RULE CHANGE

Australian Energy Market Commission

CONSULTATION PAPER

National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018

Rule Proponent

Jemena Gas Networks (NSW) Ltd

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

Contents

1 Introduction

On 14 December 2017, Jemena Gas Networks (NSW) Ltd **(JGN)** submitted a rule change request to the Australian Energy Market Commission (Commission) seeking to amend the National Gas Rules (NGR). The rule change request seeks to provide a mechanism to minimise pricing volatility for New South Wales gas customers that may occur due to the delay caused by merits review, judicial review and the finalisation of the AER's remade final decision for JGN's 2015-20 access arrangement period. The rule change proposes to allow the recovery of JGN's revenue to be spread over the 2015-20 and 2020-25 access arrangement periods.

This consultation paper has been prepared to facilitate public consultation on the rule change request and to seek stakeholder comments on JGN’s rule change request or any other aspects of the paper.

Further details on providing a submission can be found in Chapter 6 of this paper.

This paper:

- sets out a summary of, and a background to, the rule change request;
- identifies a number of questions and issues to facilitate the consultation on this rule change request; and
- outlines the process for making submissions.

2 Background

This chapter outlines key information to provide background and context to the rule change request. It provides:

- an overview of economic regulation of gas distribution service providers;
- an overview of the access arrangement[1] relevant to this rule change request;
- a discussion on aspects of an access arrangement that are relevant to the rule change request; and
- an overview of rule change requests on cross period revenue smoothing submitted by electricity distribution network service providers (DNSPs) in 2017.

2.1 Overview of economic regulation of gas distribution service providers

2.1.1 Framework for pipeline regulation

Due to their capital intensive nature, gas pipelines in one geographic area are most efficiently provided by one supplier and this results in a natural monopoly market structure. Under the current regulatory framework, different forms of economic regulation apply to gas pipelines in different circumstances. A tailored level of regulation is applied based on the extent of the market failure the regulation is intended to address, and the relative regulatory burden of each form of regulation.

JGN operates the NSW gas distribution network. The NSW gas distribution network is a covered pipeline that is subject to full regulation. This means that its reference tariffs are regulated through its access arrangement, under the process outlined in section 2.3.

The National Gas Law (NGL) and NGR set out the economic regulatory framework governing gas distribution service providers.[2] The NGL and the NGR set out, among other matters, the roles of regulatory bodies, the process of making access arrangements as well as the process for the review of economic regulatory decisions. Section 2.1.2 provides an overview of institutions involved in economic regulation and review of decisions and section 2.1.3 provides an overview of the process involved in determining total revenue and reference tariffs.

1 An access arrangement covers the reference tariffs and terms and conditions that apply to services provided through gas pipelines. An access arrangement period is typically 5 years.

2 The NGL specifies the National Gas Objective (NGO) and revenue and pricing principles. The NGR govern access to gas pipeline services and have the force of law, under the NGL. Jurisdictional legal instruments also provide aspects of the regulatory frameworks for gas distribution service providers.

2.1.2 Institutions involved in economic regulation and review of decisions

A number of regulatory institutions have roles in the economic regulation of services provided by gas distribution service providers. These are set out in Table 2.1 below.

Table 2.1 Relevant institutions involved in gas regulation and review of decisions

Institution	Role
National Competition Council (NCC)	• Make recommendations to the relevant Minister on pipeline coverage and coverage revocation • Make decisions on light and full regulation
Australian Energy Market Commission (AEMC)	• Makes the NGR • The AEMC's rule making powers in respect of the NGR are exercised under the NGL.
Australian Energy Regulator (AER) / Economic Regulation Authority of WA (ERA)	• Perform economic regulatory, compliance and enforcement functions, including the setting of reference tariffs for gas distribution service providers • Exercise economic regulatory powers and functions in respect of gas distribution service providers under the NGL and the NGR
Australian Competition Tribunal (Tribunal)	• The Tribunal previously reviewed access arrangement decisions made by the AER and ERA in accordance with the merits review framework. Merits review of these decisions ceased to be available from October 2017.[3] • Merits review allowed parties affected by prescribed decisions to have the decisions reviewed by the Tribunal where it could establish that there were grounds for this to occur. • The grounds for merits review were different from judicial review as affected parties had to demonstrate an error of fact, incorrect exercise of discretion, or unreasonableness of a decision by the AER or ERA.[4]
Federal Court of Australia	• Decisions of the AER, ERA and Tribunal are subject to judicial review under the *Administrative Decisions (Judicial Review) Act 1977* (Cth). • The grounds for judicial review relate to the legality of the administrative decision (e.g. an error of law).

3 The commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017* (Cth) in October 2017 significantly altered the availability of merits review by both preventing a decision of the AER being subject to merits review by a body established under a State or Territory law and also by broadly denying consent to the conferral on the Tribunal of merits review under a State/Territory energy law or the *Australian Energy Market Act 2004,* although limited jurisdiction remains in relation to a decision relating to the disclosure of confidential or protected information.

4 Section 246 of the NGL

2.1.3 Process for revision to a gas distribution access arrangement

The AER is responsible for the making of an access arrangement for covered gas pipelines, in all Australian states and territories except Western Australia. An access arrangement period usually covers five years.

Submission and review of an access arrangement revision proposal

The process for revision of an access arrangement begins with the gas distribution service provider submitting an access arrangement revision proposal (proposal) to the AER.[5] The proposal sets out revisions to the access arrangement that the gas distribution service provider proposes for the next access arrangement period.[6] Once the AER has received the proposal, it publishes it on its website and invites stakeholders to provide comments.

Draft and final access arrangement decisions

Once the consultation period on the proposal has ended, the AER will consider the gas distribution service provider's proposal in detail and make a draft decision. The draft decision sets out the AER's assessment of all elements of the proposal, taking into account stakeholder views and other available information. Stakeholders are invited to provide submissions on the AER's draft decision.

In response to the AER's draft decision, the gas distribution service provider may submit a revised proposal. The AER assesses stakeholder's submissions and the revised proposal (if submitted) and makes a final decision. The AER's final decision is a decision to either approve, or to refuse to approve an access arrangement proposal (or a revised proposal if applicable).[7] If the AER in an access arrangement final decision refuses to approve an access arrangement proposal, then the AER must itself propose an access arrangement or revisions to the access arrangement (as the case requires).[8]

Review of AER's access arrangement decisions

An access arrangement decision by the AER was generally a 'reviewable regulatory decision' under the NGL.[9] Parties that were interested or affected by the AER's access arrangement decision could apply to the Australian Competition Tribunal (Tribunal) for a review of the decision under the limited merits review framework in Chapter 8,

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5 Rule 52 of NGR

6 As a general rule, a revision commencement date will fall 5 years after the access arrangement took effect or the last revision commencement date. See rule 50 of NGR.

7 If the AER withholds approval to any element of an access arrangement proposal, the proposal cannot be approved. See rule 41 of NGR

8 Rule 64 in NGR

9 Section 244 of the NGL. The effect of this section has been significantly altered in October 2017 as a result of the commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017* (Cth), as outlined in Table 2.1.

Part 5, Division 2 of the NGL.[10] In general terms, the applicant needed to demonstrate an error of fact, incorrect exercise of discretion, or unreasonableness by the AER in respect of the access arrangement decision.[11] In addition, the applicant needed to demonstrate why the Tribunal varying or setting aside that decision on the basis of one or more of those grounds would, or would be likely to, result in a decision that was materially preferable to the existing decision in terms of making a contribution to the achievement of the NGO.[12]

If the applicant or the AER was not satisfied with the decision of the Tribunal, it could apply to the Federal Court of Australia for judicial review of the Tribunal's decision.

The affected party also has an option to apply to the Federal Court of Australia for a judicial review of the AER's access arrangement decision. This relates to the legality of the administrative decision (e.g. an error of law).

2.2 Access arrangements relevant to this rule change request

2.2.1 Status of access arrangement, reviews and remittal

The final decision on the access arrangement relevant to this rule change was made by the AER in June 2015 and related to JGN's access arrangement for the period from 1 July 2015 to 30 June 2020.

In June 2015, JGN applied to the Tribunal for merits review and the Federal Court for judicial review of the AER's final decision for its 2015-20 access arrangement. In February 2016, the Tribunal set aside the AER's final decision and remitted the decision to the AER to remake its decision in accordance with the Tribunal's directions.[13]

In March 2016, the AER applied to the Federal Court for judicial review of the Tribunal's decision to set aside the AER's final decision on JGN's 2015-20 access arrangement.[14] The Federal Court upheld the AER's grounds on imputation tax credits (gamma), but otherwise dismissed the AER's application for judicial review.

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10 The effect of this Division has been significantly altered in October 2017 as a result of the commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017* (Cth), as outlined in Table 2.1.

11 Section 246(1) of the NGL. The effect of this section has been significantly altered in October 2017 as a result of the commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017* (Cth), as outlined in Table 2.1.

12 Section 246(1a) of the NGL.

13 AER, *Jemena Gas Networks (NSW) - Access arrangement 2015-20 - Remittal*, website viewed 22 March 2018. https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20-remittal

14 AER, *Jemena Gas Networks (NSW) - Access Arrangement 2015-20*, website viewed 22 March 2018. https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20

As a result of the Federal Court's decision, the AER is now required to remake its decision on return on debt and market expansion capital expenditure (capex) for JGN's 2015-20 access arrangement. In December 2017, the AER commenced this remittal process by publishing a position paper in relation to return on debt.[15]

2.2.2 Undertakings provided to the AER by JGN

Since the Tribunal set aside the AER's final decision on revisions to JGN's access arrangement, JGN has submitted undertakings to the AER under section 230A of the NGL which set out the reference tariffs to apply in 2016-17[16] and 2017-18[17]. The undertakings were used to set reference tariffs in these years, whilst legal and regulatory processes were still to be finalised. The reference tariffs set in 2016-17 and 2017-18 were higher than they would have been in the AER's original final decision.[18]

2.3 Aspects of access arrangement that are relevant to this request

This section provides a description of the components of an access arrangement that may have implications for the issues in the rule change request.

It is important to note that gas distribution service providers do not bill end customers directly for the provision of network services. Network charges are billed to retailers who then recover these charges through their retail tariffs, which are the tariffs paid by end customers.

2.3.1 Total revenue

Rule 76 of the NGR requires total revenue to be determined for each regulatory year of the access arrangement period. Total revenue is made of a number of building block components that, in combination, provides a forecast of the efficient cost of providing gas distribution services for a regulatory year.[19] The outcome of the AER's remade decision may result in an increase or decrease in JGN's revenue for the 2015-20 access arrangement period.

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15 AER, *Position paper - Remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.https://www.aer.gov.au/system/files/Position%20Paper%20-%20remitted%20debt%20decisions%20-%20Australian%20Energy%20Regulator%20-%20Dec%202017_1.pdf

16 Jemena Gas Networks (NSW), *Enforceable undertaking*, May 2016. https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20%28NSW%29%20enforceable%20undertaking%20-%20May%202016.pdf

17 Jemena Gas Networks (NSW), *Enforceable undertaking*, May 2017. https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20%28NSW%29%20-%20Enforceable%20undertaking%20-%20May%202017.pdf

18 JGN's tariffs for 2016-17 remained unchanged from tariffs in 2016-17, which were higher than the 12 per cent reduction in real terms set out in the AER's original final decision. JGN's tariffs for 2017-18 reduced by 7 per cent in real terms (but from tariffs applicable in 2015-16), which JGN considered was consistent with the price change in the AER's original final decision.

19 Rule 76 of the NGR

2.3.2 Smoothing of revenue within the access arrangement period

The revenue for each regulatory year in an access arrangement period can vary as it depends on the efficient costs of operating a gas distribution network as determined by the AER. Rule 92(1) and 92(2) requires an access arrangement to include a reference tariff variation mechanism for variation of a reference tariff across the access arrangement period. The reference tariff variation mechanism must be designed to equalise (in terms of present values) forecast revenue from reference services over the access arrangement period with the portion of total revenue allocated to reference services for the access arrangement period. As JGN operates under a weighted average price cap, the AER gives effect to this by determining the weighted average price change each year (the X factor) such that the net present value (NPV) of unsmoothed and smoothed revenue is equal across the access arrangement period.[20]

2.3.3 Mechanics for reference tariff variation

Rule 97(2) of the NGR provides a number of methods for which a reference tariff may be varied.[21] For JGN's 2015-20 access arrangement period, the AER decided to apply a weighted average price cap on reference tariffs.[22] A brief description of this control mechanism is in Box 2.1 below.

Box 2.1 Weighted average price cap

A weighted average price cap (or tariff basket) means that the reference tariffs (i.e. prices) determined by the AER (including the means of varying the tariffs from year to year) are the binding constraint across the access arrangement period, as opposed to the revenue requirement in the AER's final decision.[23] Where actual demand across the access arrangement period varies from the demand forecast in the access arrangement, JGN's actual revenue will vary from the forecast revenue in the AER's final decision. In general, if actual demand is above forecast demand, JGN's actual revenue will be above forecast revenue, and vice versa.[24]

The AER determines the weighted average price change for each regulatory year such that the net present value of unsmoothed and smoothed forecast revenue is equal across the entire access arrangement period.[25]

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20 AER, *Final decision – Jemena Gas Networks (NSW) Ltd access arrangement 2015-20 – Overview*, p. 20.

21 Other forms of control are variable caps on revenue derived from a particular combination of reference services; revenue yield control; or a combination of all of any of the above. Rule 97(2) of NGR.

22 AER, Final decision, *Jemena Gas Networks (NSW) Ltd Access Arrangement 2015-20*, Overview, June 2015, p15

23 AER, Final decision, *Jemena Gas Networks (NSW) Ltd Access Arrangement 2015-20*, Overview, June 2015, p15

24 Ibid.

25 Ibid, p20.

2.4 Rule changes on NSW and ACT DNSP revenue smoothing

In 2016, the NSW DNSPs[26] (jointly) and the ActewAGL (now Evoenergy) made separate rule change requests for participant derogations to smooth revenue across two regulatory control periods.[27] The rule change requests sought to minimise price volatility for NSW and ACT electricity customers that may occur as a result of the outcomes of merits reviews, judicial reviews and the AER's remade 2014-19 distribution determinations for the NSW and ACT DNSPs.

In 2017, the Commission made new rules in response to these rule change requests that provide a process that allows for any increased or decreased revenue that results from the AER's remaking of the distribution determinations for the current regulatory control period to be recovered over the current and/or subsequent regulatory control periods.[28]

Key aspects of the final rule included:

- the AER is provided with discretion to decide whether revenue should be smoothed over two regulatory control periods, and if so, how any adjustment is allocated between the two regulatory control periods;
- the AER is to make a decision on revenue adjustment and smoothing that is separate from any distribution determination; and
- a principle to clarify that DNSPs should not be able to derive any windfall gains or losses as a result of revenue adjustment and smoothing.

26 Ausgrid, Endeavour Energy and Essential Energy

27 A regulatory control period is the equivalent of an access arrangement period for an electricity network service provider. One regulatory control period is usually a period of five years.

28 AEMC 2017, *Participant derogation - NSW DNSPs revenue smoothing*, Rule Determination, 1 August 2017, Sydney, p.iii; and AEMC 2017, *Participant derogation - ACT DNSP revenue smoothing*, Rule Determination, 1 August 2017, Sydney, p.iii

3 Rule change request

This chapter provides a summary of the rule change request and the proposed solution.

3.1 Rationale for the rule change request

As outlined in section 2.2, there has been a delay in the finalisation of the AER's final decision on JGN's 2015-20 access arrangement due to merits review and judicial review proceedings. During this delay, JGN provided undertakings to the AER which set JGN's tariffs higher than what it considered would have been the case had the AER's original final decision not been set aside.[29]

JGN considers that, due to these delays, potential exists for network price volatility for customers over the next three regulatory years (from 2018-19 to 2020-21), in the absence of a rule change.[30] JGN submits that this is because there is currently no mechanism in the NGR to shift revenue recovery between access arrangement periods in order to reduce price volatility.[31]

JGN considers that there is uncertainty around the extent of price volatility, given the range of outcomes that could result from the AER's remade final decision for JGN's 2015-20 access arrangement period.[32] Based on modelling by JGN, it considers that in the absence of a rule change, the tariff path outcomes are likely to lie somewhere at or between the following scenarios:[33]

- a 16.5% decrease in real prices between 2018-19 and 2019-20 and a 25.8% increase in real prices between 2019-20 and 2020-21 if the AER's remade final decision is as per the AER's original final decision; and

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29 Tariffs for 2016-17 and 2017-18 were set in accordance with undertakings provided to the AER by JGN under section 230A of the NGL. Tariffs for 2016-17 remained unchanged from tariffs in 2016-17, which were higher than the 12 per cent reduction in real terms set out in the AER's original final decision. Tariffs for 2017-18 reduced by 7 per cent in real terms (but from tariffs applicable in 2015-16), which JGN considered was consistent with the price change in the AER's original final decision. Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p5.

30 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.5

31 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.10

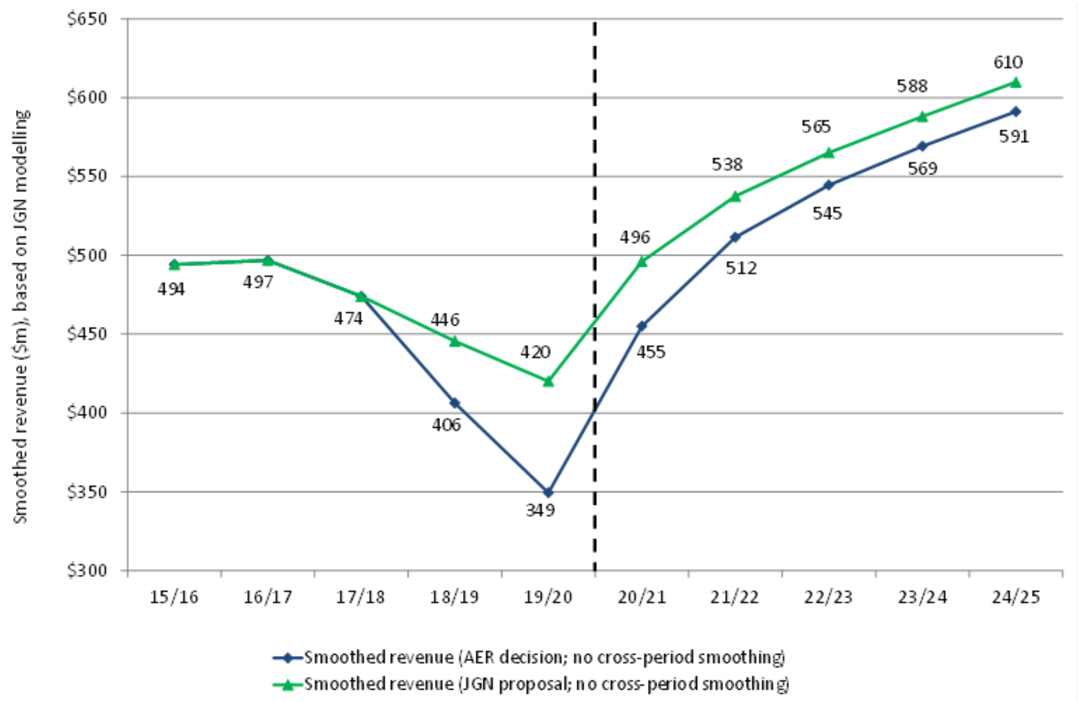
32 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p5.

33 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp.5-6 and B1-B2.

- an 8.4% decrease in real prices between 2018-19 and 2019-20 and a 14% increase in real prices between 2019-20 and 2020-21 if the AER's remade final decision is as per JGN's revised proposal.[34]

Forecast smoothed revenue under these scenarios, based on modelling by JGN,[35] is shown in Figure 3.1 below.

Figure 3.1 JGN's forecast revenue based on AER remade decision as per original AER final decision or JGN revised proposal (return on debt), without cross period smoothing



Source: Modelling by JGN[36]

3.2 Proposed solution

In order to minimise this potential pricing volatility, JGN submitted the rule change request to allow for revenue recovery to be shifted between the current access arrangement period (2015-20) and the subsequent access arrangement period (2020-25). This would involve bringing forward some revenue recovery from the 2020-25 access arrangement period into the 2015-20 access arrangement period.[37]

34 That is, JGN's revised proposed settings for return on debt for 2015-20.

35 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp. B1-B2

36 Jemena Gas Networks, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp. B1-B2.

37 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.9

JGN proposes to provide the AER with discretion to decide whether or not to make an 'adjustment determination'. The proposed rule provides the AER with the power to make an 'adjustment determination' if it is satisfied that doing so is likely to reduce volatility in reference tariffs for JGN's customers and is likely to contribute to the NGO.[38]

An overview of the operation of the proposed revenue smoothing mechanism is outlined in Box 3.1 below. Stakeholders should refer to the rule change request for a further explanation of how it is intended to operate.[39]

38 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.A-1

39 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017

Box 3.1 Overview of the operation of the proposed revenue smoothing mechanism

JGN states that the proposed rule would be implemented by the AER by making a separate determination ('an 'adjustment determination') that must be made no earlier than the remade 2015-20 access arrangement and no later than 1 March 2019. As noted above, the AER would have discretion to decide whether or not to make an 'adjustment determination'.

If the AER decides to make an 'adjustment determination', the proposed effect would be to vary the AER's remade final decision for JGN's 2015-20 access arrangement. The 'adjustment determination' must be designed to minimise volatility in reference tariffs for JGN's customers across both the 2015-20 and 2020-25 access arrangement periods and be NPV neutral.[40] The 'adjustment determination' would have regard to:

- the effect of the 'adjustment determination' on the reference tariff variation mechanism for the 2015-20 access arrangement period;
- the effect of the 'adjustment determination' on the reference tariff variation mechanism for the 2020-25 access arrangement period; and
- the current best estimate of total revenue and demand for reference services for each regulatory year in the 2020-25 access arrangement period.

JGN proposes that the 'adjustment determination' must include:

- an adjustment amount; and
- a revised calculation of the portion of total revenue that is allocated to reference services for the 2015-20 access arrangement period, with the adjustment amount added.

Source: Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017. Proposed rule, pp. A1-A3

If the proposed rule is made, there are various tariff path outcomes that could arise, which vary depending on a range of factors including:

- whether the AER's remade decision is as per its original decision, JGN's revised proposal[41] or somewhere in between these scenarios;
- the adjustment amount determined by the AER;

40 The design of the adjustment amount must have regard to the fact that the adjustment amount affects revenue (and hence reference tariffs) in both access arrangement periods in an offsetting manner.

41 That is, JGN's proposed settings for return on debt and market expansion capex for 2015-20

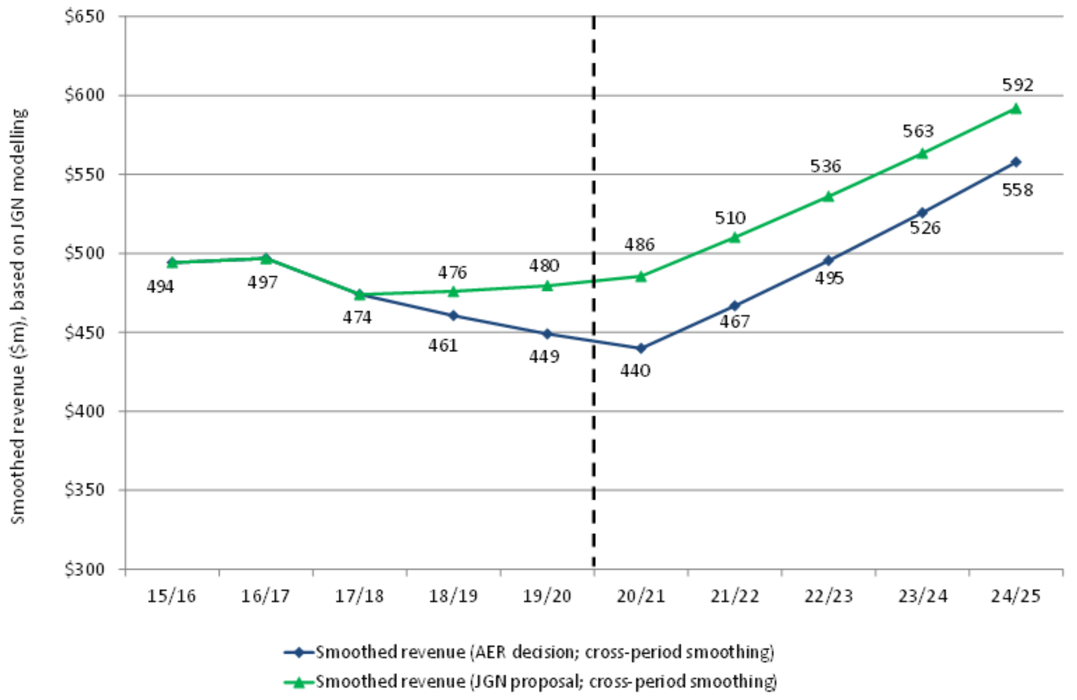
- the way in which the AER decides to revise total revenue and the reference tariff variation mechanism in each of JGN's 2015-20 and 2020-25 access arrangement periods.

Based on modelling by JGN, if the rule change is made and the AER minimises pricing volatility by smoothing JGN's revenue over the 2015-20 and 2020-25 access arrangement periods, the tariff path outcomes are likely to lie somewhere between:[42]

- a 5.4% decrease in real prices between 2018-19 and 2019-20 and a 5.4% decrease in real prices between 2019-20 and 2020-21 if the AER's remade final decision is as per the AER's original final decision; and
- a 2.2% decrease in real prices between 2018-19 and 2019-20 and a 2.2% decrease in real prices between 2019-20 and 2020-21 if the AER's remade final decision is as per JGN's revised proposal.[43]

Forecast smoothed revenue under these scenarios,[44] based on modelling by JGN,[45] is shown in Figure 3.2 below.

Figure 3.2 JGN's forecast revenue based on AER remade decision as per original AER final decision or JGN revised proposal (return on debt), with cross period smoothing



Source: Modelling by JGN[46]

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42 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp. 9-10 and B1-B2

43 That is, JGN's revised proposed settings for return on debt for 2015-20.

44 The possible revenue outcomes are not limited to these two scenarios.

45 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp. B1-B2

3.3 Alternative approaches

JGN recognises that there are potentially other approaches in the current NGR that could be used to smooth revenue over two access arrangement periods. For example, JGN recognise that it may be possible to adjust the depreciation schedule with the effect of increasing revenue in the current access arrangement period, by bringing forward revenue from the subsequent access arrangement period.[47] However JGN suggest that adjusting the depreciation schedule in this way is likely to be contentious and complex and is unlikely to be cost effective or efficient.[48]

While this alternative approach may allow smoothing of JGN's total revenue over two access arrangement periods, it would involve changes to the depreciation schedule of one or more asset classes over multiple access arrangement periods, which may not be cost effective or efficient and therefore may not accord with the revenue and pricing principles.[49]

3.4 Limited or wider rule change

JGN considers that given their unique circumstances, a rule change that only applies to them is more appropriate than a wider rule change that would apply to all covered gas service providers.[50] JGN is proposing a rule of limited application as it is seeking to address what it considers to be a one-off issue, due to the following events:

- the findings of the Tribunal in its merits review;
- the AER's application for judicial review; and
- as a result, the delay in the remaking of the AER's final decision for JGN's 2015-20 access arrangement.

According to JGN, these circumstances only apply to JGN in relation to its current access arrangement period. Therefore, JGN is proposing a rule which only applies to JGN for the current and subsequent access arrangement periods.[51]

46 Jemena Gas Networks, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pp. B1-B2.

47 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p13

48 Ibid, p13.

49 Section 24 of the NGL

50 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p14

51 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p14

4 Assessment framework

The Commission's assessment of the rule change request must consider whether the proposed rule promotes the NGO.

The Commission can make changes to the NGR that are different from the changes proposed in the rule change request if the Commission is satisfied that its changes will, or are likely to, better promote the NGO than the changes proposed in the rule change request.

4.1 Rule making test

Under the NGL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NGO.

The NGO is:[52]

> "To promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

Based on a preliminary assessment of the rule change request, the Commission considers that the most relevant aspects of the NGO are the efficient operation and use of natural gas services with respect to the price of natural gas.

4.2 Proposed assessment framework

The Commission proposes to assess if the rule change request is likely to promote the NGO through consideration of the following criteria:

- **Is reducing price volatility in the long term interests of consumers?**

Consumers may experience a price variation of a large magnitude from one year to another arising from the delay in the finalisation of JGN's 2015-20 access arrangement. This price volatility may lead some of JGN's consumers to make decisions on their investment and use of natural gas services, that in the long term, are inefficient. If this is the case, minimising pricing volatility would benefit consumers.

In the rule changes on revenue smoothing for the NSW and ACT DNSPs, the Commission considered that the minimisation of pricing volatility is in the long term interests of consumers. The Commission considered that price volatility may lead some consumers to make inefficient budgetary decisions on energy spending, or inefficient

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52 Section 23 of the NGL.

investment decisions on the use of electricity services.[53] Therefore, the Commission considered that stable prices allow consumers to make informed decisions as to their energy spending and usage.[54]

- **If so, what is the best method to minimise price volatility?**

If it is decided that minimising price volatility is in the long term interests of consumers, the Commission will assess the best method for minimising pricing volatility.

- **Does the rule change align with the revenue and pricing principles?**

The Commission will also consider whether the proposed rule is consistent with the revenue and pricing principles as set out in the NGL,[55] specifically the following revenue and pricing principles:

- a service provider should be provided with a reasonable opportunity to recover at least the efficient costs of providing reference services;
- a service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides; and
- a reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which that tariff relates.

53 AEMC 2017, *Participant derogation - NSW DNSPs revenue smoothing*, Rule Determination, 1 August 2017, Sydney, pp11-12 and AEMC 2017, *Participant derogation - ACT DNSP revenue smoothing*, Rule Determination, 1 August 2017, Sydney, pp10-11.

54 AEMC 2017, *Participant derogation - NSW DNSPs revenue smoothing*, Rule Determination, 1 August 2017, Sydney, p16 and AEMC 2017, *Participant derogation - ACT DNSP revenue smoothing*, Rule Determination, 1 August 2017, Sydney, p15.

55 Section 24 of the NGL.

5 Issues for consultation

This chapter identifies issues for consultation in relation to JGN's rule change request to allow the shifting of revenue recovery between the current and the subsequent access arrangement periods to reduce network price volatility. The issues below are provided as a guideline for submissions. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper, including the proposed assessment framework.

5.1 Costs and benefits of reducing pricing volatility

As discussed in previous sections, JGN consider that the delay in the finalisation of settings for its 2015-20 access arrangement period could lead to significant network price volatility for customers over the next three regulatory years (2018-19 to 2020-21). JGN consider that, in the absence of a rule change, its tariffs (prices) could decrease significantly in the final year of the current access arrangement period followed by a potentially significant increase in the first year of the subsequent access arrangement period. This could be detrimental to consumers, or lead to them making inefficient decisions.

Conversely, if the timing of the recovery of revenue is spread over two access arrangement periods, the change in reference tariffs could be more gradual, and therefore create a less extreme price signal, however it could occur over a longer period.

Question 1 Long term interests of consumers

(a) To what extent would significant pricing volatility impact consumers and lead to inefficient usage or investment decisions by consumers?

(b) Would allowing the timing of the recovery of revenue to be spread over two access arrangement periods lead to more efficient usage and investment decisions by consumers?

5.2 Mechanism for smoothing

The rule change request acknowledges the uncertainty around the outcomes of the AER's remade final decision and that there are a number of potential different scenarios that could eventuate. To manage this uncertainty, JGN's proposed rule provides the AER with discretion regarding whether or not to make an 'adjustment determination', the objective of an 'adjustment determination',[56] and what an 'adjustment determination' is to include, as outlined in Chapter 3.

56 That is, the 'adjustment determination' must be designed to minimise, so far as reasonably possible, volatility in reference tariffs for JGN's customers across the current and subsequent access arrangement periods.

Question 2 Adjustment mechanism

Does JGN's proposed rule provide the appropriate mechanism to enable the timing of revenue recovery to be spread across two access arrangement periods? What is the appropriate degree of detail and prescription for a mechanism to manage revenue volatility under uncertain circumstances?

6 Lodging a submission

The Commission has published a notice under section 303 of the NGL for this rule change proposal inviting written submission. Submissions are to be lodged online or by mail by 24 April 2018 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change requests.[57] The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Andrew Pirie on (02) 8296 7867.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code GRC0043. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

The envelope must be clearly marked with the project reference code GRC0043.

57 This guideline is available on the Commission's website www.aemc.gov.au

Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	See AEMC
DNSP	Distribution Network Service Provider
ERA	Economic Regulation Authority of Western Australia
JGN	Jemena Gas Networks (NSW) Ltd
NCC	National Competition Council
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NPV	Net Present Value