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CCP10 response to the Draft Decision for the Jemena Gas Networks (JGN) 2015-20 Access Arrangement - Remittal

This submission is in response to the AER's January 2019 Draft Decision (Adjustment Determination) and Draft Decision (Access Arrangement) for Jemena Gas Networks (NSW) Ltd (JGN). The Draft Decisions follow JGN's proposal for the remitted Access Arrangement for 2015-20 sent to the AER on 31 October 2018.

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. We repeat the pertinent points from our November 2018 correspondence and have updated those comments where relevant.

Summary response

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.

Unique Circumstances

We concur with the AER's observation regarding the novel circumstances associated with this Draft Decision - though we have used the term "unique circumstances", reflecting our belief that it is very unlikely that the circumstances confronting consumers, the regulator and relevant network businesses (JGN, as well as the ACT and NSW electricity distribution network businesses) in dealing with these remitted decisions will ever arise again.

These unique/novel circumstances are documented in our submission regarding the Essential Energy remitted decision¹, the first remittal to be finalised. Please refer to this submission for further exploration of the background to the remittal narrative and the unique circumstances. Recognising the unique circumstances is important because it means that the 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.

In short, the Australian Competition Tribunal has remitted the original decision, 2015-20 for JGN, back to the AER to remake their decision *"in relation to JGN's market expansion (ME) 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."*²

We note that the market expansion capex issue was unique to the remitted decision for JGN; while the debt issue was common with the other 4 remitted decisions which CCP10 has considered in separate submissions, dealing with Essential Energy, Evoenergy, Endeavour Energy and Ausgrid³.

We also recognise that the time taken for the appeal process to occur has meant that all parties have a significant amount of actual data to draw upon in finalising the 2015-20 Access Arrangement revenue decision. Also important is the fact that JGN and the Regulator agreed to enforceable undertakings as 'placeholder' prices that JGN could charge customers while the appeal process was underway, with a final 'true up' to occur once the revenue allowance was finalised. This 'true up' is included in this Draft Decision for the remitted decision.

JGN's Proposal

On 31st October 2018, JGN wrote to AER Chair, Paula Conboy, with a proposal to finalise the 2015-20 Access Arrangement that was remitted back to the AER for reconsideration of two main issues, being Market Expansion (ME) capex (remitted by the Australian Competition Tribunal in February 2016) and the cost of debt (which was remitted by the Federal Court in July 2017).

¹ <https://www.aer.gov.au/system/files/CCP10%20%20Letter%20to%20AER%20on%20Essential%20Energy%202014-19%20remade%20draft%20decision%20-%20April%202018.pdf>

² Application by Jemena Gas Networks (NSW) Ltd [2016] ACompT5.

³ <https://www.aer.gov.au/system/files/CCP10%20-%20Submission%20on%20Ausgrid%2014-19%20remade%20draft%20decisio%20-%20December%202018.pdf>

A third issue has arisen as a result of the delays in finalising the revenue allowance being the collection of revenue from consumers pursuant to a series of ‘placeholder’ revenues being agreed, while the other matters were resolved.

The proposal from JGN in summary form is:

- a) transition to the trailing average cost of debt methodology for 2015-20;
- b) an additional \$21m for market expansion capex, above the original 2015 Access Arrangement decision; and
- c) a ‘true up’ of revenues to be paid by customers over the 2015-20 period, in the light of an agreed remitted decision.

We recognise that the JGN proposal provides for a reduction in revenue of \$169 million for the total 2015-20 Access Arrangement period, which is of direct benefit to consumers.

Engagement

Jemena Gas Networks 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	18 th January 2018
CCP10 responds to AER “Debt paper”	23 rd February 2018
JGN Briefing of CCP10, and other consumer Groups	8 th August 2018
Draft proposal forwarded to CCP10 by JGN and discussed in detail	19 th September 2018
Teleconference; JGN and CCP10	4 th October
Telephone discussion	1 st 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.

Issue 1 - Market Expansion Capex

Market expansion (ME) capex refers to the costs of connecting customers to the gas network and accounts for nearly a third of JGN's capital expenditure, the largest single component of their capex. The AER's decision for 2015-20 to reduce the allowance for ME capex by about 22% had a significant impact on JGN revenue. In their Final Decision of 2015, the AER said that:

"ME capex approved in our 2015 final decision is around 22 per cent lower than JGN's proposed ME capex, driven by:

- our estimate of forecast new connections, which was lower than JGN's forecast*
- the application of historical unit rates rather than the unit rates contained in JGN's connections model*
- not including JGN's proposed additional expenditure for non-routine connections."*⁴

Jemena appealed the AER's ME capex decision. We accept that the Tribunal did not find that there were errors in the AER's approach but advised them to reconsider the approach that they had taken. In essence, there were four aspects of the AER's decision that warranted reconsideration:

1. The model used to determine the ME capex allowance
2. Contractor rates.
3. Non-routine connections
4. *Metreteks* and meter data loggers (metering equipment with particular application to higher density residential as well as commercial and industrial applications)

Both the AER and JGN have agreed to the ME capex model to be used and have agreed to its application, noting that additional data is available now compared with the data available in 2015 when the original decision was made.

For contractor rates, the Draft Decision says:

*"... 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)."*⁵

Revision of the components of costs associated with non-routine connections have resulted in a shared agreement to include some costs that were not part of the 2015 decision.

A similar situation applies to the metering equipment with modest increases on the 2015 allowance to accommodate higher costs.

⁴ AER Final Decision - JGN Access Arrangement 2015-20, June 2015, p6-9

⁵ AER Draft Decision - JGN January 2019, p33

The end result for the remade Draft Decision for JGN regarding ME capex, 2015–20 compared to the 2015 final decision (unescalated direct costs, \$million, 2019–20), is given in Figure 1 below.

	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 draft 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.

Figure 1: JGN ME Capex, comparison of 2015 final decision and remade decisions

(source - AER Draft Decision Table 5.1, p30)

CCP10 is satisfied that the remade Draft Decision for ME capex makes the necessary adjustments and represents efficient costs for consumers.

Issue 2 - Debt

There is been a separate process being undertaken with regard to cost of debt issues as this matter was remitted back to the AER for the four ACT/NSW electricity distribution businesses as well as JGN. In February 2018, CCP10 said in our submission to that process:

“CCP10 supports the AER proposal to adopt the trailing average with a transition as it is consistent with the NEO and ARORO, consistent with efficient debt costs and efficient pricing and avoids the creation of windfall losses or gains for either the NSP or the consumers.”

We recognise that the remitted decision on debt is consistent with the *allowed rate of return objective* (ARORO) and meets *efficient financing costs* criteria, supporting the AER Draft Decision statement:

*“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.”*⁶

The transition to a trailing average debt methodology effectively resolves the dispute regarding cost of debt issues, with the outstanding debt matter being about the mechanism for “transition” to the trailing average approach.

In the Draft Decision the AER proposes the following transition:

“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

⁶ AER Draft Decision – JGN, January 2019, p41

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.

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 ”⁷*

CCP10 supports this approach and considers that it is cost neutral for consumers and for JGN, so it is a fair transition.

Issue 3 - Cross Period revenue Smoothing

In their proposal, JGN says:

“as these remitted matters are being resolved in year four of our five-year regulatory period, there is only one year remaining in which to make the resulting revenue adjustment. This would lead to undesirable price volatility for our customers (through an X factor that provides a significant price drop at the end of the current period, but followed by significant price increase in the subsequent period to return JGN to revenue amounts close to cost of service.)”⁸

JGN also stated that they have sought a rule change to secure a mechanism to allow for smoothing of revenues across the 2015-20 and 2020-25 Access Arrangement periods.

JGN therefore submitted a rule change request to the AEMC (Australian Energy Market Commission) to provide a means by which to minimise potential price volatility for its customers that was likely to occur due to appeals, the remittal process and the need to ‘true

⁷ AER Draft Decision - JGN January 2019, p41

⁸ JGN Proposal for remittal Items – 31 Oct 2018, p 4

up' the differences between allowed revenue and actual revenue collected in line with the enforceable undertakings made while the remittal process was underway.

CCP10 and consumer groups support processes that minimise price volatility for consumers.

We note that on 30 August 2018, the AEMC published its gas revenue smoothing final rule which enables the proposed 'smoothing' to occur. The rule allows the AER "to let JGN recover any additional revenues that result from our remade decision on JGN's 2015–20 access arrangement across both the 2015–20 and 2020-25 access arrangement periods."

We consider this approach to be eminently sensible and support the proposal for cross period revenue smoothing so that bill impacts for customers are as consistent as possible over an extended period of time.

Long-term interests of Consumers

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 as discussed above. \$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.

Final Comments

CCP10 commends JGN for taking this opportunity to resolve the 2015-20 Access Arrangement.

Consumers were not well served by the regulatory impasse between the AER and the NSW/ACT businesses around the 2014-19 determinations and the 2015-20 JGN Access Arrangement. The AER's willingness to 'put all of their cards on the table' and to explore models and data in good faith has made this remittal process as 'pain free' as possible.

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.

<signed>

Mark Henley, Mike Swanston
On behalf of CCP10

Confidential Material

CCP10 confirms that to the best of our knowledge, this response does not contain any confidential material nor any reference to confidential material.