

# Revised Final Plan Attachment 12.1

## Response to Draft Decision: Network Revenue

August 2017

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# 1. Response to Draft Decision on Network Revenue

## 1.1 Introduction

This attachment sets out Australian Gas Networks Limited’s (AGN’s) revised building block and smoothed reference tariff revenues, the proposed price path and Ancillary Reference Service (ARS) revenue.

## 1.2 Stakeholder Engagement

For our Final Plan, we undertook stakeholder engagement on our proposed price path, including whether our prices allowed the business to maintain the credit rating used when setting in the cost of debt. Stakeholders supported our approach to not make any revenue adjustments for financeability, which is consistent with the approach we have used in this Revised Final Plan.

## 1.3 AER Draft Decision

The AER has broadly accepted our Final Plan network revenue, but have made changes to our Final Plan price path to reflect the consequential impacts of the AER’s amendments to our Final Plan. A summary of the AER’s Draft Decision in respect of network revenue and price path is set out in Table 1.1.

Table 1.1: Summary of the AER’s Draft Decision on Network Revenue and Price Path

	AER Draft Decision	AER Comment
Network Revenue	Accept	The AER’s Draft Decision revenue was \$1,115 million (\$2017).
Price Path	Modify	The AER price path, in real terms, provided for an initial cut of 6.4 per cent in 2018 followed by increases of 1.25% per year in the last four years of the next AA period <sup>1</sup> , which increase broadly aligns with the growth in the capital base of 1.6%.
ARS	Accept	The AER accepted our ARS forecast.

Note: In this ‘traffic light’ table, green shading represents no change from the Final Plan, orange represents a modification of the position outlined in the Final Plan and red shading represents a change from the Final Plan.

## 1.4 AGN Response to the Draft Decision

We have accepted the AER’s Draft Decision as the approach to determining network revenue and prices (see Table 1.2).

<sup>1</sup> AER, *Overview | Draft decision - AGN Victoria and Albury gas access arrangement 2018–22*, July 2017, page 29.

Table 1.2: Summary of AGN's Response to the AER's Draft Decision on Network Revenue

	AER Draft Decision	AGN Response	AGN Comment
Network Revenue	Accept	Accept	Network Revenue has been updated to reflect the various updates requested by the AER and for a more recent rate of return.
Price Path	Modify	Accept	We acknowledge the factors that the AER weighed up in determining the Draft Decision price path and accept the outcome of its reasoning.
ARS	Accept	Accept	We accept the AER's Draft Decision.

Note: In this 'traffic light' table, green shading represents the acceptance, orange represents a modification and red shading represents a rejection.

In our Final Plan we put forward the importance of considering the financeability of the pricing decision (in Section 12.5 of the Final Plan). We asked the AER to consider whether our Final Plan provided sufficient revenue/cash flow to achieve the assumed credit rating (BBB+/Baa1), used to determine the allowed return on debt. We made no explicit adjustment to our cash flow for financeability, consistent with stakeholder feedback.

In response the AER provided:

*"Consistent with our decision on AGN South Australian access arrangement, we are not satisfied that AGN's analysis of credit metrics provides robust evidence of a negative credit rating outcome for an efficient service provider.<sup>2</sup> We also consider that AGN's proposed approach to the use of credit metrics is an indirect test on the return on equity and remain unpersuaded by the submission that low credit metrics indicate the need for an adjustment to cash flows.<sup>3</sup> Overall, we are satisfied that our draft decision allows for AGN's reasonable needs for cash flow to meet financing, non-capital and other costs.<sup>4</sup>"<sup>5</sup>*

As stated in our Final Plan, our conservative view is that the ratings agencies require a sustained Funds from Operations (FFO) to-debt ratio of at least 9%. The Revised Final Plan credit metrics deliver an average FFO to Debt of 8.4%, which is below the 9% threshold but do increase over the term of the Access Arrangement. We consider the credit ratios are marginal at best, but as with our Final Plan we have decided not to make an explicit adjustment to our cashflow. Table 1.3 below presents the revised credit metrics.

Table 1.3: Revised Final Plan Key Credit Ratios, 2018 to 2022

	2018	2019	2020	2021	2022	Average
FFO to Debt	7.4%	8.2%	8.3%	9.3%	9.1%	8.4%
FFO to Interest Cover	2.6	2.8	2.8	3.0	3.0	2.8

<sup>2</sup> AER, *Final Decision Australian Gas Networks access arrangement - Attachment 5 - Regulatory depreciation*, May 2016, page 20–22.

<sup>3</sup> *Ibid.*, pages 72–73.

<sup>4</sup> NGR, r. 89(1)(e).

<sup>5</sup> AER, *Overview | Draft decision - AGN Victoria and Albury gas access arrangement 2018–22*, July 2017, page 22.

## 1.5 Summary

Table 1.4 provides the revised building block total revenue including and excluding ARS.

Table 1.4: Building Block Revenue 2018 to 2022 (\$nominal, million)

	2018	2019	2020	2021	2022
Return on Capital	87.9	92.4	97.7	102.4	106.3
Return of Capital (Regulatory Depreciation)	39.6	45.4	54.1	45.8	50.4
Opex	69.7	72.1	74.7	77.6	80.5
Incentive Mechanism	13.3	5.3	3.4	-2.3	0.0
Cost of Tax	12.2	12.5	12.8	9.5	10.3
<b>Building Block Total Revenue (including ARS)</b>	<b>222.6</b>	<b>227.8</b>	<b>242.8</b>	<b>233.0</b>	<b>247.6</b>
<i>Less ARS</i>	4.0	4.1	4.3	4.4	4.6
<b>Building Block Total Revenue (excluding ARS)</b>	<b>218.6</b>	<b>223.7</b>	<b>238.5</b>	<b>228.6</b>	<b>243.0</b>

Note: Totals may not add due to rounding.

Table 1.5 presents the “smoothed” tariff revenue and price path for Victoria and Albury. This results in a price cut in 2018 of 8.5% followed by price increases in each subsequent year of 1.25%, which price increases are consistent with that applied by the AER in its Draft Decision. The initial price cut in 2018 would increase to 10.7% had we maintained the subsequent price increases at 2.5%, which initial price cut is similar to that proposed in our Final Plan of 11.5%.

Table 1.5: Proposed Price Path, 2018 to 2022 (\$nominal, million)

	2018	2019	2020	2021	2022
Building Block Revenue	218.6	223.7	238.5	228.6	243.0
Price Revenue	212.8	221.4	230.6	239.9	249.8
<b>Real Price Path</b>	<b>-8.5%</b>	<b>+1.25%</b>	<b>+1.25%</b>	<b>+1.25%</b>	<b>+1.25%</b>

Table 1.6 sets out the ARS building block total revenue for Victoria and Albury.

Table 1.6: Forecast Revenue from Ancillary Reference Services, 2018 to 2022 (\$nominal, million)

	2018	2019	2020	2021	2022
Meter Gas and Installation Test	0.02	0.02	0.02	0.02	0.02
Disconnection	0.84	0.87	0.89	0.92	0.96
Reconnection	1.00	1.03	1.06	1.10	1.13
Meter Removal	0.15	0.16	0.16	0.17	0.18
Meter Reinstallation	0.00	0.00	0.00	0.00	0.01
Special Meter Read – Metropolitan	1.41	1.45	1.50	1.55	1.60
Special Meter Read – Non Metropolitan	0.59	0.61	0.63	0.65	0.67
<b>Total</b>	<b>4.02</b>	<b>4.14</b>	<b>4.27</b>	<b>4.42</b>	<b>4.57</b>

Note: Totals may not add due to rounding.