Final decision: Australian Gas Networks access arrangement 2016–21

We have made a final decision on the access arrangement for Australian Gas Networks Ltd (AGN). AGN's gas distribution network provides services to customers in South Australia. Our final decision allows AGN to recover $985.5 million ($nominal) from its customers over five years commencing 1 July 2016.

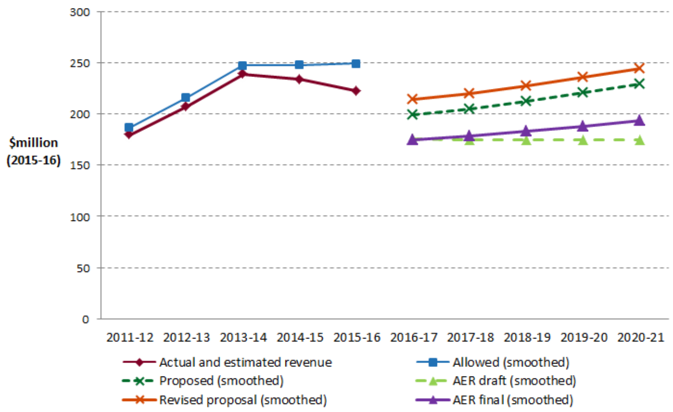
Overview

The Australian Energy Regulator (AER) approves access arrangements for AGN and other major gas networks in eastern and southern Australia under the National Gas Law (NGL) and National Gas Rules (NGR).

Our final decision allows AGN to recover $985.5 million ($nominal) from its customers over five years commencing 1 July 2016. If we had accepted AGN's revised proposal, it would have been permitted to recover $1228.4 million ($nominal) over the 2016–21 access arrangement period. Our final decision is for 19.8 per cent less revenue than AGN's revised proposal.

The figure below shows the difference between AGN's proposed revenue and our final decision.

AGN's past and proposed total revenue and AER final decision revenue allowance ($million, 2015–16)



Key elements of our decision

As a covered pipeline AGN's South Australian distribution network is subject to full regulation, which requires the service provider to submit an initial access arrangement to the regulator for approval, and revise it periodically. An access arrangement sets out the terms and conditions under which third parties can use a pipeline. It must specify at least one reference service likely to be sought by a significant part of the market, and a reference tariff for that service.

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

We discuss each of these below.

Rate of return

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

Our final decision sets the allowed rate of return (or 'cost of capital') at 6.15 per cent. We have not accepted AGN's revised proposed rate of return of 8.66 per cent.

The investment environment has improved since our previous decision, which was made during the period of uncertainty surrounding the global financial crisis. This improved investment environment translates to lower financing costs necessary to attract efficient investment. We consider that AGN has sought a rate of return that is higher than necessary given the current investment environment.

We have not accepted the methodology proposed by AGN to set its rate of return. Instead, we have used the methodology we developed through extensive consultation during our Better Regulation program in 2013. We consider that our approach provides for a rate of return that better reflects the allowed rate of return objective.

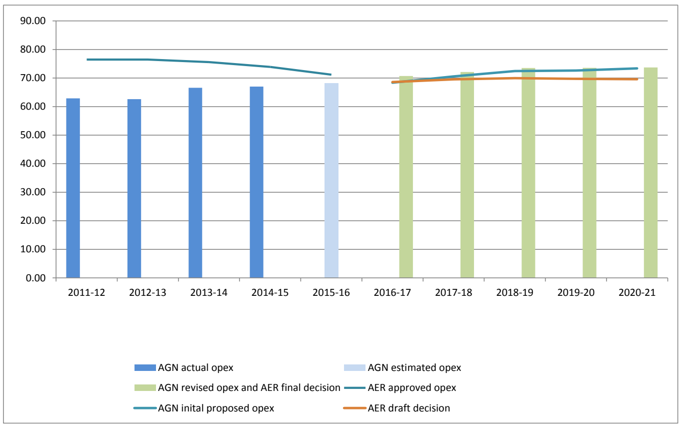
The lower rate of return in this decision will reduce AGN's average annual revenue requirement compared to the previous access arrangement period.

Operating expenditure

Opex includes forecast operating, maintenance and other non-capital costs incurred in the provision of gas distribution services. It includes labour and other non-capital costs that AGN is likely to require during the 2016–21 access arrangement period for the efficient operation of its network.

Our final decision accepts AGN's proposal to recover $363.62 million ($2015–16) for opex. We are satisfied that the level of opex reflects costs that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

AER final decision compared to AGN's past and proposed opex ($million, 2015–16)



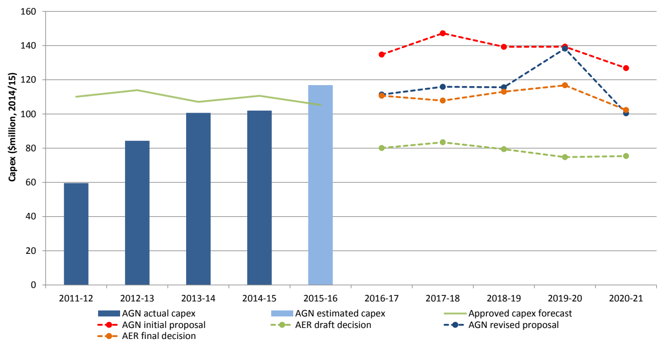
Capital expenditure

Capex refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence our required level of capex include expected growth in the network, and the age and condition of existing assets.

We must be satisfied that the level of capex proposed by AGN is justified, and reflects costs that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

Our final decision approves $550.5 million ($2014–15) total net forecast capex for the 2016–21 access arrangement period. The revised proposal AGN submitted in January sought $633.7 million ($2014–15) total net forecast capex for 2016–21. AGN subsequently provided an updated capex forecast, which reduced the mains replacement component of its capex forecast from $326.0 million to $277.2 million. This reduced its total capex forecast to $581.4m. Our final decision represents a reduction of 5.3 per cent to AGN's updated revised proposal of $581.4 million ($2014–15), or 13.1 per cent from its January revised proposal.

AER final decision compared to AGN's past and proposed capex ($million, 2014–15)



Our final decision on forecast capex is 41.4 per cent higher than the total capex forecast approved in our draft decision. This is because we now accept AGN's updated forecast of $277.2 million for mains replacement capex.

However, we have not accepted AGN's forecast of $28.5 million in capex to recover the costs of extending its network to Mt Barker and Two Wells through its forecast revenue requirement.

For more information:

More information on our final decision can be found on our website: www.aer.gov.au.