

Draft decision: Australian Gas Networks (Victoria and Albury) 2018–22

Overview

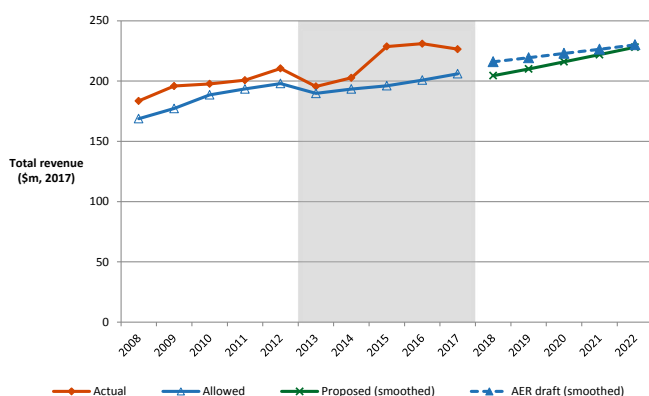
The Australian Energy Regulator (AER) approves access arrangements for Australian Gas Networks (AGN) and other major gas networks in most parts of Australia under the National Gas Law (NGL) and National Gas Rules (NGR). AGN is the owner and operator of gas distribution pipelines servicing customers in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

Our draft decision allows AGN to recover \$1200 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 6.3 per cent less than AGN's actual revenue in 2017. In 2022, allowed revenue will be 0.2 per cent lower than AGN's actual 2017 revenue.

This means a real decrease in weighted average network charges of 6.4 per cent in 2018, followed by increases of 1.25 per cent in each of the remaining years of the access arrangement period.

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

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



AGN consulted with its customers and proposed savings in operating its distribution network. As a consequence, in our draft decision we have been able to accept most of AGN's access arrangement proposal, including its capital and operating expenditure forecasts. We also accepted the methodology proposed by AGN to calculate its rate of return, which we have updated to reflect current market conditions.

The revenue we determine affects the distribution component of a customer's gas bill. For customers on AGN's network distribution charges account for approximately 25 per cent of

an average residential customer's annual gas bill and approximately 15 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.

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 bills for AGN customers rising by less than expected inflation over the 2018–22 access arrangement.

The distribution component of the average annual residential gas bill in 2018 is expected to be about \$13 (nominal) below the current 2017 level. By the end of the 2018–22 access arrangement period, the distribution component of the average annual bill is expected to be about \$35 (\$ nominal) above current levels.

The distribution component of the average annual small business gas bill in 2018 is expected to be around \$35 (\$ nominal) lower than in 2017, and about \$93 above the current 2017 level by 2022.

Key elements of our decision

We based our assessment of AGN's proposed revenue on a number of components. These include expenditure to maintain and operate the pipeline, and the return to shareholders on their investment. Together, these determine the revenue that AGN may recover from its customers.

Our draft decision approves slightly more revenue than set out in AGN's initial proposal, because we have identified and corrected some errors in the modelling initially submitted with its proposal.

AGN has reported opex efficiencies in the current period, which are reflected in a lower opex forecast for 2018–22. The total forecast opex approved in this draft decision is 5.4 per cent lower than that included in AGN's approved revenue for 2013–17. While AGN expects to spend in line with its approved capex forecast for 2013–17, its capex forecast for 2018–22 is also 6.7 per cent less than its expenditure in the current period. Our draft decision introduces a new capital expenditure incentive scheme, which in combination with the existing opex incentive scheme will strengthen incentives on AGN to find more efficient ways to operate and maintain its

network.

However, offsetting reductions in AGN's capital and operating expenditure forecasts, is an increase in its regulatory depreciation allowance between the 2013–17 access arrangement period, and the 2018–22 access arrangement period. We discuss the higher regulatory depreciation allowance below.

Our draft decision also makes an assessment on forecast demand as this is a key factor in setting reference tariffs. The key elements of our draft decision in respect to demand are also discussed below.

Minor modelling adjustments

The total forecast revenue approved by us incorporates corrections and updates to AGN's proposal confirmed by AGN. It therefore provides for revenue which is 3.3 per cent higher than initially set out in AGN's proposal as it was submitted to us in December 2016.

The changes we have made are to reconcile the models AGN submitted with the intent of its proposal. We have worked with AGN to correct these errors, which relate to the capital base, regulatory depreciation and corporate income tax.

Consistent with our usual practice (and as contemplated in AGN's proposal) we have also updated AGN's inputs to the calculation of the approved rate of return, taking into account more recent data. Our draft decision therefore applies a rate of return of 5.75 per cent, compared to the placeholder of 5.28 per cent in AGN's proposal. The rate of return will be updated again for our final decision.

Regulatory depreciation

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

AGN's depreciation allowance has increased by approximately \$128.9 million (\$ 2017) between the 2013–17 and 2018–22 access arrangement periods. This increase reflects:

- a substantial mains replacement program that is being undertaken by AGN to maintain the safety and security of its network. This program is coming to an end, and depreciation of the assets being replaced will be accelerated so that they are removed more quickly from the capital base
- growth in AGN's capital base of 26.9 per cent in real terms over the current period, and further projected growth of 8.4 per cent from 2018 to 2022
- a change to a 'year on year' depreciation approach which means that the same costs are recovered over a shorter period of time. Our analysis suggests the impact of this to be modest and therefore unlikely to have a significant impact on the efficient growth in the market for AGN's 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), such that an increase in

forecast demand has the effect of reducing tariffs and vice versa.

Our draft decision is based on:

- a decrease in total residential gas demand of 0.2 per cent per year compared with 0.6 per cent per year in current period
- an increase in total small commercial demand of 0.2 per cent per year compared with 0.8 per cent per year in current period
- an increase in industrial demand of 0.1 per cent per year compared to 0.9 per cent in the current period.

More information about our consultation process

AGN 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 AGN's revised proposal by 15 September 2017. More information on AGN's proposal, our draft decision and how to make a submission is on our website: www.aer.gov.au.