Attachment 8

Revenue requirement and price impacts

Access arrangement information

ACT and Queanbeyan-Palerang gas network 2021–26

Submission to the Australian Energy Regulator

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Key points

Evoenergy's proposed annual revenue requirement is comprised of each of the building blocks specified in the National Gas Rules (Rules) and the AER's final gas distribution post-tax revenue model (PTRM) published in April 2020. The proposed total revenue requirement for the 2021-26 regulatory period is 10 per cent lower than the total allowed revenue requirement in the AER's decision for the 2016-21 regulatory period, and 14 per cent lower on a per customer basis. The key drivers of the reduction are the rate of return and tax expenses, offset to a small extent by an increase in depreciation and operating expenses.

Evoenergy has smoothed the annual revenue requirements to deliver the full price reduction to customers in the first year of the regulatory period. Evoenergy considers this to be consistent with consumer feedback on affordability concerns and price stability.

Unsmoothed and smoothed revenue

$ million nominal	2021/22	2022/23	2023/24	2024/25	2025/26
Unsmoothed revenue	58.84	60.35	62.86	64.67	69.04
Smoothed revenue	61.92	62.42	62.97	63.62	64.02

Our proposal delivers a real reduction in network prices of over 4 per cent in 2021/22, followed by stable network prices for the remaining four years of the period. Given that Evoenergy's distribution network charges comprise approximately 25 per cent of the typical residential retail bill, this results in a 1 per cent (or $17) real reduction in the indicative retail bill for 2021/22.

8.1 Introduction

The Rules require that the access arrangement information include the total revenue to be derived from pipeline services for each regulatory year of the access arrangement period.[1]

Rule 76 requires the building block approach to be used to determine the total revenue for each year of the access arrangement period and specifies the building blocks as:

(a) a return on the projected capital base for the year; and
(b) depreciation on the projected capital base for the year; and
(c) the estimated cost of corporate income tax for the year; and

[1] Rules, cl. 72(1)(m)

(d) increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency; and
(e) a forecast of operating expenditure for the year.

Consistent with the requirements of the Rules, Evoenergy has calculated the total revenue for each year of the access arrangement period using the building block methodology. In addition, Evoenergy has adopted the AER's approach to calculating depreciation, forecast inflation, taxation expenses and the rate of return, as contained in the gas distribution PTRM and the AER's final decisions on these issues.

8.2 Annual revenue requirement

Evoenergy's calculation of each of the building blocks that comprise the proposed revenue requirement are discussed in the following sections:

- Attachments 3, 4 and 5: return on capital
- Attachment 4: regulatory depreciation
- Attachment 2: operating expenditure
- Attachment 9: revenue adjustments (incentive scheme outcomes)
- Attachment 6: net tax allowance

Within the PTRM, the AER combines the indexation of the capital base and straight-line depreciation into a single building block category referred to as return of capital or 'regulatory depreciation'. The negative indexation adjustment is made to avoid double-counting inflation due to the application of a nominal rate of return to an indexed capital base. In addition, the PTRM aggregates all revenue increments and decrements into a single category referred to as 'revenue adjustments'.

The proposed values for each of the building blocks are presented in Table 8.1.

Table 8.1 Building block revenue requirement

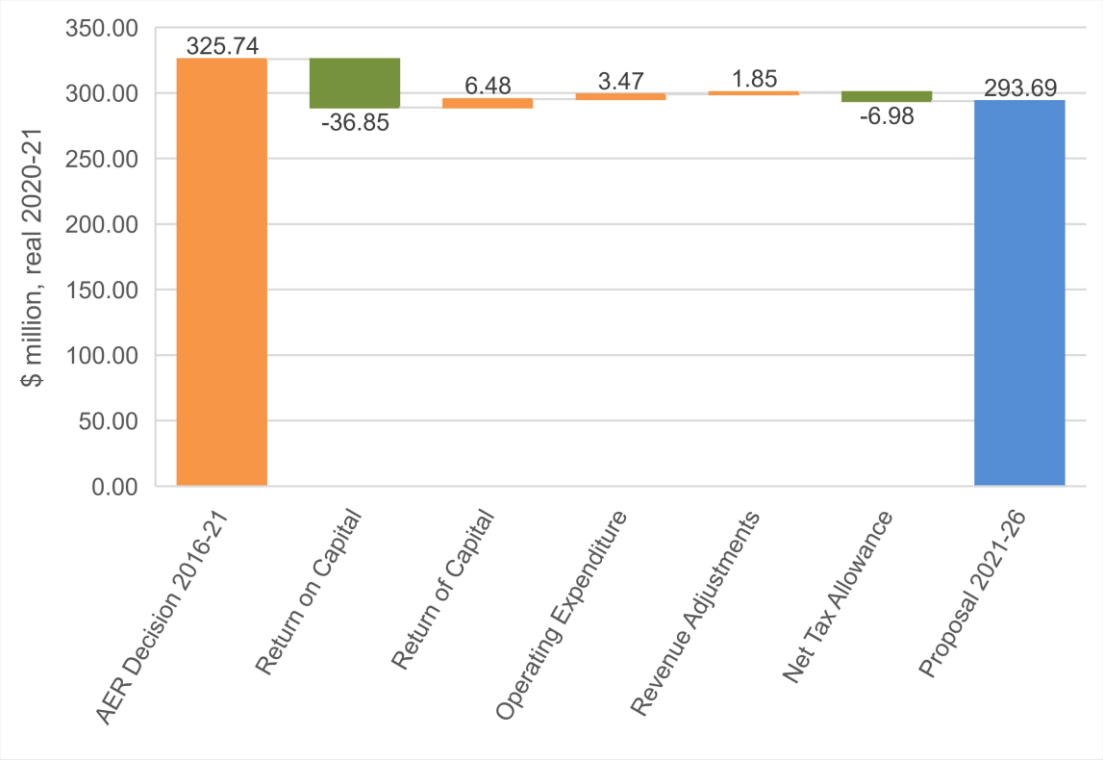
Building block component ($m, nominal)	2021/22	2022/23	2023/24	2024/25	2025/26
Return on capital	17.89	17.78	17.61	17.26	16.82
Return of capital (regulatory depreciation)	6.73	7.73	8.81	9.86	10.91
Operating expenditure	35.41	36.92	37.17	38.77	41.02
Revenue adjustments	-1.59	-2.38	-0.98	-1.48	-
Net tax allowance	0.39	0.30	0.26	0.25	0.29
Total revenue (unsmoothed)	**58.84**	**60.35**	**62.86**	**64.67**	**69.04**

The proposed total unsmoothed revenue requirement for the 2021-26 regulatory period is 10 per cent lower than the allowed total unsmoothed revenue requirement in the current regulatory period (2016-21), reflecting Evoenergy's efforts to reduce costs where possible to ensure services are delivered efficiently. As shown in Figure 8.1, the key factors driving the difference in the revenue requirement are:

- a reduction in the return on capital as a result of a lower rate of return and declining capital base (see Attachments 4 and 5);

- an increase in regulatory depreciation as a result of increased expenditure on metering in the current and forthcoming regulatory period (see Attachment 4);
- an increase in operating expenditure as a result of expensing pipeline inspection (pigging) costs that were capitalised in the 2016-21 period and an increase in ACT Government taxes (see Attachment 2);
- an increase in revenue adjustments, as the penalty that Evoenergy has incurred under the efficiency carry-over mechanism is not as large as the penalty incurred in the 2016-21 regulatory period (see Attachment 9); and
- a reduction in the tax allowance as a result of the AER's decisions to introduce diminishing value depreciation for tax purposes, cap gas asset lives at 20 years and increase the value of imputation credits (see Attachment 6).

Figure 8.1 Comparison of unsmoothed revenue requirement



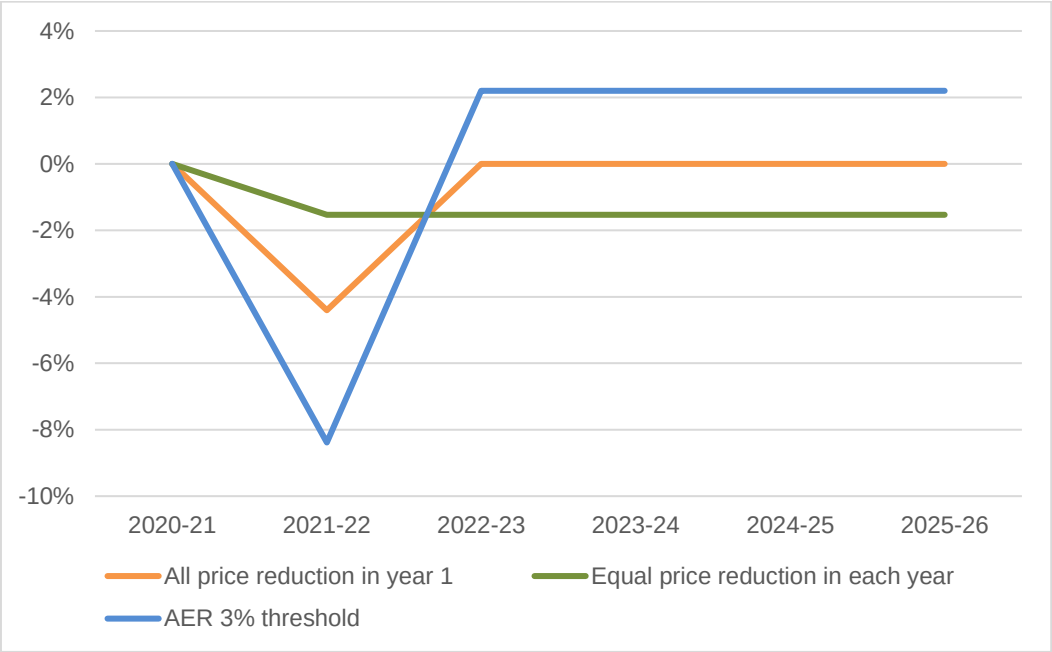
8.3 Smoothed annual revenue requirement

Evoenergy has considered three options for smoothing revenue over the access arrangement period:

- capturing all the real price reduction in year 1 followed by zero real price changes in the following years;
- smoothing the real price reduction over the full access arrangement period with equal price reductions in each year;
- setting the price changes in each year to meet the AER's preferred threshold of 3 per cent between smoothed and unsmoothed revenue in the final year.

The resulting price path for each option is shown in Figure 8.2.

Figure 8.2 Price path options



The first option, where all the price reduction is put in the first year, results in a real price reduction in 2021/22 of just over 4 per cent, with prices remaining stable in real terms for the following four years of the access arrangement period. The second option, where the price reduction is held constant in each year, results in a 1.5 per cent real price reduction in each of the 5 years of the access arrangement period. The third option, which reflects the AER's preferred approach of limiting the difference between the smoothed and unsmoothed revenue in the final year of the access arrangement period, results in a large price reduction in 2021/22 of over 8 per cent, followed by real increases of 2.2 per cent in each of the following four years.

In Evoenergy's view, the first option, which delivers all of the price reduction to customers in the first year, followed by zero real price changes in the following four years provides the best outcome in terms of price stability and meeting affordability concerns. The feedback from Evoenergy's consumer engagement included concerns about the level of network charges coupled with feedback that consumers seek price stability. Over 50 per cent of survey respondents felt that the current price of gas was not reasonable and nearly 20 per cent felt that reducing network charges should be a prime focus for Evoenergy going forward. In Evoenergy's view, the best approach to addressing these concerns is to provide all of the price reduction to customers as soon as possible in the access arrangement period, followed by no further real price increases in the following four years. While Evoenergy recognises that this approach results in a final year difference in excess of 3 per cent, it is preferable to the very large swings in network pricing that would result from implementing the AER's preferred method.

Evoenergy notes that ultimately, the retail prices faced by customers will be driven to a greater extent by the wholesale price of gas than by Evoenergy's network charges. Indicative wholesale gas prices forecast by CORE Energy for the Australian Energy

Market Operator (AEMO) suggest that wholesale gas prices for our region will increase by around five per cent in real terms on average over the period.[2]

We have modelled the indicative retail bill impacts of the three different scenarios, taking into account the expected wholesale gas price forecast, to assess whether any of the different scenarios would result in unintended bill instability at a retail bill level. Under each scenario the annual bill increase was less than three per cent in real terms, and so we do not consider forecast movements in the wholesale gas price to materially impact the proposed price path. Taking this into account, we maintain that our proposed approach will deliver the best outcome for consumers.

Reflecting the first option for smoothing revenue over the access arrangement period, Table 8.2 presents Evoenergy's proposed smoothed revenue for the access arrangement period.

Table 8.2 Smoothed revenue requirement

$million, nominal	2021/22	2022/23	2023/24	2024/25	2025/26
Smoothed revenue requirement	61.92	62.42	62.97	63.62	64.02

8.4 Expected bill impacts

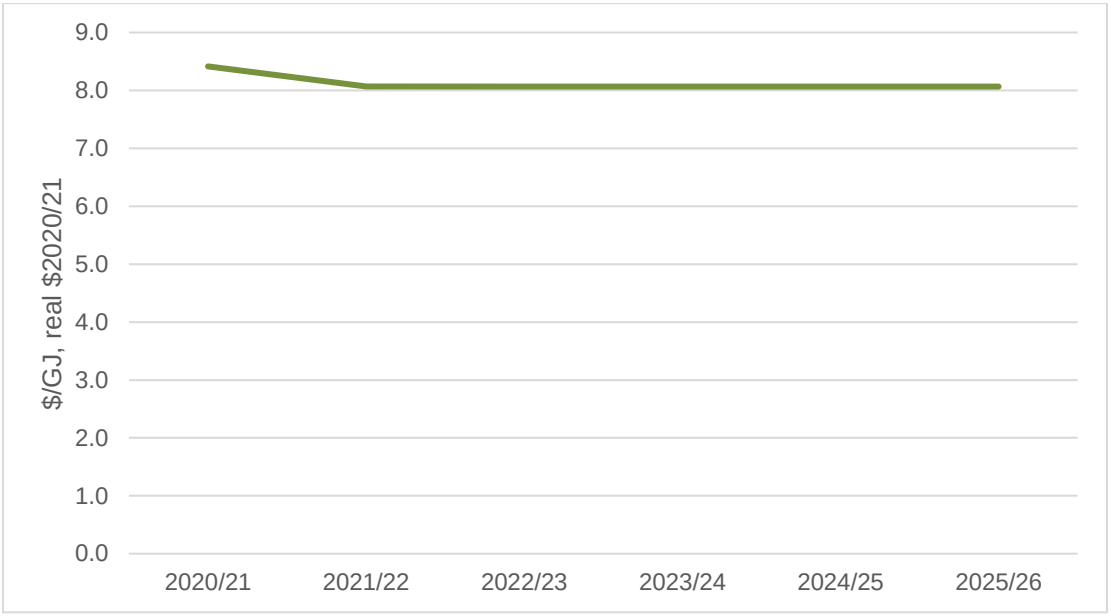
At the outset, it is important to explain the difference between the reduction in the proposed revenue requirement and the proposed price reduction. As set out in section 8.2, Evoenergy is proposing a revenue requirement for the 2021-26 access arrangement period that is 10 per cent below the AER's allowed revenue requirement for the current period. This does not imply that prices will also decline by 10 per cent. Prices are determined by both the change in revenue *and* the change in volumes. While Evoenergy is proposing a 10 per cent reduction in revenue, it is also forecasting a significant decline is usage volumes (see Attachment 7). This means that there are lower volumes over which to spread the revenue requirement and, as a result, the price reduction is smaller than the revenue reduction.

The combination of Evoenergy's revenue requirement and forecast volumes results in a real reduction in network prices of 4 per cent in 2021/22 and zero in the following four years. These network price changes will have an impact on the retail gas bills of customers in the ACT and Queanbeyan-Palerang areas of NSW. To provide an indication of the expected impact, Evoenergy has adopted the same approach as used by the AER.

This approach involves first dividing the proposed smoothed revenue requirement by forecast gas throughput to arrive at an indicative price path. Figure 8.3 shows the indicative real price path for Evoenergy's gas distribution charges over the 2021-26 period.

[2] AEMO *2020 Gas Statement of Opportunities - CORE Energy wholesale gas price outlook*

Figure 8.3 Indicative real price path



The expected retail bill impact for the average residential customer is then estimated by adjusting the distribution component of the bill in line with the indicative price path, while holding all other elements of the bill constant in real terms. In reality, it is likely that other elements of the bill (particularly the wholesale price of gas) will also vary over the 2021-26 regulatory period and impact final prices. However, this analysis is focused on isolating the impact of the proposed distribution element of the bill.

Given that Evoenergy's network charges account for only 28 per cent of the average residential bill, the proposal has a relatively small impact on the average retail residential bill, reducing the average bill by 1 per cent in real terms (or $14) in 2021/22 followed by zero real price changes in the following four years (see Table 8.3).

Table 8.3 Real indicative retail bill impacts, average residential customers

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Residential annual gas bill	1224[1]	1210	1210	1210	1210	1210
Evoenergy component	337[2]	323	323	323	323	323
Residual component	887	887	887	887	887	887
Annual change $		-14	0	0	0	0
Annual change %		-1.1%	0.0%	0.0%	0.0%	0.0%

1 The starting retail bill for 2020/21 is calculated by applying the average residential usage of 77 MJ per day (which is the average usage for residential customers over the 2021-26 period based on CIE forecasts) to ActewAGL Retail's standard pricing for 2020/21.

2 Evoenergy's component of the average retail residential gas bill is calculated by dividing Evoenergy's network bill for the average residential customer by ActewAGL Retail's bill for the average residential customer. Both bills are based on the average residential usage of 77 MJ per day and 2020/21 pricing.

The same approach has been used to estimate the expected bill impact for the average commercial customer. Holding all other elements of the bill constant, Evoenergy's proposed network charges are estimated to reduce the average annual commercial gas

bill by -0.9 per cent or $125 in 2021/22 in real terms, followed by zero real price changes in the following four years (see Table 8.4).

Table 8.4 Real indicative retail bill impacts, average commercial customers

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Commercial annual gas bill	13527	13402	13402	13402	13402	13402
Evoenergy component	3043	2918	2918	2918	2918	2918
Residual component	10485	10485	10485	10485	10485	10485
Annual change $		-125	0	0	0	0
Annual change %		-0.9%	0.0%	0.0%	0.0%	0.0%

*May not sum due to rounding.

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)