

Revised Final Plan Attachment 7.5

Response to Draft Decision: Operating Expenditure

August 2017

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1. Response to Draft Decision on Operating Expenditure

1.1 Introduction

This attachment sets out Australian Gas Networks Limited's (AGN's) response to the Australian Energy Regulator's (AER's) Draft Decision on operating expenditure (opex) for our Victorian and Albury networks over the next (2018 to 2022) Access Arrangement (AA) period.

The AER approved our proposed opex forecast after verifying our forecast through an alternative forecasting methodology.¹ We have accepted the AER's Draft Decision and have updated our opex forecast in our Revised Final Plan for actual 2016 opex, which was not available at the time we provided our Final Plan to the AER in December 2016.²

The Revised Final Plan opex forecast is \$348 million (\$2017), which is \$4 million (or 1%) higher than the Final Plan opex forecast of \$344 million.

1.2 Stakeholder Engagement

In preparing this Revised Final Plan we have continued to engage with stakeholders, including our Reference Groups and through the submissions to the AER on our Final Plan.

There were four stakeholder submissions on our proposed opex forecast, which were focused on our proposed marketing step change. A summary of the key feedback provided in relation to our opex proposal is provided in Table 1.1 below.

Table 1.1: Consideration of Stakeholder Feedback on our Opex Proposal

Stakeholder Feedback on the Final Plan	Our Response to Feedback on the Final Plan
Stakeholder submissions did not provide any further feedback in relation to our opex forecasting methodology.	We have accepted the AER's Draft Decision, which provides an opex allowance broadly consistent with that resulting from the opex forecasting methodology used in our Final Plan.
Stakeholder support for our proposed marketing step change was mixed. <ul style="list-style-type: none"> • Some stakeholders considered that we had not sufficiently demonstrated stakeholder support for our proposed marketing step change.³ • Other stakeholders supported our marketing proposal, subject to a positive cost benefit analysis.⁴ 	We consider that marketing is a prudent and efficient activity for our business to undertake. However we have accepted the AER's Draft Decision to not include our proposed marketing step change on the basis that our base year reflects prudent and efficient expenditure. This decision is consistent with the AER's base-step-trend approach to forecasting opex.

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 AER, *Attachment 7 – Operating Expenditure | Draft decision - AGN Victoria and Albury gas access arrangement 2018–22*, July 2017, page 7-5.

² *Ibid.*

³ Consumer Challenge Panel, *Advice to the Australian Energy Regulator | Consumer Challenge Panel Sub-Panel CCP11 | Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 2018 to 2022*, March 2017, page 58.

⁴ Red Energy and Lumo Energy, *Re: Australian Gas Networks Access Arrangement*, March 2017, page 2.

1.3 AER Draft Decision

As the AER comments in its Draft Decision:

“Our draft decision is to accept AGN’s forecast opex of \$344.0 million (\$2017) for the 2018-22 access arrangement period.”⁵

The AER assessed our opex proposal by verifying it against their own alternative forecasting methodology.⁶ As the AER states:

“We have not included some aspects of AGN’s proposal in our alternative estimate, such as the marketing step change. However, this is offset by other factors, with the result that overall there is not a material difference between our estimate and AGN’s proposal.”⁷

In particular, in its alternative estimate the AER:

- rejected our proposed marketing step change on the basis that costs reflective of a prudent and efficient marketing program were already included in our base year; and
- adjusted our base year roll forward forecasting approach, including by applying a productivity adjustment to our forecast of output growth.

We have provided a summary of the AER’s Draft Decision in Table 1.2 below.

Table 1.2: Summary of AER’s Draft Decision on Opex

	AER Draft Decision	AER Comment
Base Year	Accept	Accepted 2016 as the appropriate base year from which to forecast opex for the next AA period, but expects AGN to update its estimate of 2016 opex to reflect actual information not available at the time we submitted our Final Plan. ⁸
Rate of Change	Modify	Accepted our approach to forecasting real cost escalation on the basis it is consistent with the AER’s preferred approach. ⁹ Accepted our methodology of calculating output growth, however reduced our output growth forecast to reflect an implicit productivity adjustment. ¹⁰ Did not accept our proposed step change in relation to joint marketing activities with the other Victorian gas distribution businesses on the basis that <i>“Marketing is a ‘business-as-usual’ expense for AGN to consider within its existing base opex forecast.”¹¹</i>

Note: In this ‘traffic light’ table, green shading represents the AER’s acceptance of AGN’s Final Plan, orange represents the AER’s modification of AGN’s Final Plan and red shading represents the AER’s rejection of AGN’s Final Plan.

⁵ AER, Attachment 7 – Operating Expenditure | Draft decision - AGN Victoria and Albury gas access arrangement 2018–22, July 2017, page 7-5.

⁶ Ibid, page 7-5.

⁷ Ibid, page 7-5.

⁸ Ibid, page 7-12.

⁹ Ibid, page 7-13.

¹⁰ Ibid, page 7-15.

¹¹ Ibid, page 7-16.

1.4 AGN Response to the Draft Decision

We have accepted the AER's Draft Decision on the basis that it is consistent with our opex proposal in our Final Plan (see Table 1.3).

Table 1.3: Summary of AGN's Response to the AER's Draft Decision on Opex

	AER Draft Decision	AGN Response	AGN Comment
Base Year	Accept	Accept	We have accepted the AER's Draft Decision and have updated our base year to reflect actual 2016 opex of \$66 million, consistent with our 2016 Annual Regulatory Information Notices (RIN) submitted to the AER in May 2017.
Rate of Change	Modify	Accept	The AER has verified our proposed rate of change through an alternative forecasting approach. We have accepted the AER's Draft Decision on the basis forecast opex is consistent with our Final Plan.

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

Despite accepting the AER's Draft Decision not to accept our marketing step change, we continue to consider that marketing is a prudent and efficient activity for gas distribution businesses to undertake in Victoria. In particular, we consider the joint marketing proposal with Multinet Gas and AusNet Services is prudent and efficient given the following:

- gas continues to be a fuel of choice, with the competitive pressures faced by our business increasing due to the various alternative energy solutions available to energy users in Australia;
- stakeholders have continued to support our marketing proposal since the release of the Draft Decision;
- there are three gas distribution businesses in Victoria and all three businesses operate in the Melbourne metropolitan area which has prevented those businesses from delivering prudent levels of marketing in the past, given the potential 'free rider effect';
- we have demonstrated that our marketing program provides benefits to our customers; and
- the benefits of our marketing program are distributed across our customer base, through lower tariffs over the medium-to-long term.

We may continue to seek additional marketing in the future in the event that AGN is not able to deliver a prudent marketing program, particularly as a result of the third point above.

1.5 Summary

Our Revised Final Plan opex forecast (updated for actual 2016 opex), is provided in Table 1.4.

Table 1.4: Revised Final Plan Opex Forecast (\$2017, million)

	2018	2019	2020	2021	2022	Total
Total <i>(excluding Debt Raising Costs)</i>	67.2	67.9	68.7	69.5	70.4	343.7
Debt Raising Costs	0.8	0.8	0.8	0.8	0.9	4.1
Total <i>(including Debt Raising Costs)</i>	68.0	68.7	69.5	70.4	71.3	347.8