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1 April 2022

Clare Savage
Chair
Australian Energy Regulator (AER)
GPO Box 520
Melbourne VIC 3001

Dear Clare

AusNet's Proposal for the 1 January to 30 June 2023 Extension Period

Please find attached AusNet's gas Access Arrangement Review proposal for the 1 January to 30 June 2023 extension period.

As you will be aware, this extension proposal is necessary given the passing of the *National Energy Legislation Amendment Act 2020 (Vic)*. That Act requires that regulatory determinations for gas in Victoria are set on a financial rather than calendar years basis. Our 2018-22 gas access arrangement period has, therefore, been extended by six months (to 30 June 2023) to facilitate that change.

In preparing our six-month extension proposal, we have largely adopted the pragmatic approach outlined by the AER in its November 2021 position paper.[1] By trending forward most elements of the AER's decision for the access arrangement period we are currently in, we have minimised the complexity associated with this transition. However, our approach differs in two minor ways from the AER's position paper:

1. We have prepared a six-month demand forecast (rather than using the most recent actual demand for the equivalent, January to June period); and
2. We have updated the placeholder inflation estimate in the Half Year 2023 Post Tax Revenue Model (HY2023 PTRM).

These minor amendments have improved the accuracy of our forecasts and, therefore, our proposal. Further information on our modelling approach is outlined in Attachment 1.

Importantly, our proposal will allow us to continue to undertake the critical work necessary to meet our safety obligations and keep our customers safe. With respect to price, recognising the importance of minimising price volatility for our customers, our proposal extends 2022 calendar year prices to 30 June 2023 (with any over or under recovery corrected for in the access arrangement period commencing on 1 July 2023).

Please contact me (Ph: 0438 530 076 or email: thomas.hallam@ausnetservices.com.au) if the AER would like to discuss any aspect of our proposal.

Yours sincerely

Tom Hallam
General Manager, Regulation

1 AER, *Position paper, Approach to six-month extension of access arrangements*, November 2021.

<table>
<tr><th>Issue</th><th>Outcome and approach for the six-month extension period</th></tr>
<tr><td>Pricing</td><td>Victorian gas distributors operate under weighted average price caps. This means the prices approved by the AER are the binding constraint across an access arrangement period rather than the total revenue requirement set in an AER decision.

Prices are derived from the total revenue requirement after consideration of demand for each price category. Where actual demand varies from the demand forecast in the access arrangement, the business's actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, actual revenue will be above forecast revenue and vice versa.

Consistent with the approach outlined in the AER's position paper, we are proposing to extend 2022 calendar year prices to 30 June 2023 and have adjusted for inflation.[2] We have adjusted our 2022 gas distribution tariffs using a 3.75% inflation – a forecast taken from the Reserve Bank of Australia's (RBA) February 2022 Statement of Monetary Policy, and which reflects its expectations for inflation for the June 2022 quarter.[3]</td></tr>
<tr><td>Capital expenditure (capex)</td><td>We are proposing a net capex forecast of $47.3 million (real $2022) for the six-month extension period (excluding WACC adjustments).

Consistent with the approach outlined in the AER's position paper, our capex forecast has been derived by taking the capex allowance for 2022 and then:
• Halving the forecast capex allowance to reflect half a year's worth of capex.
• Escalating the forecast by inflation.</td></tr>
<tr><td>Operating expenditure (opex)</td><td>We are proposing an opex forecast of $31.2 million (real $2022) excluding debt raising costs (or $31.6 million including debt raising costs) for the six-month extension period.

Consistent with the approach outlined in the AER's position paper, our opex forecast has been derived by us taking the opex allowance for 2022 (excluding debt raising cost) and then:
• Dividing it by two to reflect half a year's worth of operations and maintenance expenditure.
• Applying a rate of change that is equivalent to three quarters of the AER's approved rate of change for 2022.
• Escalating the forecast by inflation.

We then used the AER's benchmark approach to forecast debt raising costs for HY2023.</td></tr>
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2 NSP's have the option in the half year Post Tax Revenue Model (PTRM) to set their tariff inputs using t (2023 prices). Use of the June quarter is also consistent with what would be applied in an annual tariff variation.

3 This document is available at: https://www.rba.gov.au/publications/smp/2022/feb/ (accessed 24/03/2022).

Revenue	For the half year period, we are proposing $87.4 million (real $2022) in revenue excluding ancillary reference services. To the extent that revenue in this period is different from the revenue approved by the AER, any under or over recovery will be corrected for in the access arrangement period commencing 1 July 2023.
Incentive schemes	For the six-month extension period we have proposed: • Not applying the capital expenditure sharing scheme (CESS). • Applying the efficiency carryover mechanism. Importantly, any revenue adjustments from the application of the efficiency carryover mechanism in the 2018–22 access arrangement period would commence from 1 January 2023. This approach is consistent with the AER's position paper.
Demand forecasts	Forecast demand plays an important role in the derivation of reference tariffs. The AER's position paper suggested that given the short length of the extension period, using the most recent actual demand for the equivalent, January to June period was reasonable. After discussing this issue with the AER, we have proposed an alternative approach. Our demand forecast, prepared by an independent consultant, has involved: 1. Understanding the key drivers of demand and the magnitude of the impact of those drivers – drivers include weather, prices, the efficiency of gas devices, population growth and the composition of dwellings. 2. Projecting forward key drivers using publicly available estimates. 3. Projecting forward demand using the relationships established between drivers and demand and the projections of key drivers. This approach results in more robust estimates for demand in the six-month extension period and better reflects the circumstances we are in.
Rate of return	We have applied the approach outlined in the AER's October 2021, Modified Rate of Return Instrument for the Victorian gas distribution networks during the extension period of 1 January 2023 to 30 June 2023 to calculate our rate of return.[4]
Modelling of capital base, depreciation, tax, and revenues	We have used the PTRM, Roll Forward Model (RFM) and Depreciation tracking model that were published by the AER as part of our six-month extension proposal.

4 AER, *Modified Rate of Return Instrument for the Victorian gas distribution networks during the extension period of 1 January 2023 to 30 June 2023*, October 2021.

Inflation	We have replaced the AER's placeholder inflation forecast (1.24%) in the HYPTRM with 1.37%. This forecast is based on the latest (February 2022) RBA Statement of Monetary Policy inflation forecast for the year ended June 2023. We note the AER has indicated that it intends to halve the inflation forecast from the August 2022 RBA Statement of Monetary Policy for the year ending 30 June 2023 to derive an estimate of expected inflation for the six-month extension period in making its Draft Decision.
Billing for Tariff M/D customers	Given the absence of a mechanism to allow for the correction of estimated volumes billed in the six-month extension period, we are proposing to bill Tariff M/D customers on actual volumes. This is a relatively simple change that we have discussed with the AER.