Draft decision: JGN Gas Networks (NSW) 2020–25

We have made a draft decision on the gas access arrangement proposed by Jemena Gas Networks (NSW) Ltd ('JGN') — the gas distribution network operator servicing customers across NSW including greater Sydney, the Hunter, the Illawarra and several other regional areas. Our draft decision allows JGN to recover $2,157.6 million ($ nominal) from its customers over five years, from 1 July 2020 to 30 June 2025.

Estimated impact on customer gas bills ($ nominal)

The revenue we allow forms the distribution network component of retail gas bills. JGN's share of the bill for a typical residential customer on its network is 41 per cent for coastal areas and 33 per cent for regional areas.

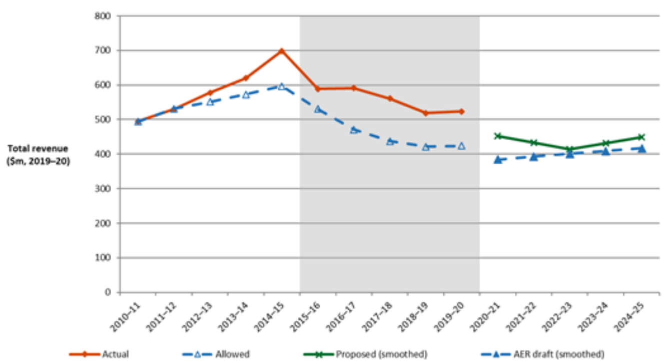
We estimate that if our draft decision is implemented, average annual bills for JGN's residential customers would reduce by $34 for coastal areas and $50 for regional areas by the end of the 2020–25 period (as at 30 June 2025), compared to the current level (as at 30 June 2020). Average annual bills for small business customers would reduce by $179 over the same period.

Overview

The AER approves pipeline access arrangements for JGN and other major gas networks in most of Australia under the National Gas Law and Rules.

Our draft decision allows for a $282 million ($2019–20), or 12.3 per cent, reduction in JGN's total revenue for the 2020–25 access arrangement period compared to allowed revenue for the 2015–20 period.

JGN's past and proposed total revenue, and AER's draft decision revenue allowance ($ million, 2019–20)



Our draft decision allows $185.7 million ($ nominal), or 7.9 per cent, less revenue than proposed by JGN for the 2020–25 period.

Having assessed JGN's proposal, we consider our 2020–25 draft decision is justified as it acknowledges the following key themes:

- ensuring consumers pay no more than they need for safe and reliable gas services
- JGN's high-quality consumer engagement approach
- potential future investment uncertainty faced by JGN.

The biggest contributor to the difference between our draft decision revenue and JGN's proposal is the current rate of return and, therefore, the return on capital. Other key differences include capex, opex, depreciation and tax.

Our draft decision also incorporates the revenue impact of our 2015–20 remade final decision for JGN (the 'remittal'). Under that decision, JGN will return $169.1 million ($2019–20) to its customers over the 2020–25 period.

Rate of return and gamma

In December 2018, the National Gas Law and National Electricity Law were amended to require us to make a binding rate of return instrument (2018 instrument). As a binding instrument, it sets out the methodology for calculating the rate of return. The method must be capable of automatic application to all regulated network service providers without the exercise of discretion.

Whilst JGN has applied the 2018 instrument and proposes a 4.96 per cent rate of return, currently the risk free rate and cost of debt is lower than at the time of its proposal.

As required under the National Gas Rules, we have applied the 2018 instrument and estimate a placeholder allowed rate of return of 4.46 per cent (nominal vanilla), which will be updated for our final decision on the averaging periods. Our draft decision also applies an imputation credits ('gamma') value of 0.585, as per the 2018 instrument.

Consequently, our draft decision allowance for the return on capital 'building block' is $133.2 million ($ nominal) lower than JGN's proposal.

Capital expenditure (capex)

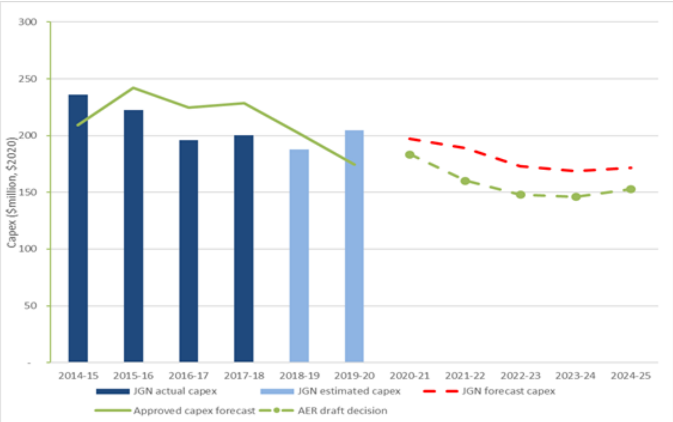
Capex refers to the capital costs and expenditure incurred in the provision of pipeline services. It mostly relates to assets with long lives, the costs of which are recovered over several access arrangement periods.

Capex is added to JGN's capital base, which is used to determine the return on capital and regulatory depreciation (return of capital) 'building block' allowances. All else being equal, higher forecast capex will lead to a higher projected capital base value and higher return on capital and depreciation allowances.

Our draft decision on JGN's revenue includes a total net capex forecast of $791.1 million ($2019–20) for the 2020–25 period. This is $108.4 million, or 12.0 per cent, lower than JGN's proposal.

Compared to JGN's proposal, our capex draft decision includes lower forecasts for information technology, connections, augmentation, meter replacement and mains replacement.

JGN's past and proposed capex, and AER's draft decision capex allowance ($ million, 2019–20)



Regulatory depreciation

Depreciation is the amount that JGN recovers over time to pay for the cost of an asset.

Our draft decision depreciation allowance of $411.4 million ($ nominal) for the 2020–25 period is $30.8 million, or 7.0 per cent, lower than JGN's proposal.

The majority of the reduction to JGN's proposal for the depreciation allowance is due to our draft decision on JGN's proposal for shorter standard asset lives for its pipeline asset class. Our lower total net capex forecast also made a material contribution to the lower depreciation allowance.

Operating expenditure (opex)

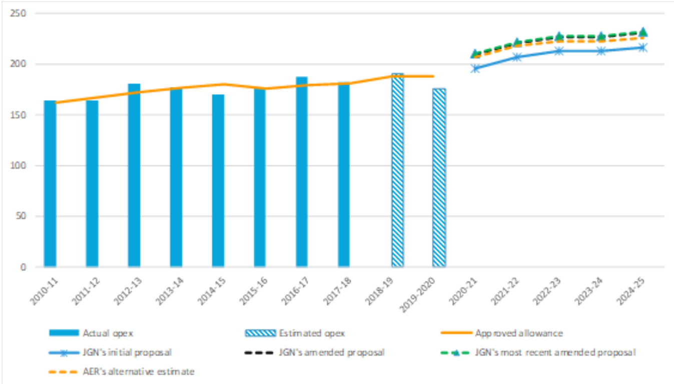
Opex is the operating, maintenance and other non-capital expenses incurred in the provision of pipeline services.

Our approach to forecasting opex is largely the same as JGN (that is, applying the 'base–step–trend' approach).

However, our draft decision total opex forecast of $1,096.6 million ($2019–20) for the 2020–25 period is $23.8 million, or 2.1 per cent, lower than JGN's amended opex proposal (amended on 8 October 2019).

Compared to JGN's proposal, our opex draft decision incorporates a more recent inflation forecast from the Reserve Bank of Australia, our forecast for lower input price growth, and our forecast for lower output growth.

JGN's past and proposed opex, and AER's draft decision opex allowance ($ million, 2019–20)



Forecast demand

Tariff levels depend on estimates of forecast total demand. In simple terms, tariffs are determined by dividing cost (as reflected in forecast revenue) by total demand (GJ/day). Forecast demand also affects the forecasts of opex and capex (new connections).

Over the 2020–25 period, our draft decision forecasts:

- an increase in total residential gas demand of 0.90 per cent per year, compared to the 1.34 per cent per year increase for the 2015–20 period
- an increase in total small commercial demand of 0.38 per cent per year, compared to the 1.12 per cent decrease for the 2015–20 period
- a reduction in industrial demand of 2.18 per cent per year for the maximum daily quantity (MDQ) and 2.12 per cent per year for the annual quantity demand (ACQ), compared to the 3.54 per cent and 2.08 per cent decrease, respectively, for the 2015–20 period.

Next steps and more information:

JGN will submit a revised proposal in response to this draft decision by **13 January 2020**.

Interested stakeholders are invited to make submissions on our draft decision and JGN's revised proposal by **17 February 2020**.

More information on JGN's proposal, our draft decision and how to make a submission is on our website: www.aer.gov.au