes per connection. This resulted in forecast Tariff V expenditure of \$333.8 million (unescalated direct costs, \$2019–20). Table 5-3 shows our approved Tariff V expenditure by customer category, and our remade draft decision on ME capex.

Table 5-3 JGN remade draft decision on ME capex for 2015–20, by connection type (unescalated direct costs, \$million, 2019–20)

Connection type	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tariff V	73.6	70.3	66.8	63.3	59.9	333.8
Residential	66.7	63.1	59.4	55.8	52.1	297.1
I&C volume	6.9	7.1	7.3	7.6	7.8	36.7
Tariff D and MME projects	2.2	2.1	2.1	2.1	2.1	10.7
Total ME capex	75.8	72.4	68.9	65.4	62.0	344.5

Source: AER analysis.

Notes: (a) Excluding AER material and labour escalation adjustments.

(b) Totals may not add due to rounding.

Forecast Tariff V new connections numbers

To calculate JGN’s ME capex allowance, we relied on the forecast number of new connections that we used in our 2015 final decision.

As JGN is regulated under a price cap⁷⁵, its tariffs have been set with respect to forecast gas demand and number of new connections that was applied in the 2015 final decision. Under a

⁷⁴ For the final decision, we calculated Tariff V expenditure by multiplying historical five-year average unit rates with forecast connection numbers. A major component of these unit rates was the contractor rates.

⁷⁵ More accurately, the tariff variation mechanism that applies to JGN in the 2015–20 AA is the tariff basket price control.

price cap, the service provider's revenues are determined by the product of its tariff structures and the quantity demanded under each element of that tariff structure. Price caps are determined with respect to the expected volume of gas demand as forecast at the start of the regulatory period. As such, we determined the maximum tariffs that could be charged to consumers in the 2015 final decision.

Where the actual demand is lower than forecast demand, a service provider can earn a lower revenue than originally forecast. Conversely, the service provider can earn higher revenue where actual demand is higher than the forecast demand on which the price cap has been set.

Additional changes to the Tariff V estimate compared with our 2015 final decision

Based on further information we received from JGN throughout the remittal process, we have made changes to our approach to non-routine costs, Metreteks and meter data loggers (MDLs) from our 2015 final decision. We have also identified and amended calculation errors that impacted our 2015 final decision ME capex allowance. Collectively, these changes have resulted in an increase of approximately \$6 million compared with our 2015 final decision, as discussed below.

- *Non-routine connections* — Non-routine costs are associated with connections requiring non-standard works, such as night works and horizontal drilling. In our 2015 final decision, we did not accept JGN's proposal for non-routine connection costs, as we considered these costs should be recovered via contribution from the requesting customer, to the extent that the costs are incremental to a routine, basic or standard connection.⁷⁶ In its submission to the Tribunal, JGN stated that we had conflated two issues – non-routine connections and connections warranting customer contributions – each of which is distinct.⁷⁷ JGN classifies 'routine' and 'non-routine' connections based on the kind of activities performed to undertake each connection, as distinct from works where customer contributions apply (that is, those high-cost connections where costs are not expected to be fully recovered through future revenue). We accept that these costs should have been included in the estimate of Tariff V expenditure in our 2015 final decision. As a result, as part of this remade decision, we have included these components in our calculation of Tariff V unit rates.
- *Metreteks and meter data loggers (MDLs)* — These are metering data logging and associated equipment primarily used in medium-high density housing and industrial and commercial customers, respectively. In our 2015 final decision, we did not accept what appeared to be a step-change in JGN's 2013–14 data. These expenditure items were added as new line items in its regulatory information notice. We considered that these costs were already included in the 2013–14 Tariff V unit rates, as they had been for the unit rates from 2009–10 to 2012–13.⁷⁸ JGN stated in its submission to the Tribunal that these costs had been separated out of the unit rates and volumes for 2013–14, and were

This is the same as a 'weighted average price cap'.

⁷⁶ NGR, r. 119M.

⁷⁷ JGN, *Jemena Gas Network submissions on framework issues, return on debt and market expansion capital expenditure*, [344(b)].

⁷⁸ AER, *Final decision—Jemena Gas Networks (NSW) Ltd access arrangement 2015–20, Attachment 6: Capital expenditure*, June 2015, p. 6-28.

not otherwise included in the other unit rates for meters, mains or services.⁷⁹ We accept that these costs should have been included in the estimate of Tariff V expenditure in our 2015 final decision. As a result, as part of this remade decision, we have included these components in our calculation of Tariff V unit rates and have confirmed that these costs are not double-counted in the historical data.

- *Amendments to formulas* — We have identified and amended two calculation errors that impacted on our estimate of Tariff V expenditure in our 2015 final decision. These errors affected the calculation of labour and material escalation for electricity to gas services, and the calculation of meters unit rates for Tariff V industrial and commercial customers.

5.3.2 Return on debt constituent decision

The allowed rate of return provides a network service provider a return on capital that a benchmark efficient entity would require to finance (through debt and equity) investment in its network.⁸⁰ The return on capital building block is calculated as a product of the rate of return and the value of the regulatory asset base (RAB). The rate of return is discussed in this section.

JGN's revenue Proposal has implicitly adopted our return on capital allowance that we set in our 2015 final decision (with minor updates for updated return on debt data). This was based on a transition to a trailing average methodology for calculating the return on debt.

Since our 2015 final decision, having regard to the decisions of the Tribunal and Court, we have revised our general approach to determining the return on debt. We now apply a revenue neutral transition when moving from the on-the-day methodology for estimating the cost of debt to a trailing average methodology. The basis for this revenue neutral transition is discussed in more detail later.

While our approach, and the reasoning to support it, has changed since the 2015 final decision, the revenue outcome of our new approach is approximately the same as in that decision.⁸¹ JGN's Proposal is consistent with our new approach to determining the return on debt.

The revised rate of return allowance for this remade draft decision is set out in Table 5-4. These numbers reflect our 2015 final decision with respect to the return on equity and the gearing ratio and a revenue neutral transition calculated using partially updated debt yield data from the Reserve Bank of Australia (RBA)⁸² and fully updated data from Bloomberg. The RBA data has been updated for the pre 5 June 2018 RBA revisions only, due to the unique circumstances described in section 5.3.2.5. They also reflect the debt averaging periods we determined to use in our 2015 final decision.

⁷⁹ Australian Competition Tribunal, *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5*, [352].

⁸⁰ The term 'network service provider' relates to service providers that provide gas and electricity transmission and distribution services.

⁸¹ We note a very small change in revenue occurs due to the use of updated debt yield data (pre 5 June 2018 updates).

⁸² Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3*, 4 July 2018.

Table 5-4 JGN remade draft decision return on debt and return on capital (\$million, nominal) and percentage debt portfolio rate of return⁸³

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Draft decision debt portfolio rate of return	4.27%	4.39%	4.47%	4.50%	4.50%	
Draft decision return on debt	76.42	82.60	87.68	91.76	94.40	432.9
Draft decision return on capital	167.02	177.45	186.62	193.82	198.62	923.5

5.3.2.1 The NGR requirements

In the case of this remittal, we must determine a rate of return such that it achieves the allowed rate of return objective (ARORO).⁸⁴ The ARORO is that the rate of return is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of its regulated services (its reference services in the case of gas service providers).⁸⁵ Therefore, each remade debt decision must contribute to achieving the ARORO.

Other legislative requirements relevant to remaking our debt decision include the NGO, the RPP and any interrelationships with other related components of an access arrangement determination. The NGO is relevant because we are required to make an access arrangement determination that will, or is likely to, contribute to the achievement of the NGO to the greatest degree.⁸⁶ The RPP are relevant because we must take them into account in exercising this type of decision-making power.⁸⁷ We must also take into account any interrelationships between our remade debt decision and any other related component of an access arrangement determination.⁸⁸

⁸³ These numbers reflect the final decision including annual debt updates using data prior to the 5 June 2018 RBA update.

⁸⁴ NGR s 87(2).

⁸⁵ NGR s 87(3).

⁸⁶ NGL, ss. 23 and 28(1)(b)(iii)(A).

⁸⁷ The RPP that are directly relevant to remaking our debt decision are set out at NGL, ss. 24(2), 24(3), 24(5), 24(6) and 24(7).

⁸⁸ NGL s 28(1)(b)(ii).

5.3.2.2 The Tribunal's decision

On 26 February 2016, the Tribunal handed down its decisions.⁸⁹ The Tribunal instructed us to remake the constituent decision on the return on debt in relation to the introduction of the trailing average in accordance with the Tribunal's reasons for its decisions without giving a clear clarification of the directions for the remittal.⁹⁰ The Tribunal found us in error in our definition of a benchmark efficient entity as a "regulated" entity. The Tribunal also found us in error in our construction of NGR rule 87, based on the information available to the Tribunal at that time.

5.3.2.3 Judicial Review

On 24 March 2016, we applied to the Federal Court for judicial review of the Tribunal's decisions. On 24 May 2017, the Court dismissed our appeal on the return on debt and upheld the Tribunal's decisions in relation to this issue. It upheld the AER's appeal in relation to the value of imputation credits (gamma).⁹¹

We have carefully considered the full reasoning of the Court in considering what to do to achieve the ARORO, NGO and RPP in this decision. Of relevance, in relation to the Court's decision the Court clarified that:

- a benchmark efficient entity is not necessarily either regulated or unregulated
- the important characteristic of a benchmark efficient entity is that it has a similar degree of risk to the service provider with respect to the provision of its regulated services
- a change in debt estimation methodology does not necessarily result in any impacts for a benchmark efficient entity

In relation to both the decisions of the Tribunal and Court, we also make the following observations:

- The decisions of the Tribunal and Court were not focussed on the interpretation of "efficient financing costs" in the ARORO. We consider this to be an important factor.
- Neither decision removes the requirement to apply a debt methodology that we consider will achieve the relevant legislative objectives for each of the respective service providers affected by the remittals.
- Neither decision requires the use of a trailing average methodology for determining the cost of debt in this remittal.

In subsequent decisions involving other parties, the Tribunal and Full Federal Court have made various findings and comments which are also relevant to these matters. In particular, both the Tribunal and Federal Court have made comments about our new approach to

⁸⁹ *Applications by Jemena Gas Networks (NSW) Ltd* [2016] ACompT5; *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1.

⁹⁰ *Applications by Jemena Gas Networks (NSW) Ltd* [2016] ACompT5; *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1,

⁹¹ *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79; *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80.

estimating the return on debt that help to clarify how the Tribunal's decision for JGN should be interpreted.⁹² This is discussed in more detail below.

5.3.2.4 Other relevant legal processes

Other legal decisions that we have had regard to in our remade draft decision are:

- the decision of the Australian Competition Tribunal for SA Power Networks and the subsequent decision of the Full Federal Court on the appeal of this decision⁹³
- the decisions of the Australian Competition Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd⁹⁴

The decisions of the Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd are particularly important as they are directly concerned with the application of our new approach to estimating the return on debt.

After the Tribunal handed down its decisions for JGN, we reconsidered our approach to debt estimation methodology. The new approach, which we adopted in our decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks, does not rely upon a conceptualisation of a benchmark efficient entity as a regulated entity. It recognises that different service providers may have a different benchmark efficient entity. The new approach also does not rely on a change in methodology impacting a benchmark efficient entity to justify our revenue neutral transition. Our new approach does not rely upon an assessment of historical financing practices. Instead, it considers the efficient financing costs (being the costs of equity and debt) in a forward looking manner. Our new approach was subject to review by the Tribunal.

The Tribunal upheld our new approach. It explained more clearly how each of the Tribunal's and Court's decisions should be read together consistently. It provided clarification for the earlier Tribunal's decision on the directions of the Tribunal for the remittal that were previously unclear to us. We consider these decisions support a revenue neutral transition when moving to a trailing average methodology based on our new approach, or the continuance of an on-the-day methodology for determining the cost of debt, to achieve the NGO.

An important aspect of the decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd is the consideration in those decisions of the interpretation of the "allowed rate of return objective" (or ARORO) and the meaning of "efficient financing costs".⁹⁵ We consider these decisions support our ex ante interpretation of efficient financing costs. These decisions and our view on them are covered in further detail in our debt Position Paper on our remitted debt decisions.⁹⁶

⁹² See, for example, *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3 at [295].

⁹³ *Application by SA Power Networks* [2016] ACompT 11; *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

⁹⁴ *Application by ActewAGL Distribution* [2017] ACompT 2.

⁹⁵ *Ibid.*

⁹⁶ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015–20 (NSW) Access Arrangement*, December 2017.

On 18 January 2018, the Full Federal Court handed down its decision on *SA Power Networks v Australian Competition Tribunal*.⁹⁷ This was a review brought by SA Power Networks from a decision of the Tribunal.⁹⁸ The Full Federal Court noted that the Court had not had the benefit of hearing a number of issues in relation to JGN's review that had been subsequently put to it in *SA Power Networks v Australian Competition Tribunal*. In particular, the Court stated:

"We would add that the present proceeding has raised a number of issues that were not advanced by the parties in *AER v Australian Competition Tribunal* [i.e. the JGN case]. The Full Court's observation at [572] of *AER v Australian Competition Tribunal* that there were no impacts in the form of hedging contracts that needed to be unwound was made in the context of the facts of that case and the submissions that were advanced by the parties at that time. No wider consideration of the possible 'impacts' of a change in methodology to estimate the return on debt was advanced or addressed. We do not regard *AER v Australian Competition Tribunal* as in any way confining the 'impacts' to which the AER might have regard when applying r 6.5.2(k)(4)."

We consider this Full Federal Court decision also supports our new revenue neutral debt transition approach which we propose to apply in this remitted debt decision.

5.3.2.5 Our approach to debt in this remitted debt decision

In remaking our debt decision, we are moving to a trailing average approach to estimating the return on debt from our previous on-the-day methodology. We will apply a revenue neutral transition in moving to this methodology. As noted by the Tribunal in its decision for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd, our revenue neutral transition is effectively a combination of the on-the-day methodology and trailing average methodology.

Our approach follows the same general approach we have applied in other revenue determinations since the Full Federal Court decision, although there are two issues that we wish to clarify which are explained below.

The first is that we have used updated Bloomberg debt series data and partially updated RBA debt data (as available prior to 5 June 2018) when making our calculations.⁹⁹ The RBA has made three changes to its yield curve estimates over the relevant period and Bloomberg has removed a period of data from publication. Given the timing of the third RBA update and the remittal process discussed further below, we have used data reflecting the Bloomberg update and the first two RBA updates in making this draft decision.

The most recent round of RBA data updates were published on 5 June 2018, and involved a back-casting of yield curve estimates covering the 2015–20 period.¹⁰⁰ We understand a

⁹⁷ *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

⁹⁸ *Application by SA Power Networks* [2016] ACompT 11.

⁹⁹ We note that while our application of a revenue neutral transition to a trailing average is mathematically the same as our 2015 final decision, our reasoning has changed and is entirely based on the reasoning as set out in our APA VTS final decision.

¹⁰⁰ Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3*, 4 July 2018.

primary driver of the update was to reflect improvements in the methodology used by the RBA to convert bonds issued in US dollars into Australian dollar-equivalent terms.

We consider that, on balance, it would not be in the long-term interests of consumers to apply the 5 June 2018 RBA debt update at this time, given the particular circumstances before us.

As noted in section 5.1.1, the approach we have applied in remaking this draft decision has necessarily been influenced by the circumstances that we face now. They are materially different from those that we faced when we made our 2015 final decision, and what we would generally face in making an access arrangement determination. For example, this is highlighted by the fact that we are nearly four years into the applicable five-year 2015–20 access arrangement period. We note that the updated RBA data was not been applied in our other (electricity) remade decisions covering the 2014-19 regulatory control period for Essential Energy, Endeavour Energy, Evoenergy and Ausgrid.

Stakeholders have told us they would like regulatory certainty and resolving the outstanding remittals in a timely manner will provide this certainty. Certainty is of benefit to both consumers and the network businesses and, therefore, will contribute to the NGO. To a large degree, this explains the concerted effort by all parties during pre-lodgement discussions (in all the remittals) to agree the key financial parameters which, in turn, could be developed into a proposal by the relevant network business (in this case, JGN) and put to us for consideration and further stakeholder consultation under the regulatory determination process.

In summary, given the novel circumstances, the late timing of the 5 June 2018 RBA data update, the good faith in which parties have sought resolution of the remittal, and the broad stakeholder support for JGN's Proposal, on balance, we consider that not applying the updated RBA data (as updated on 5 June 2018) to this remade draft decision is the outcome that contributes to the NGO to the greatest degree. We will consider all stakeholder submissions received on this issue, and other issues more generally, before publishing our final decision.

The second issue relates to JGN's proposal to use the year 4 portfolio estimate for year 5 of the access arrangement period when calculating the return on debt. While we have accepted the outcome of this proposal in setting relevant tariffs for the final year of the access arrangement period, we wish to clarify that the trailing average debt will continue to be calculated on the basis of the applicable averaging period for the 2020 regulatory year. That is, for the purposes of calculating the trailing average cost of debt in future regulatory years, we will estimate the rate of return on debt for the 2020 regulatory year based on the debt averaging period that has been accepted for that regulatory year.

5.3.2.6 Stakeholder submissions on our cost of debt Position Paper

On 21 December 2017, we published a cost of debt Position Paper.¹⁰¹ It set out our proposed approach to our remitted debt decision. On 22 January 2018, we published links to the decision of the Full Federal Court in *SA Power Networks v Australian Competition Tribunal (No 2) [2018] FCAFC 3* and invited interested parties to comment on the decision and/or our view that it supported our proposed position to the remitted debt decisions in their submissions to our debt Position Paper. All parties to the Tribunal litigation were notified of the debt Position Paper and the Full Court's decision via email on 21 December 2017 and 22 January 2018, respectively.

In response to our debt Position Paper, we received submissions from CCP10¹⁰², Evoenergy¹⁰³, JGN¹⁰⁴, PIAC¹⁰⁵ and ECA¹⁰⁶. We have had regard to these submissions in making this draft decision.

5.3.2.7 Reasons for our draft decision

For the reasons set out in our debt Position Paper¹⁰⁷ on our remitted debt decisions and in our APA VTS final decision, we consider a revenue neutral transition to a trailing average debt estimation methodology will lead to an allowed rate of return that will achieve the ARORO and contribute to the achievement of the NGO to the greatest degree. This rate of return will both reflect ex ante efficient financing costs and result in an approximately zero NPV investment outcome which is important to achieving efficient investment incentives. A revenue neutral transition will also substantially eliminate any wealth impact on JGN from changing the debt estimation methodology.

We rely on the reasoning in our APA VTS decision in making this draft decision for JGN as set out in Attachment 3 of our APA VTS determination.¹⁰⁸ This includes an explanation of how our approach has changed in response to relevant legal decisions. We also rely on our explanation and reasoning as set out in the debt Position Paper on our remitted debt decisions in making this draft decision.¹⁰⁹

In relation to the timing of the initial debt averaging period (for the commencement of the trailing average), we have used the initial averaging period set out in our 2015 final decision

¹⁰¹ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015–20 (NSW) Access Arrangement*, December 2017.

¹⁰² Consumer Challenge Panel, *Remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) access arrangement*, 23 February 2018.

¹⁰³ Evoenergy, *December 2017 Position Paper – Remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) access arrangement*, 23 February 2018.

¹⁰⁴ JGN, *AER Position Paper – Remitted debt decisions*, 23 February 2018.

¹⁰⁵ Public Interest Advocacy Centre, *Submission to position paper on NSW network debt remittals*, 23 February 2018.

¹⁰⁶ Energy Consumers Australia, *Submission to the remitted revenue determinations for NSW/ACT 2014-19 and Essential Energy proposal*, 6 March 2018

¹⁰⁷ *Ibid.*

¹⁰⁸ AER, *Final Decision APA VTS gas access arrangement 2018 to 2022, Attachment 3 - Rate of return*, November 2017. This decision discusses and applies substantively identical provisions for rate of return as those applicable to electricity distribution.

¹⁰⁹ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015–20 (NSW) Access Arrangement*, December 2017.

for the introduction of the trailing average. We also have used the debt averaging periods for years 2 to 4 of the access arrangement period, as set out in our 2015 final decision, because we consider these will lead to a rate of return that achieves the ARORO and contribute to the achievement of the NGO. All averaging periods were chosen in advance of their commencement and we consider their use should result in an ex ante efficient return on debt allowance. We consider choosing averaging periods after the periods have finished (or post commencement) is generally inappropriate due to the potential incentive on various stakeholders to advocate for averaging periods that give particular results. We have determined the final tariffs to apply in the final year of the access arrangement period in this determination despite the debt averaging period for the 2020 regulatory year not having commenced. However, as noted above, for the purposes of calculating the trailing average cost of debt in this access arrangement (and in future regulatory years under the Rate of return instrument), we will estimate the rate of return on debt for the 2020 regulatory year using the applicable averaging period for that year.¹¹⁰

We also consider our overall approach will lead to an overall allowed rate of return that will achieve the ARORO and contribute to achieving the NGO because:

- the return on equity we determined in our 2015 final decision was upheld on appeal as was the gearing ratio and we consider these values remain appropriate
- our combination of the yield from two debt series we used to estimate the return on debt in the 2015 final decision, a simple average of yields estimated from the Bloomberg and RBA yield curves, was upheld on appeal in the Tribunal and we consider remains appropriate
- we consider the overall allowed rate of return estimated using our return on debt, return on equity and gearing estimates will result in an allowed rate of return that will achieve the ARORO and contribute to achieving the NGO

As noted earlier, we have had regard to submissions received in response to our debt Position Paper in making this draft decision.¹¹¹

¹¹⁰ As accepted in our 2015 final determination and in accordance with the methodology for its calculation as set out in that determination

¹¹¹ AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015–20 (NSW) Access Arrangement*, December 2017.

5.4 Other aspects of the 2015 final decision to be varied

5.4.1 Reference tariff variation mechanism

In its remittal proposal, JGN proposed amendments to the tariff variation mechanism for pass throughs¹¹² it has not yet recovered in the 2015–20 access arrangement period.¹¹³ As we discuss below, we consider these proposed amendments are appropriate.

The reference tariff variation mechanism was not a subject of JGN’s appeal of our June 2015 final decision.¹¹⁴ However, if this remade draft decision becomes our final decision, the decision amends certain aspects of the reference tariff variation mechanism in the access arrangement for the 2015–20 access arrangement period.¹¹⁵

The Tribunal’s directions that we are to comply with in remaking our decision includes:¹¹⁶

- “(d) the AER is to consider, and to the extent to which it considers appropriate, to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 28(1)(b) of the National Gas Law in the light of such variations as are made to the Final Decision by reason of (a)–(c) hereof.”

During the appeal process, JGN entered into enforceable undertakings with the AER to set prices for the 2016–17 to 2018–19 regulatory years. The enforceable undertakings were interim arrangements that provided price stability, predictability and transparency while our 2015 final decision was under appeal. Given their interim nature, the enforceable undertakings did not account for the adjustments that would normally have occurred as part of the annual tariff variation process, such as pass throughs and licence fees.

Under normal circumstances, we would incorporate these factors into reference tariffs for 2019–20 through iterative calculations for each completed regulatory year of the access arrangement period.¹¹⁷ However, given the novel circumstances of the remittal, JGN has proposed amendments to the tariff variation mechanism that incorporates these factors into 2019–20 tariffs through a single calculation.¹¹⁸ JGN noted the calculation method in its Proposal results in a value that is closer to the “expected revenue” amount under its tariff variation mechanism compared to the calculation in the 2015–20 access arrangement.¹¹⁹

¹¹² Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

¹¹³ JGN, *2015–20 access arrangement remittal proposal*, October 2018, p. 4.

¹¹⁴ The reference tariff variation mechanism for JGN is the tariff basket price control (also known as a weighted average price cap).

¹¹⁵ See JGN, *Access arrangement: JGN’s NSW gas distribution networks: 1 July 2015 – 30 June 2020 (Incorporating revisions required by AER Final Decision 3 June 2015)*, June 2015, pp. 5–14 and schedule 3.

¹¹⁶ *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*.

¹¹⁷ These are the calculations we would have made in the annual tariff variation process had there been no appeal of our 2015 final decision.

¹¹⁸ JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, Appendix A.

¹¹⁹ JGN, *Email: Draft adjustments to the tariff variation mechanism in the Access Arrangement*, 27 November 2018.

We agree with JGN's assessment. The difference in expected revenues between the two calculation methods is immaterial and so does not provide JGN with any windfall gains or losses.

Further, JGN's calculation method in its Proposal is administratively simpler as it is a single calculation, rather than an iterative one.

5.4.2 Annual Variation Notice submission date

JGN has proposed to amend clause 3.6(a) of the access arrangement such that JGN would submit the Variation Notice for the 2019–20 regulatory year on or before 15 April 2019, rather than 15 March 2019.¹²⁰

We consider this extension to the submission date is reasonable. This is because the timing of our remade final decision and final decision adjustment determination (scheduled for 28 February 2019) introduces time constraints on the development of the 2019–20 Variation Notice.

¹²⁰ JGN, *2015–20 access arrangement remittal proposal*, October 2018, p. 7.

Appendix A

Background on our remade draft decision

Under the National Gas Law (NGL), JGN must submit revisions to its access arrangement to the AER for approval.¹²¹ The central component of JGN's proposal is the amount of revenue it proposes to recover from consumers over a five-year access arrangement period.¹²² We must assess JGN's proposal under the National Gas Rules (NGR) and decide whether to accept JGN's proposal or substitute an alternative amount of revenue that we are satisfied complies with NGR requirements.

On 3 June 2015, we published our final decision on JGN's access arrangement for the 2015–20 access arrangement period. In response, JGN sought merits review of our final decision.

On 26 February 2016, the Australian Competition Tribunal (Tribunal) handed down its decisions on the limited merits review of the AER's NSW and ACT electricity distribution determinations and JGN's gas access arrangement final decision. The Tribunal set aside our determinations for these businesses and remitted our decisions to us to be remade.¹²³

On 24 March 2016, we applied to the Full Federal Court (Court) for judicial review of the Tribunal's decisions. The Court upheld our appeal regarding gamma, but dismissed other aspects including our decisions on return on debt, and aspects of JGN's capital expenditure. As a result, in terms of JGN, we were tasked with revisiting our decisions on return on debt and aspects of JGN's capital expenditure.

The remittal task – remaking our 2015 final decision for JGN

Following the Court's decision, the Tribunal's directions that we are to comply with in remaking the decision are as follows:¹²⁴

“(a) the AER is to make the constituent decision on debt having regard to the position of Jemena Gas Networks (NSW) Ltd in its Revised Regulatory Proposal concerning the trailing average approach in accordance with the reasons for this determination;

...

(c) the AER is to make the constituent decision on capital expenditure in accordance with the reasons for determination, including by reference to the current and ongoing contractual rates known, and accepted by the AER to be, prudent and efficient; and

¹²¹ NGL, s. 132.

¹²² NGR, r. 72(1)(m).

¹²³ In accordance with its orders regarding return on debt; imputation credits (gamma); and aspects of JGN's capital expenditure.

¹²⁴ *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*. Note direction (b) is omitted following the Court's decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 3) [2017] FCAFC 80, [738]-[784]*.

- (d) the AER is to consider, and to the extent to which it considers appropriate, to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 28(1)(b) of the National Gas Law in the light of such variations as are made to the Final Decision by reason of (a)–(c) hereof.”

Enforceable undertakings provided by JGN

During the time the appeals process was underway, it was not clear what network charges should apply. Neither the Tribunal or Court’s decisions, nor the NGR, provided an unambiguous way forward. To address the considerable uncertainty and provide price stability and transparency for consumers, retailers and JGN, we entered into enforceable undertakings with JGN.

In May 2016, we entered into an enforceable undertaking with JGN to establish gas distribution reference tariffs for the 12-month period commencing 1 July 2016 (2016–17). As a result, JGN’s reference tariffs were kept constant in nominal terms.

In May 2017, we entered into an enforceable undertaking with JGN to establish gas distribution reference tariffs for the 12-month period commencing 1 July 2017 (2017–18). This provided for real price reductions of 7 per cent, on average, to JGN’s gas reference tariffs, consistent with the control mechanism and the X-factor for 2017-18 from our 2015 final decision.

In April 2018, we entered into an enforceable undertaking with JGN to establish gas distribution reference tariffs for the 12-month period commencing 1 July 2018 (2018–19). This provided for real price reductions of 5.4 per cent, on average, to JGN’s gas reference tariffs, representing a greater price reduction for 2018-19 than required in our 2015 final decision (which included an X-factor of 4.9 per cent for 2018–19)

As a result of the enforceable undertakings that JGN entered into with the AER to set tariffs for the 2016–17, 2017-18 and 2018–19 regulatory years, there is potential for revenue collected by JGN through undertakings to differ, perhaps significantly, from the revenue it would be entitled to under the remade determination. If so, this could cause significant fluctuation in reference tariffs between the remaining years of the 2015–20 access arrangement period, at the time of the appeals, and the first year of the 2020-25 access arrangement period.

JGN thus submitted a rule change request to the Australian Energy Market Commission (AEMC) to provide a mechanism to minimise potential price volatility for its customers that may occur as a result of the appeals and remittal decision.¹²⁵ On 30 August 2018, the AEMC published its gas revenue smoothing final rule which provides such a mechanism.¹²⁶ The rule allows us to let JGN recover any additional revenues that result from our remade decision on JGN’s 2015–20 access arrangement across both the 2015–20 and 2020-25 access arrangement periods.¹²⁷

¹²⁵ JGN, *Rule change proposal—Cross period revenue smoothing - National Gas Rules*, 14 December 2017.

¹²⁶ NGR, Schedule 1, Part 11.

¹²⁷ AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule*, 30 August 2018; AEMC, *National Gas Amendment (Cross period revenue smoothing) Rule 2018 No. 2*, commencing 6 September 2018.