



Jemena Electricity Networks (Vic) Ltd

2021-26 Electricity Distribution Price Review

Attachment 03-01

Response to AER's Draft Decision - Annual Revenue Requirement



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Glossary

asset base	Regulated asset base
current regulatory period	The regulatory control period covering 1 January 2016 to 31 December 2020
draft decision	The draft decision on the determination that will apply to setting JEN's distribution prices for the next regulatory period
initial proposal	The initial regulatory proposal to the AER for the setting of regulated pricing for JEN for the next regulatory period
intervening period	The regulatory period covering 1 January 2021 to 30 June 2021
Jemena	Jemena is the group entity that own JEN
next regulatory period	The regulatory control period covering 1 July 2021 to 30 June 2026
revised proposal	The revised regulatory proposal to the AER for the setting of regulated pricing for JEN for the next regulatory period
standard control services	The electricity distribution services provided using JEN's shared electricity network. Per the NER definition, a standard controls service is a direct control service that is subject to a control mechanism based on a DNSP's total revenue requirement
updated proposal	Following the submission of our initial proposal, we lodged an updated regulatory proposal for the next regulatory period which adjusted the base year operating expenditure amount

Abbreviations

AER	Australian Energy Regulator
ARR	Annual Revenue Requirement
BIS	BIS Oxford Economics
CAM	Cost Allocation Methodology
CESS	Capital Expenditure Sharing Scheme
CGS	Commonwealth Government Securities
CPI	Consumer Price Index
CY	Calendar Year
DAE	Deloitte Access Economics
DMIAM	Demand Management Incentive Allowance Mechanism
DNSP	Distribution Network Service Provider
DV	Diminishing Value
EBSS	Efficiency Benefit Sharing Scheme
HY	Half Year
GSL	Guaranteed Service Level
MPS	Monetary Policy Statement
MTFP	Multilateral Total Factor Productivity
PTRM	Post Tax Revenue Model
RAB	Regulated Asset Base
RBA	Reserve Bank of Australia
RFM	Roll Forward Model
RIN	Regulatory Information Notice
RORI	Rate of Return Instrument
SL	Straight Line
TAB	Tax Asset Base
WACC	Weighted Average Cost of Capital

Overview

The Annual Revenue Requirement (**ARR**) reflects the revenues we—Jemena Electricity Networks (Vic) Ltd. (**JEN**)—require to provide standard control services to our customers over the 2021–26 regulatory control period (**f**). The ARR outlined in this document is a revision (**revised proposal**) to the ARR we sought in our 2021–26 initial regulatory proposal (**initial proposal**) and is made in response to the Australian Energy Regulator’s (**AER**’s) 2021–26 draft decision (**draft decision**). After lodging our initial proposal, we offered an updated regulatory proposal for the next regulatory period (**updated proposal**) to account for a downward adjustment to our base year operating expenditure amount.

The draft decision smoothed revenue for **JEN** was \$1,273 million (\$nominal), which is 7.8% lower than the revenue we proposed in our initial proposal. The lower revenue requirement reflects the collective impact of constituent changes made by the AER in the draft decision. In this revised proposal, we seek \$1,305 million (\$nominal) of revenue over the next regulatory period. Table OV–1 summaries these outcomes.

Table OV–1: Description of revenue impacts from the AER’s draft decision and JEN’s response

Service Type	Initial Proposal	Draft Decision	Revised Proposal
Standard control services	1,381.2	1,273.3	1,305.0

Customer impacts

What this means for our customers

When speaking to our customers, they told us affordability was important to them,⁽¹⁾ however, they also recognised how critical it is that we provide a reliable and sustainable electricity distribution service over the long term. With our ARR being the basis on which we set our bills—and therefore, our primary means on how we interact with our customers on affordability issues—it is important to our customers the ARR is set at the right levels.

To address our customers' affordability concerns:

- we have developed a revised ARR which is 5.5% (or \$76 million, \$nominal) lower than our initial proposal amount. When combined with our smart metering service charges, this will deliver 19% lower bills to our residential customers and 17% lower bills to our small business customers.
- we acknowledge that our revised proposal has ARR at 2.5% (or \$31.7 million, \$nominal) above the AER’s draft decision; however, this is necessary to afford JEN the opportunity to recover its efficient costs and to meet the reliability and sustainability objectives that our customer told us were also important.

Our customers also told us that consistency in bills from year to year was extremely important to them; they said stability helped their budgeting process.⁽²⁾ In this revised proposal, we propose a price path that offers large immediate savings to our customers in the first year of the next regulatory period—relative to the revenue recovered in the current regulatory period—and continues lower revenue each year throughout the remainder of the next regulatory period on a consistent, downward, trajectory. We consider that this profile goes towards meeting this objective for our customers.

(1) JEN, *2021-26 Electricity Distribution Price Review, Regulatory Proposal, Attachment 02-02, Community engagement report*, Pg. 43.

(2) JEN, *2021-26 Electricity Distribution Price Review, Regulatory Proposal, Attachment 02-04, Reconvening the Jemena People’s panel*, Section 3.1.

JEN's response to the draft decision

For the purposes of developing this revised proposal, we summaries of the key items from the draft decision, and our response to each of these items, is outlined in Table OV–2.

Table OV–2: Description of revenue impacts from the AER's draft decision and JEN's response

Draft decision item	AER position	JEN response
Regulatory Asset Base (RAB, asset base)		
Opening balance	<p>The AER made minor changes to JEN's proposed Roll Forward Model (RFM), which impacted the opening RAB value. The changes include updating:</p> <ul style="list-style-type: none"> • CY19 net capital expenditure estimates with actual capital expenditure which was provided to the AER as a part of the annual Regulatory Information Notice (RIN) reporting • actual and forecast CPI values as a result of new market data becoming available • placeholder nominal vanilla weighted average cost of capital (WACC) for HY21 and • relevant HY21 values to account for modelling changes relating to the regulatory period covering 1 January 2021 to 30 June 2021 (intervening period). 	<p>JEN accepts these draft decision changes.</p> <p>However, our response includes a further update for the nominal vanilla WACC for HY21 to reflect JEN's actual averaging period.</p>

Draft decision item	AER position	JEN response
Incremental capital expenditure	<p>Using our initial proposal capital expenditure forecast as a baseline, the AER made its draft decision by:</p> <ul style="list-style-type: none"> • updating actual and forecast CPI including switching from an unlagged Dec-Dec profile to a lagged Jun-Jun profile. This aligned the capital expenditure forecast with the approach taken within the RFM • substituting our initial proposal labour escalation with a revised Deloitte Access Economics (DAE) forecast to recognise the impact of the COVID-19 pandemic • modifying forecast cash flows for 21 separate capital projects to account for lower connection volumes as a result of the COVID-19 pandemic and more up to date project estimates (e.g., REFCL updates) <p>The AER also noted that its final decision will incorporate updated information and use the standard approach of averaging two independent real labour escalators.</p>	<p>JEN partially accepts these draft decision changes.</p> <p>JEN accepts the CPI profile applied by the AER; however, our revised proposal includes updates to labour escalation and a small number of capital project forecasts. JEN has used forecast labour escalation using the average of the DAE forecast and an updated BIS Oxford Economics (BIS) forecast which includes superannuation guarantee increments as recommended by the AER.</p> <p>JEN has updated a small number of project costs to address specific concerns raised by the AER in the draft decision and also to reflect new information available since submitting the initial proposal. See Attachment 04-01 and Attachment 04-01M for more detail.</p>
Rate of Return		
Return on equity	<p>The AER accepted the approach within JEN's initial proposal to calculate return on equity and the selection of risk free rate averaging period.</p>	<p>JEN accepts this aspect of the draft decision. However, JEN is concerned about the Reserve Bank of Australia's (RBA's) intervention in the bond market that will artificially suppress the risk free rate over the next 6 months.</p> <p>We have identified some measures in relation to the inflation forecast that could help mitigate the financeability issues. See Section 3.4.3 for more details.</p>
Return on debt	<p>The AER updated the Government bond yields for the latest placeholder market observables.</p>	<p>JEN accepts the draft decision changes.</p> <p>However, our revised proposal updates the "placeholder inputs" in the draft decision, in line with the modified 2018 rate of return instrument, based on newly available market information.</p>

Draft decision item	AER position	JEN response
Inflation	The AER applied a placeholder forecast rate of inflation of 2.37% in the draft decision. The AER subsequently made a draft decision on Regulatory Inflation Review ¹ and proposed to adopt the glide path method.	JEN accepts the AER's draft decision on Regulatory Inflation Review and expects the change in method to be applied without any transition. This approach is preferred given the significant deterioration in risk free rate arising from the RBA's market intervention to lower Commonwealth Government Securities (CGS) yields; which could potentially result in financeability issues for JEN. (See Section 3.4.3 for more details). However, for our revised proposal we have maintained the same placeholder inflation estimate as AER's draft decision. The AER will update it based on its final decision on Regulatory Inflation Review and latest data available at the time of final decision.
Corporate income tax		
Gamma	The AER retained JEN's initial proposal value of 58.5%.	JEN accepts this draft decision value.
Tax asset base (TAB)	The AER made minor changes within the RFM, which impacted the tax asset base (TAB), updating: <ul style="list-style-type: none"> • CY19 estimates for net capital expenditure with actual capital expenditure which became available during the annual RIN process • actual and forecast CPI values as a result of new market data becoming available • placeholder HY21 nominal vanilla WACC • relevant HY21 values to account for modelling changes regarding the intervening period. 	JEN accepts these draft decision changes. However, our response includes an update for the HY21 nominal vanilla WACC.
Tax depreciation methods	The AER accepted JEN's proposal to use the declining value method for most tax asset classes, which JEN proposed to align with the outcomes of the 2018 regulatory tax approach review.	JEN accepts these draft decision changes.
Other items		

¹ AER, *Draft position, Regulatory treatment of inflation*, October 2020.

Draft decision item	AER position	JEN response
Regulatory depreciation	<p>The AER's draft decision for regulatory depreciation:</p> <ul style="list-style-type: none"> • accepted JEN's proposed asset classes • accepted the application of the straight-line depreciation method • accepted the proposed standard asset lives with the exception of the 'Non network - other' and 'Equity raising costs' asset classes • accepted the continuation of JEN's year-by-year tracking approach to calculate straight-line depreciation of existing assets • identified and corrected a few minor errors in JEN's depreciation model, and • amended other components of JEN's proposal such as capital expenditure forecast which affected forecast regulatory depreciation. 	<p>JEN accepts this aspect of the draft decision.</p> <p>Our forecast regulatory depreciation now includes updates to the opening RAB and capital expenditure forecasts.</p>
Operating Expenditure	<p>The AER made several changes to JEN's initial proposal operating expenditure forecast including:</p> <ul style="list-style-type: none"> • significant adjustments to reduce the base year costs after claiming that JEN's base year was inefficient • applying base year reduction to newly expensed corporate overheads that were not part of the base year operating expenditure • lowering the trend forecast, mainly as a result of lower output and input price drivers • removing some step changes proposed by JEN and • revising specific forecasts proposed by JEN. 	<p>JEN does not accept AER's efficiency assessment and unreasonable reduction of our forecast operating expenditure.</p> <p>Our response contains an updated operating expenditure model which includes offering a \$20 million (\$2021) reduction in our operating expenditure forecast.</p> <p>We have updated some of our step changes and trend components.</p> <p>Refer to 'Attachment 05-01 Operating Expenditure' for a detailed discussion on why the draft decision on operating expenditure is not capable of acceptance.</p>

Draft decision item	AER position	JEN response
Revenue Adjustments	<p>The AER's draft decision retained the four revenue adjustments which JEN included in its initial proposal.</p> <p>Other than the efficiency benefit sharing scheme (EBSS), the AER applied JEN's methodology to calculate these values.</p> <p>Key aspects of the draft decision include:</p> <ul style="list-style-type: none"> • EBSS – the AER updated the forecast to include CY19 actual operating expenditure, removed some exclusions relating to 2014 and 2015, updated CPI inputs and deferred half year EBSS amounts to FY22 • Capital Expenditure Sharing Scheme (CESS) – the AER updated the forecast to reflect changes made to the roll forward of the asset base • Shared asset revenue – the AER retained the initial proposal forecast, and • Demand management incentive allowance mechanism (DMIAM) – the AER applied this adjustment based on changes to the draft decision ARR. 	<p>JEN accepts this aspect of the draft decision.</p> <p>Our response includes updated EBSS and CESS models given some inputs to these models have been updated.</p> <p>We have also updated the shared revenue and demand management incentive revenue adjustments to include changes to the revised proposal ARR.</p> <p>Refer to 'Attachment 06-01 Incentive Schemes' for more discussion on the application of the incentive schemes.</p>

Unless stated otherwise, all dollars are expressed on real 2021 basis in this document.

Supporting materials

Additional information supporting JEN's position in this document are outlined in Table OV-3.

Table OV-3: Additional documents supporting this revised proposal

Document reference	Document details
Attachment 03-01	This document
Attachment 03-01M	JEN – 03-01M SCS PTRM FY22-26 – 20201203 – Public
Attachment 03-06M	JEN – 03-06M Rate of Return Model – 20201203 – Public
Attachment 03-02M	JEN – 03-02M SCS RFM CY16-HY21 – 20201203 – Public
Attachment 03-03M	JEN – 03-03M SCS Depreciation Model CY16-HY21 – 20201203 – Public
Attachment 04-01	Response to the AER's draft decision - Capital expenditure

Document reference	Document details
Attachment 04-01M	JEN – 04-01M Capex Model – 20201203 – Public
Attachment 05-01	Response to the AER's draft decision - Operating expenditure
Attachment 05-01M	JEN – 05-01M SCS Opex Model FY22-26 – 20201203 – Public
Attachment 06-01	Response to the AER's draft decision - Incentive schemes
Attachment 06-01M	JEN – 06-01M EBSS Model – 20201203 – Public
Attachment 06-02M	JEN – 06-02M CESS Model – 20201203 – Public

1. Revised proposal revenue forecast

Our revised proposal smoothed revenue for JEN is \$1,305 million (\$nominal), which is 5.5% lower than the revenue we proposed in our initial proposal.

Table 1–1: Summary of the revenue forecasts [5 year totals] - (\$Nominal, \$M)

Revenue	Initial proposal	Draft decision	Revised proposal
Smoothed revenue	1,381.2	1,273.3	1,305.0

Our revised proposal revenue forecast reflects updates that we have made to our building block cost drivers such as:

- revising our capital expenditure forecast to address concerns raised by the AER in its draft decision
- revising our operating expenditure forecast to better reflect the efficient costs of operating our network while continuing to factor in efficiencies that will benefit our customers, including the assumed productivity factor and expected savings from our transformation program, and
- updating forecast labour escalation based on the average of the most recent BIS forecast and the DAE forecast used by the AER in the draft decision
- updating the placeholder return on debt to incorporate the most recent set of market observables.

1.1 Annual revenue requirement forecast

Table 1–2 presents our revised proposal revenue forecast, split by building block element, in nominal terms.

Table 1–2: Annual revenue requirement forecasts - (\$Nominal, \$M)

Building block element	FY22	FY23	FY24	FY25	FY26	Total
Return on capital	70.5	72.2	73.5	73.4	72.5	362.2
Regulatory depreciation	47.0	52.4	55.1	59.1	63.1	276.8
Operating expenditure	104.8	109.3	114.6	119.1	124.1	571.9
Revenue adjustments	18.2	14.9	13.5	10.6	10.8	67.9
Corporate income tax	5.3	5.4	4.4	6.4	6.3	27.7
Building block (unsmoothed) revenue requirement	245.8	254.3	261.1	268.5	276.9	1,306.5

1.2 Smoothed revenue and price path

The AER's draft decision includes a price path designed to provide significant price reductions for customers in the first year, followed by modest price reductions in the remaining four years of the next regulatory period. This was achieved by:

- setting equal X-factors for years 2 to 5 just above forecast inflation at 2.45%, and

- solving the remaining NPV difference between unsmoothed and smoothed revenue via the year 1 X-factor which resulted in a P0 value of 10.58% – i.e. a real revenue reduction – based on CY20 allowed revenue adjusted for inflation.

Table 1–3: AER draft decision smoothed revenue and real price changes - (\$Nominal, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Building block (unsmoothed) revenue requirement	247.0	252.1	255.2	259.0	261.7	1,274.9
X-factors	10.58%	2.45%	2.45%	2.45%	2.45%	N/A
Total smoothed revenue	255.3	255.0	254.7	254.3	254.0	1,273.3

Our revised proposal strives to incorporate these price path considerations in keeping with the NER requirements, however, also in response to the preferences expressed by our customers.²

- First, we have lowered the X-factors applied evenly between the second and last regulatory years of the next regulatory period to satisfy the requirement to minimise the difference between unsmoothed and smoothed revenue in the final regulatory year of the next regulatory period³ (targeting <+/-3%).
- Second, we updated the P0 to account for the rest of the changes in our revised ARR. This approach ensures customers will receive the benefits embedded within our revised proposal early while providing stable prices over the next regulatory period.

Table 1–4: Revised proposal smoothed revenue and real price changes - (\$Nominal, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Building block (unsmoothed) revenue requirement	245.8	254.3	261.1	268.5	276.9	1,306.5
X-factors	11.22%	0.90%	0.90%	0.90%	0.90%	N/A
Total smoothed revenue	253.5	257.2	260.9	264.7	268.6	1,305.0

² JEN, 2021-26 Electricity Distribution Price Review, Regulatory Proposal, Attachment 02-04, Reconvening the Jemena People's panel, Section 3.1.

³ NER, s. 6.5.9(b)(2).

2. Regulatory asset base forecast

The asset base represents the unrecovered capital expenditure that we have – or forecast to have – incurred to provide standard control services to our customers.

In our initial proposal, we estimated that the value of our asset base at the start of the next regulatory period would be \$1.55 billion (\$nominal) and that it will increase by approximately 25.9%, to \$1.95 billion (\$nominal) by the end of the next regulatory period. In our revised proposal we estimate the value of JEN’s asset base at the start of the next regulatory period would be \$1.5 billion (\$nominal) and that it will increase by approximately 26.4%, to \$1.9 billion (\$nominal) by the end of the next regulatory period.

2.1 AER’s position from the draft decision

The AER’s draft decision did not approve JEN’s proposed roll forward of the asset base. Instead, the AER estimated the closing value of our asset base (as at 30 June 2026) as \$1.90 billion (\$nominal). The reason for the differences is a change to our proposed inputs. The following changes were made to our roll forward of the asset base up to 30 June 2021:

- amended 2016 lagged actual consumer price index (**CPI**) to reflect June to June series rather than the September to September inflation series, which is consistent with the price control mechanism for the 2016-20 regulatory control period (**current regulatory period**)
- amended the 2016 equity raising costs to reflect the amended 2016 CPI input
- replaced the estimates with actual net capital expenditure for CY19 which was reported in the annual RIN response after the initial proposal was submitted
- replaced the estimate with actual inflation for the six month intervening period, and
- amended forecast inputs for inflation, nominal WACC, equity raising costs and depreciation for the six month intervening period.

The AER also made the following changes to our roll forward of the asset base in the forecast period from 1 July 2021 to 30 June 2026:

- updated the opening RAB, as at 1 July 2021, to capture the changes to the roll forward of asset base listed above
- updated the five-year forecast for net capital expenditure and
- updated forecast depreciation to include the updated closing RFM RAB balance, draft decision asset lives and the updated capital expenditure forecast.

2.2 JEN’s response to the draft decision

Table 2–1 provides an overview of our initial proposal asset base roll-forward, the AER’s draft decision, and our revised proposal forecast.

Table 2–1: Forecast value of JEN’s RAB - (\$Nominal, \$M)

	Initial proposal	Draft decision	Revised proposal
Opening RAB at 1 January 2015	1,115.6	1,115.6	1,115.6
Opening RAB at 1 January 2021	1,510.7	1,483.4	1,483.4

	Initial proposal	Draft decision	Revised proposal
Opening RAB at 1 July 2021	1,551.1	1,524.4	1,524.4
Closing RAB at 30 June 2026	1,952.8	1,903.7	1,926.6

Our response to the AER's draft decision on our asset base is summarised in Table 2–2.

Table 2–2: Description of asset base impacts from the AER's draft decision

Draft decision item	AER position	JEN response
Current Period Roll Forward Model		
Opening balance – 1 January 2015	The AER accepted the opening RAB, which JEN included in the initial proposal.	We accept the AER's draft decision
Actual net capital expenditure – 1 January 2015 to 30 December 2020	The AER accepted the net capital expenditure values included in the initial proposal except: <ul style="list-style-type: none"> the AER replaced our estimate with actual capital expenditure for CY19 which was reported in the annual RIN response after the initial proposal was submitted and the 2016 equity raising costs we adjusted to reflect the amended 2016 CPI input. 	We accept the AER's draft decision
Forecast straight-line depreciation – 1 January 2015 to 30 December 2020	The AER accepted the forecast straight-line depreciation, which JEN included in the initial proposal.	We accept the AER's draft decision
Actual inflation on opening RAB – 1 January 2015 to 30 December 2020	The AER did not accept all of our inflation inputs in the RFM. They made two changes, including: <ul style="list-style-type: none"> amending the 2016 lagged actual CPI to reflect the June to June series rather than the September to September inflation series, which is consistent with the price control mechanism for the current regulatory period and Replacing the estimate with the actual inflation value applicable for the six month intervening period. 	We accept the AER's draft decision
Intervening Period Roll Forward Model		
Forecast net capital expenditure – intervening period	The AER amended forecast equity raising costs after making changes to the intervening period Post Tax Revenue Model (PTRM).	We accept the AER's draft decision

Draft decision item	AER position	JEN response
Forecast straight-line depreciation – intervening period	The AER replaced the initial proposal forecast depreciation values after making several changes to the intervening period PTRM.	We accept the AER's draft decision
WACC and forecast inflation on opening RAB – intervening period	The AER used updated placeholder estimates for the intervening period PTRM. These placeholder estimates will be updated in the final decision.	We accept the AER's draft decision
Forecast Period Roll Forward		
Forecast net capital expenditure – 1 July 2021 to 30 June 2026	The AER updated the capital expenditure forecast to account for the COVID-19 pandemic impacts and alternative estimates for certain projects.	We partially accept the AER's draft decision. Our revised proposal includes an updated capital expenditure forecast, which addresses the concerns raised by the AER with our initial proposal forecast.
Forecast straight-line depreciation – 1 July 2021 to 30 June 2026	The AER updated forecast depreciation to capture the new closing RFM balance, draft decision asset lives and the updated capital expenditure forecast	We partially accept the AER's draft decision. Our revised proposal is updated to include our revised capital expenditure forecast.
Forecast inflation – 1 July 2021 to 30 June 2026	The AER's draft decision includes an estimate of expected inflation of 2.37%. The AER recognised in the draft decision that it is currently reviewing the regulatory treatment of inflation within the regulatory framework, including the method likely to result in the best estimates of expected inflation.	JEN accepts the AER's draft decision on Regulatory Inflation Review. JEN considers the change in the method should be applied without any transition given the significant deterioration in risk free rate from the RBA's intervention to lower Commonwealth Government Securities (CGS) yields that could potentially result in financeability issues. See Section 3.4.3 for more details.
Forecast WACC – 1 July 2021 to 30 June 2026	The AER applied the modified 2018 Rate of Return Instrument (RORI) to calculate a forecast placeholder WACC for RY22.	We accept the AER's draft decision, however, note that the RORI is resulting in an unrealistic low rate of return in the historically low interest rate environment. Our revised proposal updates the WACC forecast with an alternative placeholder containing more recent market observables. However, we anticipate the AER to update this value in their final decision using our actual averaging periods.

2.3 Revised proposal asset base forecast

We have updated our asset base forecast in our revised proposal.

2.3.1 Closing asset base as at 30 June 2021

We have developed a revised estimate of our closing asset base as at 30 June 2021, which has been updated to account for the new actual nominal vanilla WACC applicable to the intervening period.

Table 2–3 sets out the roll forward of the asset base over the current regulatory period and the intervening period.

Table 2–3: Roll forward of the asset base in the current and intervening periods - (\$Nominal, \$M)

	CY16	CY17	CY18	CY19	CY20	HY21
Opening balance	1,186.8	1,238.2	1,312.5	1,386.1	1,428.4	1,483.4
Add indexation of RAB	17.9	12.7	25.4	28.8	22.8	18.1
Add net capital expenditure	115.9	134.7	128.4	100.2	126.1	61.6
Less straight-line depreciation	(82.4)	(73.0)	(80.2)	(86.7)	(93.7)	(38.8)
Adjustments	-	-	-	-	(0.2)	(0.0)
Closing balance	1,238.2	1,312.5	1,386.1	1,428.4	1,483.4	1,524.4

2.3.2 Forecast asset base for the next regulatory period

We have developed a revised forecast of our asset base over the next regulatory period, set out in Table 2–4, which incorporates our revised capital expenditure and depreciation forecasts.

Table 2–4: Roll forward of the asset base over the next regulatory period - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26
Opening balance	1,524.4	1,592.3	1,655.2	1,691.0	1,714.2
Add net capital expenditure	149.2	149.9	125.5	116.2	94.9
Less straight-line depreciation	(81.3)	(86.9)	(89.8)	(93.0)	(95.9)
Closing balance	1,592.3	1,655.2	1,691.0	1,714.2	1,713.3

3. Rate of return forecast

3.1 Rate of return overview

The AER published its new RORI in December 2018. This instrument is binding on the AER in making a distribution determination.

In our initial proposal, we used a placeholder rate of return (specified as a nominal vanilla WACC) of 4.80% for the next regulatory period. This rate was calculated using the methods and assumptions set out in the AER's 2018 RORI. In its draft decision, the AER accepted our proposed method for calculating the WACC, however, replaced our placeholder inputs using updated market data. Subsequently, we have updated the rate of return parameters using the latest market data for this revised proposal to determine a nominal vanilla WACC of 4.63%.

Table 3–1 sets out the placeholder rate of return in our initial proposal, the AER's draft decision, and our revised proposal.

Table 3–1: Comparison of JEN's placeholder rate of return - (Percent)

	Initial proposal	Draft decision	Revised proposal
Nominal vanilla WACC in year 1	4.80%	4.67%	4.63%

3.2 Return on debt and equity

3.2.1 AER's position from the draft decision

The AER's draft decision included a return on debt placeholder of 4.74%, which is 0.13% lower than the placeholder in our initial proposal.

The AER's draft decision return on equity placeholder of 4.56% is 0.14% lower than that in our initial proposal.

Table 3–2: Comparison of JEN's return on debt and equity parameters - (Percent)

Parameters	Initial proposal	Draft decision	Revised proposal
Return on debt in year 1	4.87%	4.74%	4.67%
Risk free rate	1.04%	0.90%	0.90%
Equity beta	60.00%	60.00%	60.00%
MRP	6.10%	6.10%	6.10%
Return on equity	4.70%	4.56%	4.56%

In its draft decision, the AER accepted our proposed debt averaging periods. The difference in placeholder return on debt is driven by changes in market conditions that have arisen since we submitted our initial proposal.

The difference in the placeholder return on equity is driven by a reduction in the risk free rate since we submitted our initial proposal on 31 January 2020. In its draft decision, the AER accepted JEN's proposed equity averaging period. The AER will replace the placeholder risk free rate with an updated risk-free rate value calculated using the method outlined in clause 4 of the RORI and the averaging period which it has accepted when it makes its final decision.

3.2.2 JEN's response to the draft decision

Our response to the AER's draft decision regarding the return on debt and return on equity is summarised in Table 3–3.

Table 3–3: JEN's response to AER draft decision regarding return on debt and return on equity

Draft decision item	AER position	JEN response
Return on debt	The AER accepted our approach, however, updated the placeholder annual debt observations in the forecast period to reflect the latest market information.	We accept the AER's draft decision. In our revised proposal we updated the placeholder annual debt observations in the forecast period using the latest available actual debt observation for JEN, noting that the AER will update it annually with our nominated averaging periods during the next regulatory period.
Return on equity	The AER accepted our approach, however, updated a placeholder input to reflect movements in the risk free rate since we submitted our initial proposal. The AER reduced the risk free rate from 1.04% to 0.90% in the draft decision.	We accept the AER's draft decision, noting that the AER will update this value in the final decision with our nominated averaging period.

3.3 Revised proposal rate of return

We estimate a placeholder return on debt of 4.67% and a placeholder return on equity of 4.56%. These have been determined by applying the modified 2018 RORI.⁴

Table 3–4 sets out the parameter of JEN's revised proposal placeholder rate of return.

The return on debt, return on equity, and nominal vanilla WACC estimates will be updated to reflect the actual averaging periods set out in Attachment 07-03 of JEN's initial proposal (submitted to the AER in January 2020), consistent with the AER's RORI.

Table 3–4: Revised proposal placeholder rate of return for FY22 - (Percent)

Parameters	Value (%)
Return on equity	4.56%
Return on debt	4.67%
Inflation	2.37%
Leverage	60.0%
Gamma	58.5%
Corporate tax rate	30.0%
Nominal vanilla WACC / Rate of return	4.63%

⁴ AER, Modified rate of return instrument for Victorian electricity networks during the extension period of 1 January 2021 and 30 June 2021, Oct 2020

3.4 Inflation

3.4.1 AER's position from the draft decision

The AER's draft decision includes an estimate of expected inflation of 2.37% used as a placeholder value.

3.4.2 JEN's response to the draft decision

Our response to the AER's draft decision on inflations is provided in Table 3–5.

Table 3–5: JEN's response to AER draft decision on inflation

Draft decision item	AER position	JEN response
Inflation	<p>The AER's draft decision includes an estimate of expected inflation of 2.37%. The AER recognised in the draft decision that it is currently reviewing the regulatory treatment of inflation within the regulatory framework, including the method likely to result in the best estimates of expected inflation.</p> <p>The AER's October 2020 draft decision on the regulatory treatment of inflation proposed to introduce both a five year horizon and a glide-path from the RBA's year two inflation forecast to 2.5% in year five to provide the best estimate of expected inflation. The AER's final decision of this review is expected in December 2020.</p> <p>The AER expects to apply amendments to the PTRM (if any) within the final determination for JEN in April 2021.</p>	<p>For our revised proposal we have adopted the same placeholder value as the AER. This value will be updated by the AER based on latest RBA Monetary Policy Statement (MPS) available at the time of AER's final decision.</p> <p>On 6 November 2020 Jemena submitted a response to the AER's 'Draft Position Paper on Regulatory Treatment of Inflation' along with an expert report.⁵ In this revised proposal, we agree with the AER that the 5 year glide path is an improvement to the current forecast method. We also advocate that there is no rational basis for delaying the implementation of this change to the PTRM inflation forecast. We also agree with the AER that there is no urgency for a framework change if the method change is adopted without any transition.</p>

3.4.3 Revised proposal inflation forecast

We agree with the AER that the 5 year glide path is an improvement to the current forecast method and makes the PTRM and RFM internally consistent and capable of delivering an NPV=0 outcome. The immediate implementation of this change in method addresses the issue with the framework and removes the need to pursue any framework change.

We engaged CEG as our expert to review the AER's draft position paper and Dr Lally's advice to the AER. CEG has provided an expert report, the key findings of which are:⁶

1. The AER's proposed adoption of a 5 year inflation forecast (with a glide path) in the PTRM is logical and consistent with what is required to generate NPV=0 outcomes. This conclusion is entirely in agreement with the advice the AER sought from Dr Lally.

⁵ Jemena, *Response to AER's Draft Position Paper on Regulatory Treatment of Inflation*, 6 November 2020.

⁶ CEG, *Response to AER draft position paper on inflation*, November 2020.

2. There is no rational basis for delaying the implementation of this change to the PTRM inflation forecast because –
 - a. The National Electricity Rules require that the best method is implemented, and this must be a 5 year forecast (for the reason provided in point 1 above). In addition, the AER’s own reasoning establishes that a glide path is the best estimate.
 - b. Implementing a delay would impose an expected windfall loss on Victorian DNSPs (compensation lower than costs) equal to 0.35% pa based on the AER’s own estimates.
 - c. The AER’s position paper already imposes a significant embedded delay because the AER forecasts cover the next regulatory period. However, the RFM covering the next regulatory period will use inflation from 1 January 2020 to 31 December 2024. Due to very low (actual and forecast) inflation in the 18 months from 1 January 2020 to 30 June 2021, Victorian DNSPs already face 0.40% per annum under-compensation on their funding costs over 5 years – even with the immediate introduction of the AER 5 year estimate.
 - d. The Victorian DNSPs’ forthcoming AER decisions occur at a time of very low risk free rates causing very low return on equity estimates (and these are potentially artificially lower due to RBA intervention in the long maturity end of the yield curve). This creates material financeability concerns even before consideration of the 40bp under-compensation explained in the previous point. Imposing a further 0.35% pa would only place pressure on already strained financeability metrics.

On 3 November 2020, RBA Governor Philip Lowe announced that a package to support the Australian economy as it recovers from the COVID-19 pandemic:⁷

Today’s package has three elements. These are:

- *first, a reduction in the cash rate target, the three-year yield target and the interest rate on new drawings under the Term Funding Facility to 10 basis points, from the current 25 basis points.*
- *second, a reduction in the interest rate on Exchange Settlement balances to zero from the current 10 basis points.*
- *and third, the introduction of a program of government bond purchases. **In particular, we are intending to buy \$100 billion of government bonds over the next six months**, purchasing bonds issued by the Australian Government as well as by the states and territories.*

Together, these three elements represent a significant package. The lower interest rates and our plan to buy \$100 billion of government bonds over the next six months will help people get jobs and support the recovery of the Australian economy.

*The package combines the price-based target at the shorter part of the yield curve that has been in place since March with a quantity target at the longer part of the yield curve. **In doing so, it will lower the whole structure of interest rates in Australia.** This lower structure of interest rates will work to support the economy through the normal transmission mechanisms, including lower borrowing costs, a lower exchange rate than otherwise and higher asset prices.*

(emphasis added)

This intervention by the RBA artificially lowers the interest rates over the next 6 months commencing November 2020 and creates a significant risk for JEN because it is likely to deliver a lower risk free rate and return on equity compared to the actual cost to investors over the next 5 years.

Given the 2018 RORI is binding on the AER and it cannot change the method for measuring risk free rate, we recommend that the AER considers applying its glide path inflation forecast method without any transition and using December 2019 to December 2024 inflation series in PTRM forecast inflation to mitigate any financeability

⁷ Philip Lowe, *Today’s Monetary Policy Decision*, 3 November 2020.

issues created from RBA's intervention in the bond market. The use of this series will exactly match the inflation used to index the RAB in the RFM.

CEG discussed this risk and noted that:⁸

By immediately implementing the use of a 5 year glide path the AER substantially reduces, but does not necessarily eliminate, the stress that low risk free rates place on equity cash-flows.....However, there is still a material risk that changes in risk free rates and/or RBA forecast between now and JEN's final decision could undo some, or all, of the cashflow benefits from this measure. This is especially the case in the context of the RBA's long term bond purchase operations – which have the potential to materially distort long term bond rates relative to their values without such RBA intervention.

CEG provided some practical measures that the AER could consider in Victorian final decisions to address financeability issues if the risk free rate continues to decline over the next six months due to RBA's intervention in the bond market, given the measurement of risk free rate is binding on the AER as a result of binding 2018 RORI.

These measures include:⁹

- *Instead of forecasting inflation from June 2021 to June 2026, forecast 5 years of inflation based on:*
 - *December 2020 to December 2025; or*
 - *December 2019 to December 2024.*

Given current low inflation, both of these approaches would almost certainly lower PTRM inflation. Both of these approaches will better match the actual inflation used in the RFM (which is a December-December series). The second approach will perfectly match the inflation to be used in the RFM.

- *Lower the 5th year target inflation from 2.5% to a lower level that can be determined using, for example, inflation swaps or some other approach the AER considers helps it in making a financeable decision; and*
- *Lower asset lives for some categories of investment to increase depreciation allowance.*

These measures provide some flexibility to the AER in ensuring the final decision is financeable even in light of declining CGS yields, where the CGS yields might not provide an accurate estimate of the actual risk free rate over next 5 years because of the RBA's current 6 month quantitative easing program.

⁸ CEG, *Response to AER draft position paper on inflation – A report for Jemena*, November 2020, paras. 78–79,

⁹ CEG, *Response to AER draft position paper on inflation – A report for Jemena*, November 2020, para. 80,

4. Regulatory depreciation forecast

Depreciation represents the decline in the unrecovered value of an asset over time or—more aptly—the value that is being recovered over time. Including forecast regulatory depreciation in our revenue requirement enables us to recover the investment in our network over time in accordance with the economic lives of our assets. This enables us to finance the purchase of new replacement assets so that we can continue to provide our distribution services in the future.

4.1 AER's position from the draft decision

In its draft decision, the AER has not accepted our forecast regulatory depreciation and has instead determined an amount of \$274 million (\$nominal) over the next regulatory period, which is 1.75% less than our initial proposal.

Table 4–1: Comparison of regulatory depreciation forecasts - (\$2021, \$M)

	Initial proposal	Draft decision	Revised proposal
Straight line depreciation	451.9	443.4	446.9
Less indexation	(192.5)	(188.5)	(189.6)
Forecast regulatory depreciation	259.4	254.9	257.2

In its draft decision, the AER has:

- accepted JEN's proposed asset classes
- accepted the application of the straight-line depreciation method
- accepted the proposed standard asset lives with the exception of the 'Non network - other' and 'Equity raising costs' asset classes
- accepted the continuation of JEN's year-by-year tracking approach to calculate straight-line depreciation of existing assets
- identified and corrected a few minor items in JEN's depreciation model, and
- amended other components of JEN's proposal, which affected the forecast regulatory depreciation.

4.2 JEN's response to the draft decision

Our response to elements of the AER's draft decision regarding regulatory depreciation is summarised in Table 4–2.

Table 4–2: JEN's response to AER draft decision on regulatory depreciation

Draft decision item	AER position	JEN response
Asset classes	The AER accepted JEN's proposed asset classes which were consistent with the asset classes used in the current regulatory period and the adjustments required to implement	We accept the AER's draft decision

Draft decision item	AER position	JEN response
	the outcomes of the AER's recent tax review.	
Depreciation method	The AER accepted our proposal to use real straight-line depreciation less annual inflation indexation of the projected asset base to forecast our regulatory depreciation allowance over the next regulatory period.	We accept the AER's draft decision
Regulatory asset lives	The AER accepted the proposed standard asset lives except for the 'Non network - other' and 'Equity raising costs' asset classes.	<p>We accept the changes in the AER's draft decision.</p> <p>JEN's revised proposal will adopt a standard life of 10.5 years for 'Non network - Other' rather than the 5.0 years initially proposed.</p> <p>JEN's revised proposal will adopt the AER's methodology to calculate the standard life of 'Equity Raising Costs' within the PTRM. This will be based on the weighted average of the standard asset lives and total forecast capital expenditure for each asset class over the next regulatory period. This means our revised standard life for 'Equity Raising Costs' will be similar to, however, not equal to, the 42.1 years applied in the draft decision.</p>
Year-on-year tracking	The AER accepted our proposal to continue using the year-on-year tracking approach for calculating real straight line depreciation on existing assets.	We accept the AER's draft decision.
Modelling adjustments	The AER identified and corrected a few minor items in JEN's depreciation model including updates to latest CPI and WACC estimates and a few minor formula changes which were addressed during the information request process.	We accept the AER's draft decision.
Regulatory depreciation for the next regulatory period	<p>The AER reduced our forecast regulatory depreciation to account for:</p> <ul style="list-style-type: none"> • a lower opening RAB as at 1 July 2021 which was derived from the updated RFM, and 	<p>We partially accept the AER's draft decision.</p> <p>We have developed an updated forecast of regulatory depreciation which is greater than the AER's draft decision. This mainly reflects our</p>

Draft decision item	AER position	JEN response
	<ul style="list-style-type: none"> a reduction in the capital expenditure forecast for the next regulatory period. 	revised proposal capital expenditure forecast.

4.3 Revised proposal regulatory depreciation forecast

Table 4–3 summaries our revised forecast of regulatory depreciation over the next regulatory period. Attachment 03-01M provides the underlying calculations.

Table 4–3: Forecast regulatory depreciation for the next regulatory period - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Straight line depreciation	81.3	86.9	89.8	93.0	95.9	446.9
Less indexation	(35.4)	(36.9)	(38.4)	(39.2)	(39.8)	(189.6)
Regulatory depreciation	45.9	50.0	51.4	53.8	56.1	257.2

5. Operating expenditure

We are concerned by the AER's decision to reject our operating expenditure proposal for the next regulatory period. The AER's draft decision alternative operating expenditure forecast for JEN is \$500 million (\$2021, including debt raising costs), which is 10.6% lower than the operating expenditure we proposed in our initial proposal as updated for our responses to AER information requests.

Attachment 05-01 provides a detailed response to the AER's draft decision where we outline why the AER should reconsider its draft decision on base year operating expenditure, trend, step changes, and specific forecasts. The following two sections provide a summary of Attachment 05-01.

5.1 AER's position from the draft decision and JEN's response

A summary of the key decision items outlined in the AER's draft decision and our response to each of these is outlined in Table OV-2.

Table 5-1: JEN's response to AER draft decision on operating expenditure

Draft decision item	AER position	JEN response
Base year		
Selection of a base year	AER accepted our proposal to use 2018 as an appropriate base year.	Accept
Efficiency adjustment to the base year amount	AER applied a 15% adjustment to JEN's estimated final year operating expenditure informed by its benchmark modelling of estimated efficient operating expenditure.	<p>Reject – Our analysis shows that no efficiency adjustment is required on our revised proposal operating expenditure, which includes a negative step change of \$4 million per annum that was not included in our initial proposal, to pass on expected savings from our CY19 transformation program.</p> <p>We have significant concerns with the economic benchmarking analysis that the AER used to justify its 15% adjustment. Both our and CEPA's¹⁰ analysis shows that once the impact of capitalisation practices across businesses and reliability of model results are considered, JEN's efficiency score materially improves and its base year proposal can be used for setting its operating expenditure allowance for the next regulatory period.</p> <p>We are also concerned that the top-down benchmarking analysis has been deterministically applied in the draft decision despite its imprecision. Recent errors with the Multilateral Total Factor Productivity (MTFP), for instance, are an important reminder that such modelling is prone to error, assumption, and methodology choices that mean the modelled outcomes are subjective. Although tempting to assume modelled outputs accurately reflect the level of relative efficiency, operating and financial accounting practices vary across DNSPs. Accordingly raw benchmarking outcomes cannot be relied upon to provide a full indication of efficiency</p>

¹⁰ CEPA's report is provided in Attachment 05-05.

Draft decision item	AER position	JEN response
		<p>level. Due consideration needs to be given to the impacts of differences in capitalisation practices across businesses when interpreting and relying on the model results.</p> <p>We recommend that the AER at the very least apply an operating environment factor (OEF) for JEN to take into account the impact of capitalisation differences on JEN's efficiency score and not apply translog model results to JEN due to statistical and other issues. This will demonstrate that our revised proposal provides a prudent and efficient basis to set operating expenditure allowance for the next regulatory period.</p>
Efficiency adjustment to newly expensed corporate overheads	The AER applied a 15% adjustment to JEN's newly expensed corporate overheads	<p>Reject – The base year operating expenditure efficiency adjustment should not be applied to the newly expensed corporate overheads. This is because these costs represent a movement from capital expenditure to operating expenditure, and are not costs that were in the reported base year operating expenditure used for the AER's efficiency assessment.</p>
Final year increment	The AER accepted a final year increment that is \$0.6 million (\$2021) (or \$2.9 million (\$2021) over the next regulatory period) lower than JEN proposed due to an updated inflation estimate and by adopting an average of capitalised corporate overheads from 2016 to 2018.	<p>Accept</p>
Trending of base year		
Input cost trend	<p>The AER used labour price growth based on a forecast it obtained from DAE rather than its standard approach of averaging two forecasts (BIS and DAE). It cited that only the DAE forecast factors in the impacts of the COVID-19 pandemic, and that its final decision will revisit this based on the information available then. The AER has accounted for the legislated superannuation guarantee increases in the DAE forecast.</p> <p>The AER also reduced the cost input weight applied to labour.</p>	<p>Partially accept – JEN's revised operating expenditure forecast reflects the AER's past practice of relying on more than one expert forecaster where available. JEN has provided updated forecasts from BIS that account for the impacts of COVID-19 and the increase in superannuation guarantee which we have then averaged with the AER's DAE forecast.</p> <p>JEN retains the AER's draft decision labour weight in the revised proposal but recommends the AER rely on a more recent industry average labour weight by using the 2015–19 average instead of the 2014–16 average used in the draft decision.</p>
Output growth trend	The AER relied on output weights from the multilateral total factor productivity (MTFP) and the four econometric models using 2018 data. The output weights for Translog models are based on the Australian sample mean instead	<p>Accept – Although JEN has concerns with using MTFP and translog models due to their statistical issues, JEN's revised operating expenditure forecast retains the AER's standard approach of averaging across all five models. JEN recommends that the AER</p>

Draft decision item	AER position	JEN response
	<p>of its past practice of international sample mean.</p> <p>The AER stated that it will update the output weights according to the 2020 benchmarking report in its final decision.</p> <p>The AER also updated JEN's forecast on –</p> <ul style="list-style-type: none"> • customer numbers to reflect project dwelling growth in light of the COVID-19 pandemic • ratcheted maximum demand based on AEMO's 2019 forecast • energy throughput to reflect the historical average growth rate for 2006–18 	<p>review the reliability and reasonableness of the output weights from MTFP and translog models before applying them to the operating expenditure forecast in its final decision.</p> <p>JEN accepts the AER's output growth rates on customer numbers, circuit length and ratcheted maximum demand.</p> <p>However, we have:</p> <ul style="list-style-type: none"> • incorporated updated customer numbers from our restated Economic Benchmarking RIN response and retains the growth rate from the AER's draft decision • updated the energy throughput forecasts that reflect the most recent 5-year average growth rate from the 2015–19 period.
Productivity	<p>The AER applied an 0.37% productivity rate in 2021-22 to reflect 9 months of escalation then 0.5% productivity rate per year for each subsequent year of the next regulatory period. This is consistent with its standard approach and its operating expenditure forecast for the intervening period.</p>	Accept
Specific forecasts		
Guaranteed service level (GSL) payments	<p>The AER adopted a slightly higher forecast than JEN initially proposed because it adopted the historical average of JEN's annual payments from 2015 to 2019. This differs to JEN's proposal which relied on actual payments in the 2018 base year.</p> <p>It noted that the final decision may require updating for the outcome of a current review of the Victorian GSL scheme.</p>	Accept – JEN has reviewed the final decision changes to the Victorian Electricity Distribution Code, and our analysis shows that although the payment and volume of payments are both expected to increase, the overall increase in GSL payments is likely to be immaterial.
Electricity Levy for Energy Safe Victoria (ESV)	<p>The AER acknowledges that this levy has increased and is not within our ability to control. Yet it did not provide any additional funding for this nor did it agree to the alternative of using the existing B term in the price control mechanism for standard control services.</p>	Reject – These are actual and unavoidable cost increases over which JEN has no control. They are efficiently incurred in line with JEN's licence obligations and it is incorrect to overlay an "exceptional circumstances" ¹¹ test to efficient cost recovery during a price review. <p>These must be funded either as a specific forecast or an annual pricing adjustment. JEN proposes to include this ESV levy in the specific forecast.</p>
Step changes		
Bushfire Insurance Premium	Accepted \$28.2 million as proposed (with updates for the AER's inflation forecast)	Accept
REFCL testing & maintenance	Accepted \$1.3 million as proposed (with an expectation that JEN will update its revised forecast for inflation and the outcome of our	Partially accept – JEN has retained the step change accepted by the AER, however,

¹¹ AER, Attachment 6: Operating expenditure | Draft decision – Jemena 2021–26, Pg. 6-75

Draft decision item	AER position	JEN response
	requested ESV exemption on testing and maintenance obligations)	updated it to reflect more recent cost estimates and inflation forecast.
Cyber-security	Accepted \$2.9 million as proposed	Accept
Future Grid program	Rejected this \$3.8 million step change	Accept
Transitional return on debt alignment costs	Accepted JEN's withdrawal of this \$0.9 million step change	Accept
Environmental Protection Agency (EPA) regulation changes	Rejected this \$4.2 million step change	Accept
Additional RIN reporting	Rejected this \$0.5 million step change	Accept
Other operating expenditure items		
Debt raising costs	The AER applied its standard calculation approach and assumptions to determine allowed debt raising costs.	Accept

5.2 Revised proposal operating expenditure forecast

Our revised forecast operating expenditure (excluding debt raising costs) for the next regulatory period is \$528 million (\$2021), which is \$32 million (\$2021) higher than the AER's draft decision, and \$27 million (\$2021) lower than our updated proposal.

Our revised proposal operating expenditure forecast reflects:

- the AER's draft decision to accept our use of 2018 as the base year, however, we have not applied the AER's efficiency adjustment. Instead, we have included a \$4 million (\$2021) negative step change for projected efficiency gains from our transformation program
- our proposed methodology for forecasting input cost growth, which is the AER's standard practice of averaging two available forecasts with both accounting for the impacts of the COVID-19 pandemic and the increase in the superannuation guarantee
- our revised energy throughput forecast which is used to forecast output growth and updated customer number forecast (retaining the same growth rate as used in the draft decision)
- updated specific forecast for increased ESV levies, which the draft decision acknowledge were an unavoidable cost increase
- the AER's draft decision on forecast debt raising costs
- the AER's draft decision on step changes with an updated forecast for the REFCL testing & maintenance step change to reflect the current status of our exemptions and compliance requirements.

Table 5–2: Operating expenditure (including debt raising costs) for the next regulatory period – (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Initial proposal	110.5	112.8	115.7	117.7	119.8	576.6

Updated proposal	107.2	109.4	112.3	114.2	116.3	559.3
Draft decision	102.9	101.4	100.3	98.4	96.8	499.8
Revised proposal	102.4	104.3	106.8	108.5	110.3	532.3
Difference to draft decision	-0.5	2.9	6.5	10.1	13.5	32.5

6. Corporate income tax forecast

The regulatory framework (NER clause 6.5.3) enables DNSPs to recover the efficient tax costs from customers to ensure that sufficient funds are available to meet tax obligations, net of the AER's assumed value of imputation credits to shareholders of those companies.

6.1 AER's position from the draft decision

In its draft decision, the AER accepted our proposed method for calculating the corporate income tax allowance, including our proposed tax depreciation method and depreciation rates.

The AER has adjusted several inputs to the corporate income tax calculation to reflect its draft decision on other building block components. As a consequence, the AER's adjusted estimate of the net tax allowance is \$26 million (\$2021), which is approximately 9.2% below what we proposed in our initial proposal.

Table 6–1: Comparison of corporate income tax forecasts - (\$2021, \$M)

	Initial proposal	Draft decision	Revised proposal
Corporate income tax	28.5	25.9	25.8

6.2 JEN's response to the draft decision

Our response to elements of the AER's draft decision regarding corporate income tax are summarised in Table 6-2.

Table 6–2: JEN's response to AER draft decision on corporate income tax

Draft decision item	AER position	JEN response
TAB	The AER accepted JEN's proposed method to establish the opening TAB. The AER updated the opening TAB as of 1 July 2021 after updating the RFM, replacing the estimated CY19 capital expenditure with the actual values which became available after submission of our initial proposal.	We accept the AER's draft decision.
Tax depreciation methodology	The AER accepted JEN's initial proposal to continue applying the straight-line method of tax depreciation for the opening TAB value. The AER accepted JEN's application of the diminishing value (DV) method for tax depreciation to all future capital expenditure except for a limited number of assets which must be depreciated using the straight-line (SL) tax depreciation method, under the tax law.	We accept the AER's draft decision.
Standard and remaining asset lives	The AER accepted JEN's proposed standard tax asset lives for all asset classes, except for	We accept the AER's draft decision. JEN's revised proposal will adopt a standard life of 4 years for 'Non

Draft decision item	AER position	JEN response
	<p>the 'Non network - IT' and 'Non network - other' asset classes.</p> <p>The AER also accepted JEN's proposed weighted average method to calculate the remaining tax asset lives as of 1 July 2021. This method is a continuation of the approach used in the current regulatory period and applies the approach as set out in our RFM.</p>	<p>network - IT' rather than the 4.4 years initially proposed.</p> <p>JEN's revised proposal adopts a standard life of 10.3 years for 'Non network - Other' rather than the 12 years initially proposed.</p>
Income tax rate and the value of imputation credits	<p>The AER confirmed JEN correctly adopted the statutory income tax rate of 30 per cent in the initial proposal.</p> <p>The AER accepted JEN's application of a gamma value of 0.585 as it is consistent with the modified 2018 RORI.</p>	We accept the AER's draft decision
Corporate income tax	The AER accepted our approach to calculating our forecast corporate income tax, however, reduced opening TAB as of 1 July 2021 and made other adjustments to the building blocks costs, which affect revenues and in turn impact the tax calculation.	<p>We accept the AER's draft decision.</p> <p>Our revised proposal continues to use the AER's amended PTRM (version 4) to calculate the corporate income tax, which implements the changes identified from the final report of the recent tax review¹².</p> <p>We have developed an updated forecast of corporate income tax, which reflects our revised proposal ARR and capital expenditure.</p>
Tax losses	The AER accepted our proposed value of tax losses of zero for the start of the next regulatory period.	We accept the AER's draft decision

6.3 Revised proposal income tax forecast

Our corporate income tax forecast in this revised proposal reflects changes in other components that result in changes in the taxable income, including:

- Changes in ARR from return on capital revenue after amending the capital expenditure forecast and the return on debt inputs, regulatory depreciation, operating expenditure forecast and
- Changes in the capital expenditure forecast that impact the tax depreciation forecast.

The forecast – referred to as the tax building block – is calculated using the PTRM, consistent with the modified 2018 RORI and the AER's recommendations in its recent tax review. A summary of our revised corporate income tax for the next regulatory period is outlined in Table 6–3.

Table 6–3: Corporate income tax for the next regulatory period - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Taxable income	41.3	41.2	32.9	46.5	45.2	207.1
Corporate income tax	12.4	12.4	9.9	13.9	13.6	62.1

¹² AER, Review of regulatory tax approach: Final Report, 17 December 2018

	FY22	FY23	FY24	FY25	FY26	Total
Less value of imputation credits	(7.2)	(7.2)	(5.8)	(8.2)	(7.9)	(36.3)
Corporate income tax	5.1	5.1	4.1	5.8	5.6	25.8

7. Revenue adjustments

Revenue adjustments are made to building block costs to deal with incentive schemes and other adjustments needed to give effect to rule requirements.

In our initial proposal, we proposed to retain the EBSS and CESS which currently apply to JEN. These schemes provide us with a continuous incentive to identify and deliver improvements to operating expenditure and capital expenditure efficiency.

We also proposed to retain other, smaller, incentives which apply to JEN in the current regulatory period.

Our revised incentive forecast for the next regulatory period is \$63.8 million (\$2021), which is approximately \$0.05 million (\$2021) lower than the AER's draft decision, and \$14 million (\$2021) higher than our initial proposal.

Table 7–1 provides a comparison of JEN's proposed incentive scheme revenue with both the AER's draft decision and our initial proposal.

Table 7–1: Summary of the financial outcomes by incentive [5 year totals] - (\$2021, \$M)

	Initial proposal	Draft decision	Revised proposal
EBSS	23.6	25.1	25.1
CESS	25.6	38.3	38.2
Share asset decrement	(1.5)	(1.5)	(1.4)
DMIAM	2.0	2.0	2.0
Total	49.8	63.8	63.8

Our revised proposal incentive forecast reflects:

- updates to the rate of return forecast, and
- other changes mainly arising from updated capital expenditure and operating expenditure forecasts.

This lead to an immaterial change to the incentive forecasts, as shown in Table 7–1.

7.1 EBSS forecast

7.1.1 AER's position from the draft decision

The AER draft decision covered EBSS carryover amounts accrued over the current regulatory period and the six month intervening period.

The AER made several adjustments to our initial proposal including to:

- update the estimate for CY19 operating expenditure with actual CY19 reported operating expenditure
- remove exclusions from operating expenditure in CY14 and CY15 that are not applied to the current regulatory period
- update estimated inflation inputs with more recent estimates to convert amounts into 2021 dollars, and

- defer the half year 2021 EBSS carryover accrued to the beginning of 1 July 2021. The AER's calculation uses the half year 2021 WACC and first year WACC of the next regulatory period to determine the present value equivalent amount, which was added to the revenues for FY22.

7.1.2 JEN's position in the revised proposal

JEN accepts the changes made to the EBSS model in the draft decision and has prepared a revised proposal model to update the WACC forecast with more recent return on debt market observables which became available after the draft decision was released.

Table 7–2: Summary of the revised EBSS forecast - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Initial proposal	8.1	6.5	4.9	2.1	2.1	23.6
Draft decision	10.0	6.5	4.8	1.9	1.9	25.1
Revised proposal	10.0	6.5	4.8	1.9	1.9	25.1

7.2 CESS forecast

7.2.1 AER's position from the draft decision

The AER updated our CESS model to reflect changes made in the RFM and PTRM. Changes include replacing our CY19 estimate of net capital expenditure with actual CY19 net capital expenditure and updating actual and forecast CPI inputs and updated actual and forecast real vanilla WACC inputs. The AER also updated our capital expenditure deferred to the following regulatory control period.

7.2.2 JEN's position in the revised proposal

JEN accepts the changes made by the AER to our CESS model in the draft decision and has prepared a revised proposal to reflect an updated real vanilla WACC forecast with more recent return on debt market observables.

Table 7–3: Summary of the revised CESS forecast - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Initial proposal	5.1	5.1	5.1	5.1	5.1	25.6
Draft decision	7.7	7.7	7.7	7.7	7.7	38.3
Revised proposal	7.6	7.6	7.6	7.6	7.6	38.2

7.3 Shared asset decrements forecast

JEN uses some of its assets—called shared assets—to provide both unregulated services and standard control services. If the shared asset revenue is material (greater than 1% of revenue), then ten per cent of the unregulated revenues is handed back to standard control service customers via a negative revenue adjustment.

7.3.1 AER's position from the draft decision

The AER accepted the need for the revenue adjustment and retained the same values used by JEN in the initial proposal.

7.3.2 JEN's position in the revised proposal

In our revised proposal, we have updated the shared revenue adjustment to include the changes to the revised proposal ARR.

Table 7–4: Summary of the revised forecast for share asset decrements - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Initial proposal	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(1.5)
Draft decision	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(1.5)
Revised proposal	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(1.4)

The reduction in shared asset revenue adjustment is due to the ARR in the revised proposal dropping to \$1,217 million (\$2021) from \$1,286 million (\$2021) in the initial proposal.

7.4 Demand management innovation allowance mechanism forecasts

7.4.1 AER's position from the draft decision

The AER accepted the application of the DMIAM and applied the same methodology used by JEN in the initial proposal.

Changes to the DMIAM revenue adjustment were a result of other draft decision outcomes and the flow on impacts to the ARR.

7.4.2 JEN's position in the revised proposal

JEN accepts the draft decision however we have also updated the DMIAM forecast to include changes to the revised proposal ARR.

This is because the DMIAM is based on a fixed allowance of \$0.2 million (\$2017), plus 0.075 per cent of the ARR for each regulatory year, as set out in the PTRM (Attachment 03-01M).

Table 7–5: Summary of the revised forecast for DMIAM - (\$2021, \$M)

	FY22	FY23	FY24	FY25	FY26	Total
Initial proposal	0.4	0.4	0.4	0.4	0.4	2.0
Draft decision	0.4	0.4	0.4	0.4	0.4	2.0
Revised proposal	0.4	0.4	0.4	0.4	0.4	2.0