Final decision

Australian Gas Networks (Victoria and Albury) gas distribution access arrangement

1 January to 30 June 2023 extension period

November 2022

AUSTRALIAN ENERGY REGULATOR

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1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia. The regulatory framework governing gas transmission and distribution networks is the National Gas Law and Rules (NGL and NGR). Our work is guided by the National Gas Objective (NGO).[1]

A regulated gas network business must periodically apply to us for a ruling on network charges, in the form of an access arrangement. Our decision on the access arrangement currently in place for Victorian gas distributor Australian Gas Networks (AGN) was made in November 2017, for the period 1 January 2018 to 31 December 2022 (2018–22 period).

On 20 October 2020, the *National Energy Legislation Amendment Act 2020* (Vic) was enacted to change the timing of Victorian gas distribution access arrangement periods. Where previous access arrangement decisions for AGN have been made by reference to calendar years, future access arrangements will be made for financial years. To facilitate this, AGN's approved access arrangement for the 2018–22 period will be extended by 6 months from 1 January to 30 June 2023 (extension period). AGN's next access arrangement will then cover the period 1 July 2023 to 30 June 2028 (2023–28 period).

We have determined revenue and prices for the extension period in accordance with Orders in Council made on 30 September 2021 (the Orders).[2] The approach we have applied is the same as that set out in, and consulted on, in our December 2021 Position Paper and July 2022 Draft Decision. We have exercised the discretion afforded us under Orders in Council to adopt a pragmatic approach to extending the life of the existing decision to cover an additional 6 months, keeping the transition process simple by trending forward most elements of our previous decision as a basis for the additional revenue requirement. The Orders also allow us to smooth revenue between the extension period of 1 January to 30 June 2023, and the new 2023–28 period commencing on 1 July 2023.[3]

Our final decision is to extend AGN's current, 2022 prices to 30 June 2023, adjusted for a half-year of actual inflation to keep them constant in real terms. The expected revenue that would be recovered at those prices is higher than the building block revenue we have approved for that period. That over-recovery will be corrected in—and its impact on prices smoothed over—the 2023–28 period. This means our decision on revenue and prices for the extension period is in three parts:

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1 NGL, s. 23: "...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."

2 Minister for Energy, Environment and Climate Change*, 'Order Setting Requirements for Modifications and Variations to Instruments – Section 64 National Gas (Victoria) Act 2008'*, Victoria Government Gazette, No. G39, 30 September 2021, p. 2076 [Section 64 Order]; Minister for Energy, Environment and Climate Change, *'Order Setting Requirements for Modifications and Variations to Instruments – Section 65 National Gas (Victoria) Act 2008'*, Victoria Government Gazette, No. G39, 30 September 2021, p. 2081 [Section 65 Order]

3 Section 64 Order.

1. *Extension period allowed revenue* (the revenue to be derived from the provision of the relevant pipeline services for the 1 January to 30 June 2023 extension period) is determined by reference to the extended, 2022 tariffs and to forecast demand for the extension period. We discuss this in section 2.
2. *Extension period building block revenue* is determined within the parameters set out in the NGR and the Orders, applying a similar, trend forward approach for capital expenditure (capex) and operating expenditure (opex) to that used for the electricity distribution extension period. We discuss this in section 3.
3. When smoothing revenue and price paths for the new, 2023–28 period we will complete a *'true up'* of any difference between extension period allowed revenue and extension period building block revenue. We will then distribute that difference over one or more of the next 5 years to achieve the best outcome for consumers. We discuss this in section 4.

For illustrative purposes, the modelled impact of this final decision is that AGN's average distribution tariffs from 1 January 2023 to 30 June 2023 will be 3.03% higher in nominal terms than they are now, reflecting a half-year actual inflation applied to its current, 2022 tariffs. Applying our final decision on forecast demand, the expected, allowed revenue recovered at those prices over the 6-month extension period is $115.1 million.[4]

This is $50.2 million (77.3%) higher than our final decision on AGN's building block revenue of $64.9 million for the extension period.[5] This over-recovery of $50.2 million will therefore be returned to customers over the course of the next, 2023–28 period as an offset to approved prices for that period. This true up is net present value (NPV) neutral and so should ensure that both AGN and consumers are not materially better (or worse) off as a result of continuing the 2022 tariffs (extended for actual inflation) throughout the applicable access arrangement extension period. The Orders allow us to spread this adjustment over the whole of the 2023–28 access arrangement period, or to apply it only to some years within that period. This decision does not need to be made now, and can instead be deferred until our final decision on revenue and price paths for the 2023–28 access arrangement period. In considering this, we will have regard to any submissions from stakeholders on the 2023–28 price paths in our draft decision on AGN's proposal for 2023–28.

4 The allowed revenue total of $115.1 million comprises $113.3 million for reference services and $1.8 million for ancillary reference services.

5 The building block total of $64.9 million comprises $63.1 million for reference services and $1.8 million for ancillary reference services.

2 Extension period allowed revenue

Extension period allowed revenue is AGN's revenue from the provision of services over the 6-month extension period. Under the Orders, our determination of extension period allowed revenue must be an amount between:[6]

- extension period building block revenue (discussed in section 3), and
- the total revenue for the applicable access arrangement extension period determined by the AER based on the tariffs and tariff classes approved by the AER for the regulatory year commencing on 1 January 2022, adjusted for inflation.

The approach taken in this final decision is to apply AGN's tariffs and tariff classes from the current (2022) regulatory year, adjusted for a half-year of actual inflation (1-year lagged), for an additional 6 months over the extension period (i.e. from 1 January to 30 June 2023).

Extension period allowed revenue, in simple terms, is the approved extended tariffs multiplied by forecast demand.

2.1 Extending 2022 prices over the extension period

Our final decision is to extend the 2022 tariffs by indexing for a half year of inflation, consistent with AGN's revised proposal, and the approach set out in our draft decision and position paper. [7] Therefore, we have indexed the tariffs by 3.03% based on actual CPI of 6.14% for the June 2022 quarter as published by the Australian Bureau of Statistics (ABS), which became available after our draft decision.[8]

In the draft decision, we applied a placeholder estimate of the half year inflation for the June 2022 quarter to the 2022 tariffs. We considered that applying a half year of inflation appropriately converts the tariffs from 'end-of-year' (31 December) 2022 terms to 'end-of-half-year' (30 June) 2023 terms. Further, the June 2022 quarter is appropriate as the June series (1-year lagged) is consistent with the annual tariff mechanism for haulage reference services in our 2018–22 decision, subject to an adjustment for the half year.

AGN's revised proposal adopted our draft decision approach and applied a half year actual inflation to the 2022 tariffs.[9]

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6 Section 64 Order, p. 2079.

7 AER, *Position paper: Approach to six-month extension of access arrangements for Victorian gas distributors,* November 2021, p. 14; AER, *Draft decision AusNet gas distribution access arrangement 1 January to 30 June extension period*, July 2022, p. 5; AER, *Draft decision AGN gas distribution access arrangement 1 January to 30 June extension period*, July 2022, p. 6; AER, *Draft decision MGN gas distribution access arrangement 1 January to 30 June extension period*, July 2022, p. 5.

8 Our draft decision used a placeholder estimate for the June 2022 quarter from the RBA's May 2022 Statement of Monetary Policy. The 3.03% is derived from the equation: (1+6.14%)^0.5 –1. We have used unrounded figures to escalate tariffs.

9 Australian Gas Infrastructure Group, *Revised Variation Proposal H1 2023-Response to DD*, p. 5.

2.2 Expected demand over the extension period

We need a demand forecast for each reference service that AGN will provide during the extension period in order to calculate its extension period allowed revenue.

The Orders do not prescribe an approach to our assessment of demand forecasts for the extension period. Our approach to forecast demand for the purposes of the extension period is guided by principles for forecasts and estimates set out in the NGR:[10]

- Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate, and
- A forecast or estimate must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.

AGN's proposed forecast was initially based on a weather corrected historical model that predicted the number of new connections and the usage per customer to forecast total consumption. It also excluded data from 2020 and 2021, noting that the impact of the COVID 19 pandemic on demand was an anomaly. This differed from our suggested approach of a simple trend forward of historical demand. However, we accept that the use of a weather corrected trend is consistent with best practice in forecasting. We also accept the exclusion of 2020 and 2021 data, though we note these have very little actual impact on the ultimate demand forecasts.

AGN has updated its demand forecasts to reflect the anticipated impact of the Victorian Gas Substitution Roadmap (the Roadmap). The Roadmap proposes a range of policy measures that are likely to impact the number of new customers connecting to gas networks, and the amount of gas consumed per connection. These policies, among other things, change the energy efficiency standards of new dwellings to capture the efficiency of their appliances, and also provide cash incentives to switch from gas appliances to electricity.

We note that the impact of these changes is very minor in the 6-month extension period, and AGN's new proposal is not materially different from its initial proposal. We accept these adjustments are reasonable, and that the new policies will take some time to materially change the consumption behaviour of a large number of customers. Consequently, we accept that the forecast has been arrived at on a reasonable basis, and is the best forecast possible in the circumstances.

2.3 Calculating extension period allowed revenue

AGN operates under a weighted average price cap. This means the prices we determine and the means of varying the prices from year to year are the binding constraint across an access arrangement period rather than the revenue requirement that informs them.

In a typical access arrangement determination, forecast demand is applied to the forecast revenue requirement to derive reference tariffs. In this decision, we already have the 2022 reference tariffs and, as discussed above, have indexed these for a half year of inflation to

10 NGR, r. 74.

apply them to the extension period. So we are instead multiplying those tariffs by forecast demand to produce extension period allowed revenue.

Adopting our final decision on demand forecasts for 1 January to 30 June 2023 and applying those forecasts to the extended, 2022 tariffs, results in extension period allowed revenue of $115.1 million.[11]

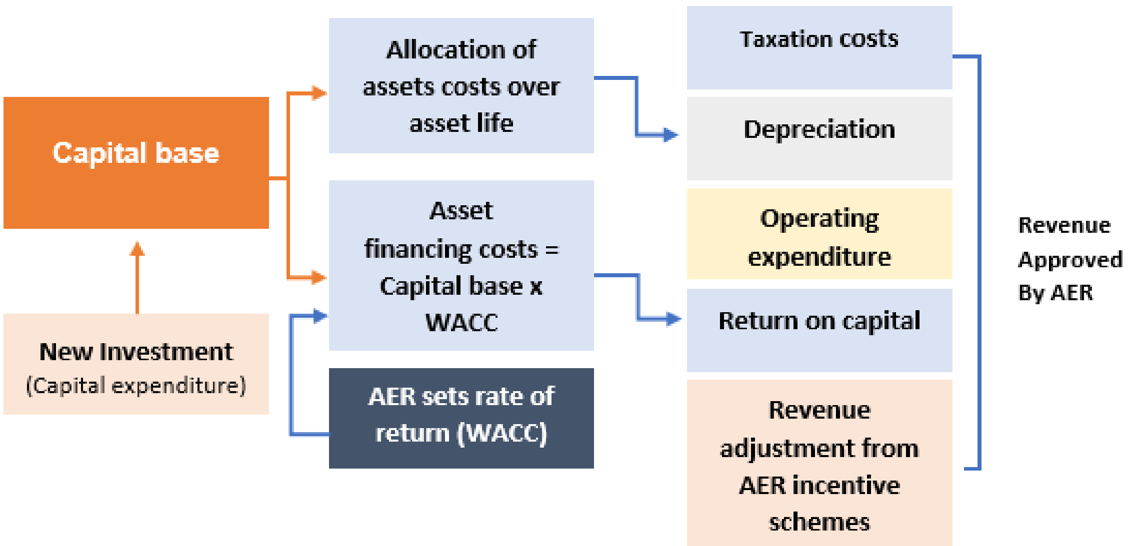
[11] The allowed revenue total of $115.1 million comprises $113.3 million for reference services and $1.8 million for ancillary reference services.

3 Extension period building block revenue

Our determination of extension period building block revenue is based on a similar 'building block' approach to our usual regulatory decisions. It looks at five cost components:

- return on the capital base – or return on capital, to compensate investors for the opportunity cost of funds invested in this business
- depreciation of the capital base – or return of capital, to return the initial investment to investors over time
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services
- revenue increments/decrements resulting from the opex efficiency carryover mechanism that applied to AGN in the 2018–22 access arrangement period
- estimated cost of corporate income tax.

Figure 1 The building block approach to determining total revenue



Source: AER.

For the purposes of determining building block revenue for the 1 January to 30 June 2023 extension period, the Orders allows us to apply variations to our standard, 5-year revenue models.[12] The models used in this final decision for the extension period are based on the Post Tax Revenue Model (PTRM) and Roll Forward Model (RFM)[13] that we will use for the 2023–28 access arrangement proposal, adjusted to accommodate the additional 6-month period.

12 Section 64 Order, p. 2078.

13 AER, *Gas transmission and distribution network service providers, Roll forward models (version 1.1)*, April 2020; AER, *Gas transmission and distribution network service providers, Post-tax revenue models (version 2)*, April 2021.

Our final decision is that AGN's building block revenue for the 1 January to 30 June 2023 extension period is $64.9 million.[14] Table 1 shows our final decision on the building block revenue for the 6-month extension period.

Table 1. Extension period building block revenue 1 January to 30 June 2023 ($nominal)

	HY2023[d]
Return on capital	50.3
Regulatory depreciation[a]	–27.7
Operating expenditure[b]	42.6
Revenue adjustments[c]	–0.3
Cost of corporate income tax	0.0
Building block revenue (including ARS)	**64.9**
Less: Ancillary reference services	1.8
Building block revenue (excluding ARS)	**63.1**

Source: AER analysis.
(a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening capital base.
(b) Includes debt raising costs.
(c) Revenue adjustments from the efficiency carryover mechanism.
(d) This is for the 6-month extension period of 1 January to 30 June 2023.

We discuss the building block components of this calculation in the sections below.

3.1 Capital base

The capital base roll forward accounts for the value of AGN's regulated assets over the extension period. The opening value of the capital base on 1 January 2023 is used to determine the return on capital and return of capital (depreciation) building blocks.

This final decision includes opening capital base value of $1900.7 million as at 1 January 2023. This value is $0.8 million higher than AGN's revised proposed opening capital base of $1899.9 million ($ nominal) as at 1 January 2023.[15] To determine the opening capital base, AGN has rolled forward the capital base over the 2018–22 access arrangement period. We have reviewed the key inputs of AGN's proposed RFM, such as forecast inflation, rate of return, gross capex values, capital contribution values, forecast depreciation amounts and asset lives. We found most of these inputs were correct and reconciled with relevant data sources.[16]

However, we have identified some of the proposed inputs required corrections and updates. Therefore, we have made the following amendments to AGN's proposed RFM inputs:

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[14] Includes Ancillary Reference Services. Nominal revenue includes the expected impact of inflation.

[15] AGN, *AGN Variation Proposal H1 2023_Attachment_1.4_Roll Forward Model_Final Submission*, 2 September 2022.

[16] Data sources included ABS data, annual regulatory information notices (RINs) and the 2018–22 decision models.

- 2022 gross capex and capital contribution placeholder estimates[17] were amended to be consistent with AGN's proposed estimates in the 2023–28 proposal.[18] In its response to our information request, AGN agreed with this amendment[19]
- 2017 capex and capital contribution inputs for the 'Meters' and 'Mains and services' asset classes, respectively, were amended to be consistent with the values reported in the regulatory information notice (RIN) for that year.[20]

We have established the opening capital base on 1 January 2023 using the standard published RFM that roll forwards the capital base for 2018–22, based on actual capex up to 2021 and latest estimates for 2022 capex. The RFM also reflects 2018–22 forecast depreciation and actual CPI.

This roll forward process includes an adjustment at the end of the 2018–22 access arrangement period to account for the difference between actual 2017 capex and the estimate approved in the 2018–22 decision.[21] Additionally, final year adjustments may be applied at 30 June 2023 to establish the opening capital base value at 1 July 2023 for the purposes of the 2023–28 access arrangement.[22] Table 2 sets out the roll forward of AGN's capital base over the 2018–22 access arrangement period.

Table 2. Capital base roll forward for the 2018–22 period ($ nominal)

	2018	2019	2020	2021	2022[a]
Opening capital base	1572.0	1612.1	1668.3	1729.2	1778.5
Net capex[b]	87.7	108.1	129.9	142.2	172.6
Indexation of capital base	30.4	33.5	26.6	–6.0	68.4
Less: straight-line depreciation[c]	77.9	85.4	95.6	86.9	94.3
Interim closing capital base	1612.1	1668.3	1729.2	1778.5	1925.2
Difference between estimated and actual capex in 2017					–19.2
Return on difference for 2017 capex					–5.3
Closing capital base as at 31 December 2022					**1900.7**

Source: AER analysis.

(a) Based on estimated capex provided by AGN. We will true-up the capital base for actual capex at the next access arrangement review.

(b) As-incurred, net of disposals and capital contributions, and adjusted for actual CPI and half-year WACC.

17 For the 2023–28 decision, we note these capex estimates may be revised based on more up to date information.

18 AGN, *AGN Revisions to Final Plan 2023-28_Attachment 1.6A GSR Response_Roll Forward Model*, 2 September 2022.

19 AGN, *Response to information request IR#015*, 6 September 2022.

20 AGN, *Regulatory Information Notice-Attachment 1-Written Response*, July 2022. sc. 3.1, pg. 8. This amendment reflects AGN's 2017 RIN resubmission which reduced net capex for 2017 by $1700. We accept AGN's basis for the RIN resubmission as we consider the change provides an accurate representation of capex for that year.

21 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2018–22 determination.

22 This includes reallocation for accelerated depreciation purposes.

(c) Adjusted for actual CPI. Based on forecast capex.

Reference tariffs for the 2023–28 period (from 1 July 2023) will be established using a modified 5.5-year RFM to establish the opening capital base at 1 July 2023. That opening capital base will include capex undertaken during the extension period.

3.2 Regulatory depreciation

Our calculation of extension period building block revenue includes –$27.7 million for the depreciation of AGN's capital base. The depreciation amount is negative as the indexation of AGN's capital base exceeds the straight line depreciation.[23] AGN's revised proposal reflects:

- the straight-line depreciation method for calculating the regulatory depreciation amount as set out in the PTRM, and the year-by-year tracking approach to implement this method.[24] An adjustment is required to reflect that the 2023 period is a half year rather than full year and AGN has therefore used our modified depreciation tracking module of the RFM, which allows for the tracking calculations to reflect the extension period
- the same asset classes and standard asset lives approved for the 2018–22 period
- the opening capital asset base at 1 January 2023 (section 3.1)
- expected inflation (section 3.3.1) for the 6-month extension period.

Our final decision regulatory depreciation is lower than AGN's revised proposed amount of –$23.4 million ($ nominal) and reflects our correction to the year-by-year tracking depreciation inputs in the PTRM to align with the outputs calculated in the depreciation tracking module.

Table 3 sets out our final decision on the regulatory depreciation amount for AGN's 6-month extension period.

Table 3. Regulatory depreciation amount for 1 January to 30 June 2023 ($ nominal)

	HY2023[a]
Straight-line depreciation	30.7
Less inflation indexation on opening capital base	58.5
Regulatory depreciation	**–27.7**

Source: AER analysis.
(a) HY2023 is the 6-month extension period of 1 January to 30 June 2023.

Reference tariffs for the 2023–28 period will also be established using the modified depreciation tracking module to calculate the depreciation of assets in the 1 July 2023 capital base.

23 The regulatory depreciation amount is the net total of the straight-line depreciation less the indexation of the capital base.

24 For this 6-month extension period, the straight-line depreciation is not impacted by the 6-month forecast net capex. This is consistent with our standard approach of capex entering the capital base at the end of the year in which it is incurred and depreciating from the following year.

3.3 Rate of return and value of imputation credits

For the purposes of determining extension period building block revenue, the Orders require us to apply our 2018 Rate of Return Instrument (2018 Instrument), with modifications to give effect to the change of the access arrangement period from a calendar year to a financial year basis.[25] We published the modified 2018 Instrument that applies to this decision on 29 October 2021.[26]

The rate of return applied in this final decision on extension period building block revenue is 2.65% (5.37% annualised). This is a higher rate of return than applied in AGN's proposal because we have updated our estimates of the risk-free rate and the return on debt using AGN's nominated averaging periods. We accept AGN's proposed risk-free rate averaging period[27] and debt averaging periods because they comply with the conditions set out in the modified Instrument.[28]

The value of imputation credits applied in this final decision is 0.585, as set out in the modified 2018 Instrument.

3.3.1 Expected inflation

In implementing our current approach to estimating the expected inflation rate for the 6-month access arrangement extension period, this final decision:

- uses inflation forecasts (CPI) from the August 2022 RBA Statement on Monetary Policy for the year ending 30 June 2023.
- halves this one-year forecast from the RBA to derive an estimate of expected inflation for the 6-month period, 1 January to 30 June 2023.

This results in an inflation forecast of 3.08%.

3.4 Capital expenditure

For the purposes of determining the projected capital base for the applicable access arrangement extension period, the Orders requires forecast capital expenditure (capex) consists of parts that:[29]

- the AER is satisfied meet the new capital expenditure criteria set out in rule 79 of the NGR; or
- are expenditure not exceeding half of the average of the corresponding forecast capital expenditure as approved by the AER over the previous regulatory years as selected by the AER, adjusted for inflation.

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25 Section 64 Order, pp. 2077–2078.

26 Available here and on project page for the AGN access arrangement review: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023-28/transitional-decision.

27 This is also known as the return on equity averaging period.

28 AER, *Modified Rate of Return Instrument for the Victorian gas distribution networks during the extension period of 1 January 2023 to 30 June 2023*, October 2021, cll. 7–8, 23–25 and 36.

29 Section 64 Orders, p. 2078.

As in our draft decision, we have taken the second of these options. To forecast capex for the 6 months from 1 January to 30 June 2023, we have halved the forecast conforming capex that we determined for 2022, and escalated the resultant allowance by CPI only. This produces forecast capex $40.2 million for the extension period.

Table 4. Forecast capex allowance 1 January to 30 June 2023 ($2022–23)

]	Forecast capex ($ million)
Total capex (including customer contributions)	41.0
Customer contributions	0.7
Net capex (excluding contributions)	40.2

Source: AGN Variation Proposal H1 2023_Attachment_1.3_PTRM_Final Submission_Public. PTRM inputs.

Irrespective of any over or under spend during the extension period, it is AGN’s actual capex, which must be assessed by us as conforming capex under the NGR as part of our next review, that will ultimately be rolled into the capital base at the conclusion of the 2023–28 access arrangement period.

3.5 Operating expenditure

For the purposes of determining the extension period building block revenue, the Orders require that the forecast of operating expenditure (opex) consist of parts that:[30]

- the AER is satisfied meet the criteria governing opex set out in rule 91 of the NGR; or
- are expenditure not exceeding half of the corresponding forecast opex as approved by the AER for the regulatory year commencing on 1 January 2022, adjusted for inflation and any rate of change that the AER considers appropriate having regard to changes in output, prices, productivity, and any other relevant factors that the AER may consider relevant.

As in our draft decision, we have taken the second of these options. To forecast opex for the 6 months from 1 January to 30 June 2023, we have:

- Applied a rate of change to half the forecast opex that we determined for 2022,[31] in addition to adjusting for inflation. The applicable rate of change is equal to three quarters of the rate of change we used for 2022. We apply three-quarters of the rate of change for 2022 to forecast opex for the extension period, rather than half, to represent the change in the *average* level of output, opex input prices (e.g. wages), and productivity between the *average* levels over the 2022 calendar year and the first 6 months of 2023.

  This can be thought of as the change in outputs, prices, and productivity at the end of June 2022 compared to the end of March 2023 (that is, at the mid points of the 2 periods). This is 9 months. Further, the change in outputs, prices, and productivity between the 6-month extension period and the first year of the new access arrangement period will also be 9 months. This gives a total of 18 months rate of change between calendar year 2022 and 2023–24.

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30 Section 64 Orders, p. 2078.

31 Excluding debt raising costs and ancillary reference services.

- Forecast debt raising costs consistently with our use of category specific forecasts for debt raising costs in our opex forecasts for 2022. Debt raising costs are transaction costs incurred each time debt is raised or refinanced. Unlike other elements of our opex forecasts for 2022, for which we used a base–step–trend forecasting approach, we forecast debt raising costs based on a benchmarking approach rather than a service provider's actual costs. This ensures consistency with the forecast of the cost of debt in the rate of return building block.

This produces forecast opex for the 1 January to 30 June 2023 extension period of $41.3 million ($2022). This forecast reflects that we have:

- accepted the forecast of opex, excluding ancillary reference services and debt raising costs, that AGN included in its revised proposal which was the same as our alternative estimate [32]
- accepted the ancillary reference services opex AGN included in its revised proposal
- updated debt raising costs using our standard benchmark approach.

Table 5. Forecast opex allowance 1 January to 30 June 2023 ($2022)

	AGN proposal	AER draft decision	AGN revised proposal	AER final decision
Forecast opex, excluding ancillary reference services and debt raising costs	37.5	38.4	39.1	39.1
Ancillary reference services	2.3	2.3	1.7	1.7
Debt raising costs	0.5	0.5	0.5	0.5
Total forecast opex	**40.2**	**41.2**	**41.3**	**41.3**

Source: AGN, *Proposed half year 2023 PTRM*, April 2022; AGN, *Revised Victoria distribution network access arrangement variation proposal*, September 2022, p. 7; AGN, *Revised proposed half year 2023 PTRM*, September 2022; AER analysis.

The approach we have taken to forecasting extension period opex does not account for the efficiency gains and losses AGN has achieved in the current period. That is, forecast opex for the extension period allows AGN to retain the recurrent efficiency gains and losses it has achieved in the 2018–22 access arrangement period. We have accounted for this when we calculated the efficiency carryover amounts to be included in AGN's revenue under the opex incentive mechanism for the extension period so that these efficiency gains are not double counted (see section 3.6). While we could have adjusted the opex in the 6-month extension period to account for efficiency gains and losses we would then have needed to account for the efficiency gains and losses in the efficiency carryover amounts, which results in the same revenue outcome. We discussed this in more detail in our draft decision.

32 AGN did not include its revised opex forecast, excluding ancillary reference services and debt raising costs, in its revised proposal PTRM . The revised proposal PTRM included the opex forecast, excluding ancillary reference services and debt raising costs, from AGN's initial proposal.

3.6 Revenue adjustments and the application of incentive schemes

Our final decision includes revenue adjustments of –$0.3 million ($2022) from the application of the opex incentive mechanism in the 2018–22 access arrangement period in AGN's building block revenue for the extension period. AGN also included –$0.3 million ($2022) in its revised proposal.[33]

Our calculation of the carryover amount is based on the calculation of carryovers for the current access arrangement period. The purpose of the carryover amount for the half year is to subtract half of the efficiency gain made in 2017. Because 2016 was used as the base year to forecast opex for the 2018–22 access arrangement period, forecast opex did not reflect any efficiency gains (or losses) made after 2016. Similarly, the calculation of carryovers for the 2018–22 access arrangement period assumed AGN underspent its opex in 2017 by the same amount it underspent opex in 2016. Because the access arrangement period was expected to be 5 years this would allow AGN to retain the actual efficiency gain it made in 2017 for an additional five years, consistent with gains made in other years. However, because the access arrangement period has been extended by 6 months, we need to subtract half of the difference between the actual efficiency gain it made in 2017 and the efficiency gain we assumed for 2017 when we calculated carryovers for the 2018–22 period. This ensures the efficiency gain made in 2017 is only retained for five years, consistent with the access arrangement for the 2013–17 access arrangement period.

Our final decision does not include any revenue adjustments associated with capital expenditure sharing scheme (CESS) calculations for the 2018–22 period. Consistent with our draft decision, these revenue adjustments will be deferred to begin from 1 July 2023.

3.7 Corporate income tax

Our final decision calculates of the cost of corporate income tax based on the approach used for the current 2018–22 period, except for the value of imputation credits (gamma), which is based on the modified 2018 Instrument as set out in section 3.3.

For our draft decision, we determine a cost of corporate income tax of zero for AGN for the 6-month extension period, consistent with AGN's revised proposal. This is because AGN is expected to incur a forecast tax loss for the 6-month extension period.[34] We have determined that $25.0 million in tax losses as at 30 June 2023 will be carried forward to the 2023–28 access arrangement period where it can be used to offset future tax liabilities.

We accept AGN's proposed method to establish the opening tax asset base (TAB) as at 1 January 2023. However, we amended AGN's opening TAB value to $1245.7 million—an increase of $5.1 million. This reflects the correction of 2017 capex and revision of 2022 capex estimates in the TAB roll forward.

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[33] AGN, *Revised Victoria distribution network access arrangement variation proposal*, September 2022, p. 9.

[34] A forecast tax loss occurs when the forecast taxable income is lower than the forecast tax expense. In this event no tax is payable. Any residual amount of tax loss will be carried forward over to future access arrangement periods to offset future taxable income until the tax loss is fully exhausted.

We also accept AGN's proposed approach for calculating the remaining tax asset lives as at 1 January 2023 for all asset classes, because they are calculated based on the weighted average method as set out in our RFM. In accepting the weighted average method, we have updated AGN’s proposed remaining tax asset lives to reflect our adjustments to AGN’s opening TAB value as at 1 January 2023.

Our final decision accepts AGN's proposed standard tax asset lives which are the same as the approved standard tax asset lives for the 2018–22 period. This is consistent with the draft decision.

4 True up for revenue for the applicable access arrangement extension period

Because there is a difference between the extension period allowed revenue and the extension period building block revenue set out in sections 2 and 3 above, the Orders allow us to make adjustments for that difference through the 2023–28 access arrangement.[35]

Our final decision suggests that AGN will over recover by $50.2 million[36] during the extension period based on our acceptance of its revised proposed demand forecast.[37] As a result, its tariffs in the 2023–28 access arrangement period will be adjusted (reduced) so that AGN will return $50.2 million dollars to consumers, with interest to be calculated at the regulatory weighted average cost of capital (WACC) to maintain the time value of money.

Table 6. True up between extension period allowed revenue and extension period building block revenue ($ nominal)

	HY2023[a]
Building block revenue (excluding ARS)	63.1
Less: Total revenue - AER determined (excluding ARS)	113.3
True-up amount (excluding ARS)	**–50.2**
ARS building block revenue	1.8
Less: ARS revenue - AER determined	1.8
True-up amount for ARS revenue	0.0
Total true-up amount (including ARS)	**–50.2**

Source: AER analysis.
Note: Totals shown in table may not add up due to rounding.
(a) HY2023 is the 6-month extension period of 1 January to 30 June 2023

This true up is NPV neutral and so should ensure that both AGN and consumers are not materially better (or worse) off as a result of continuing the 2022 tariffs (extended for actual inflation) throughout the applicable access arrangement extension period. The Orders allow us to spread this adjustment over the whole of the 2023–28 access arrangement period, or to apply it only to some years within that period. This decision does not need to be made now, and can instead be deferred until our final decision on revenue and price paths for the 2023–28 access arrangement period. In considering this, we will have regard to any submissions from stakeholders on the 2023–28 price paths in our draft decision on AGN's proposal for 2023–28.

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35 Section 64 Orders, p. 2080.

36 Including Ancillary Reference Services.

37 This true up is based on AGN's expected revenue during the extension period and not its actual revenue. If actual revenue and allowed revenue in the extension period differ—e.g. because customer numbers or actual demand differ from the forecast customer numbers and demand over the 6-month period applied in our decision on extension period allowed revenue—this will not be adjusted for. This outcome is consistent with the existing weighted average price cap form of control.

Glossary

Term	Definition
AER	Australian Energy Regulator
AEMO	Australian Energy Market Operator
AGN	Australian Gas Networks
EBSS	Efficiency benefit sharing scheme
CESS	Capital expenditure sharing scheme
Capex	Capital expenditure
Opex	Operating expenditure
CPI	Consumer Price Index
Instrument (2018)	2018 Rate of Return Instrument
NGL	National Gas Law
NGR	National Gas Rules
NPV	Net present value
PTRM	Post tax revenue model
Orders	Minister for Energy, Environment and Climate Change*, ‘Order Setting Requirements for Modifications and Variations to Instruments – Section 64 National Gas (Victoria) Act 2008’*, Victoria Government Gazette, No. G39, 30 September 2021, p. 2076 [Section 64 Orders] Minister for Energy, Environment and Climate Change, *‘Order Setting Requirements for Modifications and Variations to Instruments – Section 65 National Gas (Victoria) Act 2008’*, Victoria Government Gazette, No. G39, 30 September 2021, p. 2081 [Section 65 Orders]
RBA	Reserve Bank of Australia
RFM	Roll forward model
TAB	Tax asset base