



# **FINAL DECISION**

## **Jemena Gas Networks (JGN)**

### **Adjustment Determination**

February 2019

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## Note

This adjustment determination should be read with our remade final decision on the JGN access arrangement for the 2015-20 access arrangement period.<sup>1</sup>

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<sup>1</sup> AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.

# Contents

Note .....	2
Contents .....	3
1 Background.....	4
1.1 Remaking of our 2015 final decision.....	4
1.2 AEMC revenue smoothing rule change .....	5
2 Our final decision .....	6
2.1 Adjustment amount .....	6
2.2 Subsequent adjustment amount .....	6
2.3 Reasons for our final decision.....	6

# 1 Background

This adjustment determination was brought about by:

- the appeal of our final decision on JGN's access arrangement for the 2015-20 access arrangement period (2015 final decision), and the subsequent remaking of our 2015 final decision<sup>2</sup>
- the Australian Energy Market Commission's (AEMC) rule change regarding cross period smoothing.

Under the National Gas Rules, we are required to make an adjustment determination in order to ensure JGN recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process.<sup>3</sup> This adjustment determination relates to revenue requirements from reference services that must be smoothed between the 2015-20 and 2020-25 access arrangement periods to ensure this outcome.<sup>4</sup>

## 1.1 Remaking of our 2015 final decision

In June 2015, we published our final decision on JGN's access arrangement for the 2015-20 access arrangement period.

In response, JGN sought merits review of our final decision. The Australian Competition Tribunal (Tribunal) set aside our determination and remitted our decision to us to be remade.<sup>5</sup>

In March 2016, we sought judicial review of the Tribunal's decisions on gamma and return on debt. The Court upheld our appeal regarding gamma, but dismissed our appeal regarding return on debt. As a result, we were tasked with revisiting our decisions on return on debt and aspects of JGN's capital expenditure.

On 31 October 2018, JGN submitted a proposal outlining its suggested approach to remaking our 2015 decision for the 2015-20 access arrangement period.<sup>6</sup> Some consumer groups also provided their views on the proposal. JGN's proposal and consumer groups' feedback are published on our website.

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<sup>2</sup> AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.

<sup>3</sup> NGR, Schedule 1, Part 11.

<sup>4</sup> This assumes a five-year access arrangement period immediately follows the 2015-20 access arrangement period.

<sup>5</sup> In accordance with its orders regarding return on debt; imputation credits (gamma); and aspects of JGN's capital expenditure.

<sup>6</sup> JGN, *Proposal for the remittal items - Jemena Gas Networks 2015-20 access arrangement final decision*, 31 October 2018.

We published our 2015-20 remade draft decision,<sup>7</sup> in conjunction with our draft decision adjustment determination,<sup>8</sup> for JGN on 24 January 2019. We did not receive any submissions regarding the draft decision adjustment determination.

## 1.2 AEMC revenue smoothing rule change

During the appeal process, JGN entered into enforceable undertakings with the AER to set tariffs for the 2016–17 to 2018–19 regulatory years. It was acknowledged the revenue JGN collected through undertakings could differ, perhaps significantly, from the revenue it would be entitled to under the remade determination.

If so, this could cause significant fluctuation in reference tariffs between the remaining years of the 2015-20 access arrangement period, at the time of the appeals, and the first year of the 2020-25 access arrangement period. JGN thus submitted a rule change request to the AEMC to provide a mechanism to minimise potential price volatility for its customers that may occur as a result of the appeals and remittal decision.<sup>9</sup>

On 30 August 2018, the AEMC published its Gas revenue smoothing final rule which provides such a mechanism.<sup>10</sup> This adjustment determination is made under this final rule.

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<sup>7</sup> AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

<sup>8</sup> AER, *Draft decision: Jemena Gas Networks (NSW) Ltd adjustment determination*, January 2019.

<sup>9</sup> JGN, *Rule change proposal—Cross period revenue smoothing - National Gas Rules*, 14 December 2017.

<sup>10</sup> NGR, Schedule 1, Part 11.

## 2 Our final decision

Below, we set out our final decisions for the:

- Adjustment amount (see section 2.1)
- Subsequent adjustment amount (see section 2.2)

We also set out our reasons for our final decision in section 2.3.

### 2.1 Adjustment amount

Our final decision is that the adjustment amount is \$169 million (\$ at 30 June 2020).

This adjustment amount is above the portion of total revenue for reference services that we allocated to the 2019-20 regulatory year in our remade final decision.<sup>11</sup> JGN will recover the total revenue for reference services via its tariff variation for 2019-20.<sup>12</sup> We discuss JGN's tariff variation in our remade final decision.<sup>13</sup>

### 2.2 Subsequent adjustment amount

Our final decision is that the subsequent adjustment amount is –\$169 million (\$ at 30 June 2020).

This subsequent adjustment amount is a decrease to the portion of total revenue allocated to JGN's reference services for the 2020–25 access arrangement period.<sup>14</sup> We will incorporate this amount as a reduction to JGN's building block revenue requirement for reference services—equivalent in net present value terms to the adjustment amount—for the 2020–25 access arrangement period.<sup>15</sup>

### 2.3 Reasons for our final decision

We are satisfied this final decision adjustment determination—that is, the application of the adjustment amount and the subsequent adjustment amount:<sup>16</sup>

- will likely minimise variations in reference tariffs across the 2015-20 and 2020-25 access arrangement periods

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<sup>11</sup> NGR, Schedule 1, Part 11, cl. 53; AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.

<sup>12</sup> That is, JGN will recover via its tariff variation for 2019-20 the portion of total revenue allocated to the 2019-20 regulatory year in our remade final decision plus the adjustment amount. NGR, Schedule 1, Part 11, cl. 57(4)(a).

<sup>13</sup> AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.

<sup>14</sup> NGR, Schedule 1, Part 11, cl. 53.

<sup>15</sup> NGR, Schedule 1, Part 11, cl. 53 (see definition of subsequent adjustment amount).

<sup>16</sup> NGR, Schedule 1, Part 11, cl. 56(1)(c) and (d).

- ensure JGN recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process (revenue recovery principle).

We consider this final decision adjustment determination meets the National Gas Objective (NGO) and the revenue and pricing principles.<sup>17</sup> In particular, we consider this final decision adjustment determination is in the long term interest of consumers with respect to price. In conjunction with our remade final decision, it also provides JGN with reasonable opportunity to recover at least efficient costs in providing reference services for both the 2015-20 and 2020-25 access arrangement periods.<sup>18</sup>

JGN's remittal proposal adopted our 2015 final decision, plus an additional \$21 million of market expansion capex. JGN also proposed a downward revenue adjustment of \$169 million (\$ at 30 June 2020). This recognises that prices under the enforceable undertakings were higher than they would have been if the remittal proposal had been in place throughout the 2015-20 access arrangement period.<sup>19</sup>

We accepted JGN's remittal proposal in our remade final decision for the 2015-20 access arrangement.<sup>20</sup>

Without a smoothing mechanism, JGN would potentially be required to apply the \$169 million downward revenue adjustment in the final year of the 2015-20 access arrangement period. This could lead to price fluctuations for JGN's customers. Figure 2.1 shows that our remade final decision would result in a 32 per cent reduction to average prices in the 2019-20 regulatory year compared to the 2018-19 regulatory year, if there was no smoothing mechanism in place. Depending on revenue requirements for the 2020-25 access arrangement period, there is also potential for a large rebound or increase in average prices from 2019-20 to 2020-21 (the first regulatory year of the 2020-25 access arrangement period).

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<sup>17</sup> NGR, Schedule 1, Part 11, cl. 56.

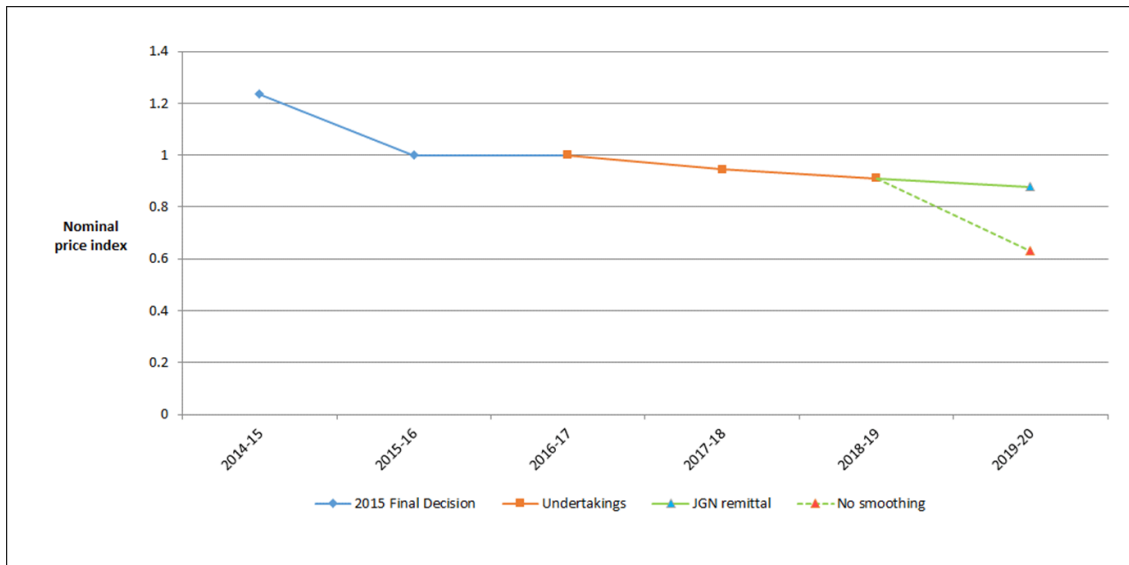
<sup>18</sup> NGL, Part 3, Division 1.

<sup>19</sup> JGN, *Proposal for the remittal items - Jemena Gas Networks 2015-20 access arrangement final decision*, 31 October 2018, pp. 3–4.

<sup>20</sup> AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.



**Figure 2.1 Nominal price index with and without smoothing**



Source: AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019.

We consider such large fluctuations in average prices, even if they are one-off, are not consistent with the NGO. Such large fluctuations may lead customers to incorrectly assume they will continue into the future. Customers may then make inefficient investment decisions based on these assumptions.

Applying the adjustment amount in the 2019-20 regulatory year ensures a smoother price path between the 2018-19 and 2019-20 regulatory years—as shown in Figure 2.1. We will then minimise any price volatility between the 2019-20 and 2020-21 regulatory years through our final decision for the 2020-25 access arrangement.

Importantly, our final decision adjustment determination in conjunction with our remade final decision gives effect to JGN's proposal for the remaking of its 2015-20 access arrangement, which we accepted and which has the support of several customer representatives.<sup>21</sup> Adding the adjustment amount to the revenue allocated to the 2019-20 regulatory year in our remade final decision ensures a consistent price path with JGN's remittal proposal.<sup>22</sup> Further, applying the subsequent adjustment amount in the 2020-25 access arrangement is consistent with JGN's proposal to return \$169 million (in net present value) to customers.<sup>23</sup>

<sup>21</sup> AER, *Final decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, February 2019; CCP, *Letter to AER on JGN 2015-20 remittal proposal*, 1 November 2018; ECA, *Letter to JGN on JGN 2015-20 remittal proposal*, 31 October 2018; PIAC, *Letter to JGN on JGN 2015-20 remittal proposal*, 1 November 2018; SVDP, *Letter to JGN on JGN 2015-20 remittal proposal*, 31 October 2018.

<sup>22</sup> JGN, *Remittal model - Forecast volume scenario - PUBLIC*, 20 November 2018.

<sup>23</sup> JGN, *2015-20 access arrangement remittal proposal*, October 2018, p. 5.