

# Draft decision: AusNet Gas Services 2018–22

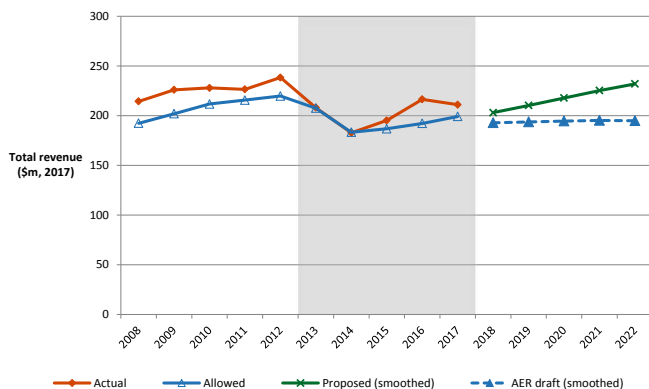
## Overview

The Australian Energy Regulator (AER) approves access arrangements for AusNet Gas Services (AusNet) and other major gas networks in most of Australia under the National Gas Law (NGL) and National Gas Rules (NGR). AusNet is the owner and operator of a gas distribution pipeline servicing customers in Victoria.

Our draft decision allows AusNet to recover \$1044.8 million (\$nominal) from its customers over five years commencing 1 January 2018. In real dollar terms, the revenue we have allowed for 2018 will be 8.7 per cent less than AusNet's actual revenue in 2017. In 2022, allowed revenue will be 7.7 per cent lower than AusNet's actual 2017 revenue.

The figure below shows the difference between AusNet's proposed revenue, and what we have allowed for each year of the access arrangement period.

### AusNet's past and proposed total revenue and AER draft decision revenue allowance (\$million, 2017)



The revenue we determine affects the distribution component of a customer's gas bill. Distribution charges make up approximately 24 per cent of an average Victorian residential customer's annual gas bill, and approximately 16 per cent of an average small business customer's annual gas bill.

Other components of customer bills include the cost of sourcing the gas, transmission network charges and retailer costs. The AER does not set retail prices.

## Key elements of our decision

We based our assessment of AusNet's proposed revenue on a number of components. These include expenditures to maintain and operate the pipeline, and the return to

shareholders on their investment. Together, these determine the revenue that AusNet may recover from its customers.

There are two components of our draft decision that drive most of the difference between the revenue that AusNet was allowed to recover in the 2013–17 access arrangement period, and the level of revenue approved for the 2018–22 access arrangement period: rate of return, and depreciation on assets. We discuss each of these below. We also highlight the key differences between our draft decision and AusNet's revised proposal.

Our draft decision also makes an assessment on forecast demand as this is a key factor in setting reference tariffs.

### Estimated impact on customer bills

If implemented, we expect that our draft decision will result in the distribution component of the average annual residential gas bill for AusNet customers declining over the 2018–22 access arrangement period.

The distribution component of the average annual residential gas bill in 2018 is expected to be about \$23 below the current, 2017 level. By the end of the 2018–22 access arrangement period, the distribution component of the average annual bill will still be about \$5 below current levels.

The distribution component of the average annual small business gas bill in 2018 is expected to be around \$37 lower than in 2017, and about \$8 below the current 2017 level by 2022.

### Rate of return

Significant investment is required to build a distribution pipeline. The return that AusNet must pay lenders and investors is referred to as the rate of return. Even a small difference in the rate of return can have a big impact on revenues.

Our draft decision sets the allowed rate of return (or 'cost of capital') at 5.94 per cent for 2017–18. This is a significant decrease compared to the rate of return approved in our previous (March 2013) final decision for AusNet of 7.07 per cent.

The investment environment has improved since our previous decision, which was made during the period of uncertainty surrounding the global financial crisis. This improved investment environment translates to lower financing costs

necessary to attract efficient investment.

The lower rate of return in this draft decision will reduce AusNet's average annual revenue requirement compared to the previous access arrangement period.

### Depreciation of assets

Depreciation is the amount that AusNet recovers over time to pay for the cost of an asset. Our decision on depreciation affects the timing of AusNet's revenue recovery, but not the amount of depreciation in total.

AusNet's depreciation allowance has increased by approximately \$54.4 million (\$ real) between the 2013–17 and 2018–22 access arrangement periods. The change to the regulatory depreciation allowance reflects growth in AusNet's capital base, which in real terms grew by 12.7 per cent over the current period and is projected to grow by 5.9 per cent from 2018 to 2022.

Also contributing to the increase in AusNet's depreciation allowance is a change in approach to calculating the depreciation of assets. Our draft decision accepts AusNet's proposal to change to a year by year tracking approach to determining depreciation. Although the proposed change does increase depreciation (and prices) over short to medium term, our analysis suggests the impact in this case to be modest and therefore unlikely to have a significant impact on the efficient growth in the market for reference services.

### Demand

Tariff levels depend on estimates of forecast total demand (GJ/day). In simple terms, tariffs are determined by dividing cost by total demand (GJ/day), so that an increase in forecast demand has the effect of reducing tariffs and vice versa.

Our draft decision forecasts:

- slight growth in total residential gas demand of 0.34 per cent per year compared with 2.4 per cent per year in current the period
- an increase in total small commercial demand of 1.05 per cent per year compared with 1.9 per cent per year in current period
- a decrease in industrial demand of 0.49 per cent per year compared to 1 per cent in the current period.

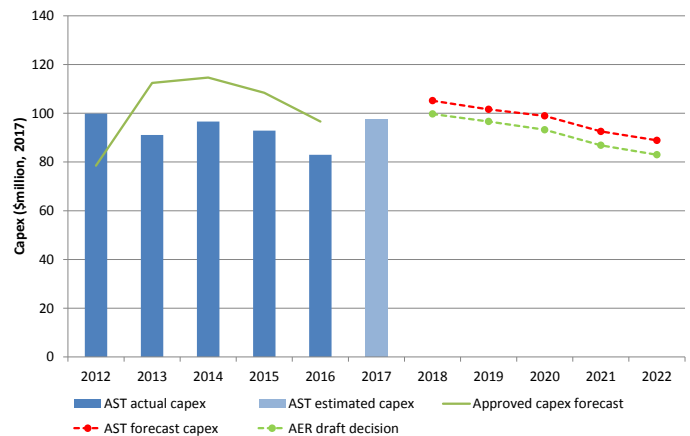
### Capital expenditure (capex)

Our draft decision approves total forecast capex of \$460 million (\$2017). This is 5.7 per cent lower than AusNet's proposal, and is in line with its actual expenditure over the current access arrangement period.

AusNet's forecast mains replacement capex made up around 28 per cent of its total forecast capex, and was 20.6 per cent higher than its actual mains replacement expenditure in the current period. On the information before us we are not satisfied that this increase in mains replacement expenditure is required. The total capex forecast in our draft decision includes a lower mains replacement forecast of \$114.5 million.

We have also made smaller adjustments to AusNet's proposed capex for meter replacement and new connections.

### AER draft decision compared to AusNet's past and proposed capex (\$million, 2017)

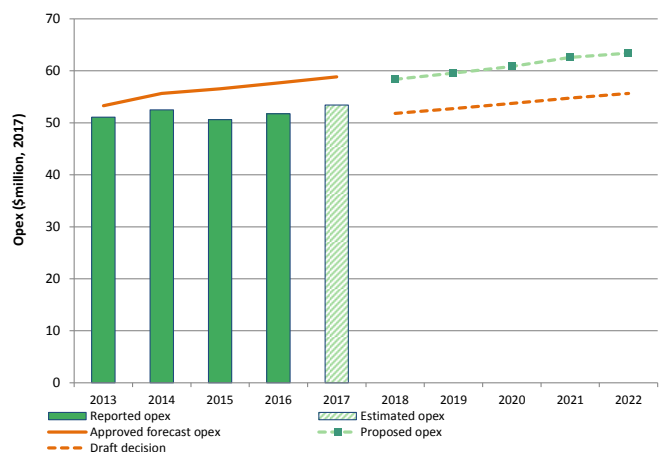


Our draft decision introduces a new capital expenditure incentive scheme, which in combination with the existing opex incentive mechanism will strengthen incentives for AusNet to find more efficient ways to operate and maintain its network.

### Operating expenditure (opex)

Our draft decision approves forecast opex of \$268.6 million (\$2017). This is a reduction of 11.9 per cent from AusNet's proposal, because we have not approved its proposed step change for marketing. We consider marketing is a 'business-as-usual' expense for AusNet to prioritise within its existing base opex forecast, if it is prudent and efficient to do so in the current operating environment. Our draft decision allows forecast opex that is largely consistent with AusNet's current period opex.

### Our draft decision compared to AusNet's past and proposed opex (\$ million, 2017)



### More information about our consultation process

AusNet will submit a revised proposal in response to this draft decision by 14 August 2017. Interested parties are invited to make submissions on both our draft decision and AusNet's revised proposal by 15 September 2017. More information on AusNet's proposal, our draft decision and how to make a submission is on our website: [www.aer.gov.au](http://www.aer.gov.au).