



**FINAL DECISION**  
**Jemena Gas Networks (NSW)**  
**Ltd**  
**Access Arrangement 2015-20**

**Attachment 10 – Reference**  
**tariff setting**

June 2015

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## Note

This attachment forms part of the AER's final decision on Jemena Gas Networks' 2015–20 access arrangement. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – services covered by the access arrangement

Attachment 2 – capital base

Attachment 3 – rate of return

Attachment 4 – value of imputation credits

Attachment 5 – regulatory depreciation

Attachment 6 – capital expenditure

Attachment 7 – operating expenditure

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## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CPI	consumer price index
DRP	debt risk premium
ERP	equity risk premium
JGN	Jemena Gas Networks (NSW) Ltd (ACN 003 004 322)
MRP	market risk premium
NGL	national gas law
NGO	national gas objective
NGR	national gas rules
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
WACC	weighted average cost of capital

## 10 Reference tariff setting

This attachment outlines our assessment of the reference tariffs proposed by JGN against the requirements of the NGL and NGR. Our evaluation focuses on the structure of reference tariffs and takes into account the revenue and pricing principles.<sup>1</sup>

### 10.1 Final decision

We accept the proposed structure of JGN's reference tariffs set out in its revised proposal. Nevertheless we consider that JGN must amend its access arrangement in order to comply with the NSW Retail Market Procedures.<sup>2</sup>

We have made all revisions necessary to give effect to this final decision to JGN's revised proposed access arrangement. These revisions can be found in schedule 2 of the *Approved Access Arrangement, JGN's NSW gas distribution networks 1 July 2015 – 30 June 2020* (June 2015).<sup>3</sup>

### 10.2 JGN's revised proposal

JGN's revised proposal accepted most of our draft decision on tariff setting. However, it proposed that it should be allowed to vary tariffs in accordance with its access arrangement and our subsequent formal approval of any proposed tariff variations.<sup>4</sup>

### 10.3 AER's assessment approach

The draft decision described in detail our approach to assessing JGN's reference tariffs. The same approach has been maintained for the final decision.<sup>5</sup>

### 10.4 Reasons for final decision

#### 10.4.1 Ability to add, vary or remove tariffs

JGN proposed a mechanism to enable it to introduce or withdrawal reference tariffs via the annual tariff variation mechanism. This was so that it could respond in a timely manner to changes in customer preferences that may, for instance, necessitate introducing a new tariff class.

On this basis JGN proposed that our draft decision, that changes such as the introduction or withdrawal of tariffs should be effected through a formal variation of the access arrangement under rule 65 of the NGR, was excessive.

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<sup>1</sup> NGL, s. 24.

<sup>2</sup> NGR, rr. 93 and 94.

<sup>3</sup> NGR, rr. 64(1) & (4).

<sup>4</sup> As oppose to a variation via rule 65 of the NGR.

<sup>5</sup> AER, *Draft decision Jemena Gas Networks (NSW) Ltd Access arrangement 2015–20 Attachment 10 – Reference tariff setting*, November 2014, pp. 9–11.

JGN reasoned that such a process would be administratively burdensome for no additional customer benefit. JGN contended that the way clause 3.1 of its access arrangement proposal is written makes sufficient provision for AER oversight of tariff structure changes.<sup>6</sup>

We agree with JGN's revised proposal that the introduction or withdrawal of reference tariffs be managed via the annual tariff variation mechanism, rather than reopening the access arrangement. This is administratively simpler, and more efficient and effective for network operators and customers, than reopening an access arrangement. The latter can be a lengthy process and is generally only reserved for making amendments on account of errors in, or omissions from, access arrangements. It is also noteworthy that the process recommended by JGN (and now accepted by us) is similar to amendments made to the NER. These allow electricity distributors to make changes to tariff structures via their tariff structure statements without amendments to their revenue determinations.

#### 10.4.2 Disconnection services

JGN proposed to rationalise its disconnection charges for small retail (i.e. household) customers by:

- removing its \$146.86 "temporary disconnection" charge.
- eliminating its "permanent disconnection" charge of \$433.88.

The separate temporary disconnection and permanent disconnection services would instead be combined into a single, \$150 "disconnection" charge.<sup>7</sup>

Our draft decision accepted this proposal. However, submissions from retailers argued that JGN should split its proposed disconnection charge into two separate charges, called "disconnection" and "reconnection".

JGN's proposed disconnection charge of \$150 includes a disconnection *and* reconnection service as a package. This means customers pay only \$150 for a temporary disconnection and then a subsequent reconnection. The same \$150 charge applies for a request for permanent disconnection (previously \$433.88).<sup>8</sup>

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<sup>6</sup> JGN, *Jemena Gas Networks (NSW) 2015–20 Access Arrangement Response to the AER's draft decision and revised proposal*, 27 February 2015, p. 116. Specifically JGN stated "clause 3.1(b) provides that JGN may vary reference tariffs in the manner contemplated by sub-clauses (i) to (iv) 'in accordance with this clause 3', which in turn invokes the process for AER approval in clauses 3.6 to 3.8".

<sup>7</sup> JGN, *Jemena Gas Networks (NSW) Ltd 2015-20 Access Arrangement Information*, June 2014, p. 117, JGN, *Jemena Gas Networks (NSW) Ltd NSW Gas Network Schedule of reference tariffs and charges effective 1 July 2014*, pp. 16–17.

<sup>8</sup> These charges have never been unbundled by JGN; AER, *Draft decision Jemena Gas Networks (NSW) Ltd Access arrangement 2015–20 Attachment 10 – Reference tariff setting*, November 2014, pp. 13–14.

We consider JGN's disconnection charge should be implemented as described above. This is despite retailers' submissions that we should require separate charges for disconnection and reconnection. These submissions are discussed below.

AGL submitted that we should reconsider our draft decision and approve separate charges. It contended that:

- the current disconnection charge does not reflect the service provided and that AGL was overcharged for these services.

We are not aware that JGN charges for services that it does not deliver. JGN submitted to us that the figures provided by AGL appear not to be the number of disconnection charges levied on AGL. Rather it is the proportion completed relative to the number of disconnection requests. Where a disconnection request is not completed, AGL is not charged for the service.<sup>9</sup> Consequently we accept JGN's submission that it only charges for services that it has performed.

- the disconnection charge is not equitable—AGL has to absorb significant fees on behalf of other retailers because it uses the disconnection service less, but is paying the same price as other retailers. AGL's submission provided data in percentage form to support its submission.

We accept JGN's submission that AGL does not have to absorb significant fees on behalf of other retailers. JGN submitted that the sample size used by AGL to derive data (in percentage form<sup>10</sup>) to support its claim is small. The number of disconnections completed by JGN for AGL is small compared to the 5000 disconnections undertaken in NSW in 2013–14.<sup>11</sup> Further, JGN stated that the sample appears to have also included difficult sites<sup>12</sup>, and as such may not be representative of all disconnections that it provides to all retailers.<sup>13</sup> We are therefore not persuaded by AGL's submission that it should pay a different price to that of other retailers for disconnections.

- disconnection should be split so that retailers are only paying for services actually performed when collecting retail debt.

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<sup>9</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, pp. 3–5. Disconnections may be complex as customers may object to the work, no access, or the site already being disconnected.

<sup>10</sup> AGL has found that only 55% of AGL's Jemena Gas customers who were successfully disconnected for debt then reconnected with AGL.

<sup>11</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, pp. 3–5. Disconnections may be complex as customers may object to the work, no access, or the site already being disconnected.

<sup>12</sup> Difficult sites can mean sites with locked gates, or internal locations where keys' or identification as a network operator is required to gain entry to the premises, or possibly also customers that have previously obstructed AGL's contractor.

<sup>13</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 4.



We are not persuaded by this submission because JGN only charges AGL for successful disconnections, or where AGL has not complied with its retail services agreement obligation.<sup>14</sup>

Origin Energy also submitted that our draft decision was inadequate, and that we should require JGN to split its disconnection charge into two separate charges (disconnection and reconnection charges). It raised two issues for our consideration:<sup>15</sup>

- Cost reflectivity—a single disconnection charge may not be cost reflective (because disconnection and a reconnection services are different tasks) and therefore the charge lacked transparency.

It appears that Origin Energy may have misunderstood that the proposed disconnection service still enables a retailer to arrange for a disconnection and subsequent reconnection for the same customer (at a cost of \$150). JGN stated that the single disconnection charge it proposed covers both services. Further, JGN submitted that splitting the charge could result in adverse market outcomes (by making disconnection easier and reconnection harder). It may result in additional costs to JGN (to change its systems to accommodate the split charges, and to manage double the number of disconnection/reconnection charge transactions). Inevitably, consumers would bear the cost of such changes. Origin Energy has not demonstrated that there is a consumer benefit to its alternative proposal and therefore we have not taken it up in this final decision.<sup>16</sup>

Nor are we persuaded by Origin Energy's submission about transparency. This is because we accept JGN's contention that it comes at the expense of higher overall costs to consumers, without corresponding offsetting benefits. JGN considered that retailers are best placed to manage customer debt rather than use JGN's resources to physically disconnect and then reconnect supply.<sup>17</sup>

- complication in the billing system between retailers, consumers and JGN by having one charge—billing issues where a consumer switches retailer.

Our view is that this issue is beyond the scope of an access arrangement because it relates to contractual arrangements between the consumer, their retailer and JGN. Consequently, we consider this issue should be addressed by retailers and JGN through other means, such as business to business operational guidelines or bilateral contractual obligations.

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<sup>14</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 4.

<sup>15</sup> Origin, *AER's draft decision and Jemena Gas Networks' revised access arrangement proposal*, 27 March 2015, pp. 13–14.

<sup>16</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, pp. 3–6.

<sup>17</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, pp. 3–6.

### 10.4.3 Cogeneration

Origin Energy's submission sought assurances from JGN that existing projects will retain their current tariff class and that JGN will continue to engage with retailers to establish the best tariff arrangement for prospective projects.

JGN stated it:

...is incentivised to facilitate new project to grow network utilisation and put downward pressure on network charges. The Access Arrangement provides an effective framework for JGN to engage with retailers in the manner requested. We will engage further with Origin about existing negotiated services and to make any requests necessary for future reference services.<sup>18</sup>

Contractual arrangements between retailers and JGN, rather than amendments to the access arrangement are the best means to address such matters.<sup>19</sup> We consider that JGN's approach sufficiently addresses Origin Energy's concerns.

### 10.4.4 Fixed Charges

Our draft decision did not require JGN to express its fixed charges on a daily basis. This outcome was advocated by retailers.

AGL's submission on the draft decision outlined that JGN's new Information Technology platform should be able to accommodate a fixed charge being expressed on a daily basis.<sup>20</sup>

Retailers did not file sufficient evidence to demonstrate that the benefits to consumers outweigh the costs of mandating these proposed changes.<sup>21</sup> However we note that JGN has submitted that it may be able to accommodate retailers' requests in future years, if the costs of the changes are negligible.<sup>22</sup>

Our final decision therefore maintains the position set out in our draft decision.

### 10.4.5 Decommissioning and meter removal charges

AGL's submission questioned JGN's proposed charges of \$1050 and \$2188 for decommissioning and meter removal respectively. AGL accepted the costs of these

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<sup>18</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 7.

<sup>19</sup> Generally, an access arrangement does not change the terms and conditions of an existing contractual arrangement, other than where the parties have expressly agreed between themselves for that to occur.

<sup>20</sup> AGL, *Jemena Gas Networks (NSW) Gas Access Arrangement 2015-20: AER Draft Decision and Revised Regulatory Proposal*, 27 March 2015, p. 5.

<sup>21</sup> AER, *Draft decision Jemena Gas Networks (NSW) Ltd Access arrangement 2015-20 Attachment 10 – Reference tariff setting*, November 2014, pp. 16–17.

<sup>22</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, pp. 5–6.

services provided the assets are removed. However, it submitted that if JGN chooses to leave assets on site (i.e. service connection) then it would expect a substantially reduced service charge to apply.<sup>23</sup>

Our draft decision considered JGN's charge for meter decommissioning and meter removal to be reasonable because it was cost reflective. We also noted that the tasks undertaken to decommission or remove a gas meter may vary between distributors and as such the charge levied may be different to the published rates.<sup>24</sup>

JGN confirmed that it does not charge a decommission fee if the service is not rendered. Decommissioning does not mean “removing all gas plant from the premises”, because assets of no practical value are commonly abandoned on site (for example decommissioned buried pipework cannot be re-used, and is not dug up and removed). Further, JGN stated that if it adopted a reduced scope of work such that decommissioning was not effectively completed (i.e. the delivery point continued to have an active connection to the network), then the decommissioning charge would not apply.<sup>25</sup>

We have therefore maintained our draft decision in regard to decommissioning and meter removal charges.

#### 10.4.6 Special Meter Reads

AGL's submission stated that the new NSW Retail Market Procedures would only require 2 business days' notice for special meter reads. AGL's submission accepted the 5 business day requirement for the 2015–2016 period prior to the new retail procedures coming into force, but does not support their inclusion from July 2016 onwards.<sup>26</sup>

We are aware that changes to the NSW Retail Market Procedures are expected to take effect in 2016, but can only make this decision based on the current legislative requirement. However this issue may be addressed via JGN's annual tariff variation proposal, which contains JGN's tariffs and charge descriptions. This occurs on an annual basis with effect from 1 July each year.<sup>27</sup>

We accept JGN's proposal to require five business days' notice for special meter reads until July 2016. Nevertheless we consider that JGN's proposed Access Arrangement

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<sup>23</sup> AGL, *Jemena Gas Networks (NSW) Gas Access Arrangement 2015-20: AER Draft Decision and Revised Regulatory Proposal*, 27 March 2015, p. 5.

<sup>24</sup> AER, *Draft decision Jemena Gas Networks (NSW) Ltd Access arrangement 2015–20 Attachment 10 – Reference tariff setting*, November 2014, pp. 15–16.

<sup>25</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 6.

<sup>26</sup> AGL, *Jemena Gas Networks (NSW) Gas Access Arrangement 2015-20: AER Draft Decision and Revised Regulatory Proposal*, 27 March 2015, p. 5.

<sup>27</sup> JGN indicated to retailers that there are other options that would allow this amendment. JGN, *Letter to AGL, re: Jemena gas AA*, 25 March 2015.

should be revised so that it can accommodate the new NSW Retail Market Procedures once in force. This will ensure that the access arrangement provisions mirror the retail services agreement. We have made revisions giving effect to this decision in schedule 2, clause 4.1(j) of the *Approved Access Arrangement, JGN's NSW gas distribution networks 1 July 2015 – 30 June 2020* (June 2015):

**Special Meter Reads** - For meter reading requested by a User for a Delivery Point that is in addition to the scheduled ordinary meter reading comprised in the Haulage Reference Service (for instance, when the meter reader makes a special visit to read a particular meter out of the usual meter reading route or schedule). This service must be scheduled by the User with the Service Provider in accordance with the NSW Retail Market Procedures.

#### 10.4.7 Temporary disconnection for small customers

AGL considered that a temporary disconnection charge for small customers is necessary in cases of housing renovations or customer debt, which might require a temporary cessation of service.

As outlined above, we are not persuaded by AGL's submission because these services are still provided. We are not persuaded because we accept JGN's submission that its proposal would not inhibit AGL's ability to request JGN to re-energise disconnected sites in the future (where physical connection remains intact).

Our response to the unbundling of disconnection services is outlined in section which applies to small customers.

#### 10.4.8 Large customer tariffs

The Energy Markets Reform Forum (EMRF) submission expressed concern that JGN is charging larger users more than is necessary. It commented that:<sup>28</sup>

- Large gas consumers prefer price path stability but this is not the same as a "preference" for a 2.5 per cent per annum price increase. That is, the EMRF is of the view that a preference for certainty does not mean a preference for a 13 per cent increase in network prices over the next 5 years.
- Large gas consumers should not face a price increase when their number connected to the gas network is declining and they do not add to network costs.
- Large gas consumers are more exposed to the future shocks of gas price increases than small consumers. The price increase proposed by JGN will also affect large consumers' financial viability.

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<sup>28</sup> Energy Markets Reform Forum, *AER Review of Jemena Gas Distribution EMRF response to AER DD and Jemena revised proposal*, March 2015, pp. 96–102

## Price path stability

We accept that a desire for price path stability does not necessarily mean that there is a preference for a 2.5 per cent per annum price increase.

We understand the EMRF's concerns. However we accept JGN's reasoning that the price decreases enjoyed by large gas users in the current access arrangement period do not reflect their network utilisation. Further this price decrease was temporary, and part of JGN's strategy to mitigate price shocks for large gas consumers as a result of the recovery of the carbon tax levy and delay in revenue recovery from the tribunal decision in 2012. That is, JGN recovered less revenue from large gas users in the current access arrangement period to mitigate price shocks.<sup>29</sup>

JGN submitted that its large customer tariff strategy in the next access arrangement is to return this market segment to a historical cost reflective proportion of JGN's total revenue. This means that large customers will see a steady price increase of around 2.5 per cent per annum in the next access arrangement period.

We consider that large gas consumers would prefer a stable price path that results in a total 13 per cent real price increase over five years, to a volatile price path that also results in a total 13 per cent real price increase over five years. The latter might be achieved through a mixture of price increases and decreases of various magnitudes over the five year access arrangement period. We do not consider that such a volatile price path profile is in the interests of consumers.

## Price increases for large users with declining network utilisation

The EMRF submitted that large gas consumers have not added to the costs of the network and that their numbers are declining. Therefore, it considered that large gas consumers' prices should not increase.

As discussed above, in the current period large users enjoyed relatively stable prices because JGN altered its pricing strategy to reduce price shocks.

We accept that large gas users will face a price increase in the 2015–20 access arrangement period. However we accept JGN's submission that it must take various pricing objectives and principles into account when setting tariffs, such as:

- the recovery of efficient costs of operation for JGN to continue to provide safe and reliable natural gas services into the future.

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<sup>29</sup> JGN, *Response to proposed tariff changes questions Information request 019*, August 2014, pp. 4–6. In June 2012, two changes to network pricing had to be introduced: (1) the delayed recovery of JGN allowed revenues (due to the 2010 tribunal merits review of the access arrangement) resulted in average price increases for each of the 2013, 2014 and 2015 years of around 11-12 per cent per annum (nominal); and (2) an approved cost pass through event to recover JGN's carbon tax liability of around \$0.11/GJ—which represented a 5-20 per cent increase in the network tariffs for demand customers, and around a 0.05 per cent increase in the network tariffs for small customers.

- keeping gas competitive compared to other fuel options for all consumers, not just large gas consumers.
- promoting efficient use of the gas network and treat customers equitably—ensure customer groups pay prices that reflect the costs they impose on the gas network and ensure that similar customers pay similar prices.
- providing stability in gas network and in end-retail prices—where possible, minimise any sharp change in end-customer bills.
- providing simplicity and transparency—ensure customers and stakeholders can understand tariffs.

Balancing the above principles means that both large and small customers may face a price increase from time to time. For the 2015–20 access arrangement, it is large gas users that will bear the largest tariff increases.

We therefore accept JGN's proposal to recover its efficient costs from large gas consumers by increasing prices for its demand tariff classes. We also consider that JGN has appropriately applied rules 93 and 94 of the NGR in setting its tariffs for the next access arrangement period.

### Price shocks and users' financial viability

The EMRF's submission suggested that our draft decision on tariff increases for large gas consumers will cause them to become financially unviable.<sup>30</sup> While financial viability is not a NGR requirement for our consideration, we have taken the long term interests of consumers into account in assessing JGN's proposed inputs to its total revenue requirement. We have also smoothed price increases over the access arrangement period to mitigate tariff volatility, including the size of any annual tariff increases.

Further, we accept JGN's submission that its network charges are only 10 per cent of a large gas consumers' bill (on average). A 2.5 per cent average per annum increase from our final decision is therefore equivalent to a 0.25 per cent average real increase to a large users' annual bill.<sup>31</sup>

### Removal of first response tariffs

The EMRF made the following points about our draft decision to allow JGN to close its first response<sup>32</sup> tariffs for new customers:

- JGN needs to promote its first response to large customers better

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<sup>30</sup> Energy Markets Reform Forum, *AER Review of Jemena Gas Distribution EMRF response to AER DD and Jemena revised proposal*, March 2015, p. 103

<sup>31</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 8.

<sup>32</sup> This tariff provides eligible large gas users with a discounted charge for participating in emergency supply curtailment.

- due to potential supply shortfalls now is not the time now to abandon this tariff.<sup>33</sup>

The first response tariff is a discounted tariff for demand customers (i.e. large gas users) who are willing to, and capable of, participating in network load shedding on a “first response” basis, and who sought this tariff when it was opened.

Our draft decision approved JGN’s proposal to close the first response tariff classes DCFR1 to DCFR11 and DMTFR1 to DMTFR5 to *new* customers; and to grandfather DCFR6 and DMTFR3 which have eligible customers and remove the first response tariffs which have no customers assigned to them.<sup>34</sup>

We accept JGN's submissions that:

- it costs large customers more to be on the first response tariff than it benefits them (around \$500,000 per annum to offset the incremental business risks to reduce gas demand quickly). This is supported by the low participation rate. It is also what large customers have told JGN.
- large gas customers who are able to participate have already done so and there is no new demand by any customer for this particular tariff.<sup>35</sup>

JGN also stated that it had consulted large customers with sufficient load to qualify for the first response tariff classes between December 2013 and May 2014. Furthermore, it consulted with twenty of its large customers prior to submitting its access arrangement proposal to us to close the first response tariffs to new customers.<sup>36</sup>

The curtailment of load by customers on the first response tariff is not necessarily the main line of defence against a severe network constraint. In the event of a gas shortfall, JGN implements network load shedding and issues directions as to which customers are required to shed load. It does this in accordance with established load shedding procedures and the customer information which has been provided to JGN by retailers. This may involve many customers being required to shed load as necessary for the event to be contained. This action most likely will not be limited to demand consumers who are on JGN's first response tariff.<sup>37</sup> Put simply, in the event of a gas shortfall all gas users may be required to restrict their gas usage.

As such, JGN no longer saw value in continuing with the first response tariff. We are satisfied with JGN's approach. Our final decision reflects this outcome.

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<sup>33</sup> Energy Markets Reform Forum, *AER Review of Jemena Gas Distribution EMRF response to AER DD and Jemena revised proposal*, March 2015, p. 103.

<sup>34</sup> AER, *Draft decision Jemena Gas Networks (NSW) Ltd Access arrangement 2015–20 Attachment 10 – Reference tariff setting*, November 2014, p. 15.

<sup>35</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 10.

<sup>36</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 10.

<sup>37</sup> JGN, *JGN's AER information request 051 Pricing matters raised in public submissions JGN response PUBLIC*, 14 April, p. 10.