FINAL DECISION

Jemena
Distribution Determination
2021 to 2026

Attachment 1
Annual revenue requirement

April 2021

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the Australian Energy Regulator (AER)'s final decision on the distribution determination that will apply to Jemena for the 2021–26 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classifications of services

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Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Negotiating framework

Contents

1 Annual revenue requirement

This attachment sets out our final decision on Jemena's annual revenue requirement (ARR) for the provision of standard control services (SCS) over the 2021–26 regulatory control period. Specifically, it sets out our final decision on:

- the ARRs (unsmoothed), which are the sum of annual building block costs
- the total revenue requirement, which is the sum of the ARRs
- the annual expected revenues (smoothed)
- the X factors.

We determine Jemena's ARRs using a building block approach. We determine the X factors by smoothing the ARRs over the regulatory control period. The X factor is used in the CPI–X methodology to determine the annual expected revenue (smoothed).

1.1 Final decision

We determine a total ARR of $1337.3 million ($ nominal, unsmoothed) for Jemena for the 2021–26 regulatory control period, reflecting our final decision on the various building block costs. This is an increase of $49.7 million ($ nominal) or 3.9 per cent to Jemena's revised proposed total ARR of $1287.6 million.[1] The key reasons for the increase are the lower expected inflation rate that resulted from our inflation review which increases regulatory depreciation (Attachment 4) and also an increase in the rate of return (Attachment 3).

We determine the annual expected revenue (smoothed) and X factor for each regulatory year of the 2021–26 regulatory control period by smoothing the ARRs. Our final decision is to approve total expected revenues of $1335.7 million ($ nominal) for Jemena for the 2021–26 regulatory control period.

Table 1.1 shows our final decision on the ARR, annual expected revenue, and X factor for each year of the 2021–26 regulatory control period.

Table 1.1 AER's final decision on Jemena's revenues for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	74.5	76.5	77.4	76.9	75.6	380.9
Regulatory depreciation[a]	52.2	56.6	59.6	63.7	68.1	300.2

[1] Jemena, *03–01M SCS PTRM FY22–26,* updated 19 March 2021.

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Operating expenditure[b]	101.4	105.4	109.9	113.9	118.2	548.8
Revenue adjustments[c]	19.4	16.1	14.6	11.8	12.0	73.8
Cost of corporate income tax	7.4	6.2	5.3	7.4	7.2	33.6
Annual revenue requirement (unsmoothed)	254.8	260.8	266.9	273.6	281.1	1337.3
Annual expected revenue (smoothed)	**261.4**	**264.3**	**267.1**	**270.0**	**272.9**	**1335.7**
X factor[d]	n/a[e]	0.90%	0.90%	0.90%	0.90%	n/a

Source: AER analysis.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).

(b) Includes debt raising costs.

(c) Includes revenue adjustments from the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), shared assets adjustments and the demand management innovation allowance mechanism (DMIAM).

(d) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.

(e) Jemena is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision. The expected revenue for 2021–22 is around 8.1 per cent lower than the approved total annual revenue for 2020 in real terms, or 6.3 per cent lower in nominal terms after taking into account the escalation by the half year Consumer Price Index (CPI) to allow comparison of the revenue from 1 July 2021 onwards.

1.2 Jemena’s revised proposal

Jemena's revised proposal included total expected revenues (smoothed) of $1286.1 million ($ nominal) for the 2021–26 regulatory control period.

Table 1.2 sets out Jemena's revised proposed ARR, the annual expected revenue, and the X factor for each year of the 2021–26 regulatory control period.

Table 1.2 Jemena's revised proposed revenues for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	70.2	72.1	73.4	73.3	72.5	361.5
Regulatory depreciation[a]	46.8	51.0	53.9	57.8	62.3	271.8
Operating expenditure[b]	101.7	106.2	111.2	115.6	120.4	555.0
Revenue adjustments[c]	19.3	16.0	14.6	11.7	12.0	73.7
Cost of corporate income tax	5.1	4.9	3.9	5.9	5.7	25.6
Annual revenue requirement (unsmoothed)[d]	243.1	250.2	256.9	264.4	272.9	1287.6

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Annual expected revenue (smoothed)[e]	**249.8**	**253.5**	**257.2**	**260.9**	**264.7**	**1286.1**
X factor	n/a[d]	0.90%	0.90%	0.90%	0.90%	n/a

Source: Jemena, *03–01M SCS PTRM FY22–26,* updated 19 March 2021.

(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.

(b) This is the revised operating expenditure (opex) forecast (submitted on 22 January 2021). Includes debt raising costs.

(c) Includes revenue adjustments from EBSS, CESS, shared assets adjustments and DMIAM.

(d) Jemena is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision.

1.3 Assessment approach

We did not change our assessment approach for the ARR from our draft decision. Attachment 1 (section 1.3) of our draft decision details that approach.[2]

1.4 Reasons for final decision

For this final decision, we determine a total ARR of $1337.3 million ($ nominal, unsmoothed) for Jemena for the 2021–26 regulatory control period. This is an increase of $49.7 million ($ nominal) or 3.9 per cent to Jemena's revised proposed total ARR of $1287.6 million ($ nominal) for this period. This reflects the impact of our final decision on the various building block costs.

The changes we made to Jemena's revised proposed building blocks include (in nominal terms):

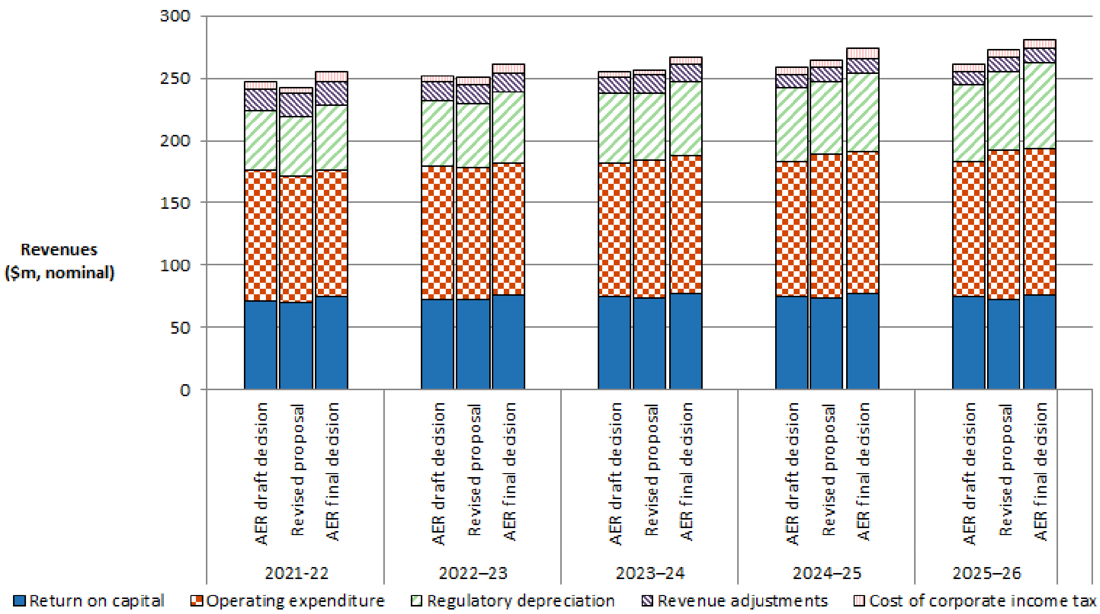
- an increase in the return on capital of $19.4 million or 5.4 per cent (Attachments 2, 3 and 5)
- an increase in the regulatory depreciation of $28.4 million or 10.5 per cent (Attachment 4)
- a reduction in the opex forecast of $6.2 million or 1.1 per cent (Attachment 6)[3]
- an increase in the cost of corporate income tax of $8.0 million or 31.4 per cent (Attachment 7).
- an increase in the revenue adjustments of $0.1 million or 0.2 per cent (section 1.4.2 and Attachments 8, 9 and 11).

2 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 1– Annual revenue requirement*, September 2020, pp. 6–7.

3 While we accept Jemena's revised proposal opex in $2020–21 terms, the lower inflation in the final decision results in a nominal reduction.

Figure 1.1 shows the building block components from our determination that make up the ARRs for Jemena, and the corresponding components from its revised proposal and our draft decision.

Figure 1.1 AER's draft and final decisions and Jemena's revised proposed annual building block revenue requirement ($ million, nominal)



Source: AER analysis; Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021.

Note: Revenue adjustments include EBSS, CESS, shared assets adjustments and DMIAM amounts. Opex includes debt raising costs.

1.4.1 X factor and annual expected revenue

For this final decision, we determine an X factor for Jemena of 0.9 per cent per annum for the four years of the regulatory control period from 2022–23 to 2025–26.[4] The net present value (NPV) of the ARRs is $1167.5 million ($ nominal) as at 1 July 2021. Based on this NPV and applying the CPI–X framework we determine that the expected revenue (smoothed) for Jemena is $261.4 million in 2021–22 increasing to $272.9 million in 2025–26 ($ nominal). The resulting total expected revenue for Jemena is $1335.7 million for the 2021–26 regulatory control period.

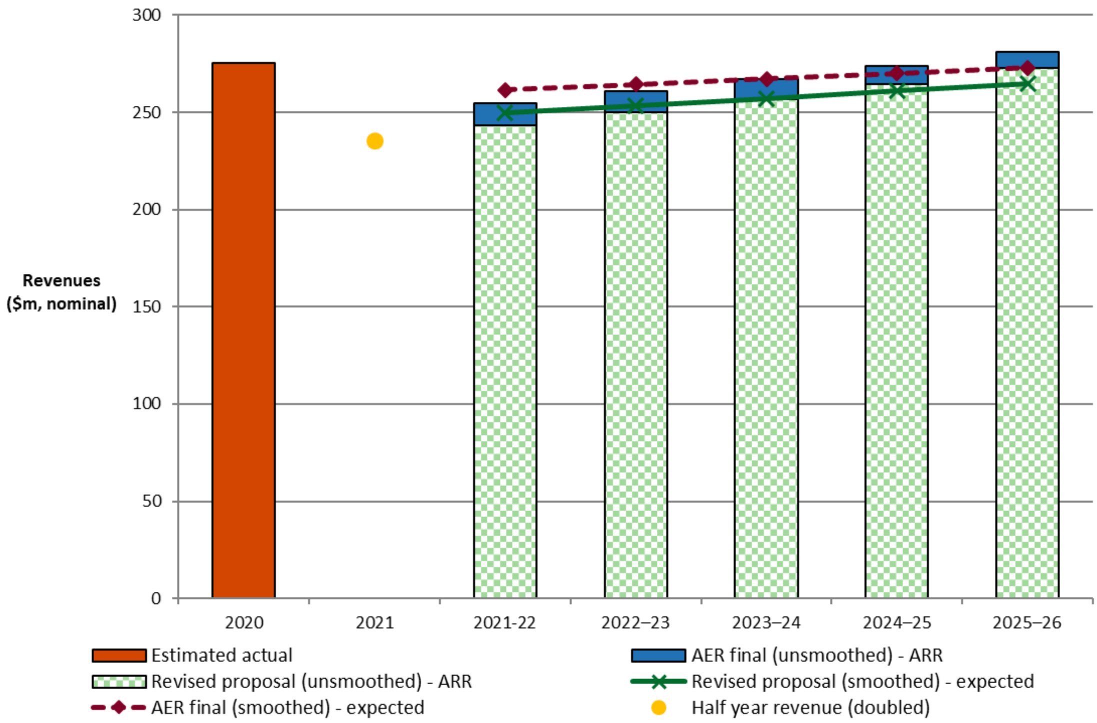
In our draft decision, we considered the 2020 total allowed revenue from Jemena's approved pricing proposal, escalated by the half year CPI, should form the 2020–21 starting revenue estimate of $278.9 million, as this was the latest available estimate

[4] Jemena is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision.

that we have approved.[5] Jemena adopted this estimate in its revised proposal.[6] This estimated 2020–21 starting revenue forms the base year to calculate the percentage change for the first year of the 2021–26 regulatory control period (P_0) for our final decision.

Figure 1.2 shows our final decision on Jemena's annual expected revenue (smoothed revenue) and the ARR (unsmoothed revenue) for the 2021–26 regulatory control period. For comparative purposes, the revenue for 2021 is shown as double the amount determined for the six month extension period between 1 January 2021 and 30 June 2021.[7]

Figure 1.2 AER's final decision on Jemena's revenue for the 2021–26 regulatory control period ($ million, nominal)



Source: Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021; AER analysis.

Note: Revenue for 2021 is based on doubling the amount determined for the half year period between 1 January 2021 and 30 June 2021.

Red Energy and Lumo Energy submitted that the revenues should remain stable to the extent possible in order to provide customers with stable tariffs in the long run.[8] We have considered the submission and taken into account the building block costs

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5 Jemena, *Revised Tariff Approval Model 2020*, 7 October 2019.

6 Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021.

7 AER, *Model – Final decision six-month extension – Jemena – 2021 HY Post-Tax Revenue Model,* October 2020.

8 Red Energy and Lumo Energy, *Submission on the Victorian EDPR Revised Proposal and draft decision*, 17 January 2021, p. 1

determined in this final decision when smoothing the expected revenues for Jemena over the 2021–26 regulatory control period. In doing so, we have set the expected revenue for the first regulatory year at $261.4 million ($ nominal) which is $6.6 million higher than the ARR for that year. We then apply an expected inflation rate of 2.00 per cent per annum and an X factor of 0.9 per cent per annum to determine the expected revenue in subsequent years.[9] We consider that our profile of X factors results in an expected revenue in the last year of the regulatory control period that is as close as reasonably possible to the ARR for that year.[10] This approach is consistent with our draft decision.[11]

Our final decision results in an average decrease of 0.4 per cent per annum ($ nominal) in the expected (smoothed) revenue from 2020–21 to the end of the 2021−26 regulatory control period.[12] This consists of an initial decrease of 6.3 per cent from 2020–21 to 2021–22, followed by average annual increases of 1.1 per cent during the remainder of the 2021–26 regulatory control period.[13] Our final decision also results in a decrease of 4.6 per cent in real terms ($2020–21) to Jemena's total ARR relative to that in the 2016–20 regulatory control period. This is largely due to a lower rate of return (and therefore lower return on capital) and a lower cost of corporate income tax in this final decision for the 2021–26 regulatory control period than that approved in the 2016–20 determination.

Figure 1.3 compares our final decision building blocks for Jemena's 2021–26 regulatory control period with Jemena's revised proposed revenue requirement for the same period, and the approved revenue for the 2016–20 regulatory control period.

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9 NER, cl. 6.5.9(a).

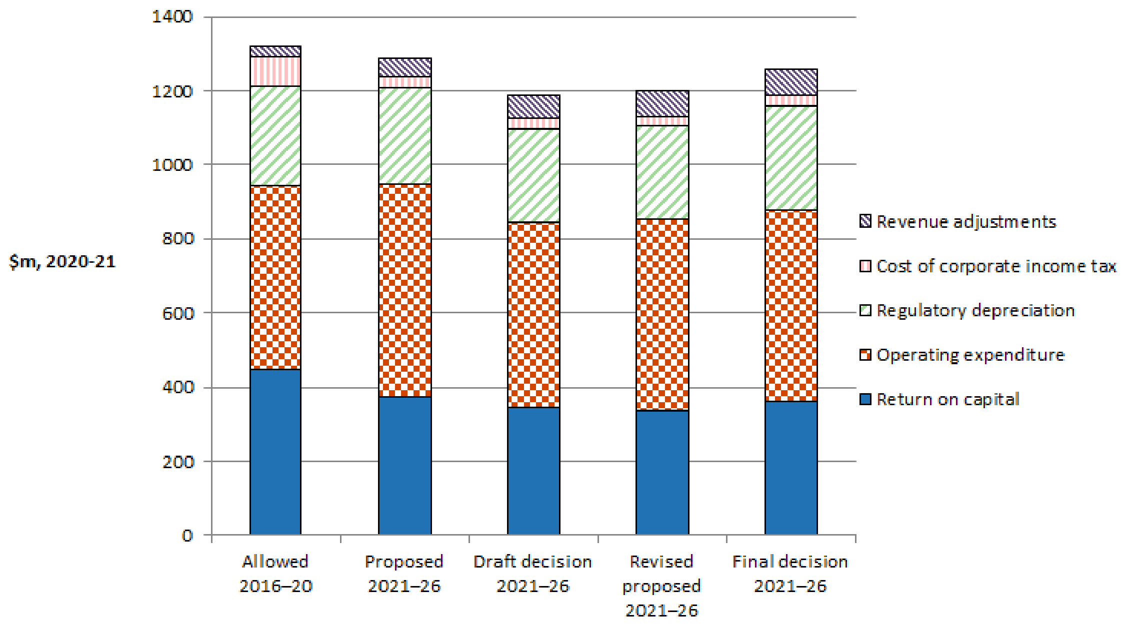
10 NER, cl. 6.5.9(b)(2). We consider a divergence of up to 3.0 per cent between the expected revenue and ARR for the last year of the regulatory control period is appropriate, if this can achieve smoother price changes for users over the regulatory control period. In the present circumstances, based on the X factors we have determined for Jemena, this divergence is around 2.9 per cent.

11 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 1 – Annual revenue requirement*, September 2020, pp. 9–11.

12 In real 2020–21 dollar terms, our approved expected revenue for Jemena results in an average decrease of 2.4 per cent per annum over the 2021–26 regulatory control period.

13 In real 2020–21 dollar terms, this consists of an initial decrease of 8.1 per cent from 2020–21 to 2021–22, followed by annual average decreases of 0.9 per cent during the remainder of the 2021–26 regulatory control period.

Figure 1.3 Total revenue by building block components ($ million, 2020−21)



Source: Jemena, *Att 07-15 SCS PTRM FY22-26*, 31 January 2020; Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021; AER analysis.

1.4.2 Shared assets

Our final decision is to apply a shared asset revenue adjustment to Jemena's total expected revenue for the 2021–26 regulatory control period.

In our draft decision, we applied a shared asset revenue adjustment to Jemena's revenues using the method from our shared asset guideline.[14] Our draft decision shared asset adjustment was consistent with the adjustment Jemena calculated in its initial proposal.

In its revised proposal, Jemena submitted that it updated the shared revenue adjustment to reflect changes to the revised proposal ARRs. We note that while smoothed revenue is used to determine whether the materiality threshold is met for unregulated revenue, we consider that changes in the ARRs should not affect the shared asset adjustment. We note that the revenue difference between the two approaches is immaterial.[15] For this final decision, we have therefore maintained our draft decision approach.[16]

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14 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 1 – Annual revenue requirement*, September 2020, pp. 12–13.

15 Our final decision shared asset decrement is $18,683 higher than the amount in Jemena's revised proposal.

16 Jemena, *Att 03–01 Annual revenue requirement – revised*, 03 December 2020, pp. 24–25.

Consistent with the draft decision, we confirm our assessment that Jemena's forecast unregulated revenues from shared assets for the 2021–26 regulatory control period are reasonable. Therefore, our final decision will see $1.5 million ($2020–21) shared with customers across the 2021–26 regulatory control period, using the same assessment approach as the draft decision.

Table 1.3 compares the shared asset revenue adjustments of Jemena's revised proposal and our final decision.

Table 1.3 AER's final decision on Jemena's shared asset revenue adjustment ($ million, 2020–21)

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Jemena's revised proposal	–0.3	–0.3	–0.3	–0.3	–0.3	–1.4
AER's final decision	**–0.3**	**–0.3**	**–0.3**	**–0.3**	**–0.3**	**–1.5**

Source: Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021; AER analysis.

1.4.3 Indicative average distribution price impact

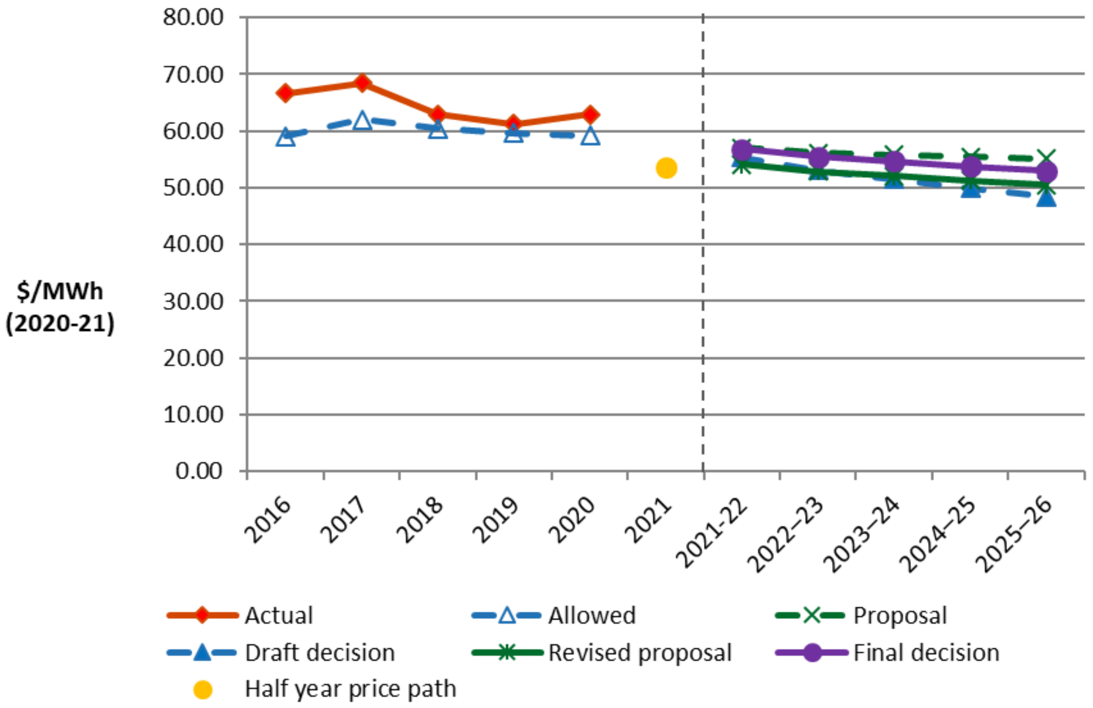
Our final decision on Jemena's expected revenues ultimately affects the prices customers pay for electricity. There are several steps required in translating our revenue decision into indicative distribution price impact.

We regulate Jemena's SCS under a revenue cap form of control. This means our final decision on Jemena's expected revenues does not directly translate to price impacts. This is because Jemena's revenue is fixed under the revenue cap form of control, so changes in the consumption of electricity will affect the prices ultimately charged to customers. We are not required to establish the distribution prices for Jemena as part of this determination. However, we will assess Jemena's annual pricing proposals before the commencement of each regulatory year within the 2021–26 regulatory control period. In each assessment we will administer the pricing requirements set in this distribution determination.

For this final decision, we have estimated some indicative average distribution price impacts flowing from our final determination on the expected revenues for Jemena over the 2021–26 regulatory control period. In this section, our estimates only relate to SCS (that is, the core electricity distribution charges), not alternative control services (such as metering charges). These indicative price impacts assume that actual energy consumption across the 2021–26 regulatory control period matches Jemena's forecast energy consumption, which we have adopted for this final decision. We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

Figure 1.4 shows Jemena's indicative average price path over the period 2016 to 2025–26 in real 2020–21 dollar terms based on the expected revenues established in our final decision compared to Jemena's revised proposed revenue requirement.

Figure 1.4 Indicative price path for Jemena ($/MWh, 2020–21)



Source: AER analysis.

Note: The price for 2021 is based on the revenue and energy throughput estimates for the half year period between 1 January 2021 and 30 June 2021.

We estimate that our final decision on Jemena's annual expected revenue will result in a decrease to average distribution charges by about 3.4 per cent per annum over the 2021–26 regulatory control period in real 2020–21 dollar terms.[17] This compares to the real average decrease of approximately 4.3 per cent per annum in Jemena's revised proposal for the 2021–26 regulatory control period.[18] These high-level estimates reflect the aggregate change across the entire network and do not reflect the particular tariff components for specific end users.

Table 1.4 compares the revenue and price impacts of Jemena's revised proposal and our final decision.

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17 In nominal terms we estimate average distribution charges to decrease by 1.4 per cent per annum. This amount reflects an expected inflation rate of 2.00 per cent per annum as determined in this final decision.

18 In nominal terms Jemena's revised proposal would decrease distribution charges by 2.0 per cent per annum. This amount reflects an expected inflation rate of 2.37 per cent per annum as proposed by Jemena in its revised proposal.

Table 1.4 Comparison of revenue and price impacts of Jemena's revised proposal and the AER's final decision ($ nominal)

	2020[b]	2021–22	2022–23	2023–24	2024–25	2025–26
AER final decision						
Revenue ($ million)	278.9	261.4	264.3	267.1	270.0	272.9
Price path ($/MWh)[a]	62.89	58.01	57.73	58.00	58.27	58.50
Revenue (change)		–6.3%	1.1%	1.1%	1.1%	1.1%
Price path (change)		–7.7%	–0.5%	0.5%	0.5%	0.4%
Jemena revised proposal						
Revenue ($ million)	278.9	249.8	253.5	257.2	260.9	264.7
Price path ($/MWh)[a]	62.89	55.44	55.38	55.84	56.30	56.74
Revenue (change)		–10.4%	1.5%	1.5%	1.5%	1.5%
Price path (change)		–11.8%	–0.1%	0.8%	0.8%	0.8%

Source: Jemena, *03–01M SCS PTRM FY22–26*, updated 19 March 2021; AER analysis.

(a) The price path is in nominal terms and is constructed by dividing nominal expected revenue for SCS by forecast energy consumption for each year of the regulatory control period.

(b) This is based on Jemena's 2020 approved pricing proposal, and has been indexed by the CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the price path from 1 July 2021 onwards.

1.4.4 Expected impact of decision on electricity bills

The annual electricity bill for customers in Jemena's network reflects the combined costs of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs. This final decision primarily relates to the distribution charges for SCS, which represent approximately 24.8 per cent on average for residential customers' and 31.6 per cent on average for small business customers' annual electricity bills in Jemena's network area.[19]

We estimate the expected bill impact by varying the distribution charges in accordance with our final decision, while holding all other components—including the metering component—constant.[20] This approach isolates the effect of our final decision on the

[19] Jemena, *Information request 040*, July 2020.

[20] We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

core distribution charges only. However, this does not imply that other components will remain unchanged across the regulatory control period.[21]

Based on this approach, we expect that our final decision on the distribution component will decrease the average annual residential electricity bill in 2025–26 by about $26 ($ nominal) or 1.7 per cent from the 2020 total bill level.

Similarly, for an average small business customer, we expect that our final decision on the distribution component will decrease the average annual residential electricity bill in 2025–26 by about $139 ($ nominal) or 2.2 per cent from the 2020 total bill level.

Our estimated impact is based on an average annual electricity usage of around 4,000 kWh per annum for residential households and 20,000 kWh for small businesses.[22] Therefore, customers with different usage will experience different changes in their bills. We also note that there are other factors, such as metering, wholesale and retail costs, which affect electricity bills.

Table 1.5 shows our estimated impact of our final decision and Jemena's revised proposal on the average annual electricity bills for residential and small business customers in its network over the 2021–26 regulatory control period.

Table 1.5 Estimated impact of Jemena's revised proposal and AER's final decision on annual electricity bills for the 2021–26 regulatory control period ($ nominal)

	2020	2021–22	2022–23	2023–24	2024–25	2025–26
AER final decision						
Residential annual bill	1514[a]	1485	1483	1485	1487	1488
Annual change[c]		–29 (–1.9%)	–2 (–0.1%)	2 (0.1%)	2 (0.1%)	1 (0.1%)
Small business annual bill	6316[b]	6162	6153	6161	6170	6177
Annual change[c]		–155 (–2.4%)	–9 (–0.1%)	9 (0.1%)	8 (0.1%)	7 (0.1%)
Jemena revised proposal						
Residential annual bill	1514[a]	1470	1469	1472	1475	1477
Annual change[c]		–44 (–2.9%)	–0 (–0.0%)	3 (0.2%)	3 (0.2%)	3 (0.2%)
Small business annual bill	6316[b]	6080	6078	6093	6107	6121
Annual change[c]		–236 (–3.7%)	–2 (–0.0%)	15 (0.2%)	15 (0.2%)	14 (0.2%)

21 It also assumes that actual energy consumption will equal the forecast adopted in our final decision. Since Jemena operates under a revenue cap, changes in energy consumption will also affect annual electricity bills across the 2021–26 regulatory control period.

22 Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 – Final decision*, 18 November 2019, pp. 72−73.

Source: AER analysis; Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 – Final decision*, 18 November 2019, p. 76.

(a) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 – Final decision* and reflects the average consumption of 4000 kWh for residential customers in Victoria. This is then indexed by the CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.

(b) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 – Final decision* and reflects the average consumption of 20000 kWh for small business customers in Victoria. This is then indexed by the CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.

(c) Annual change amounts and percentages are indicative. They are derived by varying the distribution component of the 2020 bill amounts in proportion to yearly expected revenue divided by forecast energy as provided by Jemena. Actual bill impacts will vary depending on electricity consumption and tariff class.

Shortened forms

Shortened form	Extended form
$/MWh	dollars per megawatt hour
AER	Australian Energy Regulator
ARR	annual revenue requirement
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
kWh	kilowatt hour
NER	National Electricity Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
SCS	standard control services