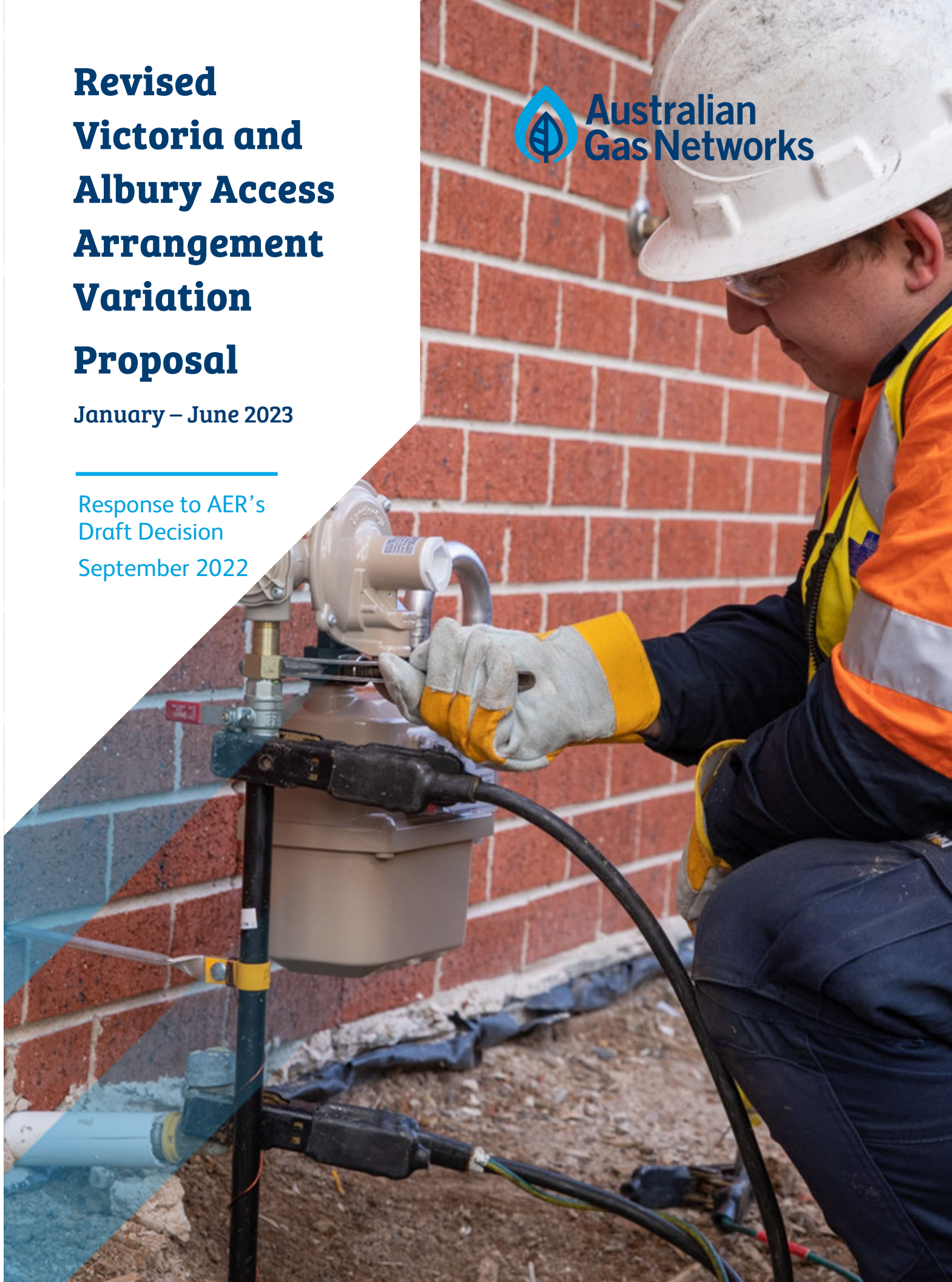


Revised Victoria and Albury Access Arrangement Variation Proposal

January – June 2023

Response to AER's
Draft Decision
September 2022



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We are Australian Gas Networks. We deliver gas safely and reliably to more than 700,000 homes and businesses in Victoria and Albury every year.

Our vision is to be the leading gas infrastructure business in Australia by delivering for customers, being a good employer and being sustainably cost efficient.

We are committed to sustainable gas delivery today, and tomorrow. Gas networks can decarbonise heat through the use of renewable gases like hydrogen and biomethane. Through Hydrogen Park Murray Valley and the Australian Hydrogen Centre we are laying a foundation for a strong zero emissions future so our customers can continue to enjoy gas cooking and heating in their homes and businesses.

CEO Foreword

We are pleased to provide this revised Access Arrangement Variation Proposal for Australian Gas Networks (AGN's) Victoria and Albury for the January to June 2023 extension period.



This revised Variation Proposal reflects the feedback from the AER in its Draft Decision.

AGN is part of the Australian Gas Infrastructure Group (AGIG), one of Australia's largest gas infrastructure businesses. Through AGN Victoria and Albury we serve over 700,000 customers in Victoria and New South Wales, including in the Melbourne CBD, northern, eastern and outer southern areas of metropolitan Melbourne, the Mornington Peninsula, and northern, eastern and south-eastern areas of Victoria and Albury. AGN plays a vital role in delivering safe, reliable, affordable and low emissions energy for residential,

commercial and industrial customers.

In serving these customers it is our vision to be the leading gas infrastructure business in Australia. We aim to do this by achieving top quartile performance in delivering for customers, being a good employer and being sustainably cost efficient.

This revised Variation Proposal responds to the AER's Draft Decision published on 13 July 2022. In particular, it:

- Accepts the AER's inclusion of revenue adjustments in the six month period from the opex incentive mechanism equivalent to half of the efficiency gains in 2017;
- applies the latest inflation actuals and forecasts, published after the AER's Draft Decision; and
- provides a new value of demand for the six months 1 January to 30 June 2023 to align with the updated demand forecasts for the next AA period which we have submitted in our revisions to the Final Plan.

Following these changes it also provides for an updated adjustment to revenues in the next AA period (1 July 2023 to 30 June 2028) that ensures both customers and AGN are neutral to the extension of the current AA period by six months to 30 June 2023.

Craig de Laine
Chief Executive Officer



1 Overview

1.1 Background

Australian Gas Networks Limited (AGN) is part of Australian Gas Infrastructure Group (AGIG), one of the largest gas infrastructure businesses in Australia. We deliver gas safely and reliably to more than 700,000 homes and businesses in Victoria and Albury every year.

On 27 October 2020 the *National Energy Legislation Amendment Act 2020* (Vic) (NELA Act) came into effect extending the current AA period for Victorian gas distribution businesses by six months to align future AA periods with financial years (instead of calendar years). On 30 September 2021 the Victorian Government published an Order in Council (the Order) under the National Gas (Victoria) Act 2008 to give effect to the extension of the current AA period. The order required the Victorian networks including AGN to submit a proposal to the AER for the six-month extension period. The AER released a Position Paper on 8 November 2021 that set out transitional arrangements for the six months.

On 1 April 2022, we submitted our variation proposal for our Victoria and Albury natural gas distribution networks for the six month extension period 1 January 2023 to 30 June 2023. It set out the key building blocks and proposed revenue adjustment in the next AA period consistent with arrangements detailed in the Order and Position Paper.

On 13 July 2022, the AER published its Draft Decision on our Variation proposal. This revised Variation proposal is our response to the Draft Decision.

1.2 Our Response to the Draft Decision

Table 1.1 provides a summary of the AER's Draft Decision and our response. The table notes whether we accept, modify or reject the Draft Decision in the revised Final Plan. The table also provides a reference to the relevant attachment explaining the reasons behind our approach.

As the table shows, we have either accepted or modified the majority of the Draft Decision.

A document map is available in Attachment 1.8A. The Document Map outlines the structure of the original Final Plan, and highlights in blue new attachments included in this revised Final Plan.

Table 1.1: Summary of our response to the AER's Draft Decision

Topic	AER Draft Decision	AGN Response	AGN Comment
Operating expenditure	Accept	Accept	We agree with the AER's approach to update the opex forecast for most recent inflation. Since the AER's Draft Decision, the RBA has released a further update to its inflation forecasts in the August Statement of Monetary Policy. Our opex forecast in this revised Variation Proposal has been updated to reflect this. Further information is outlined in Section 1.3.2 below.
Capital expenditure	Accept	Accept	Our capex forecast in this revised Variation Proposal is consistent with our initial proposal which was accepted in the AER's Draft Decision. Further information is outlined in Section 1.3.3 below.

Topic	AER Draft Decision	AGN Response	AGN Comment
Capital base	Accept	Accept	We agree with the AER's approach to establishing the opening capital base on 1 January 2023. We have/have not provided an updated estimated capex for 2022. The regulatory depreciation in this revised Variation Proposal has been updated to reflect most recent inflation and changes in forecast opex as noted above. Further information is detailed in Section 1.3.4 below.
Financing costs	Accept	Accept	We have continued to adopt the AER's Rate of Return Instrument. Further information is detailed in Section 1.3.5 below.
Incentives	Modify	Accept	As noted in the AER's Draft Decision, we accept the AER's inclusion of revenue adjustments in the six month period from the opex incentive mechanism equivalent to half of the efficiency gains in 2017.
Demand	Placeholder	Modify	We have provided a new value of demand for the six months 1 January to 30 June 2023. This new value aligns with the updated demand forecasts for the next AA period which we have submitted in our revisions to the Final Plan for the next AA period following the release of the Victorian Government's Gas Substitution Roadmap. Further information is detailed in Section 1.3.7 below and Attachments 13.1A and 13.2A of our Revisions to our Final Plan – GSR Response.
Revenue and pricing	Modify	Modify	We agree with the AER's approach to update forecasts for most recent inflation. Since the AER's Draft Decision, the RBA has released a further update to its inflation forecasts in the August Statement of Monetary Policy. Our forecasts in this revised Variation Proposal have been updated to reflect this. We have revised the calculation of forecast tariff revenue for the period to reflect the new value of demand above. Further information is detailed in Section 1.3.8 below.

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

1.3 Our revised Variation Proposal

Our revised Variation Proposal accepts the majority of the AER's Draft Decision. Any changes reflect updated information and consideration of changes happening alongside this process (i.e. the impacts of the Gas Substitution Roadmap on our demand forecast for the next AA period).

1.3.1 Summary

Our revised Variation Proposal results in building block revenue for the 1 January to 30 June 2023 extension period of \$60.7 million. This is \$17.8 million below the AER's Draft Decision and our initial Variation Proposal. Table 1.2 summarises our revised Variation Proposal building block revenue.

Table 1.2: Building block revenue (\$ million, December 2022)

Building Block	Initial Variation Proposal	AER Draft Decision	Revised Variation Proposal
Return on capital	45.0	48.6	45.0
Regulatory depreciation	-5.2	-9.5	-23.4
Operating expenditure	40.5	41.2	40.9
Revenue adjustments	0.0	-0.3	0.0
Cost of corporate income tax	0.0	0.0	0.0
Building block revenue (including ARS)	80.3	80.9	62.5
Less: Ancillary reference services	1.8	2.4	1.8
Building block revenue (excluding ARS)	78.5	78.6	60.7

Our forecast tariff revenue for the 1 January to 30 June 2023 extension period of \$113.3 million. This is \$0.4 million below the AER's Draft Decision, and \$0.4 million below our initial Variation Proposal. This results in a revenue adjustment in the next AA period of -\$52.6 million, which is -18.1 million below the AER's Draft Decision, and \$17.4 million below our initial Variation Proposal. Our forecast tariff revenue and the calculation of the revenue adjustment for the next AA period are outlined in Table 1.3 below.

Table 1.3: Calculation of the revenue adjustment for the next AA period (\$ million, December 2022)

	Initial Variation Proposal	AER Draft Decision	Revised Variation Proposal
Building block revenue (excluding ARS) (A)	78.5	78.6	60.7
Forecast tariff revenue (B)	113.7	113.7	113.3
ARS Adjustment (C)	0.0	0.6	0.0
Revenue adjustment (B – A + C)	-35.2	-34.5	-52.6

1.3.2 Operating expenditure

We and the AER have applied the same simple trend forward methodology to calculate the opex allowance for the six months January to June 2023. We agree with the AER's approach in its Draft Decision to update the opex forecast for most recent inflation.

Since the AER's Draft Decision, the June 2022 inflation numbers have been published by the ABS and the RBA has released a further update to its inflation forecasts in the August Statement of Monetary Policy¹. Therefore, our opex forecast in this revised Variation Proposal has been updated to reflect these. We expect a further revision will likely be made to take account of any new inflation information available when the AER makes its Final Decision for the six month period in December.

Total opex including debt raising costs for the six month period is forecast to be \$42 million, as shown in Table 1.4 below.

Table 1.4: Revised opex forecast (\$ million, December 2022)

	Initial Variation Proposal	AER Draft Decision	Revised Variation Proposal
Forecast opex, excluding ARS & DRC	37.5	38.4	39.1
Ancillary reference services	2.3	2.3	2.4
Debt raising costs	0.5	0.5	0.5
Total forecast opex	40.2	41.2	42.0

Our opex forecast calculations are provided in Attachment 1.6A, Revised opex forecast.

1.3.3 Capital expenditure

We and the AER have applied the same method to calculate the capex allowance for the six months January to June 2023. As the capex forecast, consistent with the Roll Forward Model, adopt a one year lagged value of inflation, these values were known at the time of our initial proposal. Therefore, our capex forecast in this revised Variation Proposal is consistent with our initial proposal which was accepted in the AER's Draft Decision.

Total net capex for the six month period is forecast to be \$40 million, as shown in Table 1.5 below.

Table 1.5: Capex forecast (\$ million, December 2022)

	Forecast capex
Total capex (including customer contributions)	41.0
Customer contributions	0.8
Net capex (excluding contributions)	40.2

Our capex forecast calculations were provided in Attachment 1.7 Capex forecast, to our initial Variation Proposal.

¹ RBA statement of monetary policy inflation forecast, August 2022, Appendix, <https://www.rba.gov.au/publications/smp/2022/aug/forecasts.html>

1.3.4 Capital base

Our roll forward of the capital base over the 2018-2022 period is shown in Table 1.6 below. In rolling forward the capital base we have updated for expected inflation and applied the same forecast for 2022 capex submitted in our initial Variation Proposal in April.

Table 1.6: Roll forward of capital base over the current AA period

	2018	2019	2020	2021	2022
Opening Capital Base	1,572.0	1,612.1	1,668.3	1,729.1	1,778.5
Net Capex	87.7	108.1	129.9	142.2	171.8
Nominal Forecast Regulatory Depreciation	-47.5	-51.9	-69.0	-92.9	-25.9
Interim closing capital base	1,612.1	1,668.3	1,729.1	1,778.5	1,924.4
Difference between estimated and actual capex in 2017					-19.2
Return on difference for 2017 capex					-5.3
Closing capital base as at 31 December 2022					1,899.9

Our revised regulatory depreciation for the six months January to June 2023 is -\$23.4 million. This is a larger negative amount than our initial Variation Proposal amount of -\$5.2 million, and lower than the -\$9.5 million in the AER's Draft Decision. In calculating the revised regulatory depreciation we have reflected the AER's correction to the year-by-year tracking depreciation inputs in the PTRM to align with the outputs calculated in the depreciation tracking module and updated expected inflation.

Our revised regulatory depreciation is summarised in Table 1.7 below.

Table 1.7: Revised Regulatory depreciation (\$ million, December 2022)

	Initial Variation proposal	AER Draft Decision	Revised Variation Proposal
Straight-line depreciation	34.7	40.0	58.5
Less inflation indexation on opening capital base	40.0	30.4	35.1
Regulatory depreciation	-5.2	-9.5	-23.4

1.3.5 Financing costs

We have applied our initial proposal rate of return of 2.37% (4.74% annualised) in our revised Variation Proposal. We recognise the AER will update the rate our return again in its final decision.

Our revised Variation Proposal includes a tax allowance of zero. This is consistent with our initial Variation Proposal and the AER’s Draft Decision.

1.3.6 Incentives

We accept the AER’s Draft Decision to include revenue adjustments from the application of the opex incentive mechanism in the 2018-22 access arrangement period in our building block revenue for the extension period. We have updated the revenue adjustment to -\$0.3 million.

The calculation of the carryover amount for the extension period is based on subtracting half of the efficiency gain made in 2017 from building block revenue in the extension period. This adjustment makes sure the efficiency gain made in 2017 is retained for a period of five years, consistent with the usual operation of the efficiency carryover mechanism.

As noted for opex above, new inflation estimates are available since the AER’s Draft Decision. Therefore, our revenue adjustment in this revised Variation Proposal has been updated to reflect these. We expect a further revision will likely be made to take account of any new inflation information available when the AER makes its Final Decision for the six month period in December.

1.3.7 Demand

We have updated forecast demand for the six months January to June 2023 consistent with the revisions we have made to our demand forecast for the next AA period in Response to the Victorian Gas Substitution Roadmap. More information on our demand forecast can be found in the Revisions to our Final Plan – GSR Response, also submitted to the AER on 2 September 2022.

1.3.8 Revenue and Pricing

Our revised Variation Proposal extends the 2022 tariffs by indexing for a half year of inflation consistent with our initial Variation Proposal and the AER’s Draft Decision. We have updated for actual inflation, therefore we have indexed our tariffs by 3.0%, which is a half year adjustment to the actual inflation of 6.1% for the June 2022 quarter.

Table 1.8: Summary of the six month extension period revenue and revenue adjustment (\$ million, nominal)

	HY2023
Building Block Revenue (excluding ARS)	78.5
<i>Less:</i> Total Revenue – AER Determined (excluding ARS)	113.7
True-up Amount (excluding ARS)	-35.2
ARS Building Block Revenue	1.8
<i>Less:</i> ARS Revenue – AER Determined	1.8
True-up Amount for ARS Revenue	-
Total True-up Amount including ARS	-35.2

1.4 Next steps

After receiving our revised Access Arrangement Variation Proposal for the six-month period beginning on 1 January 2023, the AER will make it available for public consultation with submissions due on 30 September 2022. Customers and other stakeholders are encouraged to participate in this process. The AER is expected to make a Final Decision on our plans for the six-month period beginning on 1 January 2023 before the end of 2022.

Throughout this process we continue to engage with our customers and stakeholders and welcome any feedback, which can be provided:

- online at gasmatters.agig.com.au
- by mail
- in person

Contact information is provided on the back cover of this document.

1.5 Structure of this revised Variation Proposal

The structure of all of the revisions to our Variation Proposal is outlined in Attachment 1.3A. It has been structured to include the following:

- all of the documents provided to the AER in the April 2022 Variation Proposal, which is referred to as our Variation Proposal (for the purposes of brevity and clarity, these documents are not attached to this submission of revisions to our Variation Proposal as they have already been provided to the AER); and
- further documents which provide additional information, or modify the Variation Proposal, all of which are attachments to our Variation Proposal.

More specifically, the structure of the revisions to our Variation Proposal consists of:

- this Overview, which includes a CEO Foreword, an overview of key areas, and a list of new attachments; and
- attachments to the revisions to our Variation Proposal. All information contained in these attachments supersedes information previously provided in our Variation Proposal to the extent that there is any conflict.

Unless otherwise stated, information presented in the revisions to our Variation Proposal is in dollars of December 2022 unless otherwise stated.

Glossary			
AA	Access Arrangement	Next AA period	2023/24 to 2027/28
AER	Australian Energy Regulator	NGL	National Gas Law
AGN	Australian Gas Networks	NGR	National Gas Rules
ARS	Ancillary Reference Service	opex	Operating Expenditure
capex	Capital Expenditure	RBA	Reserve Bank of Australia
Current AA period	2018 to 2022	TAB	Tax Asset Base



Feedback

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