

Revised Final Plan Attachment 9.6

Response to Draft Decision: Capital Base

August 2017

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1. Response to Draft Decision on Capital Base

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 the capital base over the current (2013 to 2017) Access Arrangement (AA) period and forecast for the next (2018 to 2022) AA period.

The AER has largely accepted our approach to adjusting our capital base for capital expenditure (capex), disposal, depreciation and inflation. The AER have made minor amendments in its Draft Decision in respect of the opening capital base, which amendments AGN has accepted as part of this Revised Final Plan. In its Draft Decision, the AER has also requested we update the capital base for actual 2016 capex and an updated forecast of 2017 capex, which we have done.

These amendments result in an opening capital base as at 1 January 2018 of \$1,572 million (\$nominal) and a closing capital base as at 31 December 2022 of \$1,936 million (\$nominal).

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.

Stakeholders generally consider the adjustment of the capital base to be largely mechanical, governed by the requirements of the National Gas Rules (NGR).

There were three stakeholder submissions on certain elements of the capital base proposed in our Final Plan (see Table 1.1).

Table 1.1: Consideration of Stakeholder Feedback on our Capital Base

Stakeholder Feedback on the Final Plan	Our Response to Feedback on the Final Plan
<p>In their submission Consumer Challenge Panel 11 (CCP11) asked the AER to carefully consider changes to asset lives, particularly the reduction in the life of low pressure mains <i>“...to determine whether the assets life is justifiably less than previously allowed”</i>.¹</p>	<p>Consistent with our Final Plan, we have aligned the economic and technical lives of the low pressure mains scheduled to be replaced by the end of the next AA period. This approach is consistent with stakeholder feedback on our Final Plan, the AER’s Draft Decision and the NGR.</p>
<p>CCP11 asked the AER to examine the change in depreciation methodology from a weighted average approach to year by year tracking and <i>“...if there is a material adverse impact on consumers through higher revenue requirement by the NSPs [Network Service Providers], consider rejecting the proposal.”</i>²</p>	<p>As outlined in our Final Plan, the ‘year-by-year’ tracking approach more closely reflects the life of our assets and is consistent with recent AER decisions. The AER has considered and approved this change in their Draft Decision.</p>
<p>In their joint submission Red Energy and Lumo Energy supported our approach to estimating expected inflation – adopting the AER’s estimate of expected inflation, while working collaboratively with the AER during their formal review of inflation to put forward <i>“...an alternative method that they [we] consider would more accurately the [estimate the expected] inflation rate.”</i>³ These sentiments were also supported in the Uniting Communities submission.⁴</p>	<p>Since our Final Plan the AER has commenced a formal review of regulatory inflation, which we are actively participating in. As we await the outcomes of this review, we continue to apply the AER’s current method of estimating expected inflation.</p>
<p>The CCP11 noted in their submission that, <i>“with respect to the forecast of inflation, AGN has applied a forecast of 1.6 per cent...”</i>.⁵</p>	<p>In our Final Plan we applied the AER’s approach to estimating expected inflation, which resulted in a forecast of inflation of 2.39%. We noted our preference for a market based approach to estimating expected inflation (breakeven approach), which was 1.6% at the time. However, consistent with our approach to rate of return and gamma, we applied the AER’s preferred approach given the current uncertainty.</p> <p>In this Revised Final Plan we continue to apply the AER preferred approach, with the latest estimate of expected inflation being 2.47%.</p> <p>We note that the AER has initiated a dedicated review of inflation, which process we are participating in.</p>

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 CCP11, *Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 2018 to 2022*, page 53, 3 March 2017.

² Ibid, page 54.

³ Red Energy and Lumo Energy, *Australian Gas Networks Access Arrangement*, page 3, 6 March 2017.

⁴ Uniting Communities, *Australian Gas Networks Access Arrangement Proposal for Victoria / Albury*, page 9, 2017.

⁵ CCP11, *Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 2018 to 2022*, page 71, 3 March 2017.

1.3 AER Draft Decision

The AER approved an opening capital base of \$1,603 million (nominal) as at 1 January 2018, a \$13 million, or 1% increase from our Final Plan. The increase relates to *“amendments in the roll forward model (RFM) to correct some input and modelling errors”*⁶.

The AER approved a closing capital base of \$1,961 million (nominal) as at 31 December 2022, a \$17 million, or 1% decrease from our Final Plan. This decrease relates primarily to the lower opening capital base, discussed above, and a \$4 million increase in regulatory depreciation associated with a higher expected inflation assumption.

The AER has made certain corrections to determine our opening capital base and accepted our approach to adjust the capital base over the next AA period (see Table 1.2).

Table 1.2: Summary of AER’s Draft Decision on Capital Base

	AER Draft Decision	AER Comment
Opening capital base 1 January 2018	Modify	The AER amended our opening capital base following minor corrections identified and agreed with AGN during the review of our Final Plan.
Forecast capex	Accept	The AER accepted our capex forecast, following minor amendments identified and agreed with AGN during the review of our Final Plan (see Attachment 8.11).
Depreciation	Accept	The AER accepted our proposal to align the technical and economic lives of mains and services (distribution pipelines) to be replaced as part of our mains replacement program. The AER also accepted the standard asset lives we proposed. The AER accepted the year-by-year tracking approach in our Final Plan, making some minor changes to its application.
Inflation	Accept	The AER applied its current preferred methodology for estimating expected inflation. The inflation estimate was updated for the latest information, which increased expected inflation from 2.39% to 2.47%.
Closing capital base 31 December 2022	Modify	The AER made minor modifications to our closing capital base, reflecting the above changes.
Opening capital base 1 January 2023	Accept	The AER accepted AGN’s proposal to use the depreciation schedules based on forecast capex over the next AA period and asked that these details be included in the AA document.

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.

⁶ AER, *Draft Decision, Australian Gas Networks Victoria and Albury gas access arrangement 2018 to 2022, Attachment 2 – Capital Base*, page 2-5, July 2017.

1.4 AGN Response to the Draft Decision

AGN has accepted the AER's Draft Decision on our capital base (see Table 1.3).

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

	AER Draft Decision	AGN Response	AGN Comment
Opening capital base 1 January 2018	Modify	Accept	We have accepted corrections made by the AER in its review of our Final Plan.
Forecast capex	Accept	Accept	We have accepted the AER's Draft Decision on capex (please see Attachment 8.11 for more information).
Depreciation	Accept	Accept	We have accepted the AER's minor amendments made to calculate depreciation.
Inflation	Accept	Accept	<p>As the AER is currently running a separate review of their approach to estimating expected inflation, we have applied the AER's preferred approach pending the outcome of this review. We maintain however that an estimate of inflation derived from market information consistent with that used to determine the rate of return provides for the best estimate of inflation.</p> <p>We are actively participating in the AER's current inflation review, with the AER's final decision due in December 2017. It is expected that the outcome of the AER inflation review will be reflected in the AER's Final Decision for Victorian and Albury networks.</p>
Closing capital base 31 December 2022	Modify	Accept	We accept the AER's Draft Decision, but have modified for the latest capex estimates described in Attachment 8.11.
Opening capital base 1 January 2023	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.

1.5 Summary

We have established the capital base as at 1 January 2018 consistent with the requirements of the NGR⁷, and have accepted the amendments made by the AER in its Draft Decision. We have also updated for more recent information including, actual 2016 capex and a revised forecast of 2017 capex.

Table 1.4 shows the roll forward of the capital base from 1 January 2012 to 1 January 2018.

Table 1.4: Roll Forward of the Regulatory Asset Base 2013 to 2017 (\$nominal, million)

	2013	2014	2015	2016	2017
Opening Capital Base	1,152.2	1,237.0	1,331.4	1,439.5	1,497.3
<i>Less</i> Depreciation	41.3	45.4	51.1	55.0	58.4
<i>Plus</i> Conforming Net Capex	103.0	113.1	128.5	91.1	105.3
<i>Plus</i> Actual Inflation	23.1	26.7	30.7	21.6	19.4
<i>Plus</i> 2012 Capex Adjustments	-	-	-	-	6.3
<i>Plus</i> Funding Adjustment	-	-	-	-	2.4
Closing Value	1,237.0	1,331.4	1,439.5	1,497.3	1,572.2

Note: Totals may not add due to rounding.

The forecast capital base over the next AA period is determined in accordance with the NGR⁸, taking into account forecast depreciation, capex and inflation (see Table 1.5). This shows a closing capital base of \$1,934 million as at 31 December 2022 (\$nominal).

Table 1.5: Forecast Regulatory Asset Base 2018 to 2022 (\$nominal, million)

	2018	2019	2020	2021	2022
Opening Capital Base	1,572.2	1,652.6	1,748.6	1,832.0	1,902.0
<i>Plus</i> Forecast Conforming Net Capex	120.0	141.4	137.5	115.7	84.4
<i>Less</i> Forecast Depreciation	78.4	86.2	97.3	91.0	97.4
<i>Plus</i> Forecast Inflation	38.8	40.8	43.2	45.3	47.0
Closing Value	1,652.6	1,748.6	1,832.0	1,902.0	1,935.9

Note: Totals may not add due to rounding.

⁷ NGR, r. 77(2).

⁸ NGR, r. 78.