



FINAL DECISION
ActewAGL Distribution
Access Arrangement
2016 to 2021

Attachment 10 – Reference
tariff setting

May 2016

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Note

This attachment forms part of the AER's final decision on the access arrangement for ActewAGL Distribution for 2016–21. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Services covered by the access arrangement

Attachment 2 - Capital base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

Attachment 13 - Demand

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Shortened forms

Shortened form	Extended form
AA	Access Arrangement
AAI	Access Arrangement Information
AER	Australian Energy Regulator
ASA	Asset Services Agreement
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
CMF	construction management fee
CPI	consumer price index
DAMS	Distribution Asset Management Services
DRP	debt risk premium
EBSS	Efficiency Benefit Sharing Scheme
ECM	Efficiency Carryover Mechanism
EIL	Energy Industry Levy
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	value of imputation credits
GSL	Guaranteed Service Level
GTA	Gas Transport Services Agreement
ICRC	Independent Competition and Regulatory Commission
MRP	market risk premium
NECF	National Energy Customer Framework
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure

Shortened form	Extended form
PFP	partial factor productivity
PPI	partial performance indicators
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RoLR	retailer of last resort
RSA	Reference Service Agreement
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	tax asset base
UAFG	unaccounted for gas
UNFT	Utilities Network Facilities Tax
WACC	weighted average cost of capital
WPI	Wage Price Index

10 Reference tariff setting

This attachment outlines our assessment of the reference tariffs proposed by ActewAGL Distribution (ActewAGL) against the requirements of the National Gas Rules (NGR). Our assessment focuses on the structure of reference tariffs and takes into account the revenue and pricing principles.¹

10.1 Final decision

For the reasons set out in our draft decision, we accept ActewAGL's proposed structure of reference tariffs for the 2016–21 access arrangement period. We are satisfied the proposed structure of the reference tariffs complies with the requirements of the NGR.²

Nevertheless, the quantum of the proposed reference tariffs must be amended to reflect our final decision forecast demand and revised revenue allowance set out in this final decision. Our revisions are reflected in schedule 3 of the *Approved Access arrangement for the ACT, Queanbeyan and Palerang gas distribution network 1 July 2016 - 30 June 2021*, which gives effect to this decision.

As in our draft decision, we also approve ActewAGL's proposal to introduce and withdraw reference tariffs classes and tariffs after commencement of the 2016–21 access arrangement but only where they have been pre-approved by us.

10.2 ActewAGL's revised proposal

ActewAGL's revised proposal accepted our draft decision. Its revised proposal did not contain any changes to the proposed structure of reference tariffs approved in our draft decision.³

ActewAGL's initial proposal contained significant changes to its reference tariffs for the 2016–21 access arrangement period. It considered the changes:

- simplified the charge components
- created a tariff structure that recognises differences in which consumers use gas
- provided customers with cost reflective tariffs that encourage the efficient use and growth of the network overtime
- streamlined the process for major customers to seek additional gas capacity on the network, and

¹ NGL, ss. 24(2), 24(5).

² NGR, rr. 93, 94.

³ ActewAGL Distribution, *Response to the AER's draft decision: 2016–21 ACT, Queanbeyan and Palerang gas network access arrangement*, January 2016, pp. 103–105.

- created a tariff assignment process to enable customers to respond to ActewAGL's reference tariffs.⁴

ActewAGL's proposal also contained a new ancillary reference service for the decommissioning and removal of meters.⁵

10.3 AER's assessment approach

In an access arrangement, a service provider is required to specify for each reference service the reference tariff and the proposed approach to the setting of reference tariffs.⁶ This is done by:

- explaining how revenues and costs are allocated, including the relationship between costs and tariffs⁷
- defining the tariff classes⁸
- comparing the revenue to be raised by each reference tariff with the cost of providing each individual reference service⁹
- explaining and describing any pricing principles it employed.^{10,11}

We are required to assess ActewAGL's proposed reference tariffs. Where we do not accept them, we must determine the initial reference tariffs to apply for each reference service.

In our assessment of the proposed reference tariffs, we reviewed ActewAGL's:

- access arrangement information¹²
- access arrangement proposal¹³
- tariff structures statement¹⁴
- explanation of proposed revisions to the 2010 access arrangement.

⁴ ActewAGL Distribution, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Attachment 12: Reference tariffs*, June 2015, p. 5.

⁵ ActewAGL Distribution, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Attachment 2: Services policy*, June 2015, pp. 8–9.

⁶ NGR, rr. 48(1)(d)(i); 72(1)(j)(i); 72(1)(j)(ii).

⁷ NGR, rr. 93(1)–(2).

⁸ NGR, rr. 94(1)–(2).

⁹ NGR, r. 94(3).

¹⁰ NGR, rr. 94(3)–(4).

¹¹ NGR, rr. 48(1)(d)(i); 72(1)(j)(i); 72(1)(j)(ii).

¹² ActewAGL Distribution, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Overview*, June 2015, section 1.19; ActewAGL, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Attachment 12: Reference tariffs*, June 2015.

¹³ ActewAGL Distribution, *Access arrangement for the ACT Queanbeyan and Palerang gas distribution network 1 July 2016 to 30 June 2021*, July 2015.

¹⁴ ActewAGL Distribution, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Appendix 12.01: Tariff structures statement*, June 2015.

We also had regard to submissions received in the course of our consultation on the proposed access arrangement.¹⁵

Identifying the reference service

Service providers are required by the NGR to specify a reference tariff for each reference service.¹⁶ We first consider what is (or are) the reference service(s) for the purpose of the NGR when undertaking our review.¹⁷ Our decision on what constitutes the reference service is set out in Attachment 1 to this final decision.

Assessing the tariff setting method for the reference service

The reference tariffs for a full access arrangement must be designed to meet the requirements of the NGR. Our discretion on tariff design is limited.¹⁸

Consequently, we consider how ActewAGL intends to charge for reference services by:

1. assessing how ActewAGL intends to allocate costs and revenues between reference services and other services. It must demonstrate that total revenue is allocated between reference and other services in the ratio in which costs are allocated between reference services and other services. Furthermore, costs must also be allocated to the reference service and other services to which the cost is directly attributable.¹⁹
2. assessing how ActewAGL grouped its customers into tariff classes. ActewAGL is required to group together customers for reference services on an economically efficient basis and to avoid unnecessary transaction costs.²⁰ We consider the nature of the reference service (e.g. volume and demand tariff classes) are consistent with the need to group customers for reference services together on an economically efficient basis and avoid unnecessary transaction costs.
3. assessing how:
 - (a) the expected average revenue of a tariff class compares with the stand alone cost and avoidable cost of providing the reference service to that tariff class
 - (b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
 - (c) whether the tariffs take into account the long run marginal costs of providing reference services

¹⁵ NGR, r. 59.

¹⁶ NGR, r. 48(1)(d)(i).

¹⁷ *Access arrangement for the ACT Queanbeyan and Palerang gas distribution network 1 July 2016 to 30 June 2021*, sections 2 and 3.

¹⁸ NGR, r. 94(6).

¹⁹ NGR, r. 93(2).

²⁰ NGR, r. 94(2).

- (d) whether customers belonging to the relevant tariff class are able or likely to respond to price signals.²¹

10.4 Reasons for final decision

As per our draft decision, we accept ActewAGL's proposed reference tariff structure because we are satisfied that it complies with the NGR requirements.²² While it involves significant changes to the tariff structure in ActewAGL's current access arrangement, the new tariff structure is consistent with those applied by other gas distribution networks in recent years.²³ However, the quantum of the proposed initial reference tariffs must be amended to reflect the final decision forecast demand and revised revenue allowance.

We maintain our draft decision to permit ActewAGL to introduce or withdraw tariff classes and/or tariffs during the 2016–21 access arrangement. However, these will be limited to those we have pre-approved.

We note Origin Energy reiterated its concerns that ActewAGL's proposed multi-appliance tariffs²⁴ should be based on a customer's usage, not the number of appliances installed.²⁵ However, as per our draft decision, we consider ActewAGL's proposed tariff structures have been based on customer usage characteristics.²⁶ The intent of the multi-appliance tariff categories is to incentivise customers to install multiple gas appliances in order to bring about greater utilisation of the network throughout the year.²⁷ ActewAGL's particular focus is to encourage greater utilisation over the low gas usage periods of spring and summer.²⁸

Further, as noted in our draft decision, the multi-appliance tariffs are optional tariffs.²⁹ The default tariff for customers will remain consistent with the tariffs these customers incur in the current access arrangement period. Therefore, customers will not be discriminated against as they have a choice about assignment to a multi-appliance tariff category.

²¹ NGR, rr. 94(3)–(4).

²² NGR, rr. 93, 95.

²³ For example see: Jemena Gas Networks (New South Wales), *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, schedule 2.

²⁴ Multi-appliance tariff category is the term we have used to distinguish these tariff categories from other types of tariff categories. We note ActewAGL simply refers to the multi-appliance tariff categories as 'other proposed tariff categories'.

²⁵ Origin Energy, *RE: ActewAGL revised access arrangement*, 4 February 2016, p. 3.

²⁶ AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10—Reference tariff setting*, November 2015, pp. 10-13 to 10-15.

²⁷ AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10—Reference tariff setting*, November 2015, p. 10-13.

²⁸ ActewAGL, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Attachment 12: Reference tariffs*, June 2015, p. 23.

²⁹ AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10—Reference tariff setting*, November 2015, pp. 10-13 to 10-14.

Our final decision for ActewAGL's reference tariffs are set out in Table 10.1.

Table 10.1 AER final decision for ActewAGL's initial tariff classes and tariff charge components for the 2016–21 access arrangement period

Customer category	Tariff class	Tariff category	Charge components
Volume (V)	Residential (R)	Residential individually metered (VRI)	One fixed charge Four volume block charges Ancillary reference charges
		Residential individually metered with gas heating and other gas appliances (VRH)	One fixed charge Three volume block charges Ancillary reference charges
		Residential boundary metered (VRB)	One fixed charge Three volume block charges Ancillary reference charges
		Large scale generation principally for residential end customers (VRG)	One fixed charge Three capacity block charges Ancillary reference charges
	Business (B)	Small business individually metered (VBS)	One fixed charge Three volume block charges Ancillary reference charges
		Medium business individually metered (VBM)	One fixed charge Three volume block charges Ancillary reference charges
Demand (D)	Business (B)	Major customer capacity (DBC)	One provision of basic metering equipment charge Three demand capacity block charges Ancillary reference charges
		Major customer throughput (DBT)	One provision of basic metering equipment charge One volume charge Ancillary reference charges
		Demand business large scale generation (DBG)	One provision of basic metering equipment charge Three demand capacity block charges Ancillary reference charges

Source: AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10–Reference tariff setting*, November 2015, p. 10-8, Table 10.1; ActewAGL Distribution, *Access arrangement for the ACT, Queanbeyan and Palerang gas distribution network 1 July 2016 – 30 June 2021 — (incorporating revisions that address matters raised in the AER draft decision)*, January 2016, Schedule 3.

Our final decision for ActewAGL's ancillary reference tariffs are set out in Table 10.2.

Table 10.2 AER final decision for ActewAGL's ancillary reference services for the 2016–21 access arrangement period

Ancillary reference service	Description of service
Special meter reads	Meter reading for a delivery point that is in addition to the scheduled meter reading
Disconnections	Disconnection to prevent the withdrawal of gas at the delivery point (the method of disconnection is at the discretion of ActewAGL)
Reconnections	Reconnection to allow the withdrawal of gas at the delivery point but only where the equipment to allow the withdrawal of gas is still present at the delivery point
Decommissioning and meter removals (new)	Removal of a meter and the permanent decommissioning of a network connection (the method of disconnection is at the discretion of ActewAGL)
Request for service	Network users wishing to obtain a transport service for a delivery point must submit a request for service in accordance with the request-for-service procedure set out in the access arrangement.

Source: AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10–Reference tariff setting*, November 2015, p. 10-8, Table 10.2; ActewAGL Distribution, *Access arrangement for the ACT, Queanbeyan and Palerang gas distribution network 1 July 2016 – 30 June 2021 — (incorporating revisions that address matters raised in the AER draft decision)*, January 2016, Schedule 3.

10.4.1 Allocation of revenues and costs to reference tariffs

For the reasons set out in our draft decision, we are satisfied ActewAGL’s approach to allocating revenue and costs between reference services and non-reference services comply with the NGR³⁰ for the following reasons:

- ActewAGL’s proposed costs relating to its reference services do not include costs incurred (and recovered) from the provision of its non–reference services.
- ActewAGL has not allocated the non–reference service revenue to a reference service because the underlying costs have not been included in ActewAGL’s building block revenues.
- ActewAGL's proposal included information outlining its stand–alone costs, long run marginal costs and incremental costs which we have no objection to.

³⁰ NGR, rr. 93(1), (2).

10.4.2 Establishment of tariff classes

ActewAGL groups its customers by the nature of the haulage reference service (volume or demand) and classifies them by the type of end user (residential or business).³¹ We consider that these characteristics are likely to be the driver of costs within ActewAGL's gas distribution network. Therefore, using them to group customers into tariff classes is appropriate. We note ActewAGL's proposed tariff classes are consistent with the tariff classes applied by other gas distribution networks.³²

Based on the above reasons, we are satisfied that the proposed tariff classes are consistent with the requirements of the NGR.³³

10.4.3 Tariff classes and revenue limits

Our draft decision considered ActewAGL's initial proposed reference tariffs were consistent with the NGR requirements for tariff classes and revenue limits.³⁴ Our final decision maintains this consideration.

Our draft decision assessed ActewAGL's tariff classes and revenue limits against the following NGR considerations:

- (a) whether the expected average revenue of a tariff class compares with the stand-alone cost and avoidable cost of providing the reference service to that tariff class
- (b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
- (c) whether the tariffs take into account the long run marginal costs of reference services
- (d) whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.³⁵

³¹ ActewAGL, *Access Arrangement Information for the 2016-21 ACT, Queanbeyan and Palerang Access Arrangement, Attachment 12: Reference tariffs*, June 2015, pp. 9–23.

³² For example see: Jemena Gas Networks (New South Wales), *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, schedule 2.

³³ NGR, rr. 94(1)–(2).

³⁴ AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10—Reference tariff setting*, November 2015, pp. 10-16 to 10-18.

³⁵ NGR, r. 94.

Stand-alone and avoidable costs

We maintain our draft decision consideration³⁶ that ActewAGL's proposed reference tariffs are consistent with the NGR requirements³⁷ because the expected revenue to be recovered lies on or between:

- an upper bound representing the stand-alone cost of providing the reference service to customers who belong to that tariff class
- a lower bound representing the avoidable cost of not providing the reference service to those customers.³⁸

Transaction costs

In our draft decision we were satisfied that ActewAGL's proposed reference tariffs took into account transaction costs associated with the tariff and the need to avoid them where possible.³⁹ We considered ActewAGL has undertaken best endeavours to minimise transaction costs across access arrangements.

However, we acknowledge that additional administrative costs will be incurred in the transition to the new tariff structure. We consider these to be one-off costs and are unavoidable. We also consider the benefits of the proposed tariff structure—such as more cost reflective pricing and increasing customers' ability to respond to price signals—outweigh these incremental administrative costs.

Long run marginal cost

ActewAGL used the Average Incremental Cost approach to calculate the long run marginal cost (LRMC) by tariff class.⁴⁰

We note our discretion under the NGR on LRMC is limited.⁴¹ However, we consider the approach taken by ActewAGL is generally consistent with that applied by other gas distribution networks and has historical precedent in past access arrangements. At any rate we observe that the calculated values of LRMC are sensitive to the assumptions

³⁶ AER, *Draft decision: ActewAGL Distribution access arrangement 2016 to 2021: Attachment 10—Reference tariff setting*, November 2015, p. 10-17.

³⁷ NGR, r. 94(3).

³⁸ ActewAGL Distribution, *Access arrangement information for the ACT Queanbeyan and Palerang access arrangement—Revised in response to the AER's draft decision*, January 2016, pp. 34–35; HoustonKemp, *Development of a cost of service model for the ACT, Queanbeyan and Palerang gas distribution network: A report for ActewAGL Distribution*, June 2015, pp. 4–7, 17.

³⁹ NGR, rr. 94(2), 94(4).

⁴⁰ ActewAGL Distribution, *Access arrangement information for the ACT Queanbeyan and Palerang access arrangement—Revised in response to the AER's draft decision*, January 2016, pp. 35–37; HoustonKemp, *Development of a cost of service model for the ACT, Queanbeyan and Palerang gas distribution network: A report for ActewAGL Distribution*, June 2015, pp. 8–17.

⁴¹ NGR, r. 94(6).

made around a number of different variables. As such, these should only be used as a guide when assessing price levels and structures, rather than be considered definitive.

Response to price signals

We are satisfied ActewAGL's proposed reference tariffs have been determined having regard to whether customers are able or likely to respond to price signals.⁴²

The proposed tariff structure provides for more cost reflective tariffs which will send more appropriate price signals to end customers about their use of the network. These price signals will allow customers to make more informed choices about how they utilise the network.

We also consider the structure of declining block tariffs is well known to ActewAGL's customers and their continuation in the 2016–21 access arrangement will allow them to respond to the prices within each block (or band) by adjusting their consumption. Doing so will reduce or increase their overall network charges.

⁴² NGR, r. 94(4)(b)(ii).