FINAL DECISION
Evoenergy
Access Arrangement

2021 to 2026

Overview

April 2021

AUSTRALIAN ENERGY REGULATOR

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Note

This Overview forms part of our final decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the final decision.

Our revisions are reflected in the approved access arrangement, *Evoenergy access arrangement 2021–26 – Approved Access Arrangement – April 2021*, which gives effect to this final decision.[1,2] Our decisions under the National Gas Rules (NGR) are: under rule 62, we refuse to approve Evoenergy's access arrangement proposal; under rule 64, we propose to substitute the approved access arrangement, *Evoenergy access arrangement 2021–26 – Approved Access Arrangement – April 2021*, and we further decide to give effect to that proposal.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

In addition to this Overview, our final decision includes the following documents:

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 7 – Corporate income tax

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

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1 Under rule 62 of the NGR: (1) after considering the submissions made in response to the access arrangement draft decision within the time allowed in the notice, and any other matters the AER considers relevant, the AER must make an access arrangement final decision; (2) an access arrangement final decision is a decision to approve, or to refuse to approve, an access arrangement proposal; and (3) if the access arrangement proposal has been revised since its original submission, the access arrangement final decision relates to the proposal as revised; and (4) an access arrangement final decision must include a statement of the reasons for the decision.

2 NGR, r. 64(2) provides that the AER's proposal for an access arrangement or revisions is to be formulated with regard to (a) the matters that the Law requires an access arrangement to include, (b) the service provider's access arrangement proposal, and (c) the AER's reasons for refusing to approve that proposal.

Contents

Executive summary

The Australian Energy Regulator (AER) regulates gas transmission and distribution networks in all Australian jurisdictions except Western Australia. As part of this process, a regulated gas network business must periodically apply to us for a ruling on network charges which in turn influences the expected revenue it will recover from consumers for using its network. Our work under this framework is guided by the National Gas Objective (NGO).[3] We use our insights and expertise to determine how much money the network business can recover.

We have done this for Evoenergy for the 2021–26 access arrangement period, which runs from 1 July 2021 to 30 June 2026.[4] Evoenergy provides natural gas distribution services to approximately 150,000 homes and businesses across Canberra, Greater Queanbeyan and Bungendore, of which around 90 per cent of consumers are located in the ACT and 10 per cent in NSW. Around 98 per cent of Evoenergy's consumers are residential consumers.

This final decision allows Evoenergy to set gas network charges which are expected to result in the recovery of $317.4 million ($ nominal, smoothed) in revenue from consumers in the upcoming 2021–26 period. Our final decision is $5.5 million (1.8 per cent) higher than our draft decision of $311.9 million. It is also $1.3 million (0.4 per cent) lower than our decision for the 2016–21 period.[5]

The revenue we allow Evoenergy forms the distribution network component of retail gas bills, making up around a quarter of the bill for residential and small business consumers, who are likely to benefit from bill reductions in the first year.[6] Other key components of the bill include wholesale gas, transmission network and retail costs.

While we do not regulate retail prices, we estimate that our final decision, compared to current levels,[7] would result in a slight decrease followed by modest increases over the 2021–26 period. That is, we expect average annual bills for Evoenergy's consumers to:

- decrease by $10 (0.7 per cent) for residential consumers and $90 (0.8 per cent) for small business consumers, in the first year of the 2021–26 period[8]
- increase by $14 (1.0 per cent) for residential consumers and $127 (1.1 per cent) for small business consumers, in each of the next four years of the 2021–26 period.[9]

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3 The NGO is set out under the National Gas Law (NGL), s. 23 which is: "...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."

4 Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, January 2021.

5 The comparison between 2021–26 and 2016–21 periods is based on unsmoothed nominal revenue. Final decision revenue is $21.4 (6.7 per cent) million lower than our decision for the 2016–21 period in unsmoothed real terms.

6 Around 23 and 26 per cent of retail gas bills for typical residential and small business consumers, respectively.

7 As at 30 June 2021.

8 As at 30 June 2022.

9 As at 30 June of each of the last four years of the 2021–26 period.

Residential and small business consumer bills are estimated to be $46 (3.2 per cent) and $417 (3.5 per cent) higher, respectively, by the end of the 2021–26 period.[10]

Key themes throughout this review have been:

- ensuring consumers pay no more than they need for safe and reliable gas services
- significant improvement in Evoenergy's consumer engagement approach
- response to jurisdictional emissions reduction targets.

Evoenergy put forward a well-informed initial proposal in June 2020, underpinned by significant improvements to its consumer engagement approach. Its proposal was developed against the backdrop of the ACT Government's *Climate Change Strategy 2019–25*, including the legislated 2045 net zero greenhouse gas emissions target.[11]

The impact of evolving ACT policy settings on Evoenergy's future network planning and consumers has been a key issue for stakeholders in this review.

Following the October 2020 ACT election, policy clarifications were announced by the returned ACT Government in its *Parliamentary and Governing Agreement* in terms of intentions and planned initiatives to phase out natural gas in the ACT.[12] Evoenergy responded to these developments in its January 2021 revised proposal by lowering its 2021–26 forecasts for gas demand and capital expenditure (capex).

Our draft decision largely accepted Evoenergy's initial proposal, pending further information on gas demand and capex in particular. We acknowledge in this decision the additional stakeholder engagement conducted and research on gas demand commissioned by Evoenergy to further inform its revised proposal on these issues.

Our final decision determines a more moderate forecast decline of 9.8 per cent in ACT residential gas demand beyond the observed historical decline in demand, compared to Evoenergy's proposed 22.3 per cent, by the end of the 2021–26 period.

In the current circumstances, we acknowledge there is increased volume forecasting uncertainty in the 2021–26 period and that use of historical trends might not be the best representation of the future. Based on the information before us and our consultant's advice, we consider that our alternative demand forecast is better than Evoenergy's forecast in terms of accuracy and represents a more appropriate allocation of demand risk to consumers.

The outturn of our comparatively higher gas demand forecast is a better allocation of risk between Evoenergy and consumers, and lower retail bill increases for consumers by the end of the 2021–26 period. If we had adopted Evoenergy's revised proposal

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10 Compares 30 June 2026 (for the 2021–26 period) to 30 June 2021 (for the 2016–21 period).

11 *ACT Climate Change Strategy 2019–25*, 2019: https://www.environment.act.gov.au/cc/act-climate-change-strategy.

12 ACT Government, *Parliamentary and Governing Agreement, 10th Legislative Assembly for the Australian Capital Territory, November 2020*, p. 7.

demand forecasts in our final decision, then retail bills would have further increased by $26 and $238 for residential and small business consumers, respectively.[13] We note that if the trajectory of Evoenergy's demand is significantly different to our final decision, given the unique situation, we are open to Evoenergy submitting an application mid-period to vary its 2021–26 access arrangement.[14]

Our revenue final decision of $317.4 million for the 2021–26 period is $7.3 million (2.3 per cent) higher than Evoenergy's revised proposal of $310.2 million, driven by updates to our placeholder forecasts for inflation and the rate of return. Our final decision updates these placeholders in accordance with the outcome of the 2020 inflation review[15] and the 2018 Rate of Return Instrument (2018 Instrument), respectively. Our final decision accepts the majority of Evoenergy's reduced capex for the 2021–26 period arising from the lower gas demand forecast. We have also reviewed Evoenergy's proposed operating expenditure (opex), approved previously in our draft decision, and consider it is broadly consistent with gas demand. Our final decision also accepts Evoenergy's proposal for shorter standard lives for new investments in long-lived NSW pipeline assets, in addition to ACT pipeline assets which we accepted in our draft decision.

We have had regard to a range of sources in making this final decision, including Evoenergy's initial and revised proposals, stakeholder submissions received,[16] and additional analysis undertaken and published by us as part of our draft and final decisions. We also engaged directly with Evoenergy to obtain and discuss additional relevant information.

Overall, we are satisfied that our final decision on Evoenergy's 2021–26 access arrangement takes a prudent approach to the key issues under review, is broadly supported by the outcomes of consumers engagement, and is likely to be in the long term interests of consumers.

Ensuring consumers pay no more than they need for safe and reliable gas services

Ensuring consumers pay no more than they need for safe and reliable gas services that they want is a cornerstone of the access arrangement decision process. This involves us assessing whether Evoenergy's proposal represents a reasonable and realistic forecast of how much money it needs for the safe and reliable operation of its gas distribution network.

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13 Compares 30 June 2026 (for the 2021–26 period) to 30 June 2021 (for the 2016–21 period).

14 NGR, r. 65.

15 AER, *Final position, Regulatory treatment of inflation*, December 2020.

16 Submissions on Evoenergy's initial proposal were received from ActewAGL, ACTCOSS, CCP24, Conservation Council (ACT), ECA, EnergyAustralia, and Origin Energy. Submissions on Evoenergy's revised proposal and the AER's draft decision were received from ACTCOSS, CCP24, Conservation Council (ACT), ECA, Origin Energy, and Red Energy / Lumo Energy.

Evoenergy informs us that the key concerns of its consumers are energy affordability and fairness, environmental sustainability, responsible transition, and a safe and reliable gas service.[17] Prompted by ACT policy developments, Evoenergy further responded to consumers' concerns in its 2021–26 revised proposal by reducing its forecasts for gas demand and capex, as well as including precautionary cost increases for shorter standard lives for new investments in long-lived pipelines assets.

We encourage revenue proposals that are internally consistent – that is, the proposal elements are consistent with the key themes of that proposal. For example, in Evoenergy's case, the case for reduced new pipeline asset lives and gas demand as a consequence of government policy were accompanied by reductions in capex. While this has always been our expectation, it is more acute now given the velocity of change and transition in energy markets that are underway.

Accordingly, we have assessed Evoenergy's proposal at the component level to satisfy ourselves of the robustness of the proposed expenditures, as well as more holistically to confirm its alignment with Evoenergy's business priorities and jurisdictional policy settings. As noted earlier, a key outworking of our assessment was our decision to adopt a more moderate forecast decline in gas demand than put forward by Evoenergy. Following this adjustment to Evoenergy's proposal, we consider this achieves a better allocation of risk between Evoenergy and consumers.

Significant improvement in Evoenergy's consumer engagement approach

Our overall assessment of Evoenergy's consumer engagement approach, based on its 2021–26 proposal and stakeholder submissions, is that we are confident that Evoenergy is committed to putting consumers at the centre of its business and in ensuring stakeholders' views are reflected in its proposals to us.

Our draft decision commended Evoenergy on its consumer engagement approach in developing its initial proposal. Since then, Evoenergy has strengthened its proposal by further engaging with network users on its proposed refinements to its Reference Service Agreement, which we accept in this final decision. Evoenergy also engaged with stakeholders on the implications for capex, bills and asset stranding risk as a consequence of its reduced gas demand forecast.

Our Consumer Challenge Panel (CCP24) noted that since submitting its initial proposal, Evoenergy:[18]

> "…has continued to enact the business's comprehensive Consumer and Stakeholder Engagement Strategy."

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[17] Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. 14.

[18] CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 6.

The ACT Council of Social Service's (ACTCOSS) comments on Evoenergy's revised proposal included:[19]

> "We commend Evoenergy on its consumer engagement efforts and for incorporating many of the views and priorities of consumers…"

Section 1.4 details further consideration of Evoenergy's consumer engagement program through the lens of our framework for assessing consumer engagement. It sets out a range of considerations that we think demonstrate whether consumers have been genuinely engaged in the development of a proposal.

Following this final decision, Evoenergy has an opportunity to consolidate on the reasonably strong consumer engagement it demonstrated in this gas review, as it embarks on its early-stage engagement activities for its 2024–29 electricity review which may raise similar issues of energy affordability and transition from an electricity network perspective.

Response to jurisdictional emissions reduction targets

The future of natural gas is a live issue, particularly as renewable energy becomes cheaper and is increasingly becoming the choice of consumers. Whilst ACT and NSW consumers are still demanding gas and Evoenergy continues to support its network operations, gas networks across Australia are facing an evolving landscape with growing support for reducing carbon emissions by moving away from natural gas use for homes and businesses. This is occurring at varying speeds in different regions, driven primarily by jurisdictional government policy.

For Evoenergy, this means it will cease connecting new gas consumers in the ACT from 2023, but continue to connect NSW gas consumers over the 2021–26 period.

This issue of uncertainty was considered by CCP24:[20]

> "Evoenergy, along with other gas distribution network businesses, faces fundamental questions about the future of the gas network, driven by jurisdictional governments moving towards net zero emissions policies in a timeframe considerably less than the asset lives of a large part of the business's asset base."

Some network businesses, such as Evoenergy, are responding to uncertainties regarding the future of natural gas by seeking to recoup investments in long-lived network assets from consumers over a shorter time horizon to mitigate against asset stranding risk.

There are a variety of views from stakeholders on these matters, but a common concern is the implication for future prices for consumers. In terms of Evoenergy's gas

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[19] ACTCOSS, *Submission: Evoenergy gas network 2021–26 access arrangement revised proposal and AER draft decision*, February 2021, p. 12.

[20] CCP24, *Advice to the AER on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, p. 3.

network, we consider there is a case for some precautionary steps to be taken sooner rather than later.

Evoenergy's initial proposal sought reduced standard lives for new pipeline assets to address potential cost recovery uncertainties caused by the ACT Government's legislated 2045 net zero greenhouse gas emissions target. Evoenergy considered its proposal represented an early, precautionary measure against rising bills as a result of declining gas consumer numbers, and that accelerated depreciation of the assets will reduce the risk that, in the event of network closure, consumers who find it difficult or not feasible to move away from gas will be left to pay an unfair share of costs.[21]

Our draft decision accepted Evoenergy's proposal for shorter standard lives for new pipeline assets in the ACT region. We considered there was sufficient evidence to justify that these assets would have shorter economic lives than their technical lives due to the ACT Government's policies to move away from gas use even though there were some uncertainties regarding the path it would choose to achieve net zero emissions.[22] However, we were not persuaded that shorter lives should be used for Evoenergy's NSW assets given its positive outlook for consumer growth in this region.

This final decision accepts Evoenergy's revised proposal to apply shorter standard lives for its ACT and NSW new pipeline assets. We have changed our draft decision position as a result of carefully assessing the information provided in Evoenergy's revised proposal and the advancement of the ACT Government's climate change policy following the October 2020 ACT election.

We recognise that Evoenergy's primary business is supplying gas to the ACT which accounts for 90 per cent of its consumer base, but there are economies of scale with also supplying gas to areas outside of the ACT which fall in NSW. We expect the advancement of climate change policy in the ACT would also have implications on the future behaviour of Evoenergy's NSW consumers due to the increase in the costs per consumer associated with running the network as ACT gas demand declines. Further, greater accelerated depreciation on existing capital base assets in future periods would also increase the costs to all consumers. These factors could combine to make gas less competitive for Evoenergy's NSW consumers and encourage them to leave its network in future periods. Therefore, we consider there is sufficient evidence that pipeline assets in the NSW region of Evoenergy's network would not reach the end of their technical life due to the impact of a likely shut down of the ACT gas network.

In light of the elevated risk of network closure and a substantial reduction in demand, we consider our final decision is a prudent and responsible first step to protect the long term interests of Evoenergy's gas consumers from asset stranding risk.

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[21] Evoenergy, *Overview – Access arrangement information, ACT and Queanbeyan-Palerang gas network 2021–26*, June 2020, p. iv.

[22] AER, *Draft decision, Evoenergy 2021–26 Access arrangement, Attachment 4 – Regulatory depreciation*, November 2020.

Our final decision takes account of the views from stakeholder submissions, including CCP24 who support Evoenergy's proposed steps for managing asset stranding risk and would like to see further engagement on the future use of gas networks.

To this end, and in recognition of the importance of the gas market and our role in determining network access arrangements, we have elevated consideration of issues relating to the future regulation of gas networks in our strategic priorities list and will advance this discussion with consumers, industry, market bodies and government stakeholders this year.

1 Our final decision

Our final decision allows Evoenergy to recover $317.4 million ($ nominal, smoothed) from gas consumers from 1 July 2021 to 30 June 2026.

Evoenergy is regulated using a price cap.[23] Incentives are provided to it to reduce costs, improve service quality and undertake efficient investments.

Gas pipelines that are subject to full regulation, like Evoenergy's, are regulated by us under an approved access arrangement.[24] An access arrangement specifies certain pipeline services (reference services) and the price and non-price terms and conditions on which those reference services will be offered over a five-year period. To approve an access arrangement, we make regulatory decisions on the network charges that pipeline operators can bill users of its reference services.

For this final decision, our assessment is based on the access arrangement revised proposal that Evoenergy submitted to us on 13 January 2021.[25] Evoenergy's revised proposal, in response to our draft decision,[26] sets out its view of its expected costs, demand and required revenues for the 2021–26 period.

1.1 How our final decision would affect gas bills

Gas distribution network charges that will be set by reference to our final decision are one contributor to consumers' total retail gas bills.

Bills are made up of the cost of purchasing gas (wholesale energy cost), the cost of pipelines used to transport gas (transmission and distribution networks) and other infrastructure such as metering costs, and the retailer's costs and profit margin. These costs contribute to the retail prices charged to consumers by their chosen retailer.

Our final decision on Evoenergy affects the bill component relating to gas distribution pipelines. For consumers on Evoenergy's network, distribution charges account for around a quarter of the bill for residential and small business consumers.[27]

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23 This is a weighted average price cap (WAPC) tariff basket form of price control. This approach is consistent with other gas distributors and Evoenergy's current period access arrangement. See Attachment 10 of our draft decision for additional information: AER, *Draft decision, Evoenergy 2021–2026, Attachment 10 – Reference tariff variation mechanism*, November 2020.

24 The NGL provides for different types of regulation to apply to gas pipelines, based on competition and significance criteria. A 'full regulation' pipeline must periodically submit an access arrangement to the AER, setting out pricing for a reference service sought by a significant part of the market. 'Light regulation' pipelines are not subject to upfront price regulation. The light regulation model is a negotiate-arbitrate approach, placing greater emphasis on commercial negotiation and information disclosure. The AER plays a role only if dispute resolution mechanisms are triggered.

25 Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, January 2021; NGR, r. 62(3).

26 AER, *Draft decision*, *Evoenergy Access Arrangement 2021–26*, *Overview*, November 2020.

27 Around 23 and 26 per cent of retail gas bills for typical residential and small business consumers, respectively.

We estimate the bill impact by varying distribution charges in accordance with our final decision, while holding all other components constant. This isolates the effect of our decision on distribution charges only. However, this does not imply that other components of the bill will remain unchanged over the 2021–26 period.

Table 1 shows the estimated average annual impact of our decision on retail gas bills for consumers on Evoenergy's network compared with Evoenergy's revised proposal.

Table 1 Estimated impact of AER's final decision and Evoenergy's revised proposal on average annual gas bills for the 2021–26 period ($ nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
AER's final decision						
Residential annual bill[a]	1,440[a]	1,430	1,443	1,457	1,471	1,486
Annual change[c]		–10 (–0.7%)	13 (0.9%)	14 (1%)	14 (1%)	15 (1%)
Small business annual bill[b]	11,870[b]	11,781	11,900	12,024	12,153	12,288
Annual change[c]		–90 (–0.8%)	119 (1%)	124 (1%)	129 (1.1%)	134 (1.1%)
Evoenergy's revised proposal						
Residential annual bill[a]	1,440[a]	1,448	1,456	1,465	1,473	1,482
Annual change[c]		8 (0.5%)	8 (0.6%)	8 (0.6%)	9 (0.6%)	9 (0.6%)
Small business annual bill[b]	11,870[b]	11,941	12,015	12,091	12,168	12,247
Annual change[c]		71 (0.6%)	74 (0.6%)	76 (0.6%)	77 (0.6%)	79 (0.7%)

Source: AER analysis; Evoenergy, *Attachment 9.1 Customer bill impacts model*, January 2021.
(a) Annual bill for 2020–21 reflects the average annual consumption of 28 GJ for Evoenergy's residential consumers.
(b) Annual bill for 2020–21 reflects the average annual consumption of 469 GJ for Evoenergy's small business consumers.
(c) Annual change amounts and percentages are indicative. They are derived by varying the network tariff contribution to the 2020–21 bill amounts in proportion to the change in the tariff path. Actual bill impacts will vary depending on gas consumption and tariff class.

While we do not regulate retail prices, we estimate that under this final decision, compared to current levels, average annual bills for Evoenergy's consumers would:[28]

- decrease by $10 (0.7 per cent) for residential consumers and $90 (0.8 per cent) for small business consumers, in the first year of the 2021–26 period[29]
- increase by $14 (1.0 per cent) for residential consumers and $127 (1.1 per cent) for small business consumers, in each of the next four years of the 2021–26 period.[30]

[28] As at 30 June 2021.
[29] As at 30 June 2022.
[30] As at 30 June of each of the last four years of the 2021–26 period.

Residential and small business consumer bills are estimated to be $46 (3.2 per cent) and $417 (3.5 per cent) higher, respectively, by the end of the 2021–26 period.[31]

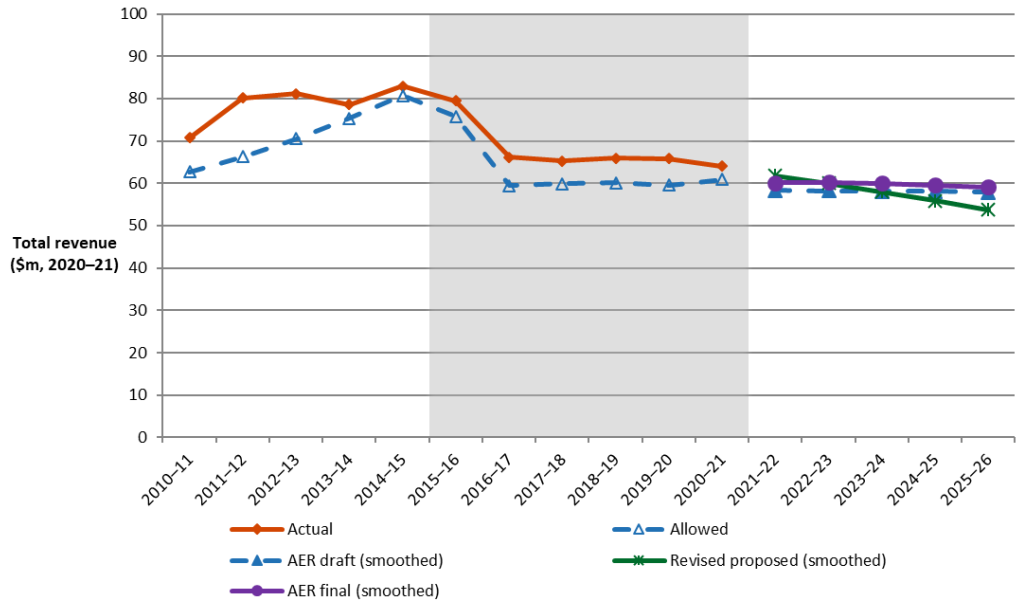
1.2 Revenue drivers

The changing impact of inflation over time makes it difficult to compare revenue from one period to the next on a like-for-like basis. To do this, we use 'real' values based on a common year, which have been adjusted for the impact of inflation ($2020–21).[32]

Our final decision for Evoenergy approves a total revenue for the 2021–26 period that is $21.4 million (6.7 per cent) lower than our decision for the 2016–21 period.[33]

Figure 1 shows our final decision for Evoenergy's smoothed revenue for the 2021–26 period, and allowed revenues for the 2011–16 and 2016–21 periods.

Figure 1 Revenue over time ($ million, 2020–21)



Source: AER analysis.

Figure 2 highlights the key drivers for the change in Evoenergy's allowed revenue from the 2016–21 period compared to what we expect in the 2021–26 period.

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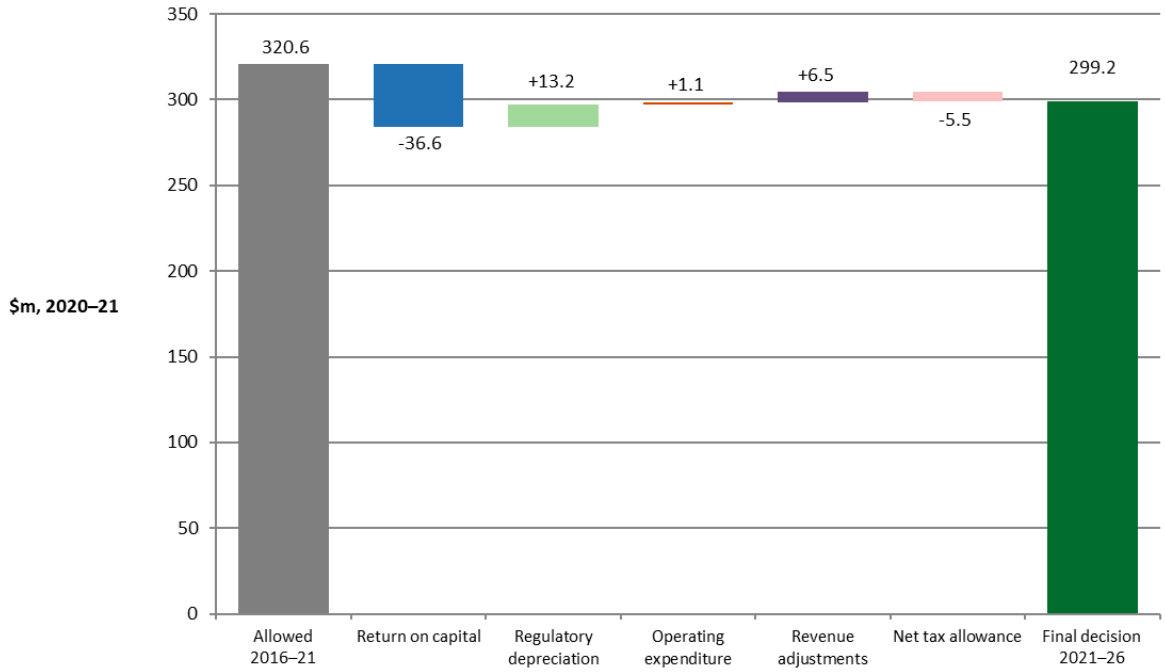
31 Compares 30 June 2026 (for the 2021–26 period) to 30 June 2021 (for the 2016–21 period).

32 That is, 30 June 2021 dollar terms based on Evoenergy's estimated actual revenue for 2020–21.

33 The comparison of total revenue between 2021–26 and 2016–21 periods is based on unsmoothed revenue. In nominal dollar terms, our final decision total revenue for the 2021–26 period is $1.3 million (0.4 per cent) lower than total revenue approved for the 2016–21 period.

Figure 2 AER's final decision for the 2021–26 period and Evoenergy's 2016–21 allowed building block costs ($ million, 2020–21)



Source: AER analysis.

It shows that our final decision for the 2021–26 period provides for:

- reductions in the building blocks for:
    - return on capital, which is $36.6 million (31.5 per cent) lower than 2016–21, driven by decreases in the nominal weighted average cost of capital (WACC) from 6.01 to 4.78 per cent in the first year of the 2016–21 and 2021–26 periods, respectively
    - corporate income tax, which is $5.5 million (66.6 per cent) lower than 2016–21, driven by the lower return on equity and higher value of imputation credits (gamma), as per the application of the 2018 Instrument and our 2018 tax review[34]
- increases in the building blocks for:
    - regulatory depreciation, which is $13.2 million (39.1 per cent) higher than 2016–21, driven by an increase in expenditure on short-life metering assets in the 2016–21 and 2021–26 periods, a lower estimate of expected inflation following the completion of our 2020 inflation review,[35] and applying shorter lives for new expenditure on pipeline assets over the 2021–26 period

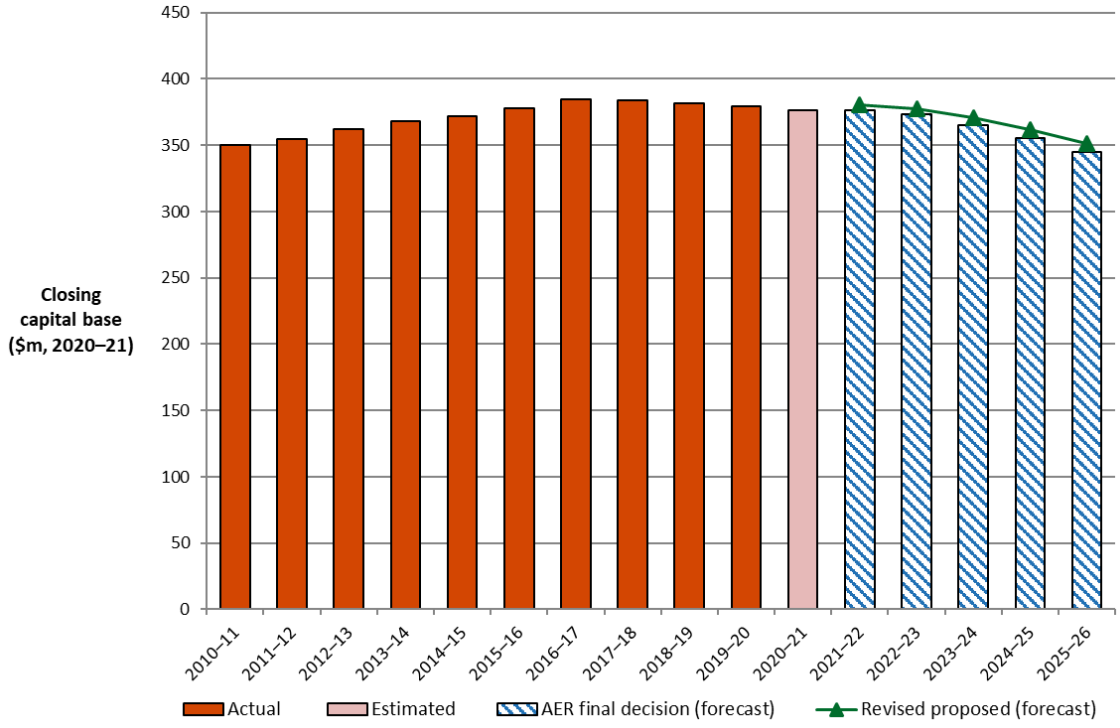
[34] AER, *Final report: Review of regulatory tax approach*, December 2018.

[35] AER, *Final position, Regulatory treatment of inflation*, December 2020.

- revenue adjustments, which are $6.5 million (83.0 per cent) higher than 2016–21, driven by an increase in the efficiency carryover mechanism (ECM) amount.

Figure 3 compares our final decision on Evoenergy's forecast capital base, to its actual and proposed forecast capital base. It shows that Evoenergy's capital base is forecast to decrease by 8.4 per cent in real terms by the end of the 2021–26 period.

Figure 3 Value of Evoenergy's capital base over time ($ million, 2020–21)



Source: AER analysis.

1.3 Key differences between our final decision and the revised proposal

Evoenergy proposed total revenue of $310.2 million ($ nominal) for the 2021–26 period.[36] Our final decision of $317.4 million allows $7.3 million (2.3 per cent) more revenue than Evoenergy sought to recover through its revised proposal.[37]

The biggest contributor to the revenue difference between our final decision and Evoenergy's revised proposal is the lower expected inflation rate that resulted from our

[36] Evoenergy, *Appendix 4.2 PTRM*, June 2020.

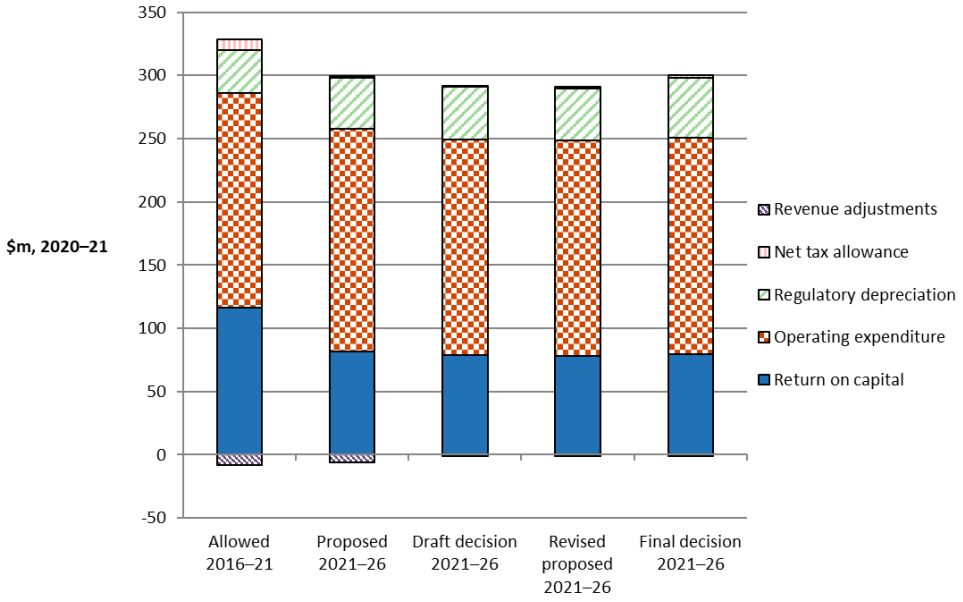
[37] NGR, r. 74 requires (1) information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate, and (2) a forecast or estimate (a) must be arrived at on a reasonable basis, and (b) must represent the best forecast or estimate possible in the circumstances.

2020 inflation review and was implemented in the post-tax revenue model (PTRM).[38] Our final decision adopts an expected inflation rate of 2.00 per cent per annum compared to Evoenergy's revised proposal of 2.37 per cent per annum. This increases building block revenue by around $4.8 million compared to Evoenergy's proposal.[39]

Another difference is the current rate of return and, therefore, the return on capital. Evoenergy has applied the 2018 Instrument and, based on the risk free rate and cost of debt at the time of the revised proposal, has included a 4.60 per cent rate of return. However, currently the cost of equity is higher than at the time of its revised proposal, leading to a rate of return of 4.78 per cent. Consequently, the return on capital building block is $1.2 million (1.4 per cent) higher than proposed.

In addition, as the higher return on capital and regulatory depreciation building blocks have increased taxable income, the corporate income tax building block is $1.4 million (89.6 per cent) higher than proposed. Figure 4 compares our final decision building block revenue to Evoenergy's revised proposal for the 2021–26 period, and to approved revenue for the 2016–21 period.

Figure 4 AER's final decision on components of total revenue ($ million, 2020–21)



Source: AER analysis.

1.4 Evoenergy's consumer engagement

Consumer engagement helps businesses determine how best to provide services that align with consumers' long term interests. Consumer engagement in this context is

[38] AER, *Gas distribution PTRM (version 2)*, April 2021.

[39] All else being equal.

about Evoenergy working openly and collaboratively with consumers and providing opportunities for their views and preferences to be heard and to influence Evoenergy's decisions.

In the regulatory process, strong consumer engagement can help us test network service providers' expenditure proposals, and can raise alternative views on matters such as service priorities, capex and opex proposals, and tariff structures. It can inform the depth of technical assessment that is required, but does not displace it.

We have assessed Evoenergy's consumer engagement program through the lens of our consumer engagement framework.[40] We used a range of considerations to demonstrate whether consumers have been genuinely engaged in the development of Evoenergy's proposal, including the nature of engagement, breadth and depth of engagement, clearly evidenced impact, and assessment of proposed expenditure outcomes. We will further develop our framework with stakeholders in the near future.

Our draft decision recognised Evoenergy's improved level of consumer engagement, citing its work in assembling a Citizens' Jury and reflecting consumers' expectations and views on the future of Evoenergy's gas network in its initial proposal.[41] We also indicated possible opportunities for Evoenergy's revised proposal, such as using a wider range of engagement activities to allow stakeholders across its network to participate and engaging stakeholders on detailed analysis.[42]

We acknowledge that, following our draft decision, Evoenergy continued to enact its Consumer and Stakeholder Engagement Strategy. This included providing regular briefings to its Energy Consumer Reference Council (ECRC)[43] and other key stakeholders on ACT policy developments and its emerging revised proposal. CCP24 submitted:[44]

> "For stakeholders, it has enhanced confidence in the sincerity of the engagement program."

Evoenergy sought to address elements of our draft decision, and those of stakeholders, regarding its consumer engagement in its revised proposal. For instance, in reviewing aspects of its Reference Service Agreement (RSA), Evoenergy engaged

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40 See Table 7; AER, *Draft decision, Jemena distribution determination 2021–26, Overview*, September 2020, p. 43.

41 Evoenergy's Citizens' Jury comprised a cross-section of the ACT community (representing owners, tenants, landlords, business operator, concession card holders, Aboriginal and Torres Strait Islander and Culturally & Linguistically Diverse members). The Jury's 28 members were selected via an independent recruitment process and deliberated over the following question over two weekends in October and November 2019: "The ACT Government has legislated for net zero greenhouse gas emission by 2045. Evoenergy is committed to transform the gas network to meeting this target. As part of this transition, what are our consumers expectations of the service provided to them?".

42 AER, *Draft decision*, *Evoenergy Access Arrangement 2021–26*, *Overview*, November 2020, p. 20.

43 Information on Evoenergy's ECRC is available here: https://www.evoenergy.com.au/consumer-engagement-program/energy-consumer-reference-council.

44 CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 7.

key stakeholders, including users of its network, to understand the areas of concern, identify improvements to existing arrangements, and obtain their support on the proposed amendments.[45]

Overall, we consider Evoenergy has engaged well with consumers in this review, reflecting many of their views and priorities in its 2021–26 proposal, with potential to further enhance its consumer engagement approach in future.

For instance, in revising its demand forecast, Evoenergy engaged a consultant (Sagacity Research) to survey residential consumers to assess their energy preferences in light of the updated ACT policy environment.[46] While stakeholders welcomed the survey, some raised concerns about the online survey and its extrapolation to consumer demand forecasts, as renters and landlords were not included.[47] ACTCOSS submitted:[48]

> "Renters are a key group that we are concerned about in terms of potential stranded customers due to the barriers they are likely to experience in transitioning from gas to electric…This is an important distinction and a critical issue given that over one-third (34%) of ACT households are renters."

Stakeholders also noted Evoenergy's limited engagement with developers regarding their intentions to advance all electric developments.[49] CCP24 and the Conservation Council suggested that Evoenergy could involve and collaborate more with stakeholders, such as the ECRC given its growing expertise[50] and gas retailers, in transitioning its network to meet jurisdictional climate change policies.[51]

CCP24[52] and ACTCOSS[53] also saw further opportunity for Evoenergy to explore and enhance consumers' understanding of declining block tariff structures and its impacts.

We encourage Evoenergy's ongoing work to further embed meaningful consumer engagement into its business-as-usual functions, particularly in relation to consumer

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45 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 8.

46 Ibid., p. 39.

47 CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, pp. 9–10.

48 ACTCOSS, *Submission: Evoenergy gas network 2021–26 access arrangement revised proposal and AER draft decision*, February 2021, p. 16.

49 Ibid., p. 16; Energy Consumers Australia, *Response to Evoenergy and Australian Gas Networks (SA) revised proposals 2021–26 – Technical report: Response to AER draft decision & Evoenergy revised access arrangement proposal 2021–26* (prepared by TRAC Partners), February 2021, p. 17.

50 CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 8.

51 Conservation Council ACT Region, *Submission to the AER – Evoenergy revised 2021–2026 gas access arrangement proposal*, February 2021, p. 5.

52 CCP24, *Advice to the AER on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, pp. 10–11.

53 ACTCOSS, *Submission: Evoenergy's gas network 2021–26 access arrangement proposal to the AER*, August 2020, pp. 21–22.

vulnerability, fairness and equity as a result of the ACT policy environment.[54] Going forward, there may be opportunities for Evoenergy to continue to explore some areas with consumers following this decision. For example, as part of its early-stage engagement activities for its 2024–29 electricity review which may raise similar issues from an electricity network perspective.

[54] ACTCOSS, *Submission: Evoenergy gas network 2021–26 access arrangement revised proposal and AER draft decision*, February 2021, pp. 12–13 and 22–23.

2 Reference services and tariffs

This section summarises our 2021–26 final decision on the services covered by Evoenergy's access arrangement, the reference tariff and variation mechanism, and forecast demand.

2.1 Services covered by the access arrangement

Evoenergy's access arrangement must specify the pipeline services it proposes as reference services, having regard to the reference service factors.[55] For each reference service, including services ancillary to the reference services, the access arrangement specifies the reference tariff and other terms and conditions on which these services will be provided.[56]

Evoenergy is to provide access to its reference services on the terms set out in its access arrangement, but may negotiate alternative terms and conditions at alternative prices with users. It may also offer other non-reference services (negotiated services) which are not subject to regulation under the access arrangement. We may be called upon to determine the tariff and other service access conditions if a dispute arises.[57]

Evoenergy's proposed reference service for the 2021–26 period is largely the same as its reference service for the 2016–21 period, and includes haulage[58] and two additional non-reference services (that is, interconnection service and negotiated service).

Evoenergy accepted our draft decision in its revised proposal.[59] Our final decision confirms our draft decision position, which is to approve Evoenergy's proposed reference services for the 2021–26 period.[60]

2.2 Reference tariff setting and variation mechanism

Reference tariff setting requires Evoenergy to explain how it allocates revenues and costs between reference services and other services, and how it determines different tariffs. This involves setting and applying the formula by which it can recover costs. Our final decision includes decisions on the structure and levels of Evoenergy's reference tariffs (reference tariff setting) and the mechanism by which those tariffs can vary over the access arrangement period (reference tariff variation mechanism).

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55 NGR, modified r. 48(1)(c) and r. 47A(15).

56 NGR, modified r. 48(1)(e).

57 NGL, Chapter 6.

58 Haulage refers to: receipt of and transportation of gas from an upstream pipeline or other gas facility through the Evoenergy network to each customer's premises for use and consumption within the premises; and providing gas metering equipment at customers' premises and associated services to read the quantity of gas flowing through the gas meters.

59 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021.

60 AER, *Draft decision, Evoenergy 2021–26 Access arrangement, Attachment 1 – Services covered by the access arrangement*, November 2020.

Our final decision accepts Evoenergy's proposed reference tariff variation mechanism.

We also accept Evoenergy's proposed cost pass through definitions, including the insurance coverage event definition it proposed to replace the insurance cap event.[61] This change is consistent with our decisions for electricity network businesses.[62] We have made minor definitional adjustments to the insurance coverage event, and have provided additional guidance on matters we will likely have regard to in assessing any insurance coverage event that occurs.

Evoenergy's initial proposal sought changes to the automatic adjustment factor.[63] We approved these changes in our draft decision, but inadvertently made a transcription error in the automatic adjustment factor formula.[64] In line with Evoenergy's revised proposal, our final decision approves retention of the original formula.[65]

We note that Evoenergy's revised proposal did not discuss its declining block tariff structure. This is despite submissions from CCP24[66] and ACTCOSS[67] expressing concerns about the environmental and social equity impacts of declining block tariffs. CCP24 encouraged engagement with consumer representatives, seeking a shared understanding of the impacts of the approved tariff structures to be developed and any additional support arrangements for vulnerable consumers to be identified. ACTCOSS questioned whether the declining block tariff structure is well known to Evoenergy's consumers and also questioned our position that consumers can respond to the declining block tariff by adjusting their consumption. ACTCOSS suspects there is little awareness of this tariff structure among residential consumers.

In response to CCP24 and ACTCOSS, we retain our draft decision position for the 2021–26 period because Evoenergy's declining block tariff is consistent with the price cap form of control. We acknowledge, however, that the form of control should be examined as part of our broader review of the reticulated gas sector.

2.3 Forecast demand

Demand is an important input into Evoenergy's reference tariffs. Under a weighted average price cap, tariffs are generally determined by dividing cost (forecast revenue) by total demand (GJ/day per consumer for each tariff class). This means that a

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61 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, pp. 55–56.

62 AER, *Final decision, South Australia Power Networks distribution determination 2020–25, Attachment 14 – Pass through events*, July 2020, pp. 13–14.

63 Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, June 2020, Schedule 4, Section 1, pp. 62–63.

64 This relates to the *realWACC* component in the automatic adjustment factor formula.

65 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, Table 11.2, p. 54.

66 CCP24, *Advice to the AER on Evoenergy gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, August 2020, pp. 10–11.

67 ACTCOSS, *Submission: Evoenergy's gas network 2021–26 access arrangement proposal to the AER*, August 2020, pp. 21–22.

decrease in demand leads to an increase in tariffs, and vice versa. Demand also affects forecasts for opex and capex (new connections) which inform our decision on the total revenue requirement.

In our draft decision, we did not accept Evoenergy's Tariff VI demand forecasts for the 2021–26 period. We were concerned with Evoenergy's adjustment to the demand forecasts prepared by its consultants, The Centre for International Economics (CIE). We also requested Evoenergy incorporate any tangible changes in its revised proposal to reflect the ACT Government's latest commitments to achieve net zero emissions.[68]

The policy settings in the ACT are likely to reduce new connections, and incentive schemes that encourage gas consumers to switch to electric appliances are likely to lower gas usage. We accept that this will reduce demand faster than the historically identified five-year trend. In this circumstance, an adjustment is needed to the trend-driven demand forecasts that are usually relied upon to derive a five-year forecast. The central question is how a reasonable adjustment can be found, given the uncertainty surrounding future gas consumption, and the impact lower or higher demand will have on consumer tariffs.

Evoenergy's demand consultant, CIE, adopted a standard demand forecasting approach to produce a base model, and then applied post-model adjustments which reduced the demand forecast. Our final decision is to not accept Evoenergy's revised demand forecast for individual volume consumers (Tariff VI) for the 2021–26 period. Specifically, we do not accept Evoenergy's post-model adjustment to:

- reduce the average consumption of ACT residential owner occupier consumers by 22.3 per cent by 2025–26
- increase customer exits by a further 15,329 by 2025–26.

The above adjustments are based on CIE's interpretation of Sagacity Research's survey results which we do not consider are fit for the purpose of forecasting gas demand and customer numbers.

Based on our consultant's (ACIL Allen) advice, we have provided an alternative forecast.

[68] AER, *Draft Decision, Evoenergy access arrangement 2021–26, Attachment 12 – Demand*, November 2020, p. 4.

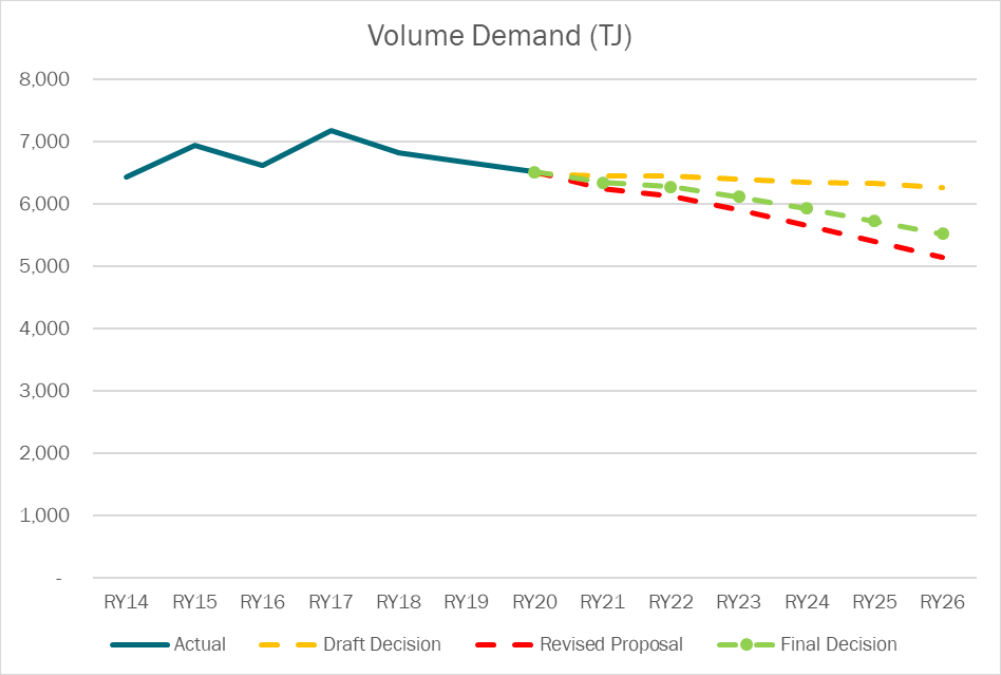
As set out in Figures 5 and 6, the alternative forecast draws on 19 months of recently observed data from the incremental impact of the ACT Energy Efficiency Improvement Scheme (EEIS). The scheme provides incentives for gas customers to switch to electricity. The data shows the actual switching rate to date, and in our view provides a reasonable basis for forecasting customer responses to the scheme in future. We use the revealed switching rate to make our own post-model adjustment. Our alternative forecast:

- reduces the average consumption of ACT residential consumers by a further 9.8 per cent by 2025–26 beyond the observed historical decline in demand
- increases customer exits by a further 5,688 by 2025–26.

We consider that the use of actual revealed data to forecast future demand remains a more robust and reliable approach than the approach adopted by Evoenergy. This approach was used by CIE for Evoenergy's initial proposal, but not for its revised proposal which relied on a survey of potential consumer behaviour conducted by Sagacity Research to derive post-model adjustments.

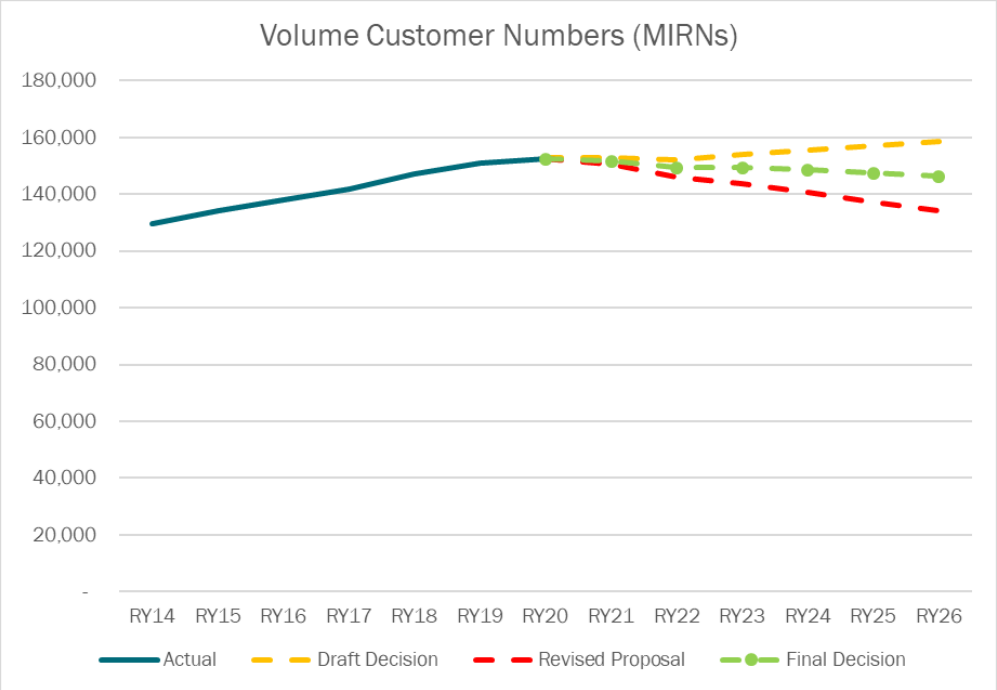
In using the EEIS data, we are assuming that the associated fall in demand will remain in line with the short-term trend for the next five years. Under normal circumstances, we would not have accepted such an assumption, as a rebate may have a limited effective life. However, given the ACT Government's policy direction, assuming that similar switching schemes will continue to operate is a reasonable assumption.

Figure 5 AER's final decision on Evoenergy's revised forecast demand (Tariff VI and Tariff VB) for the 2021–26 period



Source: AER analysis. Includes commercial, NSW residential and volume boundary demand. 2013–14 to 2019–20 years represents non-weather corrected actuals.

Figure 6 AER's final decision on Evoenergy's revised forecast customer numbers (Tariff VI and Tariff VB) for the 2021–26 period



Source: AER analysis. Includes commercial, NSW residential and volume boundary numbers.

Our final decision accepts the following aspects of Evoenergy's demand forecast for the 2021–26 period:

- the base model, which has been derived by CIE and takes into account of weather normalisation, price elasticity, historical trends and projections in line with the Australian Energy Market Operator's (AEMO) demand forecasting approach
- Evoenergy's input assumption to exclude greenfield developments from its connection forecast from 1 July 2021, driven by existing ACT Government policy
- Evoenergy's input assumption to exclude all in-filled (brownfield) developments from its connection forecast from 1 January 2023, driven by the latest ACT Government policy
- Evoenergy's proposed demand forecast for volume boundary consumers (Tariff VB)
- Evoenergy's proposed demand forecast for industrial and large government consumers (Tariff D).

Our final decision demand forecast represents:

- A decrease in total residential and commercial gas demand of 2.7 per cent per year over the 2021–26 period, compared to Evoenergy's revised proposed decrease of 3.8 per cent per year, and the 0.8 per cent per year decrease for the 2016–21 period. This is due to both forecast reductions in consumption per connection of 2.0 per cent per year and net consumer connections of 0.7 per cent per year, compared to Evoenergy's revised proposed net consumer connections decrease of 2.3 per cent per year.[69]
- A decrease in industrial and large government demand of 2.7 per cent per year over the 2021–26 period, compared to a decrease of 0.6 per cent per year over the 2016–21 period.

In the current circumstances, we acknowledge there is increased volume forecasting uncertainty in the 2021–26 period. We also acknowledge that the use of historical trends might not be the best representation of the future. Based on the information before us and our consultant's advice, we do not accept that Evoenergy's demand forecast is better in terms of accuracy or is the appropriate allocation of demand risk to consumers. However, given the unique situation, we are open to Evoenergy submitting an application mid-period to vary its 2021–26 access arrangement if the trajectory of its demand is significantly different to our final decision.[70] This is in line with submissions from Energy Consumers Australia (ECA) and CCP24 to allow for the potential revisit of Evoenergy's demand forecast.

Attachment 12 provides further detail on our demand decision.

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[69] This compares to a reduction in consumption per connection of 2.7 per cent per year, and a growth in net consumer connections of 1.9 per cent, in the 2016–21 period.

[70] NGR, r. 65.

3 Total revenue requirement

The total revenue requirement is a forecast of the efficient cost of providing gas distribution services over the 2021–26 period. We determine annual revenue, and the total revenue requirement, in nominal terms. To do this, we take into account expected future inflation to determine nominal price levels in future years. Our decision uses five-year inflation expectations to convert revenues to nominal values.

Tariffs are derived from the total revenue requirement after consideration of demand for each tariff category. Our 2021–26 final decision is that Evoenergy will continue to operate under a weighted average tariff cap. This means the tariffs we determine (including the means of varying the tariffs from year-to-year) are the binding constraint across the 2021–26 period, rather than the total revenue requirement set in our decision.[71] Tariffs are adjusted each year using X factors – the percentage changes in real weighted average tariffs from year-to-year – as explained in section 3.3.

3.1 The building block approach

We employ a building block approach to determine Evoenergy's total revenue requirement. That is, we base the total revenue requirement on our estimate of the efficient costs that Evoenergy is likely to incur in providing its reference services. The building block costs, as shown in Figure 7, include:[72]

- return on the projected capital base (or return on capital) – to compensate investors for the opportunity cost of funds invested in the business[73]
- depreciation of the projected capital base (or return of capital) – to return the initial investment to investors over time[74]
- forecast opex – the operating, maintenance and other non-capital expenses incurred in the provision of network services
- revenue adjustments – including revenue increments/decrements resulting from the application of incentive schemes
- estimated cost of corporate income tax.

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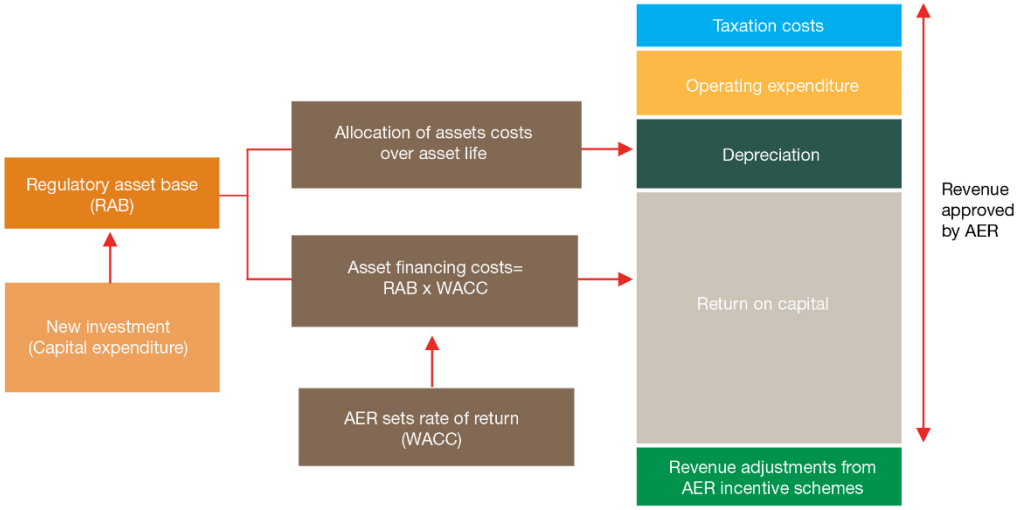
71 Where 2021–26 actual demand varies from the 2021–26 demand forecast, Evoenergy's actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, Evoenergy's actual revenue will be above forecast revenue, and vice versa.

72 NGR, r. 76.

73 Note that forecast capex that is approved in our decision affects the projected size of the capital base and, therefore, the revenue generated from the return on capital and depreciation building blocks.

74 Ibid.

Figure 7 The building block approach to determining total revenue



We use an incentive approach where, once regulated revenues are set for a five-year period, networks that keep actual costs below the regulatory forecast of costs retain part of the benefit. This incentive framework is a foundation of our regulatory approach and promotes the delivery of the NGO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent access arrangement periods.

The next section summarises our final decision, by building block, and provides our high level reasons and analysis.[75]

3.2 Final decision on total revenue

Our final decision sets out a number of amendments to the building block inputs making up Evoenergy's revised proposal total revenue of $310.2 million ($ nominal, smoothed). We expand on these in section 4.

Based on our assessment of the building block costs,[76] our final decision determines a higher total revenue of $317.4 million ($ nominal, smoothed).[77] It follows that our final decision requires amendments to the 2021–22 tariffs set out in Evoenergy's revised proposal, which is for a 0.05 per cent real tariffs reduction. We also require

[75] NGR, r. 74 requires (1) information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate, and (2) a forecast or estimate (a) must be arrived at on a reasonable basis, and (b) must represent the best forecast or estimate possible in the circumstances.

[76] Using the building block approach set out in the NGR, r. 76.

[77] This is calculated by smoothing the unsmoothed building block revenue for the 2021–26 period, as set in this decision.

consequential amendments to Evoenergy's proposed 2022–26 tariff path, which is for constant real tariffs throughout 2022–26.[78]

Table 2 sets out our final decision on Evoenergy's total revenue requirement, by building block, for each year of the 2021–26 period, the total revenue after equalisation (smoothing), and the X factors for use in the tariff variation mechanism.

Table 2 AER's final decision on Evoenergy's smoothed total revenue and X factors for the 2021–26 period ($ million, nominal)

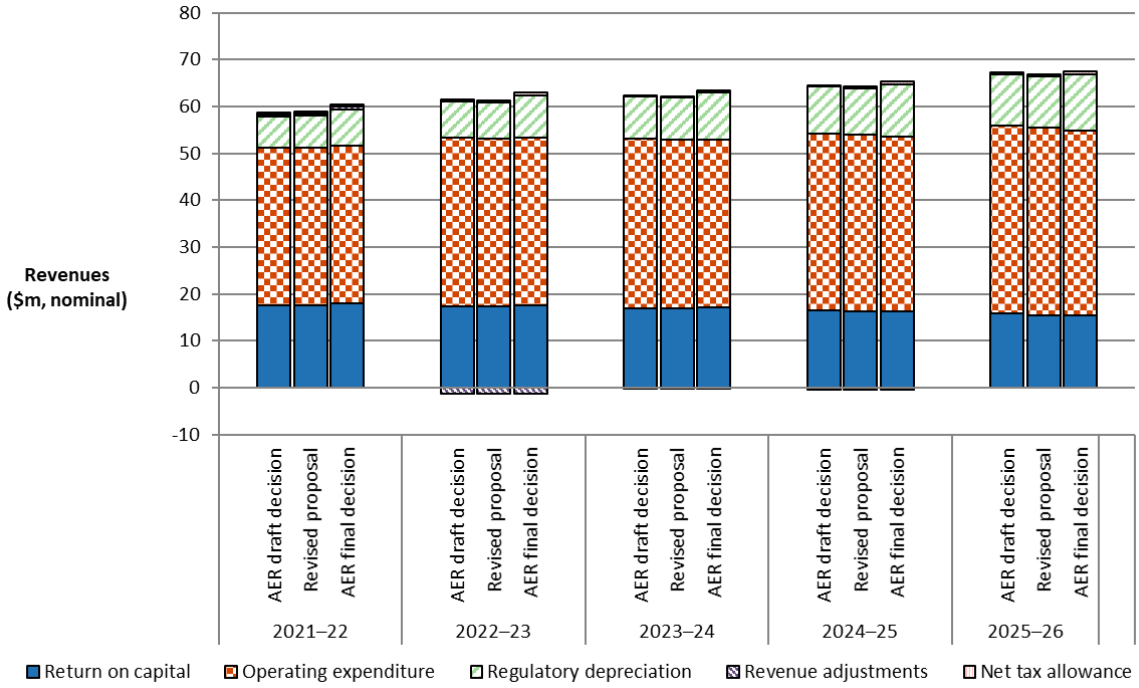
Building block	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	18.0	17.6	17.1	16.3	15.5	84.5
Regulatory depreciation	7.7	9.1	10.1	11.1	12.0	50.1
Operating expenditure	33.6	35.7	35.7	37.3	39.3	181.6
Revenue adjustments	0.5	–1.4	–0.1	–0.5	0.0	–1.4
Net tax allowance	0.6	0.6	0.5	0.6	0.6	2.9
Building block revenue – unsmoothed	60.5	61.6	63.4	64.7	67.4	317.7
Building block revenue – smoothed	**61.4**	**62.6**	**63.7**	**64.5**	**65.3**	**317.4**
X factors[a]	4.85%	–2.01%	–2.01%	–2.01%	–2.01%	n/a
Inflation forecast	2.00%	2.00%	2.00%	2.00%	2.00%	n/a
Nominal price change[b]	–2.95%	4.05%	4.05%	4.05%	4.05%	n/a

Source: AER analysis.
n/a: not applicable.
(a) Under the CPI–X form of control, a positive X factor is a decrease in price (and, therefore, in revenue). The X factor for 2021–22 is indicative only. Our decision establishes 2021–22 tariffs directly, rather than referencing a change from 2020–21 tariffs.
(b) The formula for a nominal price change under the CPI–X form of control is: [(1+CPI)*(1–X factor)]–1.

Figure 8 shows the effect of our final decision adjustments to Evoenergy's proposed building blocks for the 2021–26 period. It shows increases to the proposed building blocks for the return on capital, regulatory depreciation and tax.

[78] Our draft decision discusses our approach to revenue smoothing and tariffs: AER, *Draft decision, Evoenergy access arrangement 2021–26, Overview*, November 2020, pp. 29–32.

Figure 8 AER's draft and final decisions and Evoenergy's revised proposed building block revenue (unsmoothed) ($ million, nominal)



Source: AER analysis.
Note: Revenue adjustments includes the efficiency carryover mechanism (ECM).

3.3 Revenue equalisation (smoothing) and tariffs

After assessing Evoenergy's total building block revenue (unsmoothed), we determine the forecast revenue (smoothed) profile across the 2021–26 period.[79]

Evoenergy operates under a weighted average tariff cap as its tariff variation mechanism. This means we must determine the weighted average tariff change (the X factor) for each year such that the net present value of unsmoothed and smoothed revenue is equal across the 2021–26 period.[80]

As part of the annual reference tariff variation process, we combine the X factors from this decision with actual inflation to create reference tariffs for the coming year. This means that average prices paid by consumers, and therefore the revenues received by Evoenergy, change with the X factor plus actual inflation.[81]

Table 3 presents our final decision X factors compared to Evoenergy's proposal.

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79 This process of smoothing revenues is described in the NGR as 'revenue equalisation'. See NGR, r. 92.

80 See Attachment 10 of our draft decision for information on the mechanics of the tariff variation mechanism: AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 10 – Reference tariff variation mechanism*, November 2020.

81 Under the CPI–X form of control, a positive X factor represents a decrease in price (and, therefore, in revenue). Conversely, a negative X factor represents an increase in price (and, therefore, in revenue).

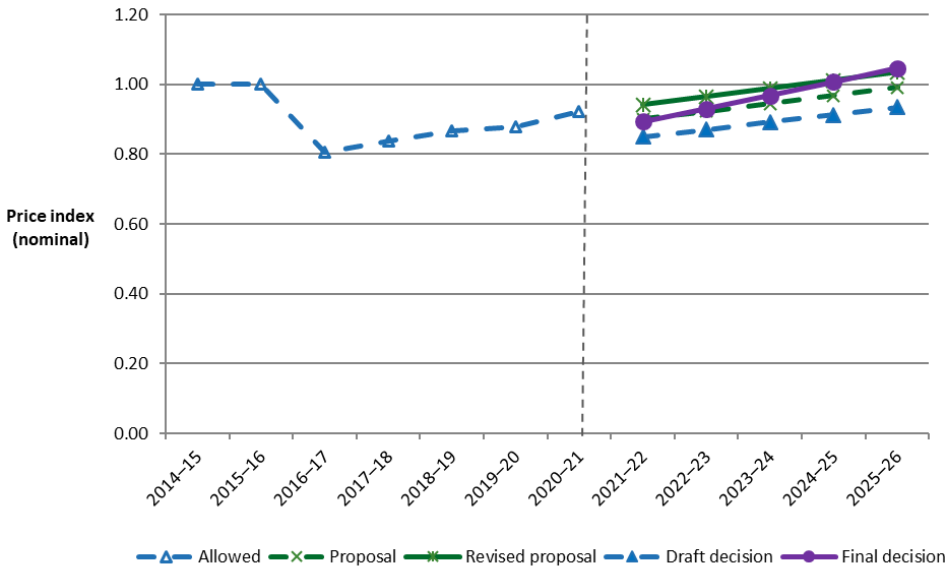
Table 3 Weighted average tariff change (X factors) for the 2021–26 period — AER's final decision and Evoenergy's revised proposal (per cent)

	2021–22	2022–23	2023–24	2024–25	2025–26
AER's final decision					
X factor[a]	4.85%	–2.01%	–2.01%	–2.01%	–2.01%
Nominal price change	–2.95%	4.05%	4.05%	4.05%	4.05%
Evoenergy's revised proposal					
X factor[a]	0.05%	0.00%	0.00%	0.00%	0.00%
Nominal price change	2.32%	2.37%	2.37%	2.37%	2.37%

Source: AER analysis; Evoenergy, *Appendix 4.2 PTRM,* June 2020.
(a) Under the CPI–X form of control, a positive X factor is a decrease in price (and, therefore, in revenue). In the table above, an X factor of –2.01 per cent in 2022–23 means a real price increase of 2.01 per cent for that year; after considering inflation, this represents a nominal price increase of 4.05 per cent. The X factor for 2021–22 is indicative only. The final decision establishes 2021–22 tariffs directly, rather than referencing a change from 2020–21 tariffs.

Figure 9 shows indicative tariff paths for Evoenergy's reference services across the 2021–26 period. It compares Evoenergy's proposed tariff path with that approved previously for the 2016–21 period, and with this final decision.[82] This provides a broad, overall indication of the average movement in tariffs across the 2021–26 period.

Figure 9 Indicative reference tariff paths for Evoenergy's reference services from 2016 to 2026 (nominal index)



Source: AER analysis.

[82] The tariff path for 2016–26 uses actual inflation outcomes for 2016–20, and expected inflation for 2021–26.

As a result of our higher demand forecast in this final decision compared to Evoenergy's revised proposal, we provide for a larger real decrease in weighted average tariffs of 4.9 per cent in 2021–22, followed by an increase in real tariffs of 2.0 per cent per year for the remaining four years of the 2021–26 period.

Our final decision tariff path is different to Evoenergy's revised proposal and our draft decision, which included a decrease to real tariffs in the first year followed by constant real tariffs for the remaining years of the 2021–26 period. We note that Evoenergy's revised proposal smoothing profile led to a 9.5 per cent final year divergence between smoothed and unsmoothed revenues.

We note that ACTCOSS and Red Energy / Lumo Energy submitted that the tariff path should be applied in such a way as to avoid any real price increases.[83]

However, adopting a constant or decreasing tariff path in the final decision would cause the final year divergence between smoothed and unsmoothed revenues to exceed 6 per cent, which is beyond our preferred target range of ±3 per cent. In our view, such a large divergence has the potential to contribute to upward price movements in the 2026–31 period, especially given the uncertainty regarding future ACT gas demand.

In setting the tariff path, we aim to minimise the likelihood of tariff volatility between the 2021–26 and 2026–31 periods. We do not know with certainty what Evoenergy's efficient costs will be in 2026–27, or across the 2026–31 period more generally. The unsmoothed building block costs for 2025–26 (the final year of the 2021–26 period) are the best available proxy. Hence, this objective requires minimising the divergence between smoothed and unsmoothed revenues for 2025–26. If there are no significant changes in forecast costs from 2025–26 to 2026–27, this final year divergence provides an estimate of the size of the tariff change at the start of the 2026–31 period.

For this final decision, we have set the final year divergence at 3 per cent, which is at the limit of our preferred target range. We note that if there are significant changes in costs at the start of the 2026–31 period, this might affect the required tariff change at that time. We are satisfied that the final decision tariff path reflects a balanced consideration of the competing objectives, as outlined previously in our draft decision.[84]

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[83] ACTCOSS, *Submission: Evoenergy gas network 2021–26 access arrangement revised proposal and AER draft decision*, February 2021, p. 15; Red Energy/Lumo Energy, *Evoenergy access arrangement 2021–26 draft decision*, February 2021, p. 1.

[84] AER, *Draft decision, Evoenergy access arrangement 2021–26, Overview*, November 2020, pp. 31–32.

4 Key elements of our final decision on revenue

The key elements of our final decision include the building blocks we use to determine the revenue that Evoenergy may recover from consumers. The following sections summarise our revenue decision. The attachments to this final decision provide a more detailed explanation of our analysis and findings.

4.1 Capital base

The capital base roll forward accounts for the value of Evoenergy's regulated assets over the 2021–26 period. The opening capital base value for a regulatory year within the period is rolled forward by indexing it for inflation, adding any conforming capex, and subtracting depreciation and other possible factors (such as asset disposals or customer contributions).[85] The opening value of the capital base is used to determine the regulatory depreciation (return of capital) and return on capital building blocks.

Our final decision approves an opening capital base value of $376.7 million ($ nominal) as at 1 July 2021. This is $4.4 million (1.1 per cent) lower than Evoenergy's proposal of $381.1 million.[86] This reduction is due to updating the roll forward model (RFM) for 2020–21 actual consumer price index (CPI) that is now available. Table 4 sets out the roll forward of the capital base for the 2016–21 period.

We also approve a forecast closing capital base value of $380.9 million as at 30 June 2026.[87] This is $14.2 million (3.6 per cent) lower than Evoenergy's proposal of $395.0 million. Our decision reflects our changes to the opening capital base as at 1 July 2021, and our final decisions on expected inflation (section 4.2.3), forecast depreciation (section 4.3) and forecast capex (section 4.4). Table 5 sets out the projected roll forward of the capital base for the 2021–26 period.

Our final decision confirms our draft decision position that the opening capital base as at 1 July 2026 is to be established using the approved depreciation schedules (straight-line) based on forecast capex at the asset class level.[88]

Attachment 2 provides further detail on our capital base decision.

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

86 Evoenergy, *Attachment 5.1 RFM*, January 2021.

87 NGR, r. 78.

88 NGR, r. 90.

Table 4 AER's final decision on Evoenergy's capital base roll forward for the 2016–21 period ($ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21[a]
Opening capital base	338.4	349.7	361.1	366.9	371.4	376.2
Net capex[b]	17.4	19.6	13.2	13.3	14.2	15.0
Indexation of capital base	5.7	5.2	6.9	6.5	6.8	3.2
Less: straight-line depreciation[c]	11.8	13.4	14.3	15.3	16.3	17.3
Interim closing capital base	349.7	361.1	366.9	371.4	376.2	377.1
Difference between estimated and actual capex in 2014–15 capex						–0.3
Return on difference for 2014–15 capex						–0.1
Closing capital base as at 30 June 2021						**376.7**

Source: AER analysis.
(a) Based on estimated capex provided by Evoenergy.
(b) Net of disposals and capital contributions, and adjusted for actual CPI. The 2015–16 capex is included in the roll forward period as it was an interval of delay.
(c) Adjusted for actual CPI. Based on forecast capex.

Table 5 AER's final decision on Evoenergy's projected capital base roll forward for the 2021–26 period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26
Opening capital base	376.7	384.0	388.6	387.9	385.1
Net capex[a]	15.1	13.7	9.5	8.3	7.8
Indexation of opening capital base	7.5	7.7	7.8	7.8	7.7
Less: straight-line depreciation	15.3	16.8	17.9	18.8	19.7
Closing capital base	**384.0**	**388.6**	**387.9**	**385.1**	**380.9**

Source: AER analysis.
(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC to compensate for the six month period before capex is added to the capital base for revenue modelling.

4.2 Rate of return, imputation credits and expected inflation

The return each business is to receive on its capital base (return on capital) is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the capital base.

We estimate the rate of return by combining the return of the two sources of funds for investment: debt and equity. This allowed rate of return provides the business with a return on capital to service the interest on its loans and give a return on equity to investors.

An accurate estimate of the rate of return is necessary to promote efficient prices in the long term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to make the required network investments and reliability may decline. If the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

The National Gas Law (NGL) requires us to apply the 2018 Instrument to estimate the rate of return for Evoenergy.[89] As set out in Table 6, this leads to a rate of return of 4.78 per cent (nominal vanilla) for this final decision, or 0.18 percentage points higher than our draft decision placeholder estimate of 4.60 per cent.[90]

Table 6 AER's final decision on Evoenergy's rate of return (% nominal)

	AER's draft decision (2021–26)	Evoenergy's revised proposal (2021–26)	AER's final decision (2021–26)	Allowed return over the access arrangement period
Nominal risk free rate	0.91%[a]	0.91%	1.41%[b]	
Market risk premium	6.1%	6.1%	6.1%	
Equity beta	0.6	0.6	0.6	
Return on equity (nominal post–tax)	4.57%	4.57%	5.07%	Constant (%)
Return on debt (nominal pre–tax)	4.62%[a]	4.62%	4.59%[c]	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	4.60%	4.60%	4.78%	Updated annually for return on debt
Expected inflation	2.37%	2.37%	2.00%	Constant (%)

Source: AER analysis; AER, *Draft decision, Evoenergy Access Arrangement 2021–26, Overview*, November 2020, p. 36; Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 35.

[a] Calculated using a placeholder averaging period of 20 business days ending 31 August 2020.
[b] Calculated using an averaging period of 60 business days ending 31 March 2021.
[c] We use the proposed debt averaging period. Return on debt has been updated for this averaging period.

This rate of return will apply to the first year of the 2021–26 period. A different rate of return will apply for the remaining regulatory years of the period. This is because we update the return on debt component of the rate of return each year, in accordance with the 2018 Instrument, to use a 10-year trailing average portfolio return on debt that is rolled forward each year. Hence, 10 per cent of the return on debt is calculated from the most recent averaging period, with 90 per cent from prior periods.

89 AER, *Rate of return instrument*, December 2018. See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision.

90 AER, *Draft decision*, *Evoenergy access arrangement 2021–26*, *Overview,* November 2020, p. 35.

We also note that Evoenergy's proposed risk free rate[91] and debt averaging periods have been (and will be) used to estimate its rate of return because they comply with the conditions set out in the 2018 Instrument.[92]

Attachment 3 provides further detail on our decision on the allowed rate of return, debt and equity raising costs, and expected inflation.[93]

4.2.1 Debt and equity raising costs

In addition to providing the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity. We include debt raising costs in the opex forecast because these are regular and ongoing costs, and equity raising costs in the capex forecast because these costs are incurred once and would be associated with funding particular capital investments.

Evoenergy has proposed to use our approach to estimate equity raising costs.[94] We have updated our estimates for this access arrangement period based on the benchmark approach using updated inputs. This results in zero equity raising costs.

Our final decision accepts the method used in Evoenergy's revised proposal, which uses an annual rate of 9.4 basis points per annum (bppa).[95] We considered this rate and found it not materially different to our alternative benchmark estimate of 9.5 bppa.

4.2.2 Imputation credits

Our final decision applies a value of imputation credits (gamma) of 0.585 as set out in the 2018 Instrument.[96] Evoenergy accepted this value in its revised proposal.[97]

4.2.3 Expected inflation

We estimate an expected inflation rate of 2.00 per cent for the 2021–26 period based on the new approach adopted in our 2020 inflation review.[98]

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91 This is also known as the return on equity averaging period.

92 AER, *Rate of Return Instrument*, December 2018, cll. 7–8, 23–25 and 36.

93 The debt averaging period is specified in the confidential appendix to Attachment 3.

94 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, pp. 34–35; Evoenergy, *Attachment 5.2 PTRM,* January 2021.

95 See section 4.5 for our final decision on opex (which encompass debt raising cost); Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, pp. 13 and 34; Evoenergy, *Attachment 5.2, PTRM,* January 2021.

96 AER, *Rate of return instrument*, December 2018, cl. 27. Also see the AER's 2018 rate of return review for more information on the value of imputation credits: AER, *Rate of return instrument explanatory statement*, December 2018, pp. 307–382.

97 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 37.

98 AER, *Final position, Regulatory treatment of inflation*, December 2020.

Evoenergy supported the new approach and advocated that we adopt it in this final decision.[99]

4.3 Regulatory depreciation

When determining the total revenue for Evoenergy, we include an amount for the depreciation (return of capital) of the projected capital base.[100] Regulatory depreciation is used to model the nominal asset values over the 2021–26 period and the depreciation amount in the total revenue requirement.[101]

Our final decision determines a regulatory depreciation amount of $50.1 million ($ nominal) for Evoenergy for the 2021–26 period. This is $6.0 million (13.6 per cent) higher than Evoenergy's revised proposal, and $5.7 million (12.8 per cent) higher than our draft decision. The key reason for the increase compared to our draft decision is our lower final decision expected inflation rate for the 2021–26 period.[102]

The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation of the capital base.

Straight-line depreciation is impacted by our decision on Evoenergy's opening capital base as at 1 July 2021, forecast capex and asset lives. Our final decision straight-line depreciation is $2.2 million lower than Evoenergy's revised proposal, mainly due to our lower opening capital base.

Our final decision indexation on the projected capital base is $8.1 million lower than Evoenergy's revised proposal, largely because we decided on an expected inflation rate of 2.00 per cent per annum for this final decision compared with an inflation rate of 2.37 per cent per annum that Evoenergy included in its revised proposal. The lower indexation has more than offset the decrease in straight-line depreciation (since indexation is deducted from the straight-line depreciation), which has resulted in a higher regulatory depreciation amount compared to the revised proposal.

In coming to our final decision on Evoenergy's straight-line depreciation, we accept Evoenergy's revised proposed:

- straight-line method to calculate regulatory depreciation, which is consistent with our draft decision
- weighted average method to calculate the remaining asset lives as at 1 July 2021 for depreciating its existing assets, which is consistent with our draft decision. In accepting the weighted average method, we have updated the revised proposed

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99 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, pp. 34–35.

100 NGR, r. 76(b).

101 The regulatory depreciation amount is the net total of the straight-line depreciation less the inflation indexation of the capital base.

102 The expected inflation rate has been determined based on the method set out in the latest version of the PTRM, which implemented the inflation review final position.

remaining asset lives as at 1 July 2021 due to our update for the 2020–21 actual inflation input to Evoenergy's proposed RFM

- standard asset lives for its asset classes, including its reductions to the standard asset lives associated with new capex for its high pressure (HP) mains, medium pressure (MP) mains and MP services asset classes. Our final decision differs from our draft decision because we now accept that Evoenergy should use shorter asset lives for its new pipeline assets in the NSW region as well as the ACT. In our draft decision, we were not persuaded that shorter asset lives should be used in NSW.

Our final decision accepts Evoenergy's revised proposal to apply shorter standard asset lives for all its new pipeline assets, and therefore not separate ACT and NSW assets for regulatory depreciation purposes. This is because we consider the shorter asset lives are better estimates of the economic lives of these asset classes than their technical lives.[103] We have changed our draft decision position as a result of carefully assessing the information provided in Evoenergy's revised proposal and the advancement of the ACT Government's climate change policy following the October 2020 ACT election.

We consider that ACT policy has advanced considerably in the time between our draft decision and when we received the revised proposal. It is now more certain that Evoenergy's consumer base in the ACT would start declining after 2023 as no new brownfield connections would be allowed. Existing consumers in the ACT who have gas appliances installed in their homes, would be more likely to switch to electricity once their appliances need to be replaced due to the rebates available to them and the marketing campaign to move away from gas use in the ACT.

We recognise that Evoenergy's primary business is supplying gas to the ACT, which accounts for 90 per cent of its consumer base. However, there are economies of scale with also supplying gas to areas outside of the ACT, which are located in NSW. We expect the advancement in ACT policy would also have implications on the future behaviour of Evoenergy's NSW gas consumers due to the increase in the costs per consumer associated with running the network as ACT gas demand declines. Further, greater accelerated depreciation on existing capital base assets in future periods would also increase the costs to all consumers. These factors could combine to make gas less competitive for Evoenergy's NSW consumers and also encourage them to leave its network in future periods. Therefore, we consider that Evoenergy's NSW assets are likely to have their economic life aligned with its ACT assets given that it operates as a single integrated network.

We consider there are too many uncertainties and costs associated with treating the NSW assets as standalone in the future as a probable option, which would justify keeping the standard asset lives of pipeline assets aligned with their technical lives. If in future, it becomes clear that the NSW portion can survive as a standalone network, we can reassess the asset lives at that time. The change to depreciation we are

[103] NGR, r. 89(1)(b).

approving in this decision can be characterised as a prudent step on the evidence available.

Table 7 sets out our final decision on Evoenergy's regulatory depreciation amount for the 2021–26 period. Attachment 4 provides further detail on our depreciation decision.

Table 7 AER's final decision on Evoenergy's regulatory depreciation amount for the 2021–26 period ($ million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Straight-line depreciation	15.3	16.8	17.9	18.8	19.7	88.5
Less: indexation on opening capital base	7.5	7.7	7.8	7.8	7.7	38.4
Regulatory depreciation	**7.7**	**9.1**	**10.1**	**11.1**	**12.0**	**50.1**

Source: AER analysis.

4.4 Capital expenditure

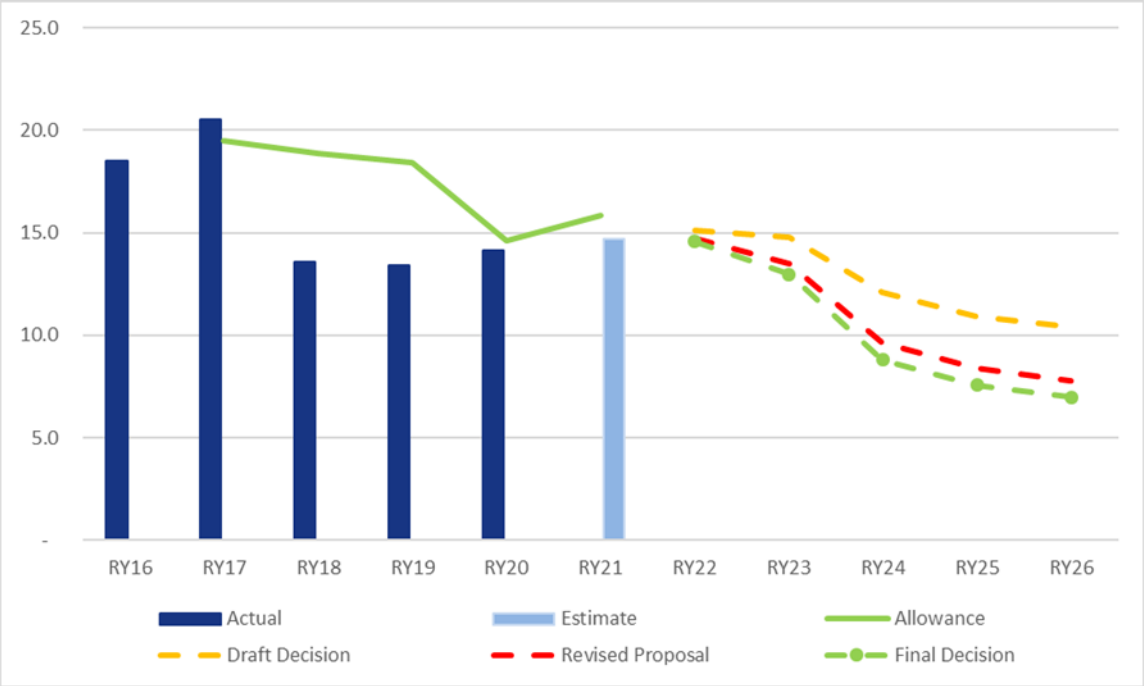
Capital expenditure (capex) refers to the capital costs and expenditure incurred in the provision of pipeline services.[104] This investment mostly relates to assets with long lives. Evoenergy recovers the costs of these assets through the return on capital and depreciation building blocks. In this way, Evoenergy recovers the financing cost and depreciation associated with these assets over the expected life of these assets.

Our final decision includes an assessment of Evoenergy's actual capex in the 2016–21 period (which forms part of its opening capital base),[105] and its forecast capex for the 2021–26 period (which forms part of its projected capital base).[106]

Figure 10 compares Evoenergy's actual and proposed forecast capex, and the forecasts approved by us both in our previous 2016–21 decision and this 2021–26 final decision. Attachment 5 provides further detail on our capex decision.

[104] NGR, r. 69.
[105] NGR, r. 77.
[106] NGR, r. 78(b).

Figure 10 AER's final decision compared to Evoenergy's past and proposed capex ($ million, 2020–21)



Source: AER analysis.

4.4.1 Conforming capex for the 2016–21 period

Evoenergy expects to spend less than our 2016–21 period capex forecast for each capex category, except capacity development where it expects to spend the full amount.

Our draft decision approved total net capex of $66.0 million ($2020–21) as conforming capex under the NGR for the 2015–16 to 2018–19 years, subject to Evoenergy providing additional information on its investment in the Ginninderry development.[107]

In its submission, CCP24 also encouraged us to investigate the gas main that will service the Ginninderry development.[108] CCP24 had questions about whether the gas main should have been built given the ACT Government's new gas policies. We have reviewed the additional information provided by Evoenergy in its revised proposal, and are satisfied that the decision was made before the ACT Government introduced its current policy and that ACT and NSW consumers are not worse off because of the investment.

[107] NGR, r. 79(1). We assessed conforming capex for 2015–16, 2016–17, 2017–18 and 2018–19. We did not assess 2019–20 and 2020–21 as they were estimated capex in our draft decision.

[108] CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 26.

This final decision approves total net capex of $80.1 million as conforming capex under the NGR for the 2015–16 to 2019–20 years, including Evoenergy's past investment of $0.2 million in the Ginninderry development.[109] We will review actual capex for 2020–21 in Evoenergy's 2026–31 access arrangement review.

4.4.2 Conforming capex for the 2021–26 period

Our final decision approves forecast net capex of $50.9 million ($2020–21) for the 2021–26 period. This is $3.1 million (5.8 per cent) lower than Evoenergy's revised proposal of $54.0 million, and $25.3 million (33.2 per cent) lower than its actual net capex for the 2016–20 period.[110]

The key difference between Evoenergy's initial and revised capex proposals is the removal of new connections in future infill developments from 1 January 2023, in line with the ACT Government's *Parliamentary and Governing Agreement*.[111] Table 8 presents our final decision by forecast capex category.

Table 8 AER's final decision and Evoenergy's revised proposal for forecast capex for the 2021–26 period ($ million, 2020–21)

Category	Evoenergy's revised proposal	AER's final decision	Difference (AER less Evoenergy)
Market expansion (Connections)	11.0	10.4	-0.6
Stay-in-business - meter renewal (Meter replacement)	26.4	24.5	-2.0
Capacity development (Augmentation)	1.1	1.0	-0.1
Stay-in-business - network renewal (Facilities and pipes)	12.8	12.4	-0.3
Non-system (Other)	-	-	-
Overhead	3.1	2.9	-0.2
GROSS TOTAL	**54.4**	**51.2**	**-3.1**
Contribution	0.3	0.3	0.0
NET TOTAL	**54.0**	**50.9**	**-3.1**

Source: AER analysis. Totals may not sum due to rounding.

[109] NGR, r. 79(1). We have assessed conforming capex for 2015–16, 2016–17, 2017–18, 2018–19 and 2019–20. We have not assessed 2020–21 as it estimated capex in our final decision.

[110] Evoenergy's capex for 2020–21 is based on an estimate only.

[111] ACT Government, *Parliamentary and Governing Agreement, 10th Legislative Assembly for the Australian Capital Territory,* November 2020, p. 7.

While our final decision approves the majority of Evoenergy's revised capex proposal, including its connections forecast, there are some parts of its capex that we do not consider to be efficient:

- Meter replacement – Our final decision includes $24.5 million of meter replacement capex, which is $2.0 million (7.5 per cent) less than proposed. Evoenergy did not adequately demonstrate that the additional 'construction management fee' allocated to this category as a result of its lower connections forecast is efficient.[112] This was supported by our independent consultant.
- Speculative investment – Our final decision does not accept the opening of a speculative capex account. Evoenergy did not provide sufficient project details to enable us to review the proposed non-conforming capex for the purpose of opening such an account. Evoenergy may propose to open a speculative capex account in future once a project scope is available for assessment.

Our final decision also updates Evoenergy's proposed capex for 2019–20 for actual inflation (reducing capex by $0.6 million) and the latest labour price growth in line with our opex alternative forecast (increasing capex by $0.1 million).

4.5 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses incurred in the provision of pipeline services.

Our final decision is to accept the total opex forecast of $171.0 million ($2020–21) in Evoenergy's revised proposal.[113] We are satisfied that Evoenergy's opex forecast meets the opex criteria[114] and that the forecasts and estimates have been arrived at on a reasonable basis or are the best possible in the circumstance.[115]

Evoenergy accepted our draft decision,[116] which was to accept its amended initial proposal.[117]

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112 The total reduction in construction management fee from our final decision is $2.6 million ($2020–21) in which the majority resides in the meter replacement category based on Evoenergy's cost allocation approach.

113 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 13.

114 NGR, r. 91.

115 NGR, r. 74.

116 AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 6, Operating expenditure*, November 2020, p. 4.

117 Evoenergy amended its initial proposal in October 2020 to update for actual audited 2019–20 opex, which was only available after Evoenergy lodged its initial proposal in June 2020.

We have updated our alternative opex estimate to reflect the latest available information. This includes updating:

- forecast inflation for the year to June 2021
- forecast labour price growth, using an average of the wage price index growth forecast from BIS Oxford Economics[118] (which Evoenergy submitted with its revised proposal) and updated forecasts from Deloitte Access Economics[119]
- our final decision on forecast demand, in particular customer numbers, energy throughput and network length.

Our alternative total opex estimate of $167.0 million is not materially different to Evoenergy's revised proposal of $171.0 million. We do not consider the $3.9 million (2.3 per cent) difference to be material because the driver of the difference is due to higher forecasts for costs that are subject to annual true-up, including the Utilities Network Facilities Tax, Energy Industry Levy and unaccounted for gas. When these costs are excluded, our alternative estimate is only $0.4 million less than proposed.

Table 9 compares our alternative opex estimate to Evoenergy's revised proposal.

Table 9 AER's final decision and Evoenergy's proposal for forecast total opex ($ million, 2020–21)

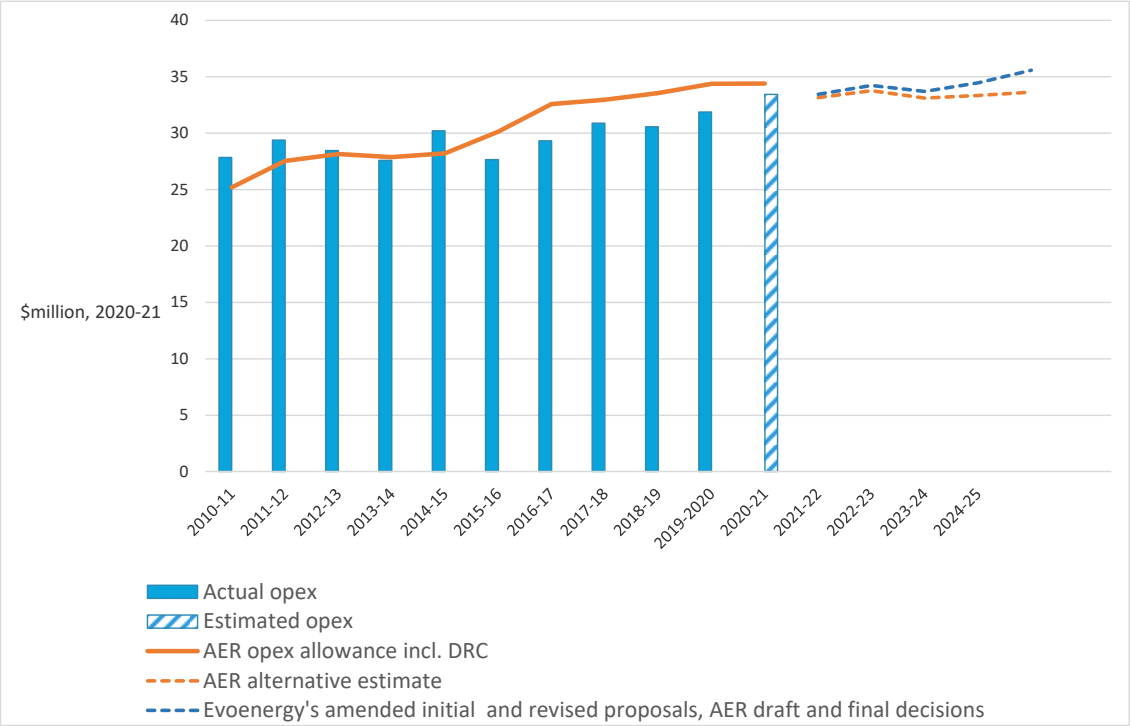
	Evoenergy's revised proposal	AER's alternative estimate	Difference (AER less Evoenergy)	Difference (per cent)
Forecast opex excluding Utilities Network Facilities Tax, Energy Industry Levy and unaccounted for gas	113.0	112.6	–0.4	–0.2
Utilities Network Facilities Tax, Energy Industry Levy and unaccounted for gas	58.0	54.4	–3.6	–2.1
Total	**171.0**	**167.0**	**–3.9**	**–2.3**

Source: Evoenergy, *Attachment 2.1 Opex Model*, January 2021; AER analysis.
Note: Numbers may not add up to total due to rounding.

Figure 11 compares the opex forecast we approve in this final decision to our alternative opex estimate, and the forecasts we approved and Evoenergy's actual opex since 2010–11.

[118] BIS Oxford Economics, *Attachment 3.4, Labour cost escalation forecasts report*, January 2021.
[119] Deloitte Access Economics, *Wage Price Index Forecasts (prepared for the AER)*, April 2021.

Figure 11 Actual and forecast opex, 2010–11 to 2025–26 ($ million, 2020–21)



Source: Evoenergy, Annual RIN (various years); Evoenergy, *Proposed reset RIN - RIN 3 Workbook 1 Forecast Consolidated*, June 2020; AER, *Final Decision*, *ActewAGL Distribution access arrangement 2016–21*, *Revenue forecast model – RFM PTRM*, May 2016; AER, *Final Decision*, *ActewAGL (ACT, Queanbeyan and Palerang) Access arrangement 2010–15*, *PTRM after appeal*, September 2010; Evoenergy, Response to information request AER IR003 Attachment 1 Evoenergy gas network 2021–26 revised opex model, 1 October 2020; Evoenergy, *Attachment 2.1 – Opex Model*, January 2021; AER analysis.

Note: Includes debt raising costs, UAG, Utilities Network Facility Tax, Energy Industry Levy, and IT access utilisation fee.

We have also considered the two stakeholder submissions we received relating to forecast opex. CCP24 and Origin Energy noted that Evoenergy did not revise its opex forecast to account for the lower demand forecasts included in its revised proposal.[120] They both considered we should review forecast opex in light of the lower demand. For this final decision, we have updated our alternative opex estimate to account for our final decision on demand. As discussed above, having done so, Evoenergy's opex forecast is not materially different from our alternative estimate and we remain satisfied the forecast meets the opex criteria[121] and requirements for forecasts and estimates.[122]

CCP24 also stated that we should apply a negative step change for marketing costs because there is now a ban on connections in new ACT sub-divisions, as well as a ban

[120] CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, p. 20; Origin Energy, *AER Draft Decision and Revised Access Arrangement Proposal for Evoenergy 2021–26*, February 2021, p. 2.

[121] NGR, r. 91.

[122] NGR, r. 74.

from 2023 on new infill developments. Consequently, CCP24 questioned the need for a marketing budget.[123]

We note an expected change in Evoenergy's marketing activities by itself does not on its face warrant a negative step change. As stated in our draft decision, we have assessed forecast opex at a total opex level ('top-down' forecasting method). We did not assess individual opex projects or programs.[124] We consider it likely that there will be a number of activities that Evoenergy conducted (or did not conduct) in the base year that it will not conduct (or will conduct) in the forecast period. If we were to provide a step change for one change in activities, we would need to provide a step change for all changes. Doing so would result in a 'bottom-up' forecast produced on an incremental basis.

Further, we asked Evoenergy how much of its marketing expenditure relates to new connections. Evoenergy stated that none of its base year expenditure relates to new connections. Evoenergy noted that it has chosen not to spend marketing on new connections, and instead it has focused its marketing on appliance upgrades, for two reasons:[125]

- Evoenergy has a very high gas penetration rate in the ACT, and believes that existing properties that remain unconnected to the gas network tend to be rental properties which are unlikely to connect in the future
- until recently, gas reticulation was mandatory in new housing estates in the ACT. This was first introduced around 2013 and was reversed in 2020. Once a network was laid in a new estate, an estimated 90–95 per cent of residential consumers chose natural gas appliances.

Evoenergy also explained that, while the bulk of marketing costs relate to appliance upgrade rebates, it also includes communications activities such as safety related communications.

Consequently, we consider that a negative step change for marketing costs is not required. However, going forward, it is important that Evoenergy periodically re-evaluates its opex costs to ensure it is funding activities that are consistent with the ACT Government's climate change strategy. Where such activities are inconsistent, we would likely not consider the associated opex costs prudent. If these activities were continued, we would factor this into our assessment of future opex proposals by Evoenergy. For example, at some point in future, it may no longer be prudent to offer rebates to upgrade to more efficient gas appliances given that the ACT Government's

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123 CCP24, *Advice to the AER on Evoenergy revised gas network 21 plan for Evoenergy (ActewAGL) ACT, Queanbeyan and Palerang access arrangement July 2021–June 2026*, February 2021, pp. 20–21.

124 AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 6 – Operating expenditure*, November 2020, p. 35.

125 Evoenergy, *Response to information request AER IR026*, 6 April 2021.

policy objective is to achieve zero emissions from gas use by 2045 and to phase out new and existing gas connections.[126]

4.6 Revenue adjustments

We have applied one adjustment to Evoenergy's revenue for the 2021–26 period, as set out below.

4.6.1 Efficiency carryover mechanism for the 2016–21 period

An ECM is intended to provide a continuous incentive for service providers to pursue efficiency improvements in opex, and provide for a fair sharing of these between service providers and network users.

Our final decision is to approve a carryover amount totalling –$1.3 million ($2020–21) from application of the ECM in the 2016–21 period. This is the same amount as our draft decision,[127] which Evoenergy accepted and included in the revenues it proposed in its revised proposal.[128] Table 10 sets out our final decision on the carryover amounts Evoenergy accrued during the 2016–21 period (to be recovered over the next period).[129]

Table 10 Final decision on carryover amounts ($ million, 2020–21)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Evoenergy's revised proposal	0.5	–1.3	–0.1	–0.5	–	**–1.3**
AER's final decision	0.5	–1.3	–0.1	–0.5	–	**–1.3**
Difference	**–**	**–**	**–**	**–**	**–**	**–**

Source: Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 50; AER analysis.
Note: Numbers may not add up due to rounding.

4.7 Corporate income tax

Our determination of the total revenue for Evoenergy includes the estimated cost of corporate income tax for the 2021–26 period.[130] Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our PTRM. This allows Evoenergy to recover the estimated cost of corporate income tax during the 2021–26 period.

126 ACT Government, *ACT Climate Change Strategy 2019–25*, 2019, p. 10.
127 AER, *Draft decision, Evoenergy access arrangement 2021–26, Attachment 8 – Efficiency carryover mechanism*, November 2020, p. 5.
128 Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 50.
129 NGR, r. 76(d).
130 NGR, r. 76(c).

Our final decision on the estimated cost of corporate income tax is $2.9 million ($ nominal) over the 2021–26 period, which is $1.4 million (89.6 per cent) higher than Evoenergy's proposal of $1.5 million. The higher tax estimate amount is due to:

- a lower expected inflation rate through our implementation of the findings of our 2020 inflation review[131] (section 4.2.3)[132]
- our final decision to apply an updated return on equity (section 4.2.1).[133]

Our final decision also determines an opening tax asset base value of $259.5 million as at 1 July 2021. This value is consistent with Evoenergy's revised proposal and is $0.8 million (0.3 per cent) lower than our draft decision.

We also accept Evoenergy's revised proposed standard and remaining tax asset lives for all its asset classes. Evoenergy's proposed standard tax asset lives are consistent with our draft decision, and we confirm our position that they are broadly consistent with the values prescribed by the Commissioner for taxation in ATO ruling 2020/3 and the *Income Tax Assessment Act*.[134]

Consistent with the draft decision, we also accept Evoenergy's revised proposal to apply the weighted average method for calculating the remaining tax asset lives as at 1 July 2021. This method is a continuation of the approved approach used in the 2016–21 period and applies the approach as set out in our RFM. Consequently, our final decision is to accept Evoenergy's revised proposed remaining asset lives.

Table 11 sets out our final decision on the estimated cost of corporate income tax for Evoenergy over the 2021–26 period. Attachment 7 provides further detail on our tax decision.

Table 11 AER's final decision on Evoenergy's cost of corporate income tax for the 2021–26 period ($ million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Tax payable	1.5	1.4	1.3	1.4	1.5	7.0
Less: value of imputation credits	0.9	0.8	0.8	0.8	0.9	4.1
Net corporate income tax allowance	**0.6**	**0.6**	**0.5**	**0.6**	**0.6**	**2.9**

Source: AER analysis.

131 AER, *Final position paper – Regulatory treatment of inflation*, December 2020.

132 All else equal, a lower expected inflation rate will increase the cost of corporate income tax because it increases the forecast regulatory depreciation, a component of the taxable income.

133 All else equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on the equity portion of the capital base, a component of the taxable income.

134 ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020),* p. 181. They are also consistent with the statutory cap on the effective life of 20 years for gas pipeline assets under the *Income Tax Assessment Act*.

5 Incentive schemes to apply for 2021–26

Our incentives schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If network businesses reduce their costs to below our forecast of efficient costs, the savings are shared with their consumers in future access arrangement periods. As set out below, this final decision determines that two incentive schemes will apply to Evoenergy for the 2021–26 period.

5.1 Efficiency carryover mechanism

Our final decision is to approve the application of an ECM to Evoenergy in the 2021–26 period. Evoenergy's revised proposal adopted the revisions we set out in our draft decision.[135]

For the avoidance of doubt, and consistent with our standard approach, when we apply the ECM to Evoenergy in the 2021–26 period, we will adjust actual opex to reverse any movements in provisions. Table 12 sets out the forecast opex we will use to calculate efficiency gains and losses for the 2021–26 period, including the categories of expenditure we will exclude.[136]

Table 12 AER's final decision on Evoenergy's forecast opex for the ECM for the 2021–26 period ($ million, 2020–21)

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
Total forecast opex	34.7	34.7	32.9	34.3	33.7	34.5	35.6
Less Utilities Network Facility Tax (UNFT)	–7.6	–7.4	–8.5	–8.8	–9.1	–9.3	–9.6
Less Energy Industry Levy (EIL)	–0.6	–0.6	–0.7	–0.7	–0.6	–0.6	–0.6
Less unaccounted for gas (UAG)	–1.6	–1.6	–1.4	–2.0	–1.9	–2.0	–2.1
Less debt raising costs	–0.2	–0.2	–0.2	–0.2	–0.2	–0.2	–0.2
Forecast opex for the ECM	**24.7**	**25.0**	**22.1**	**22.7**	**21.8**	**22.3**	**23.2**

Source: AER, *Draft decision, Evoenergy access arrangement 2021–26, Efficiency Carryover Mechanism Model*, November 2020; AER, *Final decision*, *Evoenergy access arrangement 2021–26 – PTRM*, April 2021.

[135] Evoenergy, *Revised GN21 plan – Response to the draft decision, ACT and Queanbeyan-Palerang gas network 2021–26*, January 2021, p. 51.

[136] Table 12 in this document replaces the table in clause 3.8 of the proposed access arrangement that Evoenergy submitted with its revised proposal. Table 12 adds forecast opex for 2019–20 and 2020–21, which are required to calculate the efficiency gain for 2021–22.

5.2 Capital expenditure sharing scheme

The capital expenditure sharing scheme (CESS) rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex.

Evoenergy proposes to introduce a CESS to cover the 2021–26 period. This incentive scheme currently does not exist for Evoenergy.

Our final decision approves the application of a CESS that excludes connections capex in the 2021–26 period.[137] However, we have made the following amendments to Evoenergy's proposed CESS in this final decision:

- remove the sub-clause in Evoenergy's proposed access arrangement to exclude capex found to be conforming in the speculative capex account from the operation of the CESS, given our final decision to not open a speculative capex account for Evoenergy
- aligning Evoenergy's 2021–26 access arrangement regarding CESS to be consistent with our 2020–25 Jemena Gas Networks (JGN) final decision.[138]

Attachment 13 provides further detail on our CESS decision.

[137] Evoenergy, *Access arrangement for the ACT and Queanbeyan-Palerang Regional gas distribution network, 1 July 2021 – 30 June 2026*, January 2021, section 4, p. 9.

[138] AER, *Final decision, Jemena Gas Networks (NSW) Ltd access arrangement 2020–25, Attachment 13 – Capital expenditure sharing scheme,* June 2020.

6 Non-tariff components

The non-tariff components of an access arrangement are: terms and conditions for the supply of reference services (RSA); queuing requirements;[139] extension and expansion requirements;[140] capacity trading requirements;[141] change of receipt or delivery point by the user;[142] a review submission date and a revision commencement date.[143]

This final decision confirms our draft decision position on the non-tariff components listed above.[144] We also approve the additional RSA amendments that Evoenergy put forward in its revised proposal, specifically:[145]

- allowing a delivery point to be deleted from the Customer List from the date of disconnection, instead of 20 business days from disconnection (clause 12(b)(i))
- deleting a redundant clause which Evoenergy inadvertently included in its initial proposal relating to the disconnection request process, in particular, Evoenergy's ability to recover additional costs from the user where disconnection or abolishment costs exceed ancillary charges in the access arrangement (clause 15.9(c))
- simplifying the operational balancing gas (OBG) arrangements in the RSA, reflecting stakeholders' views[146] on greater clarity of the mechanism for calculating and allocating OBG.[147] Evoenergy engaged with network users who supported the proposed amendments.[148] We approve these amendments as they simplify the RSA (such as streamlining language and bringing definitions into line with the gas Retail Market Procedures), have been informed by a reasonable level of

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139 The process or mechanism for establishing an order of priority between prospective users of spare and/or developable capacity.

140 The method for determining whether an extension or expansion is a part of the covered pipeline and the effect this will have on tariffs.

141 The arrangements for users to assign contracted capacity and change receipt and delivery points.

142 The process or mechanism for changing a user's receipt or delivery point.

143 Evoenergy proposes a review submission date of 30 June 2025 and a revision commencement date of 1 July 2026.

144 AER, *Draft decision, Evoenergy 2021–26 Access arrangement, Attachment 11 – Non-tariff components*, November 2020.

145 Evoenergy, *Reference Service Agreement, Evoenergy's gas distribution network in the ACT and Queanbeyan-Palerang, 1 July 2021 – 30 June 2026,* January 2021.

146 Evoenergy engaged Farrierswier Consulting Pty Ltd to review the existing OBG arrangements and engage key stakeholders, including all network users (AGL Wholesale Gas, ActewAGL Retail, EnergyAustralia, Evoenergy, Jemena Asset Management, Jemena EGP, Origin Energy and Weston Energy) to understand their concerns and identify improvements to OBG arrangements.

147 OBG is the gas that Evoenergy purchases on a day when the quantity of gas injected into its network is greater than the total amounts nominated by Users for delivery to that receipt point on the gas day. Evoenergy recovers the cost of OBG from Users responsible for the shortfall in nominations. The RSA sets out the arrangements for recovering the cost of OBG across Users. OBG is revenue neutral for Evoenergy.

148 Emails confirming support for the proposed changes and direction of the revised RSA were received from ActewAGL (25 February 2021), EnergyAustralia (24 February 2021), Origin Energy (26 February 2021), and Weston Energy (26 February 2021).

stakeholder engagement, and are broadly consistent with the current allocation of risks between parties.

We received one submission from Origin Energy maintaining its concerns on Evoenergy's initial proposal regarding metering equipment and the liability regime.[149] Origin Energy considers that both the retailer and distributor should share responsibility regarding access to metering equipment, and that a retailer's right to recover amounts they are entitled to should not be limited under indemnities. Origin Energy also raised two new concerns relating to metering equipment.[150]

Our draft decision accepted Evoenergy's proposed indemnity and metering equipment clauses on the basis that the clauses do not change the allocation of risk and there is an acceptable risk balance between the parties. We also noted that the clauses are consistent with those we approved for JGN in its 2020–25 access arrangement. As Origin Energy's submission provides no new information, we maintain our draft decision on this matter.

We note that the RSA remains subject to a continuous improvement process, where it is formally reviewed and amended at each access arrangement review. This does not prevent Evoenergy from continuing discussions with individual parties to work through their specific circumstances and issues, such as performance standards that may be applicable to Evoenergy. We encourage all parties to continue to engage after our decision, potentially at an industry working group level, on matters such as gas quality specification, retailer-requested disconnections by network businesses, and the liability and indemnity regime.

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149 Origin Energy, *AER Draft Decision and Revised Access Arrangement Proposal for Evoenergy 2021–26*, February 2021.

150 Ibid., p. 3. Origin Energy's concerns relate to clause 16.5(e): Evoenergy providing information to help the user recover costs from the consumer and clause 16.6: users reimbursing Evoenergy for costs incurred from site inductions and safety training required by the user.

A Shortened forms

Shortened form	Extended form
ACTCOSS	ACT Council of Social Service
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ATO	Australian Tax Office
bppa	Basis points per annum
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
CCP / CCP24	Consumer Challenge Panel, sub-panel 24
CIE	The Centre for International Economics
CPI	Consumer price index
ECA	Energy Consumers Australia
ECM	Efficiency carryover mechanism
EEIS	Energy efficiency improvement scheme
EIL	Energy Industry Levy
ENA	Energy Networks Australia
HP	High-pressure
Instrument / 2018 Instrument	2018 Rate of Return Instrument
JGN	Jemena Gas Networks (NSW) Ltd
MP	Medium-pressure
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Opex	Operating expenditure
PTRM	Post-tax revenue model
RFM	Roll forward model
RSA	Reference Service Agreement
UAG	Unaccounted for gas
UNFT	Utilities Network Facilities Tax

B List of submissions

The AER's final decision on the Evoenergy 2021–26 access arrangement has been made with regard to submissions received from the following stakeholders on Evoenergy's access arrangement revised proposal and the AER's draft decision.

Stakeholder	Date
ACT Council of Social Service (ACTCOSS)	19 February 2021
Conservation Council ACT Region	17 February 2021
Consumer Challenge Panel (CCP24)	17 February 2021
Energy Consumers Australia (ECA)	22 February 2021
Origin Energy	17 February 2021
Red Energy / Lumo Energy	25 February 2021