FINAL DECISION
Jemena Gas Networks (NSW) Ltd
Access Arrangement

2020 to 2025

Attachment 2
Capital base

June 2020

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the access arrangement that will apply to Jemena Gas Networks (NSW) Ltd ('JGN') for the 2020–25 access arrangement period. It should be read with all other parts of our final decision.

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.

Our final decision includes the following attachments:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

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Attachment 11 – Non-tariff components

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
Capex	Capital expenditure
CPI	Consumer price index
JGN	Jemena Gas Networks (NSW) Ltd
NGR	National Gas Rules
PTRM	Post-tax revenue model
RFM	Roll forward model
WACC	Weighted average cost of capital

2 Capital base

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

This attachment sets out our final decision on JGN's opening capital base as at 1 July 2020 for the 2020–25 access arrangement period. It also sets out our final decision on JGN's projected capital base for the 2020–25 period and that the forecast depreciation approach will be used for establishing the opening capital base as at the commencement of the 2025–30 period.

2.1 Final decision

Opening capital base as at 1 July 2020

Our final decision approves an opening capital base value of $3318.0 million ($ nominal) as at 1 July 2020 for JGN. This amount is $12.9 million (or 0.4 per cent) lower than JGN's revised proposed opening capital base value of $3331.0 million ($ nominal) as at 1 July 2020.[2] It reflects the update to the roll forward model (RFM) for 2019–20 actual consumer price index (CPI) that is now available. Our final decision is $34.7 million (1.0 per cent) lower than our draft decision value for JGN's opening capital base value of $3352.7 million ($ nominal).

To determine the opening capital base as at 1 July 2020, we have rolled forward the capital base over the 2015–20 period to determine a closing capital base value at 30 June 2020, in accordance with the proposed RFM. This roll forward includes an adjustment at the end of the 2015–20 period to account for the difference between actual 2014–15 capex and the estimate approved in our 2015–20 decision.[3]

In the draft decision, we accepted JGN's opening capital base as at 1 July 2020 subject to a minor update for the 2019–20 weighted average cost of capital (WACC) input in JGN's RFM to be consistent with the remittal post tax revenue model (PTRM) for the 2015–20 period. This update did not have a material impact on JGN's proposed opening capital base as at 1 July 2020.

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

2 JGN, *2020–25 Revised Proposal*, January 2020, p. 26, Table 6.4.

3 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2015–20 decision; NGR, r. 77(2)(a).

In its revised proposal, JGN adopted our draft decision to update the 2019–20 WACC input.[4] JGN also identified $3.4 million ($2019–20) of assets in its capital base which are no longer used to provide pipeline services.[5] It has made a final year adjustment at the end of the 2015–20 access arrangement period to remove these assets from the capital base.[6] We consider this final year adjustment appropriate as assets that do not provide pipeline services should not be included in the capital base and are required to be removed in accordance with rule 77(2)(e) of the National Gas Rules (NGR). Our final decision therefore accepts this adjustment to the opening capital base at 1 July 2020. We have updated this adjustment to account for 2019–20 actual CPI.[7]

We noted in the draft decision that the proposed capex for 2018–19 and 2019–20 were estimates. We expected that JGN would provide the actual capex for 2018–19 and that it may revise the 2019–20 capex estimate in the revised proposal.[8] JGN's revised proposal provided these updates to the 2018–19 and 2019–20 capex.

We are satisfied that the updated figures for 2018–19 are consistent with the capex values presented in JGN's annual reporting regulatory information notice for that year. In accepting JGN’s revised 2019–20 net capex estimate of $198.2 million ($ nominal), we note that this amount is lower than what we approved in our draft decision, reflecting more recent data. We will account for the financial impact of any difference between actual and estimated capex for 2019–20 at the next access arrangement review. For the reasons discussed in Attachment 5, we accept JGN's capex updates in its revised proposal as conforming capex during the 2015–20 access arrangement period. We therefore consider that actual conforming capex has been properly accounted for in the revised proposed capital base roll forward, consistent with the requirements of the NGR.[9]

Table 2.1 sets out our final decision on the roll forward of JGN's capital base during the 2015–20 access arrangement period to determine the opening capital base as at 1 July 2020.

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4 JGN, *2020–25 Revised Proposal – Revised 2020 Plan,* January 2020, p. 25, Table 6.2.

5 JGN, *2020–25 Revised Proposal – Attachment 6.2 – Contaminated sites asset classes,* January 2020.

6 JGN, *2020–25 Revised Proposal – Attachment 6.1 – RFM,* January 2020.

7 The CPI update decreased the value of the final year adjustment by $0.01 million.

8 JGN, *2020–25 Revised Proposal – Attachment 6.1 – RFM,* January 2020.

9 NGR, rr. 77(2)(b), 79(1).

Table 2.1 AER's final decision on JGN's capital base roll forward for the 2015–20 access arrangement period ($million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20[a]
Opening capital base	2980.2	3091.7	3162.0	3240.0	3279.4
Net capex[b]	203.7	181.9	189.9	166.2	198.2
Indexation of capital base	52.0	47.0	62.2	59.3	62.2
Less: straight-line depreciation[c]	144.2	158.6	174.0	186.1	172.6
Closing capital base	3091.7	3162.0	3240.0	3279.4	3367.2
Adjustment for 2014–15 capex[d]					–45.8
Final year adjustment[e]					–3.4
Opening capital base as at 1 July 2020					**3318.0**

Source: AER analysis.

(a) Based on estimated capex provided by JGN.

(b) Net of disposals and capital contributions, and adjusted for actual CPI.

(c) Adjusted for actual CPI. Based on forecast capex.

(d) This adjustment accounts for the difference between actual 2014–15 capex and the estimate approved in the 2015–20 decision.

(e) This adjustment relates to the removal of assets from the capital base that are no longer used to provide pipeline services at the end of the 2015–20 access arrangement period.

Forecast closing capital base as at 30 June 2025

We approve a forecast closing capital base value of $3803.3 million ($ nominal) at 30 June 2025. This is $47.0 million (or 1.2 per cent) lower than the $3850.4 million ($ nominal) in JGN's revised proposal. Our final decision on the projected closing capital base reflects our changes to the opening capital base as at 1 July 2020, and our final decisions on forecast capex (attachment 5), expected inflation (attachment 3) and forecast depreciation (attachment 4). Therefore, we do not approve JGN's revised proposed forecast closing capital base of $3850.4 million as at 30 June 2025.[10]

Table 2.2 sets out our final decision on the projected roll forward of the capital base for JGN over the 2020–25 access arrangement period.

[10] NGR, r. 78.

Table 2.2 AER's final decision on JGN's projected capital base roll forward for the 2020–25 access arrangement period ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25
Opening capital base	3318.0	3439.5	3551.3	3638.1	3710.6
Net capex[a]	196.1	195.9	179.1	175.6	182.7
Indexation of opening capital base	75.5	78.2	80.8	82.7	84.4
Less: straight-line depreciation	150.1	162.4	173.1	185.9	174.3
Closing capital base	**3439.5**	**3551.3**	**3638.1**	**3710.6**	**3803.3**

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 allowance to compensate for the six month period before capex is added to the capital base for revenue modelling.

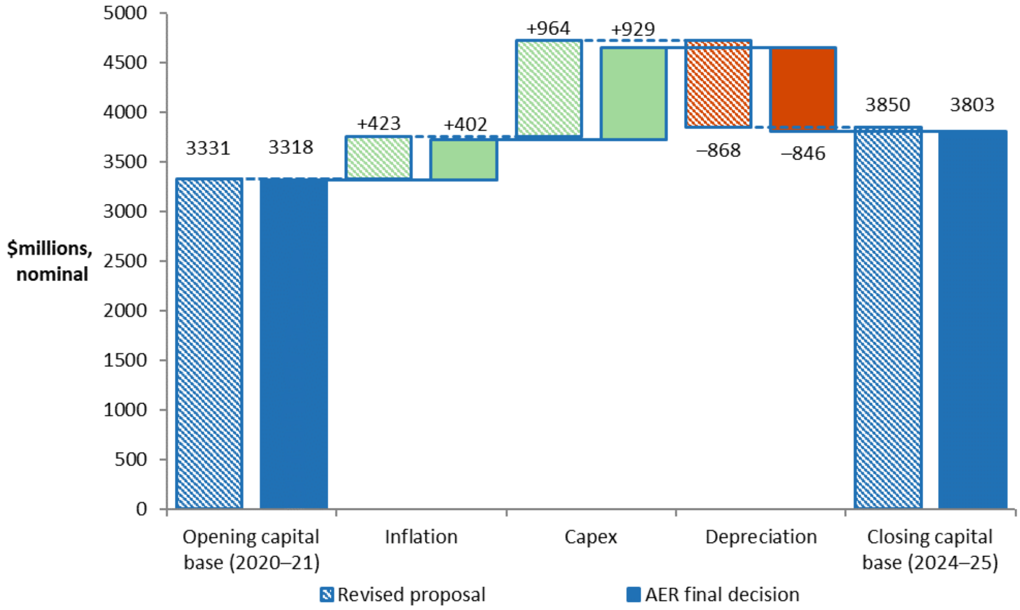
For this final decision, we confirm our draft decision position that the opening capital base as at 1 July 2025 is to be established using the approved depreciation schedules (straight-line) based on forecast capex at the asset class level.[11]

Figure 2.1 shows the key drivers of the change in JGN's projected capital base over the 2020– 25 access arrangement period for this final decision. Overall, the closing capital base at the end of the 2020–25 period is forecast to be 14.6 per cent higher than the opening capital base at the start of that period, in nominal terms. The approved forecast net capex increases the capital base by 28.0 per cent, while expected inflation increases it by 12.1 per cent. Forecast depreciation[12], on the other hand, reduces the capital base by 25.5 per cent.

[11] NGR, r. 90.

[12] This refers to straight-line depreciation. Regulatory depreciation is straight-line depreciation less the inflation indexation of the capital base.

Figure 2.1 Key drivers of changes in the capital base—JGN's revised proposal compared with AER's final decision ($million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the PTRM.

Forecast net capex is a significant driver of the increase in the capital base. In our final decision, we approve $861.8 million ($2019–20)[13] of JGN's revised proposed $889.9 million ($2019–20) total net capex for the 2020–25 access arrangement period as conforming capex under the NGR.[14] This is 3.2 per cent lower than JGN's revised proposed capex. Refer to Attachment 5 for the discussion on forecast capex.

2.2 Assessment approach

We did not change our assessment approach to the capital base from our draft decision. Attachment 2 (section 2.3) of our draft decision details that approach.[15]

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13 This amount is net of capital contributions and disposals, and excludes the half-year WACC adjustment.

14 NGR, r. 79.

15 AER, *JGN 2020–25 Access Arrangement – Draft Decision – Attachment 2 – Capital base*, November 2019, pp. 8-12.