



Draft decision

Jemena Gas Networks (NSW) Ltd

Access arrangement 2015–20

Attachment 2 – Capital base

November 2014

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Note

This attachment forms part of the AER's draft decision on Jemena Gas Networks' 2015–20 access arrangement. It should be read with other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – services covered by the access arrangement

Attachment 2 – capital base

Attachment 3 – rate of return

Attachment 4 – value of imputation credits

Attachment 5 – regulatory depreciation

Attachment 6 – capital expenditure

Attachment 7 – operating expenditure

Attachment 8 – corporate income tax

Attachment 9 – efficiency carryover mechanism

Attachment 10 – reference tariff setting

Attachment 11 – reference tariff variation mechanism

Attachment 12 – non-tariff components

Attachment 13 – demand

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Shortened forms

Shortened form	Extended form
2010–15 access arrangement	Access arrangement for JGN effective from 1 July 2010 to 30 June 2015 inclusive
2010–15 access arrangement period	1 July 2010 to 30 June 2015 inclusive
2015–20 access arrangement	Access arrangement for JGN effective from 1 July 2015 to 30 June 2020 inclusive
2015–20 access arrangement period	1 July 2015 to 30 June 2020 inclusive
Access arrangement information	Jemena Gas Networks (NSW) Ltd, <i>Access Arrangement Information 2015–20</i> , 30 June 2014
Access arrangement proposal	Jemena Gas Networks (NSW) Ltd, <i>Access arrangement, JGN's NSW gas distribution networks, 1 July 2015 – 30 June 2020</i> , 30 June 2014
AER	Australian Energy Regulator
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CPI	consumer price index
DRP	debt risk premium
ERP	equity risk premium
JGN	Jemena Gas Networks (NSW) Ltd (CAN 003 004 322)
MRP	market risk premium
NGL	national gas law
NGO	national gas objective
NGR	national gas rules

Shortened form	Extended form
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
Reference service agreement proposal	Jemena Gas Networks (NSW) Ltd, <i>Reference Service Agreement, JGN's NSW gas distribution networks</i> , 30 June 2014
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
WACC	weighted average cost of capital

2 Capital base

The capital base roll forward accounts for the value of JGN's regulated assets over the access arrangement period. The opening capital base value for a regulatory year within the access arrangement period is rolled forward by indexing it for inflation, adding any conforming capex, and subtracting depreciation and other possible factors (for example, disposals or customer contributions).¹ Following this process, the AER arrives at a closing value of the capital base at the end of the relevant year. The opening value of the capital base is used to determine the return of capital (regulatory depreciation) and return on capital building block allowances.

We are required to make a decision on JGN's opening capital base as at 1 July 2015 for the 2015–20 access arrangement period. We are also required to make a decision on JGN's projected capital base for the 2015–20 access arrangement period. This attachment presents our draft decision on these matters.

2.1 Draft decision

We do not approve JGN's proposed opening capital base of \$3045.8 million (\$nominal) as at 1 July 2015. This is because we consider that one aspect of JGN's proposed opening capital base for the 2010–15 access arrangement period does not comply with the NGR.² The non-compliance arises out of a recent Australian Competition Tribunal decision. It relates to the adjustment for the accumulated return on capital associated with the difference between estimated and actual capex for 2009–10, the final year of the previous access arrangement period.

After removing this adjustment from the capital base roll forward, we determine an opening capital base of \$3044.2 million (\$nominal) as at 1 July 2015, which is \$1.6 million (\$nominal) less than that proposed by JGN.³

¹ The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

² NGR, r. 77(2)(a).

³ Our draft decision also reflects a minor update to the estimate of 2014-15 capex submitted by JGN after the original proposal. JGN, *Email response to information request AER JGN 025a, Submissions on JGN proposal (pricing issues) - follow up*, 25 September 2014.

Table 2-1 summarises our draft decision on the roll forward of JGN's capital base during the 2010–15 access arrangement period.

Table 2-1 AER's draft decision on JGN's capital base roll forward for the 2010–15 access arrangement period (\$million, nominal)

	2010-11	2011-12	2012-13	2013-14	2014-15
Opening capital base	2312.7	2456.6	2611.2	2697.1	2839.3
Net capex at the start of the year	76.2	82.8	63.5	88.1	117.6
Indexation of assets	63.4	78.8	59.0	76.5	88.7
Net capex at end of year	78.3	85.4	64.9	90.5	121.1
Depreciation	-74.1	-92.4	-101.4	-112.7	-125.6
Closing capital base	2456.6	2611.2	2697.1	2839.3	3041.1
Adjustment for difference between estimated and actual capital expenditure in 2009-10					3.1
Opening capital base at 1 July 2015					3044.2

Source: AER analysis.

We do not approve JGN's proposed roll forward of its projected capital base across the 2015–20 period, and do not approve its closing capital base at 30 June 2020 of \$3810.2 million (\$nominal). This is because we have not approved JGN's proposed inputs to the projected capital base roll forward, specifically the opening capital base, forecast capex, forecast inflation and depreciation. Based on our approved amounts for these inputs, we determine a projected closing capital base of \$3595.2 million (\$nominal) as at 30 June 2020. This is \$215.0 million (\$nominal) less than that proposed by JGN, a reduction of 5.6 per cent.

Table 2-2 sets out the projected roll forward of the capital base during the 2015–20 access arrangement period.

Table 2-2 AER's draft decision on projected capital base roll forward for the 2015–20 access arrangement period (\$million, nominal)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening capital base	3044.2	3180.0	3302.9	3423.4	3512.5
Net capex at the start of the year	99.7	99.1	104.3	94.2	84.5
Indexation of assets	80.2	83.6	86.9	89.7	91.7
Net capex at end of year	102.2	101.6	107.0	96.6	86.7
Depreciation	-146.2	-161.4	-177.7	-191.5	-180.2
Closing capital base	3180.0	3302.9	3423.4	3512.5	3595.2

Source: AER analysis.

2.2 JGN's proposal

JGN proposed an opening capital base as at 1 July 2010 of \$2312.7 million (\$nominal).⁴ This amount is rolled forward over the 2010–15 access arrangement period to arrive at an opening capital base of \$3041.3 million (\$nominal) as at 1 July 2015. The roll forward of the capital base was calculated based on actual data for 2010–11 to 2012–13 (with the exception of depreciation which is based on approved amounts adjusted for CPI), and forecast data for 2013–14 and 2014–15. JGN also proposed to apply an adjustment to the opening capital base at 1 July 2015 to account for the difference between actual and estimated capex for 2009–10.⁵ This is because the estimated net capex of \$94.2 million (\$nominal) for 2009–10 was \$2.4 million (\$nominal) less than actual capex of \$96.9 million (\$nominal).⁶ This amount is escalated to account for the time value of money comprising the nominal rate of return over the 2010–15 access arrangement period. This adjustment increases the proposed opening capital base by \$4.5 million (\$nominal) to \$3045.8 million (\$nominal) as at 1 July 2015.⁷

JGN's proposed capital base roll forward during the 2010–15 access arrangement period is shown in table 2-3.

Table 2-3 JGN's proposed capital base roll forward during the 2010–15 access arrangement period (\$million, nominal)

Details	2010-11	2011-12	2012-13	2013-14	2014-15
Opening capital base	2312.7	2456.6	2611.2	2697.1	2839.3
Net capex at start of year	76.2	82.8	63.5	88.1	117.7
Indexation of assets	63.4	78.8	59.0	76.5	88.7
Net capex at end of year	78.3	85.4	64.9	90.5	121.2
Depreciation	-74.1	-92.4	-101.4	-112.7	-125.6
Closing capital base	2456.6	2611.2	2697.1	2839.3	3041.3
Adjustment for 2009-10 capex					4.5
Opening capital base at 1 July 2015					3045.8

Source: JGN, *2015–20 Access arrangement information*, June 2014, table 8–4, p. 84.

2.2.1 Capital expenditure in the 2010–15 access arrangement period

JGN submitted that the net capex incurred in the 2010–15 access arrangement period is estimated to be \$868.4 million (\$nominal).⁸ This is calculated by subtracting capital contributions and asset disposals from gross capex. JGN has not included any conforming assets from a speculative

⁴ JGN, *2015–2020 Access arrangement information*, June 2014, table 8–4 p, 84.

⁵ NGR, r. 77(2)(a).

⁶ JGN, *2015–2020 access arrangement information*, June 2014, table 8–2 p, 82.

⁷ JGN, *2015–2020 access arrangement information*, June 2014, table 8–4 p, 82.

The inflation adjustment for 2009–10 to 2013–14 is calculated based on actual CPI data, while 2014–15 is adjustment is based on RBA estimate. The cost of capital compensation is calculated based on real WACC of 7.63% applied in the current 201–15 access arrangement period.

⁸ JGN, *2015–2020 access arrangement information, Appendix 12.1 Revenue model*, June 2014.

investment account in rolling forward the capital base to 2014–15. It has not classified any assets as redundant assets, or re-used any assets previously classified as redundant.⁹

JGN's proposed capex amounts by asset class are set out in table 2-4. The proposed conforming capex for inclusion in the capital base is discussed in more detail in capex attachment 6.

Table 2-4 JGN's proposed conforming capital expenditure for 2009–10 and the 2010–15 access arrangement period (\$million, nominal)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Trunk Wilton-Sydney	0.0	0.0	0.0	0.0	0.0	0.0
Trunk Sydney-Newcastle	0.0	0.0	0.0	0.0	0.0	0.0
Transmission pipeline (Wilton-Wollongong)	0.0	0.0	0.0	0.0	0.0	0.0
Contract meters	0.3	0.2	0.4	0.5	1.6	1.5
Fixed plant - distribution	13.3	20.4	19.5	6.5	6.8	17.7
HP mains	4.9	13.2	19.4	8.4	12.7	4.9
HP services	0.0	0.0	0.0	2.4	1.4	0.9
MP mains	13.8	21.4	22.5	20.5	23.7	27.7
MP services	26.5	29.8	39.0	39.6	54.5	51.6
Meter reading devices	3.3	3.2	3.9	4.5	4.9	7.8
Country POTS	1.1	3.0	8.2	0.8	0.6	1.5
Tariff meters	21.4	22.2	25.3	26.9	33.2	37.1
Building	0.0	0.0	0.0	1.5	7.6	12.6
Computers	0.0	0.0	0.0	0.0	0.0	0.0
Software	9.2	35.1	25.9	12.1	16.5	44.6
Fixed plant	0.6	0.3	0.4	1.2	0.7	1.1
Furniture	0.0	0.0	0.0	0.0	0.0	0.0
Land	0.0	0.0	0.0	0.9	5.6	2.1
Leasehold improvements	1.2	0.0	0.6	0.0	1.4	24.5
Low value assets	0.0	0.0	0.0	0.0	0.0	0.0
Mobile plant	-0.1	0.1	0.2	0.5	0.7	0.9
Vehicles	1.1	3.4	2.7	2.0	6.5	2.4
Stock	0.0	0.0	0.0	0.0	0.0	0.0
Equity raising costs	0.0	2.1	0.0	0.0	0.0	0.0
Total	96.9	154.5	168.1	128.32	178.5	238.9

⁹ JGN, 2015–2020 access arrangement information, June 2014, p, 83.

Source: JGN, *2015–2020 access arrangement information Appendix 12.1 Revenue model*, June 2014. Please refer to JGN, *2015–2020 access arrangement information* June 2014, chapter 6, pp. 41–69 for explanation of the terms used for each asset class in this table.

2.2.2 Adjustment to the capital base for inflation in the 2010–15 access arrangement period

JGN proposed to account for inflation in the earlier access arrangement period by indexing the capital base. JGN used actual Australian Bureau of Statistics' December to December annual inflation values for 2009–10 to 2013–14, and the Reserve Bank of Australia's (RBA) *Statement of monetary policy* inflation forecast for 2014–15 to calculate inflation indexation for the capital base roll forward. JGN stated that this approach is consistent with the approach taken in past revisions of JGN's access arrangement and with the NGR.¹⁰

2.2.3 Depreciation in the 2010–15 access arrangement period

JGN proposed to deduct forecast depreciation (as approved in the 2010 access arrangement) in rolling forward its capital base from 2010–11 to 2014–15 in accordance with clause 3.1(c) of its 2010 access arrangement.

2.2.4 Projected capital base over the 2015–20 access arrangement period

JGN proposed a projected closing capital base as at 30 June 2020 of \$3810.2 million (\$nominal). The projected roll forward of the capital base during the 2015–20 access arrangement period is shown in Table 2-5. JGN has included in its capital base projection:

- forecast inflation of 2.55 per cent per annum¹¹
- forecast real straight-line depreciation, which is discussed in more detail in attachment 5.¹² JGN proposed to use this forecast real straight-line depreciation to determine the roll forward of the opening capital base at the next access arrangement review for the access arrangement period beginning on 1 July 2020.¹³

Table 2-5 JGN's proposed projected capital base roll forward during the 2015–20 access arrangement period (\$million, nominal)

Details	2015-16	2016-17	2017-18	2018-19	2019-20
Opening capital base	3,045.8	3,215.0	3,376.4	3,544.1	3,682.5
Net capex at start of year	116.7	119.0	129.0	119.9	108.8
Indexation of assets	80.5	84.9	89.2	93.3	96.5
Net capex at end of year	119.7	122.0	132.2	122.9	111.6
Depreciation	-147.7	-164.5	-182.7	-197.7	-189.3
Closing capital base	3,215.0	3,376.4	3,544.1	3,682.5	3,810.2

Source: JGN, *2015–2020 access arrangement information*, June 2014, Table 8-8, p. 85.

¹⁰ JGN, *2015–2020 access arrangement information*, June 2014, p. 83.

¹¹ JGN, *2015–2020 access arrangement information*, June 2014, p. 97.

¹² Under the straight-line method, the asset cost depreciates evenly in every year throughout the useful life of the asset.

¹³ JGN, *2015–2020 access arrangement information*, June 2014, p. 88.

2.3 Assessment approach

Our approach to assessing JGN's projected capital base is consistent with that adopted in previous gas decisions made under the NGR.¹⁴ In accordance with rule 77(2) and rule 78 of the NGR, we applied three steps to calculate the projected capital base:

- First, we confirm the value of the opening capital base for the first year of the 2010–15 access arrangement period (in this case, 1 July 2010). Typically, this includes making an adjustment to account for any difference between actual and estimated capex in the final year of the previous access arrangement period (in this case, 2009–10). This adjustment is also subject to any changes made in our assessment of conforming capex for that year.
- Second, the opening capital base as at 1 July 2010 is rolled forward to determine the closing capital base as at 30 June 2015. This closing capital base is also used as the value of the opening capital base for the access arrangement period as at 1 July 2015. This involves:¹⁵
 - adding conforming actual capex for each year—this requires assessing the capex and determining that it is consistent with the provisions of the 2010–15 access arrangement and data from audited annual reporting regulatory information notices, as well as the definition of 'conforming capital expenditure' in the NGR¹⁶
 - removing forecast depreciation for each year based on the approach approved for the 2010–15 access arrangement
 - removing any capital contributions during the 2010–15 access arrangement period
 - adding any speculative capex or redundant assets that were reused during the 2015–20 access arrangement period
 - removing any redundant assets and disposals during the 2010–15 access arrangement period
 - indexing the roll forward each year for actual inflation.
- Third, the capital base is projected over the 2015–20 access arrangement period by rolling forward the opening capital base as at 1 July 2015 to 30 June 2020. This involves performing the following on the opening capital base:¹⁷
 - adding forecast conforming capex for each year
 - removing forecast depreciation for each year
 - removing the forecast value of assets to be disposed of during the 2015–20 access arrangement period
 - indexing the capital base of the roll forward each year for forecast inflation.

¹⁴ For example, AER, *Final decision: Roma to Brisbane Pipeline 2012–13 to 2016–17*, April 2012; AER, *Final decision: Envestra (Victoria) access arrangement 2013–17 proposal*, March 2013; AER, *Final decision: AusNet (SP AusNet) arrangement proposal 2013–17*, March 2013; AER, *Final decision: MultiNet Gas arrangement proposal 2013–17*, March 2013.

¹⁵ NGR, r. 77(2).

¹⁶ NGR, r. 77(2).

¹⁷ NGR, r. 78.

2.3.1 Interrelationships

The level of the capital base substantially impacts the service provider's revenue and the price consumers pay. It is an input into the determination of the return on capital and depreciation (return of capital) allowances.¹⁸ Factors that influence the capital base will therefore flow through to these building block components and the annual building block revenue requirement. Other things being equal, a higher capital base increases both the return on capital and depreciation allowances. In turn, it increases the service provider's revenue, and prices for its services.

The capital base is determined by various factors, including;

- the opening capital base (meaning the value of existing assets at the beginning of the access arrangement period)
- net capex¹⁹
- depreciation
- indexation adjustment – so the capital base is presented in nominal terms, consistent with the rate of return.

The opening capital base depends on the value of existing assets as well as actual conforming net capex, actual inflation outcomes and depreciation in the past.

The capital base when projected to the end of the access arrangement period may increase due to forecast new capex and the indexation adjustment. The size of the indexation adjustment depends on expected inflation (which also affects the nominal rate of return or WACC) and the size of the capital base at the start of each year.

Depreciation reduces the capital base. The depreciation allowance depends on the size of the opening capital base and the forecast net capex. By convention, the indexation adjustment is also offset against depreciation to prevent double counting of inflation in the capital base and WACC, which are both presented in nominal terms. This reduces the apparent size of the depreciation building block that feeds into the annual building block model for setting revenue.

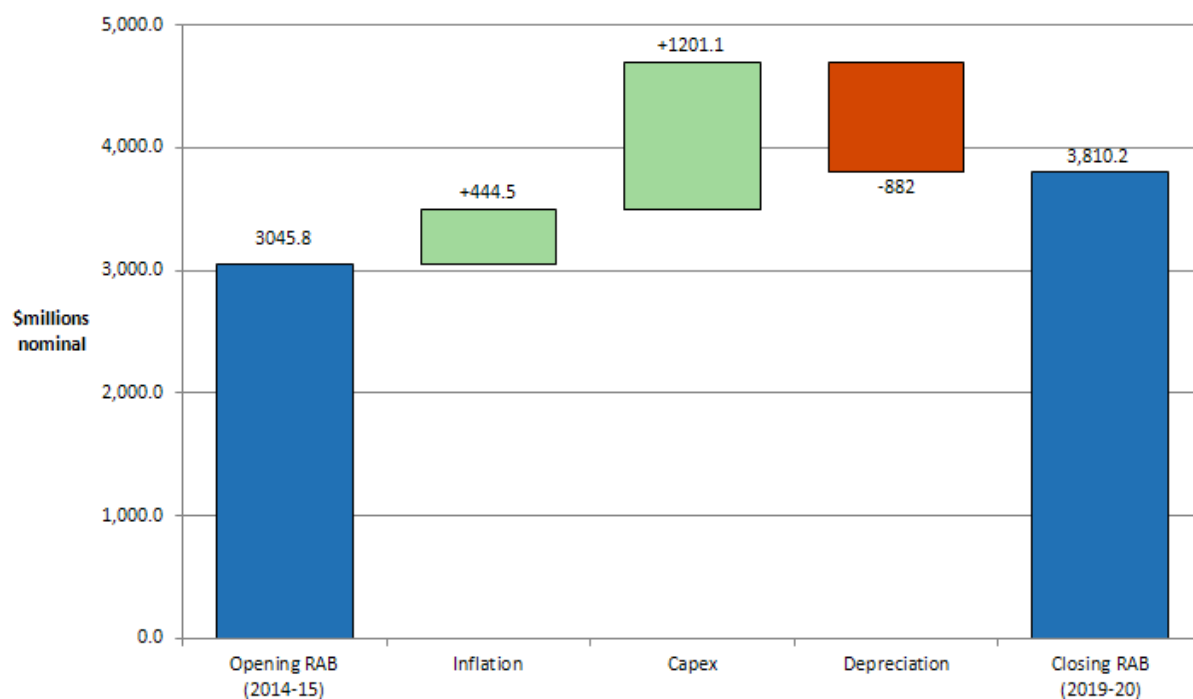
Figure 2-1 shows the key drivers of the change in the capital base over the 2015–20 access arrangement period as proposed by JGN. Overall, the closing capital base at the end of the 2015–20 regulatory control period would be 19 per cent higher than the opening capital base at the start of that period based on the proposal, in nominal terms. The proposed forecast net capex increases the capital base by about 39 per cent, while forecast inflation increases it by about 15 per cent. Forecast depreciation, on the other hand, reduces the capital base by about 29 per cent.

The capital base would rise in real terms over the 2015–20 regulatory control period based on JGN's proposal. The depreciation amount also largely depends on the opening capital base (which in turn depends on past capex). However, we do have concerns with the size of the forecast net capex. Figure 2-1 shows forecast net capex is the largest driver of the increase in the capital base and we have considered whether it is appropriate that the forecast net capex exceeds depreciation as JGN has proposed. Refer to attachment 6 for the discussion on forecast capex.

¹⁸ The size of the capital base also impacts the benchmark debt raising cost allowance. However, this amount is usually relatively small and therefore not a significant determinant of revenues overall.

¹⁹ Net capex is gross capex less disposals and capital contribution.

Figure 2-1 Key drivers of changes in the RAB (\$ million, nominal)



Source: AER analysis

A ten per cent increase in the opening capital base causes revenues to increase by about six per cent. However, the impact on revenues of the annual change in capital base depends on the source of the capital base change, as some drivers affect more than one building block cost.²⁰

2.4 Reasons for draft decision

We do not approve JGN's proposed opening capital base of \$3045.8 million (\$nominal) as at 1 July 2015. We have instead determined an opening capital base value of \$3044.2 million (\$nominal) as at 1 July 2015, a reduction of \$1.6 million (\$nominal) or 0.05 per cent from the proposed value. This is due to our removal of the proposed adjustment for the accumulated return on capital associated with the difference between estimated and actual capex for 2009–10.

We also do not approve JGN's projected closing capital base of \$3810.2 million (\$nominal) as at 30 June 2020. We instead determine a closing capital base of \$3595.2 million (\$nominal) as at 30 June 2020, a reduction of \$215.0 million (\$nominal) or 5.6 per cent from the proposed value. The main reasons for the reduction are our adjustments to its opening capital base as at 1 July 2015 (detailed in section 1.4.1), forecast net capex (detailed in capex attachment 6) and forecast depreciation (detailed in depreciation attachment 5).

We are satisfied each of these amendments is necessary having regard to the requirements of the NGR. The reasons for our decision are discussed below.

²⁰ If capex causes the capital base increase, then return on capital, depreciation, and debt raising costs all increase too. If a reduction in depreciation causes the capital base increase, revenue could increase or decrease. In this case, the higher return on capital is offset (perhaps more than offset) by the reduction in depreciation allowance. Inflation naturally increases the capital base in nominal terms. However, the real impact from changing the inflation forecast is inconsequential as revenues are updated annually by actual inflation and the X factor, which is generally unaffected by the assumed forecast inflation rate.

2.4.1 Roll forward of capital base during the 2010–15 access arrangement period

To determine the opening capital base as at 1 July 2015 we have assessed JGN's proposed roll forward of its capital base over the 2010–15 access arrangement period to determine a closing capital base value at 30 June 2015. As part of this, we reviewed the following key inputs to the capital base roll forward:

- adjustment for actual capex in 2009–10
- conforming capex in the 2010–15 access arrangement period
- depreciation amounts in the 2010–15 access arrangement period.

These are discussed further below.

We also reviewed the other key inputs into JGN's proposed capital base roll forward during the 2010–15 access arrangement period, such as CPI, rate of return, and asset lives. We found these were correct and they reconcile with relevant data sources such as ABS data, annual reporting RIN data and the 2010–15 decision model.

Adjustment for actual capex in 2009–10

We do not accept JGN's proposed approach to adjusting its capital base for actual capex in 2009–10. We consider that JGN's proposed adjustment to the opening capital base reflecting the difference between estimated and actual capex for 2009–10 should not include the accumulated return on capital associated with that difference.

JGN's actual capex in 2009–10 of \$96.9 million (\$nominal) is \$2.4 million (\$nominal) higher than the estimated \$94.2 million (\$nominal) approved in the 2010–15 access arrangement. In accordance with rule 77(2)(a) of the NGR, the opening capital base as at 1 July 2015 should be adjusted to account for this difference. Other than the amount of the capex difference, JGN also proposed to include the accumulated return on capital associated with that difference in the adjustment to the opening capital base. The Australia Competition Tribunal has determined in a recent decision that rule 77(2)(a) of the NGR does not allow the adjustment to the opening capital base for the difference in estimated and actual capex to include the accumulated return on capital associated with that difference.²¹ Consistent with the Australian Competition Tribunal's ruling, we have removed the proposed accumulated return on capital component from the adjustment to JGN's opening capital base.

On 10 July 2014, the AEMC released a rule change proposal draft determination on rule 77(2)(a) of the NGR. The proposed amendment to the rule provides the AER with power to make a return on capital adjustment associated with the difference between the estimated and the actual capex in the capital base. The AEMC's draft determination stated that it does not intend the amended rules to be applied retrospectively.²² We note that JGN's submission to the AEMC's draft decision did not contest the issue regarding the retrospective application of the rule change decision.²³

²¹ Australian Competition Tribunal, *Application by APA GasNet Australia (Operations) Pty Limited (No 2) [2013] ACompT 8*, September 2013, pp. 19–35.

²² AEMC, *Draft rule determination – National Gas Amendment (Setting the Opening Capital Base) Rule 2014*, 10 July 2014, p. 15. The AEMC statement was in response to JGN's submission stating that the rule should be applied retrospectively. See JGN, *GRC0025: Setting the opening base–JGN submission on the consultation paper*, 22 May 2014.

²³ JGN, *GRC0025: Setting the opening capital base – JGN submission on the draft determination*, 21 August 2014.

On 2 October 2014, the AEMC released its final determination on the rule change, which aligned with the draft determination.²⁴ The amended rule commenced as at that date (2 October) and there was no allowance for retrospective application.²⁵

On 3 October 2014, JGN contacted the AER to submit that the amended rule should apply to its access arrangement proposal, since the draft decision was to be released after the 2 October 2014 when the rule took effect.²⁶ We do not agree with this view because:

- We consider the relevant date is the date of the submission of JGN's access arrangement proposal (30 June 2014), not the date of the draft decision (or final decision). We consider our assessment of JGN's access arrangement is governed by the legislation current at 30 June 2014, not the legislation as later amended.²⁷
- The AEMC's intent was that the amended rule would not apply to JGN, as is stated in the AEMC draft determination.²⁸
- As a matter of procedural fairness, it would not be appropriate to change the basis for our assessment of the JGN's access arrangement proposal after the process had begun. JGN's interpretation applies equally to draft and final decisions. It also applies equally regardless of the significance of any amendment or how late it is made. To accept JGN's interpretation would potentially result in the service provider submitting a proposal under one regulatory framework, stakeholders making submissions under the same framework and the regulator making its decision under a different framework.²⁹ This would be an unusual result, given the prescribed consultation process the AER must follow under the NGR.

On this basis and for the purposes of assessing this access arrangement, we are not satisfied that the recent amendment to rule 77(2)(a) of the NGR impacts the AER's consideration. Therefore, we have not added the accumulated return on capital adjustment to JGN's opening capital base.

Conforming capital expenditure in the 2010–15 access arrangement period

Our assessment of conforming capex is set out in the capex attachment 6. In determining the opening capital base as at 1 July 2015, the AER assessed whether JGN's proposed capex amounts for the 2010–15 access arrangement are properly accounted for in the capital base roll forward.

We accept that JGN's proposed capex for the 2010–15 access arrangement period is properly included in the capital base roll forward and is consistent with the requirements of the NGR.³⁰ We note that the proposed capex accepted in this draft decision for 2013–14 and 2014–15 are estimates. As part of the final decision, we expect the 2013–14 capex estimates to be replaced by actuals and the 2014–14 capex estimates to be revised based on more up to date information.

²⁴ AEMC, *Rule determination, National Gas Amendment (Setting the Opening Capital Base) Rule 2014*, 2 October 2014.

²⁵ AEMC, *Rule determination, National Gas Amendment (Setting the Opening Capital Base) Rule 2014*, 2 October 2014, p. 3.

²⁶ JGN, *Email re: AEMC WACC clawback rule change - no impact on JGN submitted models*, 3 October 2014.

²⁷ See NGL, schedule 2, rule 43. Further, JGN appears to have held this interpretation at the time of its first submission to the AEMC. See JGN, *GRC0025: Setting the opening base—JGN submission on the consultation paper*, 22 May 2014.

²⁸ AEMC, *Draft rule determination – National Gas Amendment (Setting the Opening Capital Base) Rule 2014*, 10 July 2014, p. 15. Further, JGN had opportunity to contest this point but did not do so in its subsequent submission to the AEMC. See JGN, *GRC0025: Setting the opening capital base – JGN submission on the draft determination*, 21 August 2014.

²⁹ We note that 2 October 2014 is after the closing date for submissions from other parties on JGN's proposal (25 August 2014), so customers (who would be adversely affected by the AEMC decision if it were to apply) would not have opportunity to comment.

³⁰ NGR, r. 77(2)(b).

Depreciation used in the 2010–15 access arrangement period

Under the NGR, the AER must subtract from the capital base depreciation calculated in accordance with the relevant access arrangement.³¹

We approve JGN's proposal to roll forward the capital base to 1 July 2015 using forecast depreciation (straight-line method, adjusted for actual inflation) in accordance with clause 3.1 (c) of the approved 2010–15 access arrangement.

2.4.2 Projected capital base during the 2015–20 access arrangement period

We forecast JGN's projected capital base at 30 June 2020 to be \$3595.2 million (\$nominal), a reduction of \$215.0 million (\$nominal) or 5.6 per cent from JGN's proposal. This results from our draft decision on the inputs to the determination of the projected capital base. We have amended the inputs in the following ways:

- Reduced JGN's opening capital base as at 1 July 2015 to \$3044.2 million (\$nominal) or by 0.05 per cent to reflect the changes required in this attachment.
- Reduced JGN's proposed forecast net capex by \$211.4 million (\$real 2015) or 18.7 per cent. Our detailed assessment of the proposed forecast capex is set out in attachment 6.
- Reduced JGN's proposed forecast depreciation allowance by \$12.6 million (\$nominal) or 2.9 per cent. The AER's assessment of the proposed forecast depreciation is set out in depreciation attachment 5.
- Updated forecast inflation of 2.55 per cent per annum for the 2015–20 access arrangement period.³² While we accept JGN's proposed approach to estimate forecast inflation, we have updated the forecast for this draft decision. Our assessment of JGN's proposed forecast inflation is set out in rate of return attachment 3.

The capital base at the commencement of the 2020–25 access arrangement period will be subject to adjustments consistent with the NGR.³³ These adjustments include (but are not limited to):

- the difference between estimated and actual capex for 2014–15 (the final year of the 2015–20 access arrangement period), including an adjustment to remove any benefit or penalty associated with the difference between the estimated and actual capex³⁴
- actual inflation and approved depreciation over the 2015–20 access arrangement period.

We accept JGN's proposal to use forecast depreciation (to be approved in the final decision for the 2015–20 access arrangement period) to establish JGN's opening capital base as at 1 July 2020.³⁵ We approved such an approach in the decisions for APT Allgas, Envestra networks, and the Victorian gas service providers.³⁶ This approach is also consistent with the approach outlined in the AER's Access Arrangement Guideline.³⁷

³¹ NGR, r. 77(2)(d).

³² When rounded to two decimal places, this is the same value proposed by JGN; but the unrounded number (used in the relevant models) differs slightly at the third decimal place.

³³ NGR, r. 77(2).

³⁴ That is, the amended NGR r. 77(2)(a) will apply.

³⁵ JGN, *2015–2020 access arrangement information*, June 2014, pp. 166–167.

³⁶ AER, *Final decision: APT Allgas access arrangement*, June 2011, p. 13; AER, *Final decision: Envestra access arrangement Qld*, June 2011, p. 25; AER, *Final decision: Envestra access arrangement SA*, June 2011, p. 28. AER, *Final*

2.5 Revisions

The AER requires the following revisions to make the access arrangement proposal acceptable:

Revision 2.1: Make all necessary amendments to reflect the AER's draft decision on the roll forward of the capital base for the 2010–15 access arrangement period, as set out in Table 2-1.

Revision 2.1: Make all necessary amendments to reflect the AER's draft decision on the projected opening capital base for the 2015–20 access arrangement period, as set out in Table 2-2.

decision: Envestra (Victoria) access arrangement proposal 2013–17 Part2: Attachments, March 2013, p. 24; AER, *Final decision: AusNet (SP AusNet) arrangement proposal 2013–17 Part2: Attachments*, March 2013, p. 23; AER, *Final decision: MultiNet Gas arrangement proposal 2013–17*, March 2013, p. 24.

³⁷

AER, *Final access arrangement guideline*, March 2009, pp. 65–66.