Attachment 10

Reference services and tariffs

Access arrangement information

ACT and Queanbeyan-Palerang gas network 2021–26

Submission to the Australian Energy Regulator

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evoenergy

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10 Reference services and tariffs

Key points

As part of the 2021- 26 Access Arrangement Evoenergy is:

- simplifying its tariffs by abolishing a number of tariffs which have zero or very few customers on them
- combining residential and business tariffs into one class
- simplifying the process for Demand customers to reset their chargeable demand
- making the ancillary charges more cost reflective

10.1 Introduction

In this attachment Evoenergy sets out its proposed approach to the setting of reference tariffs for the 2021-26 access arrangement period. Evoenergy has engaged with consumers, stakeholders and the community in developing the proposed reference tariffs and has addressed all the relevant regulatory requirements. The proposal involves several changes to the tariff classes and tariff structures offered in the 2016-21 access arrangement.

This attachment is structured as follows:

- Section 10.2 summarises how customer and stakeholder feedback has informed our reference services and tariff parts of our plans
- Section 10.3 describes the services Evoenergy provides its customers
- Section 10.4 summarises our reference tariffs, assignment criteria and charges for the 2021-26 access arrangement period highlighting the proposed changes
- Section 10.5 outlines how we have allocated revenue to services
- Section 10.6 summarises how we set our network prices including how we have:
  - developed economically efficient reference tariffs
  - considered transaction costs and the ability of customers to respond to price signals and
  - developed our pricing strategy.

Section 10.7 describes our proposed tariff variation mechanism.

10.2 How customer feedback has informed our plans

In preparing our 2021-26 access arrangement revision proposal, we engaged with customers and stakeholders on a number of areas directly or indirectly related to our services and tariffs.

Following the publication of the Evoenergy GN21 draft plan, engagement continued via drop-in sessions and formal written responses. Table 10.1 summarises the submissions received regarding our services and tariffs and how we are responding to those submissions.

Table 10.1 Summary of submissions on our draft plan

Author	Topic	Feedback	How we are responding
CCP24 (following discussions with advocates)	Pricing	Equity impacts – remains concerns a declining block is not progressive and may not reflect the reality for low-income households. Low-income households may miss out on the cost advantages of declining block tariffs due to consuming less gas.	Evoenergy is not proposing to change its current declining block structure. More discussion on this is in Sections 10.6.1.4 and 10.6.2.3. It is in the interests of all customers to improve the utilisation of the network as spreading our fixed costs wider puts downward pressure on all customers' prices.
CCP24 (following discussions with advocates)	Pricing	Sustainability outcomes – a declining block tariff appears to work contrary to the ACT Government policy objectives in relation to reducing greenhouse gas emissions. A tariff structure where the unit price of gas is reduced as consumption increases appears to incentivise higher consumption levels	Evoenergy is not proposing to change its current declining block structure. More discussion on this is in Sections 10.6.1.4 and 10.6.2.5.
CCP24	Tariff structure	Potential merit in a separate tariff for NSW customers	We do not consider this is currently required. We see this, as a medium to long term tariff strategy rather than something to be implemented as part of the 2021-26 access arrangement revision proposal.
Conservation Council	Pricing	Revise tariffs consistent with 'polluter pays' and equity principles so as to reduce gas consumption and support vulnerable customers	Use of a declining block structure reflects the requirements of the NGO as it promotes the efficient use of the natural gas services and is in the long term interests of consumers of natural gas.

Author	Topic	Feedback	How we are responding
Conservation Council	Pricing	Tariffs should be determined with equity and capacity in mind. Pricing of gas should be scaled to deter higher consumption not encourage it. High-consumption users should be paying more for network access than those who use less gas	Network tariffs are determined with capacity in mind. A declining block tariff reflects the declining costs of meeting incremental demand as there are economies of scale that come with greater demand.
Conservation Council	Tariff structure	Tariff structures should also ensure that demand customers support network maintenance costs while residential 'volume' customers transition off the network	The NGR provides a framework to ensure efficient pricing, including pricing between standalone and avoidable cost as well as taking into account the LRMC when setting tariffs. Section 10.6 provides how we have met these requirements.
ATCOSS	Tariff structure	We support Evoenergy simplifying tariffs by abolishing unused tariffs under GN21	Evoenergy has included in the proposal abolishing both unused and underutilised tariffs.
ATCOSS	Pricing	Equity outcomes – remains a concern that declining usage rate is not progressive and may not equally benefit low-income households who have lower gas usage per quarter. We would value more detailed analysis of declining usage rate in relation to equitable outcomes for low-income households	Evoenergy is not proposing to change its current declining block structure. More discussion on this is in Sections 10.6.1.4 and 10.6.2.5. It is in the interests of all customers to improve the utilisation of the network as it spreading our fixed costs wider puts downward pressure on all customers' prices.
ATCOSS	Pricing	Sustainability outcomes – declining usage rate appears to work against ACT Government policy objectives in relation to reducing greenhouse gas emissions from natural gas consumption. A tariff structure where unit price of gas is reduced as consumption increases appears to incentivise higher consumption levels and hence emissions	Evoenergy is not proposing to change its current declining block structure. More discussion on this is in Sections 10.6.1.4 and 10.6.2.5. It is in the interests of all customers to improve the utilisation of the network as spreading our fixed costs wider puts downward pressure on all customers' prices.

Author	Topic	Feedback	How we are responding
Better Renting	Tariff structure Abolishment of special meter read charge	The proposed tariff structure could result in low-income households facing higher cost through both ancillary charges and higher costs per unit. Evoenergy should consider flat usage charges or an inclining block rate as well as the abolition of fees for special meter reads	Evoenergy does not believe a flat usage or inclining block structure meets the obligations it has under the NGO. Further discussion on this is in Section 10.6.2.3. Special meter reads are a common feature across gas networks that support the causer-pays principle. Abolishing special meter read charges would not remove this as a cost for Evoenergy and doing so would result in unnecessary customer cross-subsidies.

As part of our consultation process we met with retailers. This engagement included discussion on the proposed changes to the tariff structures. There was positive feedback from the retailers to the proposal to simplify the tariff structure by reducing the number of network tariffs. There was general agreement to maintaining the current block sizes.

10.3 Services we provide to our customers

10.3.1 Our services for the Access Arrangement

The Reference Tariff Proposal submitted by Evoenergy in June 2019[1] and approved by the AER in November 2019[2] confirms the haulage service is the only reference service to be provided to customers for the 2021-26 access arrangement.

This service covers the full range of activities involved in delivering gas to customers, including receiving, transporting and delivery of gas and associated activities such as meter reading and ancillary activities such as disconnections, reconnections, abolishments, and special meter readings as requested by the user.

Two other pipeline reference services, an interconnection service and a negotiated service, are offered as non-reference services.

The approved Reference Service Proposal outlines our services and how they meet the requirements of the Rules.

10.4 Tariff classes and Charge components

10.4.1 Summary of proposed revisions

Evoenergy is proposing to make several changes to its reference tariff classes and tariff categories in its 2021-26 access arrangement revision proposal. The key proposed changes are as follows.

[1] Evoenergy, Reference Service Proposal 2021-26 Gas Access Arrangement, June 2019
[2] AER, Final Decision – Evoenergy 2021-26 Reference Service Proposal, November 2019

- **Changing the tariff classes**

  We are proposing to change the way customers are grouped together by combining the separate residential and business tariff classes. This simplifies tariffs by eliminating one level of categorisation.

- **Simplifying the tariffs by abolishing tariffs which have few or no customers**

  Evoenergy is proposing to abolish a number of tariffs which have no customers or only a small number of customers to make it easier for retailers.

- **Simplifying the process for demand customers to adjust their chargeable demand**

  The process for demand customers on a capacity tariff to reduce their chargeable demand (CD) following changes such as energy efficiency programs will be simplified.

- **Setting more cost reflective ancillary charges**

  Evoenergy is proposing to modify the existing ancillary changes so that different charge levels apply above and below 25 m^3/hr rather than the current residential/business (more than 6m^3/hr).

10.4.2 Tariff classes and charge components in the 2016-21 Access Arrangement

In the 2016-21 Access Arrangement we offered the following tariffs:

- Customers are assigned to one of the following two customer groups:
  - demand customer group (D); or
  - volume customer group (V).
- Customers are assigned to one of the following two tariff classes within each customer group:
  - business tariff class (B); or
  - residential tariff class (R).
- Customers in the business tariff class can be assigned to one of the following five tariff categories:
  - small business individually metered (VBS) tariff category;
  - medium business individually metered (VBM) tariff category;
  - major customer capacity (DBC) tariff category;
  - major customer throughput (DBT) tariff category; or
  - large scale generation principally for business end customers (DBG) tariff category.
- Customers in the residential tariff class could be assigned to one of the following four tariff categories:
  - residential individually metered (VRI) tariff category;
  - residential individually metered with gas heating and other gas appliances (VRH) tariff category;
  - residential boundary metered (VRB) tariff category; or

- large scale generation principally for residential end customers (VRG) tariff category.

The VBH, VRB, VRG, VBM, VBS and VRG tariffs have seen very low rates of uptake. This was partly driven by the fact that gas retailers have not reflected the tariffs in their retail offers, and the broader policy environment in the ACT, which has impacted investment in gas generation facilities.

10.4.2.1 PROPOSED CHANGES

Evoenergy proposes to simplify its tariffs by abolishing the VRH, VBS, VBM, VRG, and DBG tariffs. This will reduce complexity and administrative costs associated with managing tariffs with only a few customers, help make Evoenergy's tariffs easier for customers to understand, and better align gas network tariffs to existing retail offers. These changes are not expected to impact end-customers given the network tariffs are not currently reflected in retail tariffs. Customers who remain on these tariffs on 30 June 2021 will be moved to the VI tariff noting that this should not change their retail tariff.

10.4.3 Proposed tariff structure and charge components for the 2021-26 access arrangement

The following sections outline the tariff structure and charge components that Evoenergy is proposing to offer in its 2021-26 access arrangement revision proposal:

With the changes to the tariff structure and the removal of the customer group classification, Evoenergy has updated its assignment criteria. Under the new tariff assignment criteria, a customer's delivery point will be allocated to a tariff category based on the following two elements:

a) the tariff class; and

b) the tariff category.

10.4.3.1 TARIFF CLASSES

A customer's delivery point will be assigned to a tariff class based on the characteristics of the energy requirements of the customer and any other end-customers that are supplied with, or consume, energy from the gas delivered by Evoenergy to the delivery point.

The two tariff classes are:

- the demand tariffs, which are available to:
  - a single business end-customer who is reasonably expected to use equal to or more than 10 TJ of gas per year at their delivery point;

These customers will also need to provide Evoenergy with emergency load management system (ELMS) information before they can be eligible for the demand tariffs, given the larger impact they have on the network; and

- the volume tariffs, which are available to a customer who does not satisfy the criteria for a demand tariff and who is:
  - a single residential customer who uses gas at the delivery point;
  - a single business customer who uses gas at the delivery point;
  - a single customer who on-supplies gas or hot water to end customers at the delivery point.

10.4.3.2 TARIFF CATEGORIES

A customer (through their retailer) may request to be assigned to a tariff category based on the additional criteria set out in Table 10.2. Evoenergy recognises that customers have different ways in which they use or consume the energy or gas at the delivery point. To support the pricing objectives set out in section 10.6.2, the tariff assignment criteria ensure that similar customers pay similar prices which reflect the costs they impose on the network.

Table 10.2 Evoenergy's proposed tariff categories

Tariff category	Abbreviation	Type of customers	Why included
Volume Individual	VI	End customers who have individual gas meters, and are using gas for the first time, or use small quantities of gas at the delivery point.	This tariff category is similar to the Volume Residential Individually metered tariffs under the 2016-21 access arrangement.
Volume Boundary	VB	End customers in high-rise dwellings or commercial complexes such as shopping centres that are supplied gas for their gas appliances, gas hot water or applications by an energy intermediary that sits between the boundary meter and the end customer.	This tariff category aims to provide end customers in multi-storey or commercial complexes with the option to access gas through a boundary-metered connection.
Demand Capacity	DC	Major customers who are reasonably expected to use equal to or more than 10 TJ of gas per year.	This tariff category is the same as the Demand Business Capacity under the 2016-21 access arrangement.
Demand Throughput	DT	Major customers who are reasonably expected to use equal to or more than 10 TJ of gas per year.	This tariff category is the same as the Demand Business Throughput under the 2016-21 access arrangement.

Table 10.3 Proposed tariff structure and charge components

Reference service	
Haulage Reference Service	
Tariff Class	
Volume (V)	Demand (D)
Tariff categories	
▪ residential individually metered (VI) ▪ medium business individually metered (VB)	▪ major customer capacity (DC) ▪ major customer throughput (DT)
▪ VI - one fixed charge - four usage block sizes ▪ VB - one fixed charge - three usage block sizes	▪ DC - one fixed charge - three capacity usage block sizes ▪ DT - one fixed charge - one usage charge

10.4.3.3 RATIONALE FOR THE PROPOSED CHANGES

Evoenergy has a number of tariffs with no, or very few, customers. This has been partly driven by the fact that gas retailers have not reflected these network tariffs in their retail tariffs and the absence of broader market systems to support the multiple tariffs[3].

To reduce complexity and administrative costs associated with managing tariffs with very few customers, to help make Evoenergy's tariffs easier for customers to understand and to align the network tariffs with the retail tariffs, Evoenergy is proposing to abolish most of the underutilised tariffs.

Evoenergy is also seeking to abolish the tariffs targeted at co-generation or tri-generation facilities. To date there has been no uptake of these tariffs. We do not see any update of these tariffs in the future given the broader policy environment in the ACT has impacted investment in gas generation facilities.

10.4.3.4 DEMAND CAPACITY

Most of the demand customers are charged on the basis of the level of network capacity they require – this is referred to as their 'chargeable demand'. Chargeable demand is usually the highest of:

- the ninth highest daily withdrawal in the previous 12 months;
- ten times the maximum hourly quantity (MHQ); and
- the maximum daily quantity (MDQ).

To ensure that these customers pay for the network capacity they use, a customer's chargeable demand automatically goes up (ratchets) if they require additional capacity. However, the requirements to reduce chargeable demand are quite stringent and may

[3] For example, there is no gas equivalent of MSATs which enables electricity retailers to identify what network tariffs apply to a site

not be responsive to a customer's lower capacity usage when their gas requirements reduce.

Evoenergy is proposing to:

- automatically resetting chargeable demand from 1 July 2021 where this will result in a reduction in charges; and
- simplifying the requirements for intra-period reductions in chargeable demand.

These changes are in line with the approach approved by the AER in JGN's Access Arrangement.

10.4.3.5 AUTOMATIC RESET

Evoenergy is proposing to automatically reset Demand Capacity customers' chargeable demand from 1 July 2021 where this would result in a reduction in the customer's network charges.

For the period from 1 July 2021, Evoenergy will reduce these customers' chargeable demand to the highest of:

- their ninth highest daily withdrawal from 1 July 2020 to 30 June 2021, or
- ten times their MHQ on 30 June 2021, or
- the MDQ on 30 June 2021.

10.4.3.6 SIMPLIFYING THE PROCESS TO REQUEST A DEMAND RESET

The requirements in the 2016-2021 Reference Service Agreement for reducing chargeable demand may be slow to reflect a customer's reduced capacity requirements, including when they have implemented technology, equipment or process changes.

We want to make sure that customers receive the benefit from making changes to their business that reduce their demand on the network. To reflect this, we are proposing to relax the requirements in our 2021-2026 Reference Services Agreement by:

- simplifying the time conditions;
- removing the materiality threshold that the reduction in demand must be more than 10 per cent; and
- amending the requirement from a 'permanent change' to being a 'significant change'.

This will provide customers additional incentives to make changes to their business processes that result in reductions to their network charges and supports keeping gas affordable for our large business customers.

10.4.3.7 TARIFF REASSIGNMENT

With the proposed abolishment of a number of tariffs, the three customers remaining for now on these tariffs will need to be reassigned to one of the remaining tariffs. There will be minimal price impact of this reassignment. Table 10.4 outlines the proposed reassignment noting that, as there are no customers on volume residential heating or the large-scale generation tariffs, reassignment for these has not been included.

Table 10.4 Tariff Reassignment

Current Tariff category	Proposed Tariff category to be reassigned to
Volume Business Small	Volume Individual
Volume Business Medium	Volume Individual

10.4.4 Ancillary Activities

At a high level, Evoenergy proposes to maintain the same ancillary activities as offered in the current access arrangement, however, we will also update the ancillary activities so that different levels of charges apply to customers above and below 25m^3/hr rather than the current residential/business (more than 6m^3/hr) split. A division on meter size at 25m^3/hr rather than a combination of customer type and meter size of 6m^3/hr is more reflective of costs given that the cost to provide the service is driven more by meter size than customer classification. The division was moved to 25m^3/hr as the capacity of a standard domestic meter is now 8m^3/hr.

Table 10.5 Evoenergy's current and proposed ancillary activities

Existing	Updates
Request for service	No change
Reconnection fee	Different charges to apply for below and above 25m^3/hr rather than current residential / business (6m^3/hr) split
Disconnection fee	Different charges to apply for below and above 25m^3/hr rather than current residential / business (6m^3/hr) split
Decommissioning & meter removal	Different charges to apply for below and above 25m^3/hr rather than current residential / business (6m^3/hr) split
Special Meter Reads	No change

10.5 Allocation of revenue to services

As with the 2016-21 access arrangement, Evoenergy has a single reference service—the haulage reference service. Evoenergy has no customers on non-reference services.[4] As a result, the required cost of service (building blocks) is allocated to the haulage reference service.

10.6 How we set our network prices

We set our prices by considering:

- The efficiency measures included in the Rules—section 10.6.1
- Our pricing objectives and strategy—section 10.6.2

[4] Evoenergy offers two non-reference services: (a) negotiated services; and (b) interconnection of embedded network services.

- The limits on annual price changes via our tariff variation mechanism— section 10.6.2.7

10.6.1 Efficiency measures

This section outlines the way Evoenergy's tariffs support allocative efficiency and meet the tariff requirements in the Rules[5].

It provides:

- demonstration of efficient prices including Evoenergy's estimates of:
  - standalone and avoidable costs; and
  - long-run marginal costs (LRMC);
- Evoenergy's consideration of transaction costs; and
- Evoenergy's consideration of its customers' ability to respond to price signals.

10.6.1.1 STANDALONE AND AVOIDABLE COSTS

Rule 94(3) requires that the expected revenue recovered for each tariff class should lie on or between the standalone cost of providing the reference service and the avoidable cost of not providing the reference service. Evoenergy has estimated standalone and avoidable costs using the cost of service model prepared by Houston Kemp for the current regulatory period[6], updated with current forecasts.

The stand alone cost for a tariff class are the costs incurred by Evoenergy to provide a gas distribution network to only supply customers within that tariff class. In contrast, the avoidable cost for a tariff class represents all the costs that are directly caused by the supply of services to customers within that tariff class. It represents the theoretical lower bound amount to be recovered from these customers. If revenue was to fall below this amount then the revenue that the business received from supplying the customer would be less than the additional costs incurred to supply the customer, requiring the business to recover the difference from other customers (ie, cross subsidise) or earn a lower return.

To estimate standalone and avoidable costs, Evoenergy's total costs are first decomposed into:

- costs that are attributable to a single tariff class, ie dedicated costs; and
- costs that are common to multiple tariff classes, ie shared costs.

The forecast capital base has been used to determine the dedicated costs for each tariff class (ie, volume and demand tariffs), with the remaining costs being identified as shared costs, to be shared between the tariff classes. After decomposing the total costs, avoidable costs for a tariff class are estimated as the dedicated costs for that tariff class, and the standalone costs are calculated as the avoidable costs for the tariff class plus the total shared costs.

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[5] Rule 94(2) requires tariffs to be established with regard to the need to group customers for reference services together on an economically efficient basis and the need to avoid unnecessary transaction costs.

[6] Houston Kemp 2015, Development of a Cost of Service Model for ACT, Queanbeyan and Palerang Gas Distribution Network, June.

Evoenergy's stand-alone and avoidable cost estimates for volume and demand tariffs are contained in Table 10.6. This demonstrates that the expected revenue sits between the two efficiency measures.

Table 10.6 Evoenergy's standalone and avoidable costs and average revenue

Tariff Class	2021-22	2022-23	2023-24	2024-25	2025-26	Compliance
Volume $m nominal terms						
Tariff Revenue	58.48	58.80	59.15	59.60	59.79	Compliant
Standalone cost	60.99	61.54	62.04	62.72	63.09	
Avoidable cost	16.49	16.52	17.38	17.44	17.73	
Demand $m nominal terms						
Tariff Revenue	2.12	2.17	2.22	2.27	2.32	Compliant
Standalone cost	45.43	45.90	45.59	46.18	46.28	
Avoidable cost	0.92	0.88	0.93	0.90	0.92	

10.6.1.2 LONG RUN MARGINAL COST

Rule 94(4) requires the distribution network service provider to take into account the long run marginal cost (LRMC) in setting tariffs.

LRMC is an estimate of the future costs that would be caused by an incremental change in demand, including the possible need to expand the capacity of the network so as to satisfy the incremental change in demand. This implies that the LRMC can be estimated by examining hypothetical upgrades of capacity to satisfy expected changes in demand.

Houston Kemp estimated Evoenergy's LRMC for the current access arrangement period using an average incremental cost (AIC) approach[7]. This involves measuring the LRMC as the present value of the future stream of growth related capital and operating expenditure, divided by the present value of the change in volumes over the same period. Evoenergy has updated the Houston Kemp cost of service model with current forecasts to estimate the LRMC by tariff class over the 2021-26 access arrangement period.

Using the Houston Kemp model, LRMC is estimated by first dividing the present value of the projected growth costs by the present value of expected increases in customer numbers and then adding the average variable costs associated with the tariff class, ie:

$$LRMC = \frac{PV(expenditure\ relating\ to\ new\ network\ capacity)}{PV(additional\ total\ new\ customers\ serviced)} + PV(average\ variable\ cost)$$

Here the expenditure relating to new network capacity includes growth in both capital and operating expenditure and these values are the same across both tariff classes. The average variable costs represent metering costs and are specific to the tariff classes. The calculation results in the LRMC associated with the growth in customer numbers.

The LRMC values are then translated into tariff charges per tariff class (so that the LRMC estimates are appropriately comparable) by assuming that the payment per customer can be expressed as a constant payment over the life of a 20 year annuity. In

[7] Ibid

other words, the estimated LRMC values can be considered as the present value of annual constant payments by customers over a period of 20 years. To estimate this constant payment the annuity is solved assuming a discount rate equal to the real vanilla WACC ie:

$$LRMC\ chargeable\ to\ each\ tariff\ class = LRMC\ x\ \frac{WACC}{1-(1+WACC)^{-20}}$$

This results in the LRMC per customer connection per annum as set out in Table 10.7.

Table 10.7 Evoenergy's LRMC by tariff component

Cost	Annual cost
LRMC Energy Consumption ($/GJ)	Undefined
LRMC volume tariff class ($/connection/annum)	365.65
LRMC demand tariff class ($/connection/annum)	372.04

It was not possible to calculate LRMC with respect to throughput volume. Energy throughput is declining over the foreseeable future period (i.e., it is negative), which implies that the AIC methodology leads to the LRMC estimate being undefined. As a result, this methodology provides no insight as to whether the LRMC is low (ie, close to zero) or potentially high.

Taking LRMC into account

Recognising both the benefits and limitations of LRMC, the Rules require that we must take into account our LRMC estimates in setting our tariff levels[8].

Factors applicable to the consideration of LRMC for gas network pricing, and which explain the reasons LRMC estimates are not equivalent to Evoenergy's tariff levels, are as follows:

- The Rules permit Evoenergy to recover its building block cost of services, which includes a return on sunk costs (i.e. the regulatory asset base) and operating expenditure, and can therefore be expected to be different to the LRMC, as acknowledged by Rule 94(5).
- Customers advised Evoenergy that they prefer for Evoenergy to minimise its fixed charge as customers see fixed charges as a barrier to gas connection and small gas consumers, particularly over the periods in which consumers use minimal quantities of gas.
- The LRMC estimates are sensitive to assumptions and the quality of input information.
- Evoenergy needs to ensure that natural gas, as a discretionary fuel, remains competitive. Keeping fixed charges low for first time gas consumers helps to keep gas competitive.
- Evoenergy's customers indicated that they valued price stability. Evoenergy notes that the LRMC estimates can be volatile when reassessed over time.

[8] Rules, clause 94(4)(a)

Gas networks are very different from electricity distribution businesses, which must, under the National Electricity Rules, base their tariffs on LRMC. This is because electricity distribution businesses' capacity requirements are primarily driven by peak demand. Gas, and in particular Evoenergy's gas network, faces competition from other fuel sources as gas is a discretionary fuel in the ACT and NSW. In addition, climate is a significant determinant of the customer mix and utilisation of the network. These factors affect the application of the LRMC to signal the impact of incremental changes in demand.

Evoenergy notes that its network does not experience capacity constraints to the same extent as some electricity networks. Evoenergy has capacity to provide additional gas network services to customers, particularly over the summer and spring period where there is currently low gas consumption. For this reason, Evoenergy is not subject to the same incentives to price its usage or fixed charges at the LRMC and can better promote the NGO by setting its tariffs to be more cost reflective and by enabling customers to respond to these tariffs to encourage the efficient use and growth of the network.

10.6.1.3 TRANSACTION COSTS

Rule 94(2)(b) requires each tariff class to be constituted with regard to the need to avoid unnecessary transaction costs. It also requires that a tariff, and each charging parameter for a tariff class, be determined with regard to the transaction costs associated with the tariff or each charging parameter.

Evoenergy has considered transaction costs such as metering charges and administrative costs when determining its tariff classes and charge components. This includes establishing an appropriate balance of transaction costs that supports Evoenergy's pricing objectives set out in Section 10.6.2 and is consistent with the revenue and pricing principles and the Rules.

We have also considered the transaction costs in proposing to abolish a number of network tariffs which have a low take up of customers and have not been reflected in retail tariffs. Abolishing these tariffs will reduce complexity and administrative costs associated with managing tariffs with only a few customers, help make Evoenergy’s tariffs easier for customers to understand, and better align gas network tariffs to existing retail offers.

Evoenergy considers that its proposed tariffs and tariff classes for the 2021–26 access arrangement period provide the appropriate balance between minimising transaction costs and ensuring that customers have incentives to respond to pricing signals. This is because:

- Our proposal to retain a structure for charges based on customer size (volume vs demand) is economically efficient. By comparison it would be inefficient to charge volume customers consuming less than 10TJ a year on capacity as the meter requirements and data handling required would need to be more sophisticated. The cost of this is avoided by charging these customers on a throughput basis using basic metering equipment.
- Postage stamp pricing for customers avoids transaction costs for customers. It would be considerably more costly to charge these customers based on location for limited benefit.
- We charge demand customers on capacity as they have the necessary metering equipment for daily reads. The size of the customers’ usage and associated impact

on the network warrant the additional costs of targeted price signalling to manage capacity demand.

- Our single reference service supports low transaction costs by having a single fixed charge component for each tariff class. Maintaining this simple approach supports customer understanding of our charges as well as minimising administration costs and complexity of retailer comparator websites.

10.6.1.4 RESPONSE TO PRICE SIGNALS

Rule 94(4)(b)(ii) requires that, where a tariff consists of two or more charging parameters, each parameter for a tariff class must be determined having regard to whether the customers belonging to the relevant tariff class are able or likely to respond to price signals.

Evoenergy considers that it has structured its tariffs and charging components to allow customers and end customers to respond to price signals. It is for this reason that we maintain the volume and demand customers' blocks as discussion in Section 10.4 and maintain a relatively low fixed charge to empower customers to control their bills.

Our declining block structure for both our volume and demand tariffs mean customers faced reduced average costs for additional gas usage. We consider that this is an appropriate price signal for customers where the marginal costs of supplying additional unit is materially lower than the average costs, encouraging increased network utilisation.

10.6.2 Strategy overview

When we initially set our tariffs and price levels, and then when we update them each year, we seek to give effect to the efficiency measures identified in section 10.6.1 in the context of a broader pricing strategy. This broader strategy seeks to best meet our pricing objectives.

Our pricing objectives for setting tariffs for the 2021-26 Access Arrangement and over the longer term are:

- **recover efficient costs** — Evoenergy needs to recover at least its efficient costs to continue providing safe and reliable network services to customers now and into the future;
- **promote the efficient use and growth of the network** — set cost-reflective tariffs to enable customers to respond to the tariffs and encourage the efficient use and growth of the network;
- **treat customers equitably** — ensure similar customers are grouped together and pay prices that reflect the costs they impose on the network;
- **keep gas competitive** — maintain and enhance the attractiveness and position of natural gas as a value-for-money fuel of choice, and promote competition with alternative energy sources;
- **provide stability in network tariffs** — where possible, minimise any sudden changes in network tariffs; and
- **provide simplicity and transparency in tariffs** — consider customer preferences and the transaction costs of providing customised tariffs, provide information on the tariffs and any tariff variations to help customers understand and be able to respond to the tariffs, and ensure consumers, stakeholders and the community value and support changes made by Evoenergy.

Evoenergy has previously tested its pricing objectives with consumers, stakeholders and the community and we consider they remain appropriate as they also have regard to the NGO and revenue and pricing principles in the NGL.

We outline some of our key strategy considerations when setting our pricings across the 2021-26 period.

10.6.2.1 VOLUME AND DEMAND MARKET REVENUE RECOVERY

We have traditionally recovered around 5 per cent of the smoothed revenue from our demand market (major customers) and 95 per cent of our revenue from our volume market (residential and commercial customers). Our approach would be to broadly maintain this split over the five years of the 2021-26 period recognising the small nature of the demand market and its potential sensitivity to any movements in the customer base. Annual movement in tariffs for a tariff class, that is, at the demand market or volume market level, are subject to a 2 per cent side constraint. Evoenergy is not proposing to alter this side constraint which is consistent with that applying to a number of other gas distributors. The application of the side constraint is shown in Box 10.1.

10.6.2.2 VOLUME CUSTOMERS' FIXED CHARGES

A fixed supply charge is an annual charge that applies to each delivery point. We consider it important to maintain a relatively low fixed charge as it reduces the barriers and doesn't overly disadvantage smaller users. The fixed charge is not necessarily seeking to recover our fixed costs and we have considered the blocks in our usage charge to ensure the prices for each of our tariff categories appropriately reflect the costs they impose on our network. This is an example of how we balance between the pricing objectives.

We set our fixed charge to encourage utilisation but still signal to the customer:

- the fixed cost nature of natural gas distribution;
- there is the cost to connect customers to the network; and,
- the fixed nature of metering costs.

10.6.2.3 VOLUME CUSTOMERS' USAGE CHARGES

While stakeholder engagement has questioned the declining block structure, consistent with other gas distribution businesses in Australia, Evoenergy is proposing to maintain a declining block usage charges. This means the average network price we charge decreases with the more gas that is used, like 'bulk buying'. This reflects:

- the costs of providing additional capacity decreases with volume increases (consistent with our pricing objective to provide pricing signals that reflect our costs); and,
- that there are benefits to our customers in 'growing the market' and encourages customers to use more gas (consistent with our pricing objective to promote efficient use of our network and lower average network charges for customers over the long term).

Our strategy over the 2016-21 period has been to target price reductions to block 2 of our volume market, which is where the heating load occurs as a means to ensure gas as a fuel of choice remains competitive. We consider that a strategy that maintains gas as an attractive proposition remains essential and is in the long term interests of our customers.

10.6.2.4 DEMAND MARKET

We are conscious the cost pressures from wholesale prices have been borne by our demand customers over the current period. We recognise the contribution demand customers connected to the network provide to all our customers by maintaining utilisation levels and sharing the fixed costs. The approach to demand customers over 2021-26 will be consistent with that taken with volume customers.

10.6.2.5 ANCILLARY ACTIVITIES

To ensure our ancillary charges continue to reflect the cost of undertaking these activities, we may adjust these year-on-year. We expect these adjustments will reflect the level of inflation unless the underlying costs materially change.

10.7 Tariff Variation Mechanism

Like most businesses operating in a competitive environment, we update our tariffs and charges each year. This enable us to respond to changing market conditions and recover our costs in a way that continues to be consistent with our long-term objectives.

We propose to retain the current method for varying reference tariffs in our 2021-26 access arrangement revision proposal. We consider these mechanisms are consistent with the revenue and pricing principles of the NGL and support the NGO by allowing tariffs to remain allocatively and dynamically efficient over the period.

10.7.1.1 FORM OF CONTROL

Evoenergy proposes to maintain a tariff basket annual tariff variation mechanism as permitted under rule 97(2)(b) in the form of a Weighted Average Price Cap (WAPC) formula for the 2021-26 period. This will be implemented using the CPI-X price control formula and annual tariff variation mechanism.

The WAPC supports the long-term interests of customers by ensuring price stability over the five-year regulatory period, whilst providing Evoenergy with an incentive for market growth. A WAPC form of price control provides Evoenergy with incentives for increasing the demand for gas such as by finding new ways to improve asset utilisation, which in turn improve economies of scale and productive efficiency in the economy more widely. Evoenergy, rather than customers, will bear the risk of actual demand differing from forecast demand.

The tariff basket price control is consistent with both the current form of control for gas networks subject to full regulation and the current tariff variation arrangements. These are both relevant considerations for the AER in deciding the reference tariff variation mechanism for the current period.

The proposed WAPC formula is shown in Box 10.1.

Box 10.1 Tariff control formula and side constraint formula

$$(1 + CPI_t)(1 - X_t)(1 + A_t)(1 + PT_t) \geq \frac{\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}$$

Subject to the side constraint formula applying to each tariff class

$$(1 + CPI_t)(1 - X_t)(1 + A_t)(1 + PT_t)(1 + 0.02) \geq \frac{\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}$$

Where Evoenergy has *n* reference tariffs, with each having up to *m* tariff components, and where:

t is the financial year for which the tariffs are being set;

p_t^{ij} is the proposed tariff for component j of reference tariff i in financial year t, i.e. the new tariff to apply from the commencement of financial year *t*;

p_{t-1}^{ij} is the tariff for component j of reference tariff i that is being charged in financial year t-1 at the time the variation notice is submitted to the AER for assessment.

q_{t-2}^{ij} is the quantity of component j of reference tariff i that was sold in financial year *t-2*;

CPI_t means, for the year t,:

- the CPI for the December quarter in financial year t–1 divided by
- the CPI for the December quarter in financial year t–2
- minus one.

If the ABS does not, or ceases to, publish the index, then CPI will mean an inflation index or measure agreed between the AER and Evoenergy

X_t means the X factor for financial year t, determined in accordance with the PTRM, updated for the annual return on debt calculated for the relevant year

A_t is the automatic adjustment factor

PT_t is the cost pass through factor

The left side of the equation provides the price cap that allows tariffs to increase by no more than the CPI, adjustment factor and approved pass throughs less the X factor:

- the X factor gives effect to the price path set out in Attachment 8. The X factor aligns forecast revenues with the net present value of cost of services, resulting in revenue equalisation.
- CPI adjusts Evoenergy's reference services for inflation.
- the adjustment factor provides for true-ups of licences fees, carbon costs, UNFT and UAG. Only the actual costs are passed on to customers or in the case of UAG an efficient cost that creates an incentive for Evoenergy to lower UAG. These adjustments can be both positive and negative.

- a pass through factor is included in the formula but only arises in the calculation of an annual tariff variation if the AER approves it on the basis that one of the predetermined cost pass through events occurred. These are events outside Evoenergy's control that either increase or decrease costs to supply the reference service.

The right side of the equation represents the weighted average of notional revenues in the current access arrangement year compared to the access arrangement year in which the proposed tariffs are to apply. The notional revenue relies upon quantities from two years previously. This is consistent with practice in other jurisdictions. This remains consistent with Rule 97(3)(b) as it reduces the administrative burden on the AER relative to the alternatives of using estimated data for this purpose.

10.7.2 Automatic Adjustments

The annual adjustment factor A_t, a component of the tariff variation mechanism, allows for differences between forecast and actual costs for specified events to be recovered or savings returned in tariffs. The proposed automatic adjustment factor, set out in Schedule 4 of the access arrangement revision proposal, covers the following uncontrollable costs:

- licence fees—due to realised licence fees differing from the allowed annual licence fee;
- unaccounted-for gas (UAG) costs—to procure gas to meet our UAG obligations compared to the annual allowance. Evoenergy's approach to assessing UAG costs is unchanged from the current AA but with updated target rates;
- carbon costs—to meet any costs incurred (directly or indirectly) arising from an obligation imposed under a new 'carbon scheme' should one be implemented in the 2021-26 period; and
- relevant taxes.

We propose maintaining each of these components in the automatic adjustment factor for the 2021-26 period with the current zero materiality threshold. Each of these events addresses circumstances or potential circumstances over which Evoenergy essentially has no control. It is appropriate to retain these actual or potential automatic adjustment factors in the tariff variation mechanism in the 2021-26 period. For the avoidance of doubt, adjustments (up or down) are made only when Evoenergy incurs costs that are different to any allowance provided by the AER. The AER also has the opportunity to scrutinise these costs annually and they must approve them prior to their being included in Evoenergy's prices.

10.7.3 Cost pass through factor

The purpose of the cost pass through framework is for the costs or savings arising from certain unforeseen events to be passed through to customers in tariffs, subject to AER approval. These costs or savings cannot be included at the time of developing the proposed access arrangement or the final decision because it is not known in advance if the events will occur during the 2021-26 period, and if they occur, what the cost impact would be.
Cost pass through events are either:

- regulation driven, which includes regulatory change and service standard events. These changes in the regulations are monitored by regulatory managers who are aware of the rights & obligations under the Access Arrangement; or

- market driven, which includes insurance, terrorism and natural disaster events. Corporate finance, risk and insurance managers involved in responding to these events are aware of rights and obligations in relation to cost pass through mechanisms.

Similar cost pass through events are in place for both regulated gas and electricity businesses. Where such external events occur that affect Evoenergy's costs, they are assessed to consider whether they fall into a category of cost pass through event and the potential value of the cost impacts.

10.7.3.1 CHANGES TO THE COST PASS THROUGH EVENTS

Evoenergy proposes to adjust the definitions for four cost pass events with one amendment leading to new definitions and to remove one event from the list of cost pass through events.

The proposed adjustments to the cost pass through events definitions are listed below:

- amend the definition of Natural Disaster Event to clarify that it includes any epidemic.
- clarification of the definition of Regulatory Change Event to clarify that this event may be triggered by the introduction of a new obligation, as well as a change to an existing obligation.
- delete the requirement in the definitions for Regulatory Change Event and Service Standard Event that costs be 'materially' increased or decreased. This requirement is duplicative and unnecessary given all Cost Pass Through Events must give rise to an "Administrative Cost Impact" before costs can be passed through (see clause 8.7, previously clause 7.7) and the definition of "Administrative Cost Impact" requires that the Event give rise to a change in cost in any relevant Financial Year that is equal to or greater than 1 per cent of the smoothed forecast revenue for that Financial Year (i.e. there is already a requirement that costs be material before they can be passed through).
- amend the definition of Service Standard Event to provide that the cessation of the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline of October 2017 constitutes a Service Standard Event. The waiver expires on 1 July 2024. In the event a further waiver is not granted, as Evoenergy provides electricity distribution services, it could not continue to provide Pipeline Services and another legal entity would be required to do so. This would entail the service provider incurring higher costs in providing the Reference Service than if Evoenergy continued to provide the services in conjunction with providing electricity distribution services.
- add a new definition of "Ring-fencing Guideline" used in the amended "Service Standard Event" definition.
- add a new definition of "Service Provider" (which will at commencement be Evoenergy) and used this in place of "ActewAGL" as appropriate throughout the AA. This will ensure the AA remains workable in the event the current waiver of Evoenergy's obligations under clause 3.1 of the AER's Ring-fencing Guideline is not renewed and another legal entity is granted the right to provide Pipeline Services.

The Network User Failure event has been removed from the cost pass through event. In February 2017, the Australian Energy Market Commission approved a rule change which enhanced the operation of the retailer insolvency cost pass through provisions in the Rules to enable distributors to collect unpaid network charges and any costs associated

with a retailer default, regardless of the size of the retailer default removing the need for this to be a cost pass through event.

The changes to the regulatory change event and removal of the network user failure event are consistent with JGN's definitions approved by the AER. The change to the service standard event to recognise the ring fencing electricity distribution waiver for gas is required due to the unique circumstances of Evoenergy.

10.7.3.2 CHANGES TO THE APPLICATION PROCESS FOR COST PASS THROUGHS

The changes proposed by Evoenergy to the application process are clarifications about the timing for notification and the provision of the cost information to be notified and passed through.

- Minor grammatical changes throughout (including to correct the references to 'Change in Costs').
- Amended the obligation in clause 8.8 (previously clause 7.8) to notify the AER of a Cost Pass Through Event which has or is likely to have an Administrative Cost Impact so that it is triggered upon that Event occurring (and not before). This is consistent with the approach in other regulatory determinations by the AER.
- Amended the obligation in clause 8.8 (previously clause 7.8) to notify the AER of a Cost Pass Through Event within 90 Business Days so that it is the later of the date on which Evoenergy becomes aware of the Cost Pass Through Event occurring and the date on which Evoenergy becomes aware that the Event will or is likely to have an Administrative Cost Impact. This is because the obligation should not be triggered before it is apparent that an Administrative Cost Impact associated with a Cost Pass Through Event is likely.
- Clarified in clauses 8.9 and 8.10 (previously clauses 7.9 and 7.10) that the cost information to be notified by Evoenergy to the AER is the Change in Cost for each relevant Financial Year.
- Clarified the drafting in clause 8.14(a) (previously clause 7.14(a)) to reflect that, in the event no determination is made, the AER is taken to have determined that the amount to be passed through is the sum of the Changes in Cost associated with the Cost Pass Through Event given to the AER by Evoenergy.

10.7.3.3 CHANGES TO THE INTER-PERIOD TREATMENT OF COST PASS THROUGH AND ADJUSTMENT AMOUNT

These changes are related to the inclusion of the intra-year tariff variation process.

- Simplified drafting by using defined terms and made minor grammatical changes.
- Added new clauses 8.18 and 8.19 to clarify that automatic adjustments factor amounts for the 2016 or 2021 access arrangement periods that are not passed through in Reference Tariffs in those periods may be passed through in the subsequent access arrangement period.
- Changes to the Annual Variation Notice by adding a subparagraph to reflect the inter-period treatment of cost pass through events already provided for in clause 8.16 (previously 7.16).

10.7.4 Tariff variation process

Section 7 of the 2021-26 access arrangement revision proposal set out the tariff variation process. This is consistent with the process currently applying during the 2016-21 access arrangement period.

In summary, for our annual process we will:

- Submit our annual reference tariff variation proposal to the AER for approval by 15 March of the year prior to the relevant financial year to which the proposal tariffs will apply;
- Include any update to the X factor for the return on debt adjustment previously approved by the AER;
- Include a pricing model that demonstrates compliance with the tariff variation mechanism.

The AER will then review the proposal for compliance with the tariff variation mechanisms and approve or reject the proposal consistent with the access arrangement terms.

There may be very limited instances where we seek to vary the tariffs outside of the annual process. This would be via the intra-year tariff variation process, in summary:

- Evoenergy would propose to the AER to vary the tariffs effective from a date other than the start of the financial year;
- Our intra-year reference tariff proposal will be made 50 days prior to the proposed date it would take effect and include the adjustments to apply for the remainder of the financial year;
- We will include a pricing model that demonstrates compliance with the tariff variation mechanism.

The AER will review this proposal for compliance with the intra-year tariff variation mechanism and approve or reject the proposal consistent with the access arrangement terms.

Evoenergy considers the tariff variation mechanism complies with Rule 97 as:

- the submission of a formulaic model minimises administrative burden on the AER by providing an objective and transparent means for the AER to exercise its oversight and powers of approval for the tariff variation; and
- it aligns with equivalent processes in other jurisdictions.

The ancillary charges variation process occurs as part of Evoenergy's annual reference tariff variation process.

Shortened forms

Term	Meaning
AA	Access Arrangement
ACT	Australian Capital Territory
ACT climate change strategy	ACT Government's Climate Change Strategy 2019-25
ACTCOSS	ACT Council of Social Service
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ANU	Australian National University
ARENA	Australian Renewable Energy Agency
BISOE	BIS Oxford Economics
CABS	A Jemena Ltd proprietary system providing retailer billing, demand customer management, network balancing and retailer nomination services.
CALD	culturally and linguistically diverse (community)
capex	capital expenditure
CCP, CCP24	the AER's Consumer Challenge Panel (number 24)
CEG	Competition Economists Group
CEPA	Centre for Efficiency and Productivity Analysis (University of Queensland)
CESS	Capital Expenditure Sharing Scheme
CIE	Centre of International Economics
CIT	Canberra Institute of Technology
CPI	consumer price index
DAE	Deloitte Access Economics
DAMS	Distribution asset management services (agreement)
DC	Demand Capacity Tariff
DT	Demand Throughput Tariff
E2G	Electricity-to-gas
EEIS	Energy Efficiency Improvement Scheme
ECM	Efficiency Carryover Mechanism
ECRC	Energy Consumer Reference Council
EGWWS	electricity, gas, water and waste services (sector)
EI	Economic Insights
EIL	Energy Industry Levy
ETC	Estimated cost of corporate income tax
EPSDD	ACT Environment, Planning and Sustainable Development Directorate

Term	Meaning
GDBs	gas distribution businesses
GN21	Evoenergy gas network access arrangement 2021–26
GJ	gigajoule = 10^9 joules
GWh	gigawatt hour
I&C	Industrial and commercial
ITAUF	Information Technology Asset Utilisation Fee
km	kilometre
LPG	liquid petroleum gas
MDLs	Meter Data Loggers
NGL	National Gas Law
NGO	National Gas Objective
NSW	New South Wales
opex	operating expenditure
PFP	Partial Factor Productivity
PJ	petajoule = 10^{15} joules
PLS	Pressure Limiting Station
PPA	power purchase agreement
PTRM	post-tax revenue model
QPRC	Queanbeyan–Palerang Regional Council (local government authority)
RAB	regulatory asset base
RFM	roll-forward model
RIN	Regulatory Information Notice
Rules	National Gas Rules
SDRS	Secondary District Regulator Sets
TAB	tax asset base
TJ	terajoule = 10^{12} joules
UAG	unaccounted for gas
UNFT	Utilities Network Facilities Tax
VB	Volume Boundary (tariff class)
VI	Volume Individual (tariff class)