Final Decision

Jemena Gas Networks (NSW) Ltd 2015–20 Access Arrangement

February 2019

AUSTRALIAN ENERGY REGULATOR

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1 Executive Summary

The Australian Energy Regulator (AER) regulates energy networks under national energy market legislation and rules. Our network regulatory functions, which relate to electricity and gas networks in all Australian states and territories, except Western Australia, include setting the amount of revenue that monopoly network businesses can recover from customers for using networks (electricity poles and wires and gas pipelines) that transport energy.

The National Gas Law (NGL) and Rules (NGR) provide the regulatory framework governing gas networks. Our work under this framework is guided by the National Gas Objective (NGO):[1]

> "…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."

This is our remade final decision on the access arrangement for the NSW gas distributor, Jemena Gas Networks (NSW) Ltd (JGN), for the 2015–20 access arrangement period, commencing 1 July 2015 to 30 June 2020. Our remade final decision is unchanged from our remade draft decision.[2]

Our remade final decision is to accept JGN's Proposal to recover total revenues of $2,246.6 million ($ nominal) from consumers over the five-year 2015-20 access arrangement period.[3] The decision will provide consumers with tariff stability and predictability and will provide for further reductions in gas distribution reference tariffs over the remainder of the 2015–20 access arrangement period.[4]

Our remade final decision will result in a revenue allowance of $17.6 million ($ nominal) above the revenue we approved in our 2015 final decision after incorporating updated information.[5] In conjunction with our final decision adjustment determination, this will lead to $169 million ($2019–20) at 30 June 2020 being returned to consumers in the 2020-25 access arrangement period.[6]

We have remade our decision in response to directions from the Australian Competition Tribunal (Tribunal). In February 2015, JGN was seeking $2,605.2 million ($ nominal) in

1 NGL, s. 23.

2 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

3 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

4 After the Australian Competition Tribunal set aside our 2015 final decision on JGN's 2015–20 access arrangement, the absence of a final 2015–20 access arrangement meant that for the regulatory years 2016-17, 2017-18 and 2018-19, JGN's tariffs have been set using enforceable undertakings submitted to us by JGN under section 230A of the NGL. For example, see AER, *Open letter to stakeholders – Gas distribution reference tariffs in NSW from 1 July 2018*, 21 March 2018.

5 This revenue increase, compared to the 2015 final decision, is due to the annual updates for return on debt and $21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

6 The $169 million ($ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

revenue for the 2015–20 access arrangement period, but we approved a revenue allowance of $2,229 million ($ nominal) in our June 2015 final decision (or $376.2 million less than what JGN proposed). In response, JGN sought limited merits review of our decision by the Tribunal. The Tribunal remitted our decision to us, specifically requiring that we remake our decision in relation to JGN's market expansion capital expenditure (capex) forecast and the rate of return on debt with respect to the trailing average approach, and otherwise vary the access arrangement as set out in our 2015 final decision as we consider appropriate.[7] This remade final decision for JGN brings this long-running 2015-20 revenue determination process to a close.

Our remade final decision has been informed by our analysis, supported by a series of stakeholder engagement processes that have occurred since the second-half of 2017 involving interested stakeholders, including consumer groups and JGN. The purpose of these discussions has been to identify and develop a common position on key matters that, in turn, could be put to us for consideration as being in the long-term interests of consumers.

On 31 October 2018, and following a series of consultations with its stakeholders, JGN submitted a new Proposal to us to resolve all outstanding issues relating to the decision we need to remake.[8] JGN proposed total revenue of $2,246.6 million ($ nominal) for the five-year 2015–20 access arrangement period. This amount is $17.6 million ($ nominal) above what we approved in our 2015 final decision after incorporating updated information.[9] This contrasts with the $100 million in revenue at issue (the key elements of our 2015 final decision that were disputed were approximately $92 million in return on debt and $8 million in capex). JGN's Proposal is based on:

- our 2015 final decision, including the constituent decisions we made on capex and the rate of return (including the cost of debt)
- the revenue that JGN has recovered thus far for the 2015–20 access arrangement period, with $169 million ($2019–20) at 30 June 2020 to be returned to customers in the 2020–25 access arrangement period.[10]

This document sets out our reasons for accepting JGN's Proposal. We have remade our decision in accordance with the NGL and NGR. Among other things, this means we have taken into account the revenue and pricing principles (RPP) and the NGO. We are satisfied that our remade final decision is likely to contribute to the achievement of the NGO to the greatest degree. The reasons for our decisions are outlined in section 5.

Our remade final decision has been informed by our analysis and stakeholder engagement and submissions. JGN[11], Energy Consumers Australia (ECA)[12], Public Interest Advocacy

7 *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*.

8 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

9 This revenue increase compared to the 2015 final decision is due to the annual updates for return on debt and $21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

10 The $169 million ($ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

11 JGN, *Response to AER draft decision for Jemena Gas Networks 2015-20 access (remittal) and adjustment determination draft decision*, 13 February 2019.

Centre (PIAC)[13] and the AER Consumer Challenge Panel (CCP10)[14] made submissions that our remade draft decision is in the long-term interests of JGN's consumers.[15] In addition, St Vincent de Paul Society Victoria (SVDP)[16], ECA[17], PIAC[18] and CCP10[19] supported JGN's Proposal.

This remade final decision has been made under novel circumstances as set out in section 5.1.1. The novel circumstances we find ourselves in heighten the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.[20]

1.1 Structure of this document

This document is structured as follows:

- Section 2 presents our remade final decision for JGN
- Section 3 presents JGN's Proposal
- Section 4 presents stakeholders' submissions on our remade draft decision
- Section 5 presents the reasons for our remade final decision

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12 Energy Consumers Australia, *Submission to the AER's draft decision on Jemena Gas Networks' access arrangement 2015-20 – Remittal*, 14 February 2019.

13 Public Interest Advocacy Centre, *Jemena Gas Networks 2015-20 access arrangement draft remittal decision*, 12 February 2019.

14 Consumer Challenge Panel, *CCP10 response to the Draft Decision for the Jemena Gas Networks (JGN) 2015-20 Access Arrangement – Remittal*, 28 January 2019.

15 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

16 St Vincent de Paul Society Victoria, *Jemena Gas Network Remittal Proposal*, 31 October 2018.

17 Energy Consumers Australia, *Proposal for the remittal of Jemena Gas Networks' determination*, 31 October 2018.

18 Public Interest Advocacy Centre, *Jemena Gas Network Remittal Proposal*, 1 November 2018.

19 Consumer Challenge Panel, *Jemena Gas Networks (JGN) 2015–20 Access Arrangement remittal proposal*, 1 November 2018.

20 Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

2 Our remade final decision

Our remade final decision, after remaking the constituent decisions for capex and the rate of return, and amending the tariff variation mechanism for pass throughs[21] that JGN has not yet recovered in the 2015–20 access arrangement period, is to accept JGN's Proposal.[22]

This means JGN can recover estimated total revenues of $2,246.6 million ($ nominal) from consumers over the 2015–20 access arrangement period. Our remade final decision is unchanged from our remade draft decision.[23] This outcome is $17.6 million ($ nominal) above the revenue allowance we set for JGN in our 2015 final decision after incorporating updated information.[24] We determine that $169 million ($2019–20) at 30 June 2020 will be returned to customers in subsequent regulatory years from 2020-21.[25]

We are satisfied that this remade final decision, taking into account the RPP and NGO, is likely to contribute to the achievement of the NGO to the greatest degree.[26] Figure 2-1 illustrates our remade decision in terms of total revenue.

The distribution network component of customers' gas bills were set by our 2015 final decision and following the Tribunal's decision, by interim pricing measures (enforceable undertakings) in 2016-17, 2017-18 and 2018-19. The enforceable undertakings from JGN addressed pricing uncertainties arising from the limited merits and judicial review processes.

At the time of our 2015 final decision, we expected the average annual gas bill in 2015-16 to fall by around 9.2 per cent for both residential customers (or $96) and small business customers (or $462) in the 2015–20 access arrangement period.[27]

In accordance with the enforceable undertakings we accepted from JGN for the 2016-17 to 2018-19 regulatory years, gas distribution reference tariffs were kept constant in nominal terms in 2016-17, reduced by an average of 7 per cent in real terms in 2017-18, and reduced by an average of 5.4 per cent in real terms in 2018-19. Under JGN's Proposal, tariffs for 2019-20 are expected to reduce by an average of 5.4 per cent in real terms.

This remade final decision, in conjunction with our final decision adjustment determination, will lead to $169 million ($2019–20) at 30 June 2020 being returned to consumers in the 2020–25 access arrangement period. Holding everything else constant, we would expect this to put downward pressure on the tariffs faced by JGN's customers.

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21 Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

22 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

23 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

24 This revenue increase compared to the 2015 final decision is due to the annual updates for return on debt and $21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

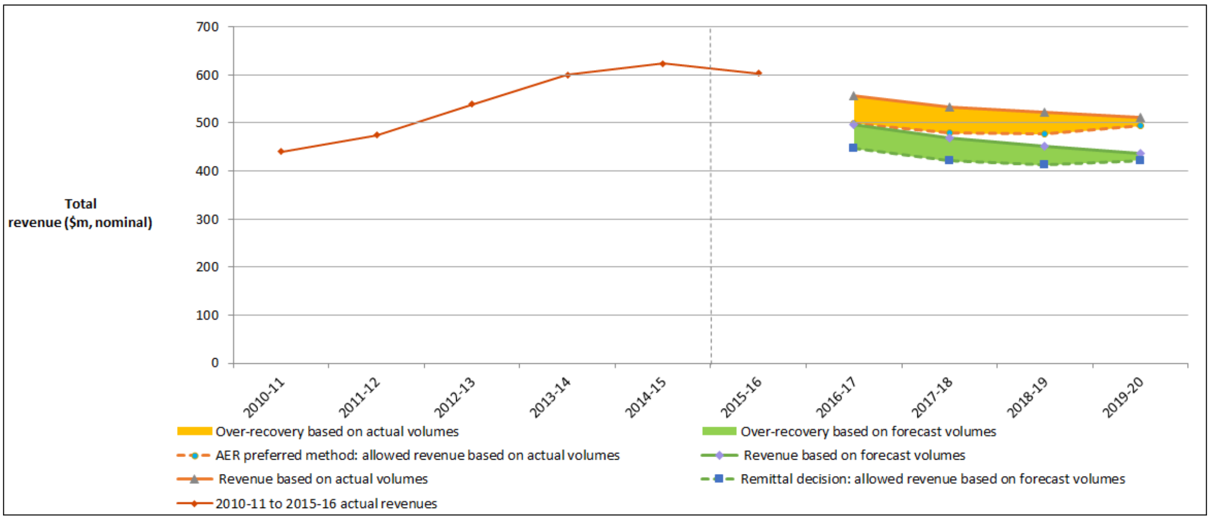
25 The $169 million ($ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

26 NGL, s. 23(1)(b)(iii).

27 AER, *Final decision: JGN 2015–20 - Fact Sheet*, June 2015.

Figure 2-1 shows how the $169 million ($2019–20) at 30 June 2020 to be returned to customers was calculated based on forecast volumes and is represented by the green area.[28]

Figure 2-1 JGN's past total revenue and the assessment of recovered revenue ($million, nominal)



Source: AER analysis.

At the same time as releasing this remade final decision, we have also released a separate final decision adjustment determination for JGN that has relevance to revenues recovered for both 2015–20 and 2020–25 access arrangement periods.[29] Under the NGR, we are required to make an adjustment determination in order to ensure JGN recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process.[30] Our adjustment determination relates to revenue requirements from reference services that JGN must smooth between the 2015–20 and 2020–25 access arrangement periods to ensure this outcome. It includes an adjustment amount of $169 million ($ as at 30 June 2020) for the 2019-20 regulatory year and an offsetting subsequent adjustment amount of $169 million ($ as at 30 June 2020) to be applied to the next (2020–25) access arrangement period.

Without a smoothing mechanism, JGN would potentially be required to apply the $169 million ($ as at 30 June 2020) downward revenue adjustment in the final year of the 2015–20 access arrangement period. This could lead to price fluctuations for JGN's customers. Figure 2-2 shows that our remade final decision would result in a 32 per cent reduction to average prices in the 2019-20 regulatory year, compared to the 2018-19 regulatory year, if there was no smoothing mechanism in place. Depending on JGN's revenue requirements for the 2020–25 access arrangement period, there is also potential for

28 The AER's preferred approach calculated $178 million in recovered revenues to be returned to JGN customers based on actual volumes. In terms of Figure 2-1, it reflects the area between the solid and dashed yellow lines.

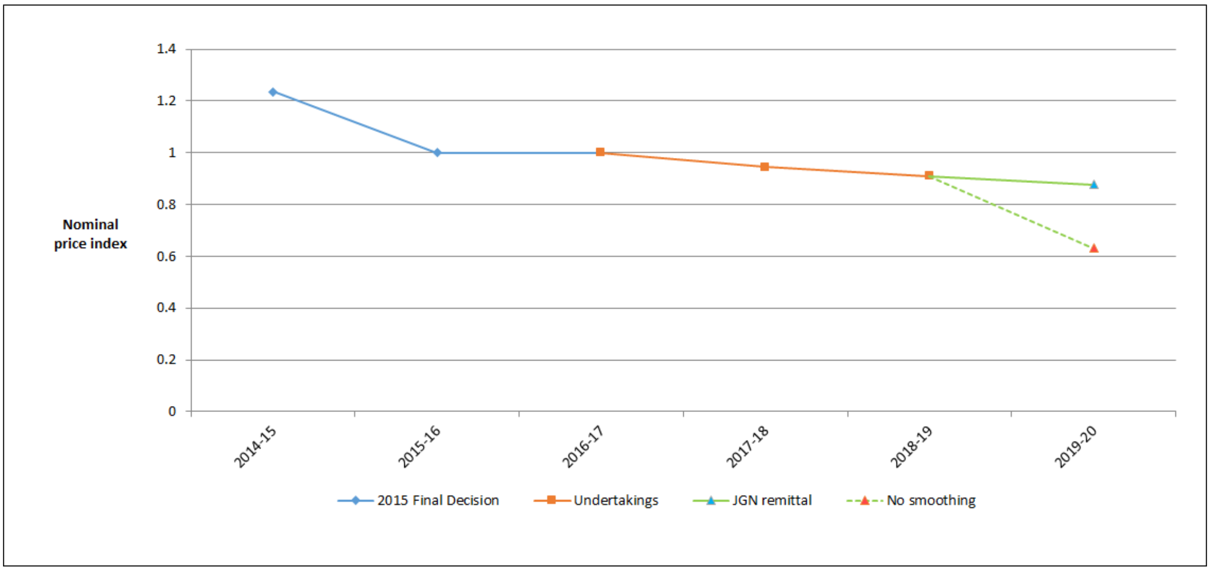
29 AER, *Final decision, JGN adjustment determination*, February 2019.

30 NGR, Schedule 1, Part 11.

a large rebound or increase in average prices from 2019-20 to 2020-21 (the first regulatory year of the 2020–25 access arrangement period).

We consider such large fluctuations in average prices, even if they are one-off, are not consistent with the NGO. Such large fluctuations may lead customers to incorrectly assume they will continue into the future. Customers may then make inefficient investment decisions based on these assumptions. Adding the adjustment amount to the revenue allocated to the 2019–20 regulatory year in our remade final decision ensures a consistent price path with JGN's Proposal.[31] Further, applying the subsequent adjustment amount in the 2020–25 access arrangement period is consistent with JGN's Proposal to return $169 million (in net present value) to customers.[32]

Figure 2-2 Nominal price index with, and without, revenue smoothing



Source: AER analysis.

31 JGN, *Remittal model - Forecast volume scenario - PUBLIC*, 20 November 2018.

32 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 5.

3 JGN's Proposal

On 31 October 2018, we received JGN's Proposal for the remaking of its access arrangement for the 2015–20 access arrangement period.[33]

It is a total revenue proposal – that is, it is not directly presented in terms of the building block components as was the case in its initial and revised regulatory proposals which preceded our June 2015 final decision. As JGN notes in its Proposal:[34]

> "We have sought an overall outcome that is acceptable to all stakeholders. It is best considered as a package rather than being viewed separately as isolated individual items."

JGN engaged with consumer groups on a near-final version of its Proposal prior to submitting its finalised Proposal to us.

Key aspects of JGN's Proposal are summarised below:[35]

> "Our proposal follows a series of consultations…held with consumer groups, JGN's Customer Council, the Consumer Challenge Panel (CCP) 10, and the AER…
>
> …the items remitted back to the AER were:
>
> - market expansion capital expenditure…
> - the cost of debt…
>
> After the Tribunal set aside the 2015 FD, the absence of a final 2015 Access Arrangement decision meant that for the regulatory years 2016/17 (RY17), 2017/18 (RY18), and 2018/19 (RY19), JGN's prices have been set using Enforceable Undertakings… A consequence of these interim arrangements is that prices effected for RY17 through the Enforceable Undertaking were higher in July 2016 than prices envisaged for that regulatory year under the 2015 FD. This has continued through RY18 and RY19. As a result, and despite some reductions in network charges in 2017 and 2018, we expect to collect $169M ($2020) in revenues above what would have occurred had a remade decision been in place during that period.
>
> Relevant to the calculation of over-recovery is the weighted average price cap (WAPC) form of control under which JGN is regulated. Under a WAPC, JGN is subject to demand forecasting risk. Where actual demand turns out to be higher or lower than forecast volumes, JGN receives higher or lower revenue than the AER's allowance. This provides JGN with the incentive to outperform the demand forecast accepted by the AER in the 2015 FD. This incentive is aligned to customers' interests as it spreads our fixed costs over more customers in the long run. JGN's demand forecast is reviewed and approved by the AER as part of a regulatory determination…
>
> We wish to demonstrate our commitment to delivering on our customers' desire for affordable, reliable, and sustainable gas services. To drive towards this, and as part of an expedited resolution to the remittal, JGN's proposal adopts the 2015 FD, including the application of a transition to the trailing average cost of debt for 2015–20 (consistent with JGN's acceptance of

33 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

34 Ibid.

35 Ibid.

the same methodology as part of the 2018 Rate of Return Guideline review process that the AER is in the process of conducting), with adjustments to account for:

- An additional allowance of…$21M ($2020) for market expansion capex compared with the 2015 FD…
- An update to the tariff variation mechanism in JGN's 2015–20 AA…to provide for the adjustment of RY20 tariffs to include those positive and negative cost pass through items not yet given effect due to the Enforceable Undertakings being in place in each of RY17, RY18 and RY19…
- A reduction of $169M in revenue for the 2015–20 access arrangement period…to recognise that, for RY17 to RY19, prices were higher than they would have been if the remade final decision had been in place from RY16. This forecast…is based on a method that is consistent with JGN's form of control, the WAPC, whereby AER approved volume forecasts are used to set revenues.

  We also recognise that the AER has forecast an alternative revenue adjustment of $178M ($2020) which is $9M ($2020) higher than JGN's calculation. We have tested these potential outcomes with stakeholders, and consider that the forecast of $169M ($2020) is consistent with the WAPC and achieves a result that is within an acceptable range to ensure an expedited resolution to the remittal. Stakeholders also considered that the $9M ($2020) benefit retained by JGN is reasonable in the context of the outstanding matters being considered as part of our remittal.

This proposal will continue to deliver lower network charges from 1 July 2019…

AER acceptance of this Proposal will finally resolve the remittal matters in full, thereby providing certainty to customers regarding their current and future prices…

JGN's acceptance of the AER's:

- approach to the cost of debt avoids a potential maximum $107M increase in network costs
- proposal for additional market expansion capex avoids up to $93M of capex allowance, which would otherwise have been added to the regulatory asset base and earn a return on this investment and recover the return of capital (depreciation)…

The Proposal enables the AER to consider the appropriate mechanisms to reduce JGN's future revenues by $169M and return this amount to customers…

Customers avoid year on year price volatility and maintain annual tariff variation certainty via:

- having the cross period smoothing rule change now in place, which allows for the AER to approve steady price decreases for RY20 and for those to continue into the next period
- the processing of JGN's positive and negative cost pass throughs (not given effect through Enforceable Undertakings over RY17 to RY19) in a way that maintains AER oversight of these changes."

4 Stakeholders' submissions on our remade draft decision

On 24 January 2019, we released our remade draft decision for JGN for the 2015-20 access arrangement period for public consultation.[36] Our remade draft decision accepted JGN's Proposal to recover total revenues of $2,246.6 million ($ nominal) from consumers over the five-year 2015-20 access arrangement period. We noted that if our remade draft decision became our final decision for JGN, it would result in a revenue allowance of $17.6 million ($ nominal) above the revenue we approved in our 2015 final decision after incorporating updated information.[37] We also noted that this would lead to $169 million ($2019–20) at 30 June 2020 being returned to consumers in the 2020-25 access arrangement period.[38]

We received four stakeholder submissions on our remade draft decision:[39]

- JGN[40]
- Energy Consumers Australia (ECA) [41]
- Public Interest Advocacy Centre (PIAC)[42]
- AER Consumer Challenge Panel, Sub-panel 10 (CCP10)[43]

All stakeholders supported our remade draft decision as being in the long-term interest of JGN's customers. Key points raised in submissions are summarised below.

We also note that our remade draft decision included a summary of supporting comments previously received from stakeholders following JGN's pre-lodgement engagement on its Proposal. Comments were received from St Vincent de Paul Society Victoria (SVDP), ECA, PIAC and CCP10.[44]

All of the above stakeholders' submissions are available on our website.[45]

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36 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

37 This revenue increase, compared to the 2015 final decision, is due to the annual updates for return on debt and $21 million of additional market expansion capital expenditure in this remittal decision. It is based on forecast volumes.

38 The $169 million ($ as at 30 June 2020) that is expected to be returned to customers in the 2020–25 access arrangement period is an estimate based on forecast volumes. It also reflects adjustments for actual inflation and the time value of money.

39 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

40 JGN, *Response to AER draft decision for Jemena Gas Networks 2015-20 access (remittal) and adjustment determination draft decision*, 13 February 2019.

41 Energy Consumers Australia, *Submission to the AER's draft decision on Jemena Gas Networks' access arrangement 2015-20 – Remittal*, 14 February 2019.

42 Public Interest Advocacy Centre, *Jemena Gas Networks 2015-20 access arrangement draft remittal decision*, 12 February 2019.

43 Consumer Challenge Panel, *CCP10 response to the Draft Decision for the Jemena Gas Networks (JGN) 2015-20 Access Arrangement – Remittal*, 28 January 2019.

44 Refer to our remade draft decision for a summary of stakeholders' comments on JGN's Proposal for the 2015-20 access arrangement period. ECA, PIAC, SVDP and CCP10 considered the proposal to be in the long-term interest of JGN's customers: AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019, pp. 16-20.

45 https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-

4.1 JGN

In its response to our remade draft decision, JGN submitted:[46]

> "We support the AER's Draft Decision to accept our remittal proposal which has received support from key consumer advocacy groups, JGN's Customer Council, and the Consumer Challenge Panel (CCP) 10.
>
> Our proposal and the AER's Draft Decisions are in the long term interests of consumers as they:
>
> - Provide for resolution of the remittal matters in full, thereby providing clarity to customers regarding their current and future prices.
> - Implement a simple and expedited process that enhances certainty, and minimises administrative cost.
> - Enable customers to benefit from JGN's acceptance of the AER's approach to the cost of debt and changes to the market expansion capex.
> - Facilitate revenues of $169M to be returned to customers in the next access arrangement period.
> - Promote pricing stability since customers avoid year on year price volatility and maintain smooth annual tariff variations.
>
> We look forward to continuing our open and collaborative discussions with the AER and stakeholders."

4.2 Energy Consumers Australia

In its response to our remade draft decision, ECA submitted:[47]

> "We supported JGN's remittal proposal in our letter of 31 October 2018 to…JGN. Our view was that, on balance, the benefits of the proposal outweighed the costs and are in the long-term interests of consumers...
>
> Consistent with the reasons in our October 2018 letter to JGN, we support the AER's draft decision to accept JGN's proposal. We understand that this means that:
>
> - JGN can recover estimated total revenues of $2,246.6 million ($ nominal) from consumers over the 2015-20 access arrangement period. The outcome of this is that JGN will receive an additional $17.6 million ($ nominal) above the allowance the AER set in 2015. We understand from the draft determination that this decision reflects annual updates for return on debt and $21 million of additional market expansion capital expenditure.
> - JGN will return $169 million ($2019-20) to consumers throughout the 2020-25 access arrangement period…Instead of returning the $169 million to consumers as a lump sum in 2019-20, the AER has chosen to smooth the return of the $169 million over the 2020-25 access arrangement period…We are pleased that the AER has taken this

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arrangement-2015-20-remittal/proposal

46 JGN, *Response to AER draft decision for Jemena Gas Networks 2015-20 access (remittal) and adjustment determination draft decision*, 13 February 2019.

47 Energy Consumers Australia, *Submission to the AER's draft decision on Jemena Gas Networks' access arrangement 2015-20 – Remittal*, 14 February 2019.

approach, and agree with its reasons, that this approach aims to reduce the risk of consumers experiencing a large increase in prices in 2019-20 to 2020-21."

4.3 Public Interest Advocacy Centre

In its response to our remade draft decision, PIAC submitted:[48]

"We support the AER's draft remittal decision to allow:

- an adjustment amount of $169 million ($ at 30 June 2020) to be allocated to the 2019-20 regulatory year in the AER's remade draft decision; and
- a subsequent adjustment amount of -$169 million ($ at 30 June 2020) to be allocated to JGN's reference services for the 2020-25 access arrangement period.

As noted in our submission to JGN's remittal proposal, by not pursuing the positions it took in 2015, JGN will ensure their customers do not face the increase in bills associated with the full allowances originally sought. The certainty that flows from the resolution of this process, and particularly the removal of the potential for judicial review of the AER's re-made decision by JGN, is also in consumers' interests."

4.4 Consumer Challenge Panel

The AER established the CCP in July 2013 to assist us to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to us to better balance the range of views considered as part of our decisions.

In its response to our remade draft decision, CCP10 submitted:[49]

"Consumer Challenge Panel subpanel CCP10 has been an active observer throughout the process to resolve the remitted JGN decision. We are pleased to support the JGN proposal and AER's Draft Decision as being in the long-term interests of consumers, reflecting the position in our letter to the AER dated 1st November 2018. This submission draws heavily on that letter since our opinions have not changed since that time…

The three issues being addressed in the remitted Access Agreement are:

- the Market Expansion (ME) capex;
- the allowance for debt (particularly moving to a trailing average methodology); and
- the 'square up' of revenues collected in accordance with 'enforceable undertakings' and the remade allowance.

CCP10 considers the proposal from JGN to resolve these three issues to be reasonable and we believe that acceptance of the proposal by the AER as it is proposed in the Draft Decision is in the long-term interests of consumers…

We concur with the AER's observation regarding the novel circumstances associated with this Draft Decision…Recognising the unique circumstances is important because it means that the

48 Public Interest Advocacy Centre, *Jemena Gas Networks 2015-20 access arrangement draft remittal decision*, 12 February 2019.

49 Consumer Challenge Panel, *CCP10 response to the Draft Decision for the Jemena Gas Networks (JGN) 2015-20 Access Arrangement – Remittal*, 28 January 2019.

details of the final decisions for all 5 remitted decisions should not be regarded as precedent-setting…The 'lesson' from the remittal decisions that does have ongoing application is the constructive manner in which consumers, the Regulator and the businesses have worked collaboratively to explore solutions and to implement the agreed outcomes….

JGN has engaged actively with organisations representing consumer interests, as well as CCP10 in seeking to finalise the remitted decisions. While engagement with CCP10 has been regular through email and telephone conversations, particularly once the pace of the process picked up from midyear, there has been a series of more formal processes of engagement that we summarise, to the best of our knowledge, in the table below.

Consultations with JGN and CCP10	Dates
AER hosted roundtable to consider ME capex, CCP10 participated with JGN and AER	18th January 2018
CCP10 responds to AER "Debt paper"	23rd February 2018
JGN Briefing of CCP10, and other consumer Groups	8th August 2018
Draft proposal forwarded to CCP10 by JGN and discussed in detail	19th September 2018
Teleconference; JGN and CCP10	4th October
Telephone discussion	1st November

We are also aware of separate discussions that have occurred between JGN and Energy Consumers Australia (ECA), the NSW Public Interest Advocacy Centre (PIAC) and the St Vincent de Paul Society, being the consumer-focussed organisations most actively involved in considering consumer interests in this instance. We understand that these discussions have been very positive and constructive and are reflected in the letters of support that the AER has received in support of the JGN proposal. The ongoing engagement and discussions have been very constructive throughout the process, a further reason for CCP10 being confident in our support of this proposal…

This Draft Decision would allow JGN to recover total revenue of about $2,246.6 million ($ nominal) over the 2015–20 access arrangement period, $17.6 million above the original 2015 decision, with adjustment for ME capex and debt…$169 million – effective 30 June 2020 – will be returned to customers in the next regulatory period 2020-25 as adjustment for the difference between actual revenue collected in accordance with enforceable undertakings made during the appeal and remittal years and the allowed revenue from the remade decision.

The crucial question is whether this remade decision is in the best outcome when considering the long-term interests of JGN's customers? Our considered response is that the JGN proposal ***is*** in the long-term interests of their customers, with customers benefitting from:

- the certainty provided by the resolution of the proposed price path, with cross period smoothing. While it is difficult to put a dollar value on improved certainty, we know that it has real value for consumers;

- the removal of the risk for consumers from the re-opening of the contentious issues from the Federal Court decision, particularly in regard to debt costs;
- the return of $169m to consumers over the regulatory period to 2025;
- ongoing focus on consumer engagement, building on relationships that we observe have been strengthened by the discussions and transparency associated with developing this proposal; and
- a further demonstrable example of “AER 2.0” being effectively applied.

It is our opinion that the benefits of this proposal significantly outweigh the costs (including the $21m ME capex increase), in aggregate, for consumers from this proposal…

CCP10 commends JGN for taking this opportunity to resolve the 2015-20 Access Arrangement...We also commend the consumer groups on their willingness to engage with JGN for this remittal process and the ‘good faith’ that they have demonstrated, and which have been responded to very constructively by JGN. Throughout the engagement, we have been impressed by the collegiate and transparent manner in which JGN has approached the pursuit of a suitable resolution. At all times we were satisfied that JGN were committed to a fair, reasonable and balanced outcome. We look forward to the level of engagement, trust and goodwill that has been demonstrated in the remittal process as now being ‘business as usual’ between consumers, JGN and the AER.”

5 Reasons for our remade final decision

Our remade final decision is unchanged from our remade draft decision.[50] Similarly, our reasons for arriving at our final position are unchanged.

5.1 Our approach

As is the case with making any Access Arrangement decision, there may be several possible overall decisions that will, or are likely to, contribute to the achievement of the NGO. In these circumstances, the NGL directs us to make the decision that we are satisfied will, or is likely to, contribute to the achievement of the NGO to the greatest degree.[51]

Determining whether any particular decision will, or is likely to, contribute to achieving the NGO is a matter of regulatory judgment which involves assessing the decision as a whole, having regard to stakeholder views, taking into account the RPP and complying with the specific requirements of the NGR. Implicit in this task is recognising that an access arrangement decision is more than just the sum of its component parts as determined in accordance with Part 8 of the NGR.

5.1.1 The novel circumstances we face

The approach we have applied in remaking this final decision has necessarily been influenced by the circumstances that we face now. These are novel circumstances because they materially differ from those we faced when we made our 2015 final decision, and what we would generally face in making an access arrangement decision.

Specifically, we are remaking this decision at a time:

- that is almost four years into the applicable five-year 2015–20 access arrangement period
- when we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes
- when we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on JGN, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt
- when we have information on JGN's actual performance for the first three years of the five-year 2015–20 access arrangement period and updated forecasts for the remaining two years
- when our decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision[52]

50 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

51 NGL, s. 23(1)(b)(iii).

52 Recognising that this prospect is to some extent alleviated by the rule made by the AEMC on 30 August 2018 that allows us to let JGN recover any additional revenues that result from our remade decision across both the 2015–20 and 2020–25

- when JGN has released, and is engaging its stakeholders on, a draft plan for its 2020-25 access arrangement proposal which is due to the AER in June 2019[53]
- when there is support from a range of stakeholders, including consumer groups, that our remade draft decision and JGN's Proposal is in the long-term interests of JGN's customers.

5.1.2 Assessing the overall decision

Ultimately, assessing whether this remade final decision achieves the NGO to the greatest degree involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of JGN's network that is in the long-term interests of consumers. This involves us balancing the various, and at times competing, factors referred to in the NGO. We must also take into account the RPP in determining how the NGO may be achieved to the greatest degree. [54]

This is the same approach that we applied in our remade draft decision[55] and 2015 final decision.[56] This approach was also affirmed by the Tribunal in its reasons of 26 February 2016.[57]

In considering whether this remade final decision is likely to contribute to the achievement of the NGO to the greatest degree, in respect of our assessment of JGN's Proposal, we note that there are potentially a range of possible outcomes that may meet the Tribunal's directions.

5.2 Assessment of JGN's Proposal

In light of the circumstances we are faced with, and the information before us, we are satisfied that accepting JGN's Proposal will result in an outcome that is likely to contribute to the achievement of the NGO to the greatest degree.

Key reasons for our decision to accept JGN's Proposal are outlined below.

First, remaking the capital expenditure and cost of debt constituent decisions reveals a result that is unchanged from our remade draft decision and broadly consistent with revenue that we arrived at in our 2015 final decision. This is discussed in sections 5.3.1 and 5.3.2, respectively. This result aligns with JGN's Proposal to accept our 2015 final decision, including the application of a transition to the trailing average cost of debt for 2015–20.

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access arrangement periods. See AEMC, *Rule determination: National Gas Amendment (Cross period revenue smoothing (Gas)) Rule, 30 August 2018;* AEMC, *National Gas Amendment (Cross period revenue smoothing) Rule 2018 No. 2*, commencing 6 September 2018.

53 https://yournetwork.jemena.com.au/draft-2020-plan

54 NGL, s. 23(1)(b)(iii).

55 AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

56 AER, *Final decision, JGN Access Arrangement 2015–20, Overview*, June 2015, pp. 45-47.

57 *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1, [77].

Second, the novel circumstances we find ourselves in heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.[58] Resolving the uncertainty created by the limited merits and judicial review processes in a timely manner, by expediting this remittal process where possible compared to an extended timeframe of potentially up to 18 months for a regular determination process, is supported by several consumer groups and JGN (particularly in light of its 2020-25 access arrangement proposal draft plan on which it is engaging stakeholders).[59] This remade final decision resolves this uncertainty and addresses the crucial issue of price stability, which informs consumers of their budgetary and investment decisions on the use of natural gas services. Price stability, or minimising price volatility, is also in the long-term interests of consumers and is one of the primary reasons we accepted the enforceable undertakings that JGN gave to us to govern prices for the 2016–17, 2017–18 and 2018–19 regulatory years.[60]

Third, we consider that, given the circumstances for this decision, a downward revenue adjustment of $9 million ($2019–20) to the $178 million ($2019-20) as at 30 June 2020 in recovered revenues we calculated to be returned to JGN customers based on actual volumes for the 2015–20 access arrangement period is likely to contribute to the achievement of the NGO to the greatest degree. We note this outcome is supported by consumer groups. JGN also notes that:[61]

> "We also recognise that the AER has forecast an alternative revenue adjustment of $178M ($2020) which is $9M ($2020) higher than JGN's calculation. We have tested these potential outcomes with stakeholders, and consider that the forecast of $169M ($2020) is consistent with the WAPC and achieves a result that is within an acceptable range to ensure an expedited resolution to the remittal. Stakeholders also considered that the $9M ($2020) benefit retained by JGN is reasonable in the context of the outstanding matters being considered as part of our remittal…"

In coming to this revenue adjustment, we have considered the following factors:

- It represents an outcome that quantifies and appropriately balances the risk and uncertainty of a protracted decision process faced by affected stakeholders, including consumers. This is in the context where stakeholders have stated a clear preference for us to remake the decision in a timely manner and to resolve uncertainty in light of the circumstances described above.
- It provides greater certainty and price stability for customers for the remainder of this and over the next access arrangement period.

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58 Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

59 Sections 4 of both the remade draft and final decisions summarise the views of consumer groups (ECA, PIAC, SVDP and CCP10) regarding their support for expediting the JGN 2015–20 remittal decision.

60 For example, see AER, *Open letter to stakeholders – Gas distribution reference tariffs in NSW from 1 July 2018*, 21 March 2018.

61 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018.

We have given weight to the expressions of support from ECA, PIAC, SVDP, CCP10 and JGN in respect of our remade draft decision and JGN's Proposal. Notably, given the circumstances, each of these stakeholders considers that this revenue adjustment results in an outcome that is in the long-term interests of JGN's customers.[62]

Our position on JGN's proposed amendments to the tariff variation mechanism for pass throughs[63] that it has not yet recovered in the 2015–20 access arrangement period is presented in section 5.4.1.

Overall, we consider that JGN's Proposal, which is $358.6 million ($ nominal) less than what it proposed in its February 2015 revised access arrangement proposal, represents an efficient level of expenditure necessary for it to provide safe and reliable natural gas services to its consumers. As we discussed in section 5.1.2, the approach we have applied in this remade final decision involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of JGN's network that is in the long-term interests of consumers. In other words, the long-term interests of consumers are served by us identifying how the level of natural gas services delivered by JGN so far during the 2015–20 access arrangement period may be done at least cost to the consumer.

5.3 Remaking the market expansion capital expenditure and return on debt constituent decisions

The Tribunal's directions that we are to comply with in remaking our decision for JGN are as follows:[64]

"(a) the AER is to make the constituent decision on debt having regard to the position of Jemena Gas Networks (NSW) Ltd in its Revised Regulatory Proposal concerning the trailing average approach in accordance with the reasons for this determination;

…

(c) the AER is to make the constituent decision on capital expenditure in accordance with the reasons for determination, including by reference to the current and ongoing contractual rates known, and accepted by the AER to be, prudent and efficient; and

(d) the AER is to consider, and to the extent to which it considers appropriate, to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 28(1)(b) of the National Gas Law in the light of such variations as are made to the Final Decision by reason of (a)–(c) hereof."

62 Energy Consumers Australia, *Proposal for the remittal of Jemena Gas Networks' determination*, 31 October 2018; Public Interest Advocacy Centre, *Jemena Gas Network Remittal Proposal*, 1 November 2018; St Vincent de Paul Society Victoria, *Jemena Gas Network Remittal Proposal*, 31 October 2018; Consumer Challenge Panel, *Jemena Gas Networks (JGN) 2015–20 Access Arrangement remittal proposal*, 1 November 2018.

63 Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

64 *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5*. Note direction (b) is omitted following the Court's decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80, [738]-[784].

The rules in the NGR and provisions in the NGL that govern our assessment of capex and debt remain unchanged on remittal.

In the following sections, we set out our remade constituent decisions for market expansion capex and the cost of debt.[65]

5.3.1 Capital expenditure constituent decision

This section discusses our remade final decision on JGN's capex for the 2015–20 access arrangement period, made in accordance with the Tribunal's orders. Our remade capex constituent decision has not changed from our remade draft decision.

5.3.1.1 The Tribunal's decision

On 3 March 2016, the Tribunal handed down its decision.[66] The Tribunal's concerns with our 2015 final decision on JGN's capex for 2015–20 specifically referred to our assessment of Market Expansion (ME) capex.

ME capex, also known as connections capex, refers to capex associated with the connection of new customers to the distributor's gas network. Gas distribution businesses have a regulatory obligation to connect residential and commercial/industrial customers to the distribution network upon request. Capex associated with connecting customers to the distribution network generally includes the cost of new mains where required, gas service pipe from the mains to the meter (services), and the meter. As connecting customers is a regulatory obligation, we consider that ME capex is justifiable under r. 79(2)(c)(iii) of the NGR.

We allowed ME capex of $285.6 million (unescalated direct costs, $2014–15) in our 2015 final decision. This was $82.4 million (or 22 per cent) lower than JGN's February 2015 revised proposal of $368.0 million (unescalated direct costs, $2014–15).[67] In making our 2015 final decision, we were not satisfied that the model used by JGN to arrive at its ME capex forecast produced the best estimate. We used an alternative model to arrive at our ME capex estimate.

65 At the same time as releasing this remade final decision, we have released a separate final adjustment determination for JGN that has relevance to both 2015–20 and 2020-25 access arrangement periods. See AER, *Final decision, JGN adjustment determination*, February 2019.

66 Australian Competition Tribunal, *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5*, 3 March 2016, p. 2.

67 AER, *Final decision—Jemena Gas Networks (NSW) Ltd access arrangement 2015–20, Attachment 6: Capital expenditure*, June 2015, p. 6-9.

The Tribunal found that our 2015 final decision to use an alternative model to arrive at our ME capex estimate was not in error.[68] However, the Tribunal determined that we were not entitled "to give no real weight to the acknowledged change in contractual arrangements after 1 July 2013."[69] It considered that "it is appropriate for the AER to have the opportunity to reconsider its ME capex."[70]

5.3.1.2 JGN's proposal

JGN has proposed an additional allowance of $21 million (unescalated costs, $2019–20) for ME capex compared with our 2015 final decision. JGN notes this is "consistent with the outcome reached by the AER and CCP10"[71], in reference to the roundtable meeting held on 18 January 2018 between JGN, CCP10 and the AER where we outlined our preferred approach to remaking the ME capex decision.[72]

5.3.1.3 Our final decision

In coming to our position, we worked extensively with JGN to understand its assumptions and worked through any issues as they arose. We provided JGN with the opportunity to give feedback on our ME capex model to ensure that our methodology was transparent.[73] Our ME capex model forms the basis for JGN's proposed uplift to ME capex for this remittal.

Market expansion capital expenditure final decision

We accept JGN's proposed uplift to ME capex of $21 million (unescalated direct costs, $2019–20) for the 2015–20 access arrangement period, compared with our 2015 final decision.[74]

As summarised in Table 5-1, this brings JGN's allowance for ME capex to $344.5 million (unescalated direct costs, $2019–20), representing a 6 per cent increase from our 2015 final decision of $323.9 million (unescalated direct costs, $2019–20).

We consider JGN's proposed ME capex as conforming capex for the 2015–20 access arrangement period and include this amount in our remade decision.[75]

68 Australian Competition Tribunal, *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT 5*, 3 March 2016, [165].
69 Ibid, [177].
70 Ibid, [187].
71 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 4.
72 AER, *AER presentation – JGN capex remittal roundtable – 18 January 2018*, 18 January 2018.
73 For example, presentations made by JGN, CCP10 and AER at the 18 January 2018 roundtable meeting are available on the AER website. See https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015–20-remittal/initiation
74 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, p. 4.
75 NGR, r. 79(1).

The increase in ME capex compared with our 2015 final decision reflects an adjustment to the contractor rates which form a part of the historical unit rates used to estimate JGN's ME capex requirement for 2015–20. Our remade decision gives full weight to JGN's contractual arrangements after 1 July 2013, in accordance with the Tribunal's decision. Furthermore, it represents the best possible forecast in the circumstances, conforms to the capex criteria and is likely to contribute to the achievement of the NGO.[76]

In remaking our decision, we also had regard to new information available and consequently made adjustments to our treatment of non-routine connections, Metreteks and meter data loggers, and corrected two minor modelling errors. These are discussed in section 5.3.1.4.1.

Our remade decision on capex impacts JGN's revenue requirement for the 2015–20 access arrangement period and consequently its tariffs for reference services. We have adjusted these aspects of the access arrangement accordingly. This capex decision does not affect any other constituent components of the 2015–20 access arrangement final decision.[77]

Table 5-1 JGN remade final decision on ME capex for 2015–20 compared to set aside 2015 final decision (unescalated direct costs, $million, 2019–20)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
2015 final decision	71.3	68.0	64.8	61.5	58.3	323.9
Remade final decision	75.8	72.4	68.9	65.4	62.0	344.5
Difference	4.5	4.3	4.1	3.9	3.7	20.6
Percentage difference (%)	6	6	6	6	6	6

Source: AER analysis.

Notes: (a) Excluding AER material and labour escalation adjustments.

(b) Totals may not add due to rounding.

Constituent decision on capital expenditure

Our remade final decision for JGN allows $1,107.5 million (escalated costs, $2019–20) for net total capital expenditure (capex). This is an increase of $21.9 million[78], or 2 per cent, from our 2015 final decision of $1,085.6 million (escalated, $2019–20). Our remade final decision for capex by category is shown in Table 5-2.

76 NGR, rr. 74 and 79; and NGL, s. 28(1).

77 NGL, s. 28(1)(b)(ii).

78 This figure includes the effect of cost escalation, which is consistent with our 2015 final decision model.

Table 5-2 JGN remade final decision on capex for 2015–20 (escalated costs, $million, 2019–20)

Category	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Connections/Market expansion	76.5	73.4	70.3	67.3	64.3	351.7^
Augmentation/Growth capacity	19.5	19.8	24.6	19.5	13.9	97.3
Mains and service renewal	13.9	18.0	14.0	9.7	11.0	66.7
Facilities renewal and upgrade	25.3	21.3	22.6	23.1	18.6	110.8
SCADA	1.5	3.0	3.1	2.4	0.8	10.9
Meter renewal and upgrade	33.7	35.3	35.9	34.4	31.7	171.0
Government authority work	0.6	0.6	0.6	0.6	0.6	2.9
IT	48.2	34.5	37.2	20.8	12.0	152.7
Other - non-distribution	8.2	3.6	4.5	8.3	5.3	30.0
TPC/FEED	-	-	-	-	-	-
Overheads	27.6	27.1	27.6	27.0	26.3	135.5
GROSS TOTAL CAPITAL EXPENDITURE	256.7	237.0	240.4	213.0	184.6	1,131.6
Contributions	6.2	4.7	4.2	4.1	4.0	23.1
Asset disposals	0.1	0.1	0.2	0.3	0.2	0.9
NET TOTAL CAPITAL EXPENDITURE	250.4	232.3	236.0	208.5	180.4	1,107.5

Source: AER analysis.

Note: Totals do not add up as JGN claimed confidentiality over mines subsidence and related party margin expenditure. ^This table presents our remade final decision in escalated cost terms. The cost escalators are consistent with the ME capex final decision model.

5.3.1.4 Methodology and reasons for our final decision

Components of ME capex

The majority of ME capex relates to connecting residential and smaller commercial and industrial customers to the network (Tariff V connections). ME capex also includes larger commercial and industrial customer connections (Tariff D connections) and major market expansion projects (MME projects).[79] The Tribunal's orders to adjust the ME capex contractor rates only relate to Tariff V connections.

Methodology

To arrive at our remade decision for ME capex, we calculated JGN's Tariff V ME capex by multiplying Tariff V historical unit rates with mains/services/meters volumes per connection and forecast number of connections. This approach is consistent with the methodology we

79 JGN defines Tariff V customers as those consuming less than 10TJ of gas per year, and Tariff D customers as those consuming more than 10TJ of gas per year.

used in our 2015 final decision. Unlike that decision, we have adjusted the historical Tariff V unit rates to account for the current and ongoing contractor rates. When calculating the Tariff V unit rates, we had regard to additional material not available at the time of the 2015 final decision. No changes were made to the Tariff D or MME projects allowances from our 2015 final decision, as JGN did not dispute these elements of ME capex.

Historical cost approach

We have used the historical cost approach in remaking our decision, giving consideration to the past performance of a gas business. Under the ex-ante regime, gas businesses are rewarded for spending less capex than allowed by the regulator. This incentive enables us to place some reliance on the historical costs of a gas business when reviewing its forecast capex. We used historical costs and mains/services/meters volumes per connection as an indicator of efficient costs and volumes for JGN's ME capex. This is the same approach that we adopted for our assessment of ME capex in our 2015 final decision.

The historical cost approach is an accepted industry practice. Many gas businesses, including JGN, have used this approach as a basis to forecast expenditure proposals. We have also used this approach previously in our assessment of access arrangement proposals for the Victorian gas businesses.

Current and ongoing contractor rates

In accordance with the Tribunal's directions, we have had regard to JGN's current and ongoing contractor rates in remaking our decision on ME capex. The disputed contractor rates specifically related to contractor work for Tariff V mains and services. These components make up the majority of Tariff V connections expenditure.

In July 2013, Zinfra Pty Ltd[80] was awarded JGN's southern region contract with the condition that pricing was to match or better the Northern Region tender outcomes (for the same scope of works).[81] We reviewed the tender documents, the tender assessment and the decision to award the four contracts. In our 2015 draft decision, we noted that:

> "We are satisfied that this was a competitive tender process. As it was a competitive tender price, we are satisfied that the unit rates established in the contracts reflect competitive unit rates prevailing in the market. On this basis we are satisfied that the unit rates drawn from these contracts which form the basis of estimates used in JGN's proposed capex are efficient [under NGR r. 71(1)]."[82]

Consequently, to fulfil the Tribunal's directions we have adjusted the Tariff V unit rates in our remade decision to reflect the difference between the current and ongoing contractor rates, and the rates that were used for the 2015 final decision (being the average contractor rates over the five years to 2013–14).[83]

80 Zinfra is owned by JGN's ultimate Australian holding company, SGSP (Australia) Assets Pty Ltd, and is therefore a related party to JGN.

81 JGN, *Jemena Gas Network submissions on framework issues, return on debt and market expansion capital expenditure*, [284(b)].

82 AER, *Draft decision—Jemena Gas Networks (NSW) Ltd access arrangement 2015–20, Attachment 6: Capital expenditure*, November 2014, p. 6-47.

83 For the 2015 final decision, we calculated Tariff V expenditure by multiplying historical five-year average unit rates with

5.3.1.4.1 Adjustments to Tariff V ME capex allowance for the remade decision

This section sets out our approach to adjusting Tariff V ME capex for this remade decision.

Tariff V adjustments

Tariff V connections expenditure makes up over 90 per cent of total ME capex and over 99 per cent of the total number of new connections. Our estimate of Tariff V connections expenditure is based on a five-year (2009–10 to 2013–14) historical average of Tariff V connections unit rates and mains/services/meters volumes per connection. The contractor component of the five-year average unit rates were adjusted to reflect the current and ongoing contractor rates.

To calculate the total Tariff V connections expenditure for each customer category, we multiplied the forecast number of new connections by the five-year average unit rates and mains/services/meters volumes per connection. This resulted in forecast Tariff V expenditure of $333.8 million (unescalated direct costs, $2019–20). Table 5-3 shows our approved Tariff V expenditure by customer category, and our remade final decision on ME capex.

Table 5-3 JGN remade final decision on ME capex for 2015–20, by connection type (unescalated direct costs, $million, 2019–20)

Connection type	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tariff V	73.6	70.3	66.8	63.3	59.9	333.8
Residential	66.7	63.1	59.4	55.8	52.1	297.1
I&C volume	6.9	7.1	7.3	7.6	7.8	36.7
Tariff D and MME projects	2.2	2.1	2.1	2.1	2.1	10.7
Total ME capex	**75.8**	**72.4**	**68.9**	**65.4**	**62.0**	**344.5**

Source: AER analysis.

Notes: (a) Excluding AER material and labour escalation adjustments.

(b) Totals may not add due to rounding.

Forecast Tariff V new connections numbers

To calculate JGN's ME capex allowance, we relied on the forecast number of new connections that we used in our 2015 final decision.

As JGN is regulated under a price cap[84], its tariffs have been set with respect to forecast gas demand and number of new connections that was applied in the 2015 final decision. Under a price cap, the service provider's revenues are determined by the product of its tariff structures and the quantity demanded under each element of that tariff structure. Price caps are determined with respect to the expected volume of gas demand as forecast at the start

forecast connection numbers. A major component of these unit rates was the contractor rates.

84 More accurately, the tariff variation mechanism that applies to JGN in the 2015–20 AA is the tariff basket price control. This is the same as a 'weighted average price cap'.

of the regulatory period. As such, we determined the maximum tariffs that could be charged to consumers in the 2015 final decision.[85]

Additional changes to the Tariff V estimate compared with our 2015 final decision

Based on further information we received from JGN throughout the remittal process, we have made changes to our approach to non-routine costs, Metreteks and meter data loggers (MDLs) from our 2015 final decision. We have also identified and amended calculation errors that impacted our 2015 final decision ME capex allowance. Collectively, these changes have resulted in an increase of approximately $6 million compared with our 2015 final decision.[86]

5.3.2 Return on debt constituent decision

In this remade final decision, our remade debt constituent decision has not changed from our remade draft decision.[87]

The allowed rate of return provides a network service provider a return on capital that a benchmark efficient entity would require to finance (through debt and equity) investment in its network.[88] The return on capital building block is calculated as a product of the rate of return and the value of the regulatory asset base (RAB). The rate of return is discussed in this section.

JGN's revenue Proposal has implicitly adopted our return on capital allowance that we set in our 2015 final decision (with minor updates for updated return on debt data). This was based on a transition to a trailing average methodology for calculating the return on debt.

Since our 2015 final decision, having regard to the decisions of the Tribunal and Court, we have revised our general approach to determining the return on debt. We now apply a revenue neutral transition when moving from the on-the-day methodology for estimating the cost of debt to a trailing average methodology. While our approach, and the reasoning to support it, has changed since the 2015 final decision, the revenue outcome of our new approach is approximately the same as in that decision.[89] JGN's Proposal is consistent with our new approach to determining the return on debt.

The revised rate of return allowance for this remade final decision is set out in Table 5-4. These numbers reflect our 2015 final decision with respect to the return on equity and the gearing ratio and a revenue neutral transition calculated using partially updated debt yield data from the Reserve Bank of Australia (RBA)[90] and fully updated data from Bloomberg.

85 Where the actual demand is lower than forecast demand, a service provider can earn a lower revenue than originally forecast. Conversely, the service provider can earn higher revenue where actual demand is higher than the forecast demand on which the price cap has been set.

86 See section 5.3.1.4.1 of: AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

87 See section 5.3.2 of: AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

88 The term 'network service provider' relates to service providers that provide gas and electricity transmission and distribution services.

89 We note a very small change in revenue occurs due to the use of updated debt yield data (pre 5 June 2018 updates).

90 Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3,* 4 July 2018.

The RBA data has been updated for the pre 5 June 2018 RBA revisions only, due to the unique circumstances described below. They also reflect the debt averaging periods we determined to use in our 2015 final decision.

The RBA data has been updated for the pre 5 June 2018 RBA revisions only. The approach we have applied in remaking this final decision has necessarily been influenced by the circumstances that we face now. They are materially different from those that we faced when we made our 2015 final decision, and what we would generally face in making an access arrangement determination. Given the circumstances, the late timing of the 5 June 2018 RBA data update, the good faith in which parties have sought resolution of the remittal, and the broad stakeholder support for JGN's Proposal, on balance, we consider that not applying the updated RBA data (as updated on 5 June 2018) to this remade final decision is the outcome that contributes to the NGO to the greatest degree.[91]

We also note JGN's proposal to use the year 4 portfolio estimate for year 5 of the access arrangement period when calculating the return on debt. While we have accepted the outcome of this proposal in setting relevant tariffs for the final year of the access arrangement period, we wish to clarify that the trailing average debt will continue to be calculated on the basis of the applicable averaging period for the 2020 regulatory year. That is, for the purposes of calculating the trailing average cost of debt in future regulatory years, we will estimate the rate of return on debt for the 2020 regulatory year based on the debt averaging period that has been accepted for that regulatory year.

Table 5-4 JGN remade final decision return on debt and return on capital ($million, nominal) and percentage debt portfolio rate of return[92]

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Final decision debt portfolio rate of return	4.27%	4.39%	4.47%	4.50%	4.50%	
Final decision return on debt	76.42	82.60	87.68	91.76	94.40	432.9
Final decision return on capital	167.02	177.45	186.62	193.82	198.62	923.5

91 See section 5.3.2.5 of: AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

92 These numbers reflect the final decision including annual debt updates using data prior to the 5 June 2018 RBA update.

5.3.2.1 The NGR requirements

We must determine a rate of return such that it achieves the allowed rate of return objective (ARORO).[93] The ARORO is that the rate of return is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of its regulated services (its reference services in the case of gas service providers).[94] Therefore, each remade debt decision must contribute to achieving the ARORO.

Other legislative requirements relevant to remaking our debt decision include the NGO, the RPP and any interrelationships with other related components of an access arrangement determination.[95, 96, 97]

5.3.2.2 The Tribunal's decision

On 26 February 2016, the Tribunal handed down its decisions.[98] The Tribunal instructed us to remake the constituent decision on the return on debt in relation to the introduction of the trailing average in accordance with the Tribunal's reasons for its decisions without giving a clear clarification of the directions for the remittal.[99] The Tribunal found us in error in our definition of a benchmark efficient entity as a "regulated" entity. The Tribunal also found us in error in our construction of NGR rule 87, based on the information available to the Tribunal at that time.

5.3.2.3 Judicial Review

On 24 March 2016, we applied to the Federal Court for judicial review of the Tribunal's decisions. On 24 May 2017, the Court dismissed our appeal on the return on debt and upheld the Tribunal's decisions in relation to this issue. It upheld the AER's appeal in relation to the value of imputation credits (gamma).[100]

We have carefully considered the full reasoning of the Court in considering what to do to achieve the ARORO, NGO and RPP in this decision. Of relevance, in relation to the Court's decision, the Court clarified that:

- a benchmark efficient entity is not necessarily either regulated or unregulated
- the important characteristic of a benchmark efficient entity is that it has a similar degree of risk to the service provider with respect to the provision of its regulated services

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93 NGR s 87(2).

94 NGR s 87(3).

95 NGL, ss. 23 and 28(1)(b)(iii)(A).

96 The RPP that are directly relevant to remaking our debt decision are set out at NGL, ss. 24(2), 24(3), 24(5), 24(6) and 24(7).

97 NGL s 28(1)(b)(ii).

98 *Applications by Jemena Gas Networks (NSW) Ltd* [2016] ACompT5; *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1.

99 Ibid.

100 *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79; *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80.

- a change in debt estimation methodology does not necessarily result in any impacts for a benchmark efficient entity

In relation to both the decisions of the Tribunal and Court, we also make the following observations:

- The decisions of the Tribunal and Court were not focussed on the interpretation of “efficient financing costs” in the ARORO. We consider this to be an important factor.
- Neither decision removes the requirement to apply a debt methodology that we consider will achieve the relevant legislative objectives for each of the respective service providers affected by the remittals.
- Neither decision requires the use of a trailing average methodology for determining the cost of debt in this remittal.

In subsequent decisions involving other parties, the Tribunal and Full Federal Court have made various findings and comments which are also relevant to these matters. In particular, both the Tribunal and Federal Court have made comments about our new approach to estimating the return on debt that help to clarify how the Tribunal’s decision for JGN should be interpreted.[101] This is discussed in more detail below.

5.3.2.4 Other relevant legal processes

Other legal decisions that we have had regard to in our remade final decision are:

- the decision of the Australian Competition Tribunal for SA Power Networks and the subsequent decision of the Full Federal Court on the appeal of this decision[102]
- the decisions of the Australian Competition Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd[103]

The decisions of the Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd are particularly important as they are directly concerned with the application of our new approach to estimating the return on debt.

After the Tribunal handed down its decisions for JGN, we reconsidered our approach to debt estimation methodology. The new approach, which we adopted in our decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks, does not rely upon a conceptualisation of a benchmark efficient entity as a regulated entity. It recognises that different service providers may have a different benchmark efficient entity. The new approach also does not rely on a change in methodology impacting a benchmark efficient entity to justify our revenue neutral transition. Our new approach does not rely upon an assessment of historical financing practices. Instead, it considers the efficient financing costs (being the costs of equity and debt) in a forward looking manner. Our new approach was subject to review by the Tribunal.

[101] See, for example, *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3 at [295].

[102] *Application by SA Power Networks* [2016] ACompT 11; *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

[103] *Application by ActewAGL Distribution* [2017] ACompT 2.

The Tribunal upheld our new approach. It explained more clearly how each of the Tribunal's and Court's decisions should be read together consistently. It provided clarification for the earlier Tribunal's decision on the directions of the Tribunal for the remittal that were previously unclear to us. We consider these decisions support a revenue neutral transition when moving to a trailing average methodology based on our new approach, or the continuance of an on-the-day methodology for determining the cost of debt, to achieve the NGO.

An important aspect of the decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd is the consideration in those decisions of the interpretation of the "allowed rate of return objective" (or ARORO) and the meaning of "efficient financing costs".[104] We consider these decisions support our ex ante interpretation of efficient financing costs. These decisions and our view on them are covered in further detail in our debt Position Paper on our remitted debt decisions.[105]

On 18 January 2018, the Full Federal Court handed down its decision on SA Power Networks v Australian Competition Tribunal.[106] This was a review brought by SA Power Networks from a decision of the Tribunal.[107] The Full Federal Court noted that the Court had not had the benefit of hearing a number of issues in relation to JGN's review that had been subsequently put to it in SA Power Networks v Australian Competition Tribunal. We consider this Full Federal Court decision also supports our new revenue neutral debt transition approach which we propose to apply in this remitted debt decision.

5.3.2.5 Reasons for our final decision

For the reasons set out in our debt Position Paper[108] on our remitted debt decisions and in our APA VTS final decision, we consider a revenue neutral transition to a trailing average debt estimation methodology will lead to an allowed rate of return that will achieve the ARORO and contribute to the achievement of the NGO to the greatest degree. This rate of return will both reflect ex ante efficient financing costs and result in an approximately zero NPV investment outcome which is important to achieving efficient investment incentives. A revenue neutral transition will also substantially eliminate any wealth impact on JGN from changing the debt estimation methodology.

We rely on the reasoning in our APA VTS decision in making this final decision for JGN as set out in Attachment 3 of our APA VTS determination.[109] This includes an explanation of how our approach has changed in response to relevant legal decisions. We also rely on our

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104 Ibid.

105 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.

106 *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

107 *Application by SA Power Networks* [2016] ACompT 11.

108 Ibid.

109 AER, *Final Decision APA VTS gas access arrangement 2018 to 2022, Attachment 3 - Rate of return*, November 2017. This decision discusses and applies substantively identical provisions for rate of return as those applicable to electricity distribution.

explanation and reasoning as set out in the debt Position Paper on our remitted debt decisions in making this final decision.[110]

In relation to the timing of the initial debt averaging period (for the commencement of the trailing average), we have used the initial averaging period set out in our 2015 final decision for the introduction of the trailing average. We also have used the debt averaging periods for years 2 to 4 of the access arrangement period, as set out in our 2015 final decision, because we consider these will lead to a rate of return that achieves the ARORO and contribute to the achievement of the NGO. All averaging periods were chosen in advance of their commencement and we consider their use should result in an ex ante efficient return on debt allowance. We consider choosing averaging periods after the periods have finished (or post commencement) is generally inappropriate due to the potential incentive on various stakeholders to advocate for averaging periods that give particular results. We have determined the final tariffs to apply in the final year of the access arrangement period in this determination despite the debt averaging period for the 2020 regulatory year not having commenced. However, as noted above, for the purposes of calculating the trailing average cost of debt in this access arrangement (and in future regulatory years under the Rate of return instrument), we will estimate the rate of return on debt for the 2020 regulatory year using the applicable averaging period for that year.[111]

We also consider our overall approach will lead to an overall allowed rate of return that will achieve the ARORO and contribute to achieving the NGO because:

- the return on equity we determined in our 2015 final decision was upheld on appeal as was the gearing ratio and we consider these values remain appropriate
- our combination of the yield from two debt series we used to estimate the return on debt in the 2015 final decision, a simple average of yields estimated from the Bloomberg and RBA yield curves, was upheld on appeal in the Tribunal and we consider remains appropriate
- we consider the overall allowed rate of return estimated using our return on debt, return on equity and gearing estimates will result in an allowed rate of return that will achieve the ARORO and contribute to achieving the NGO

Our remade return on debt constituent decision has been informed by our examination of submissions received on our debt Position Paper[112] and remade draft decision.[113] Further information on our analytical approach and the data we used to inform our analysis is outlined in our remade draft decision. We note that submissions received in response to that decision did not raise any new issues or any additional information that necessitates a change to our return on debt decision as outlined in the remade draft decision.[114]

110 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.

111 As accepted in our 2015 final determination and in accordance with the methodology for its calculation as set out in that determination

112 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.

113 See section 5.3.2 of: AER, *Draft decision: Jemena Gas Networks (NSW) Ltd 2015-20 access arrangement*, January 2019.

114 Ibid.

5.4 Other aspects of the 2015 final decision to be varied

5.4.1 Reference tariff variation mechanism

In its remittal proposal, JGN proposed amendments to the tariff variation mechanism for pass throughs[115] that it has not yet recovered in the 2015–20 access arrangement period.[116] As we discuss below, we consider these proposed amendments are appropriate.

The reference tariff variation mechanism was not a subject of JGN's appeal of our June 2015 final decision.[117] However, this remade final decision amends certain aspects of the reference tariff variation mechanism in the access arrangement for the 2015–20 access arrangement period.[118]

The Tribunal's directions that we are to comply with in remaking our decision includes:[119]

> "(d) the AER is to consider, and to the extent to which it considers appropriate, to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 28(1)(b) of the National Gas Law in the light of such variations as are made to the Final Decision by reason of (a)–(c) hereof."

During the appeal process, JGN entered into enforceable undertakings with the AER to set prices for the 2016–17 to 2018–19 regulatory years. The enforceable undertakings were interim arrangements that provided price stability, predictability and transparency while our 2015 final decision was under appeal. Given their interim nature, the enforceable undertakings did not account for the adjustments that would normally have occurred as part of the annual tariff variation process, such as pass throughs and licence fees.

Under normal circumstances, we would incorporate these factors into reference tariffs for 2019–20 through iterative calculations for each completed regulatory year of the access arrangement period.[120] However, given the circumstances of the remittal, JGN has proposed amendments to the tariff variation mechanism that incorporates these factors into 2019–20 tariffs through a single calculation.[121] JGN noted the calculation method in its Proposal results in a value that is closer to the "expected revenue" amount under its tariff variation mechanism compared to the calculation in the 2015–20 access arrangement.[122]

We agree with JGN's assessment. The difference in expected revenues between the two calculation methods is immaterial and so does not provide JGN with any windfall gains or

115 Generally refers to amounts that are normally accounted for in the annual tariff variation process, such as license fees and unaccounted for gas.

116 JGN, *2015–20 access arrangement remittal proposal*, October 2018, p. 4.

117 The reference tariff variation mechanism for JGN is the tariff basket price control (also known as a weighted average price cap).

118 See JGN, *Access arrangement: JGN's NSW gas distribution networks: 1 July 2015 – 30 June 2020 (Incorporating revisions required by AER Final Decision 3 June 2015)*, June 2015, pp. 5–14 and schedule 3.

119 *Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5.*

120 These are the calculations we would have made in the annual tariff variation process had there been no appeal of our 2015 final decision.

121 JGN, *Proposal For The Remittal Items – Jemena Gas Networks 2015–20 Access Arrangement Final Decision*, 31 October 2018, Appendix A.

122 JGN, *Email: Draft adjustments to the tariff variation mechanism in the Access Arrangement*, 27 November 2018.

losses. Further, JGN's calculation method in its Proposal is administratively simpler as it is a single calculation, rather than an iterative one.

5.4.2 Annual Variation Notice submission date

JGN has proposed to amend clause 3.6(a) of the access arrangement such that JGN would submit the Variation Notice for the 2019–20 regulatory year on or before 15 April 2019, rather than 15 March 2019.[123]

We consider this extension to the submission date is reasonable. This is because the timing of our remade final decision and final decision adjustment determination introduces time constraints on the development of the 2019–20 Variation Notice.

[123] JGN, *2015–20 access arrangement remittal proposal*, October 2018, p. 7.