Jemena Gas Networks (NSW) Ltd

2015-2020 Access Arrangement

Application to vary Jemena Gas Networks (NSW) 2015-20 Access Arrangement under clause 65(1) of the National Gas Rules

Public

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Jemena

1. APPLICATION

Jemena Gas Networks (NSW) Limited (**JGN**) submits a proposal to the AER under clause 65(1) of the National Gas Rules (**NGR**) for approval to vary the Access Arrangement for the period 1 July 2015 to 30 June 2020 (**2015-20 AA**) in the following two ways (**Application**): [1]

1. first, to amend the efficiency benefit sharing scheme (**EBSS**) formula in clause 12 to remove one-off costs from the base year for the forthcoming regulatory period to bring the EBSS into line with the AER's current application of the scheme to other networks; and

2. second, to include a new clause 1.7 in the Reference Service Agreement (**RSA**) which forms part of the 2015-20 AA to reflect changes to the NGR relating to gas day harmonisation.

JGN considers that both variations above are non-material, and therefore, under clause 66(2), the AER may approve the variation to JGN's 2015-20 AA without consultation.

As clause 12.1 of the 2015-20 AA is a fixed principle, JGN also provides its consent to the AER to vary that clause under clause 99(4)(a) of the NGR in accordance with this Application.

[1] Rule 65(2) provides that a service provider may submit a proposal for variation of its access arrangement prior to the review submission date. JGN's review submission date is 30 June 2019 (clause 1.3 of the JGN 2015-20 Access Arrangement).

2. EBSS VARIATION

2.1 BACKGROUND

In its 2015-20 AA proposal, JGN proposed to include an EBSS under rule 98 of the NGR. The access arrangement for the previous regulatory period did not include an EBSS.

The AER approved the inclusion of an EBSS[2] which is set out in section 12 of the 2015-20 AA. The EBSS proposed by JGN and approved by the AER was based upon the EBSS as it appeared in Envestra's (Victoria) 2013-17 access arrangement,[3] which reflected the AER's Electricity distribution network service providers EBSS published in June 2008 (**2008 Scheme**).

In November 2013, the AER published an updated version of its EBSS (**2013 Scheme**). In the 2013 Scheme an amendment was made to the EBSS to remove non-recurrent efficiency gains in the base year used to set the forecast operating expenditure (**opex**) to ensure that those forecasts reflect ongoing levels of efficient opex.[4]

This adjustment to remove one-off factors was not included or accounted for in the EBSS approved by the AER and included in JGN's 2015-20 AA.

2.2 REASONS FOR THE VARIATION APPLICATION

2.2.1 WHY INCLUDE AN ADJUSTMENT FOR ONE-OFF COSTS?

In undertaking a review of the 2008 Scheme, the AER considered the treatment of one-off operating costs and whether they should be accounted for in the operation of the EBSS.

The AER recognised that where there are non-recurrent efficiency gains in the base year used to set the opex forecast for the subsequent period, the forecast may not reflect the ongoing level of efficient opex and a comparison of subsequent years' opex may give the appearance of inefficiency. That is, where the regulatory allowance is different to what is expected to be spent because of one-off factors in the base year, this may create difficulties for monitoring and comparing the financial performance of networks.

To this end, the AER endorsed transferring amounts between the EBSS and the regulatory allowance where appropriate to improve transparency in a manner that does not affect the overall revenue requirement. The AER's reasoning in this regard was as follows: [5]

> *We consider there should be flexibility in the EBSS to enable revenue to be shifted from the EBSS carryover to the opex allowance to account for non-recurrent efficiency gains in the base year.*
>
> *As a result we have amended the EBSS to account for any adjustments made to base opex to remove the impacts of one-off factors.*

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[2] AER Final Decision, JGN (NSW) Access Arrangement 2015-2020, Attachment 9, 9-6.

[3] JGN 2015-20 Access Arrangement Information,30 June 2014, p 102. See also the AER's 2013-17 Envestra (Victoria) Draft Decision, Attachment 7, pp 287-88.

[4] AER Better regulation Explanatory Statement, Efficiency Benefit Sharing Scheme for Electricity Network Service Providers, section 2.2.1, pp 20-22.

[5] Ibid

> *… in the event a reflective base year is not available, we will adjust the base year to remove the impact of the one-off factor. We will make the commensurate adjustment to the EBSS carryover amounts by calculating the incremental gain in the final year in accordance with the final year equation above. This would provide a similar revenue outcome to that which would be achieved if the actual base year (with the one-off factor) was used to set the opex forecast in combination with the unadjusted EBSS carryover amounts.*

The mechanism that the AER uses to effect the above is to:

- adjust the base year that is used to set the opex allowance for the next regulatory period, and
- adjust the "deemed" opex for year 5 by a corresponding amount.

The AER determined this approach to be a relatively simple and transparent method of taking account of efficiency gains occurring in the base year that will not persist into the future, by minimising the rewards (penalties) for efficiency gains (losses) being carried forward by the opex forecast rather than the EBSS carryover amounts.[6]

2.2.2 APPLICATION TO OTHER NETWORKS

While the 2013 Scheme applies only to electricity networks under the National Electricity Rules, the same approach has been taken by the AER to other gas networks who have proposed an EBSS. For example, the following gas networks all have an approved EBSS in their current access arrangements which include an adjustment for one-off factors:

- AGN (SA) 2016-2021 Access Arrangement (clause 5.1);
- AGN (Vic and Albury) 2018-2022 Access Arrangement (clause 5.1);
- AusNet 2018-2022 Access Arrangement (clause 6.4.2); and
- MultiNet Gas 2018-2022 (clause 6.4).

2.2.3 JGN'S CIRCUMSTANCES

In preparing for JGN's 2020-25 access arrangement proposal, it became apparent to JGN that:

1. As noted above, the EBSS proposed by JGN for the 2015-20 AA period reflected the application of the EBSS in the AER's 2008 Scheme, and that the current version of the EBSS applied by the AER to gas and electricity networks includes an adjustment for one-off factors which is not included in the EBSS in JGN's 2020-25 AA.
2. JGN will likely incur one-off costs in its base year for the forthcoming regulatory period (for example, business restructuring costs as further described in JGN's Draft 2020 Plan published on 31 January 2019).[7]
3. If no adjustment is made to the EBSS in JGN's 2015-2020 AA, the retention of one-off costs in the base year will overstate the forecast opex for the forthcoming period and give the misleading impression of inefficiency (notwithstanding the revenue impact with or without the adjustment will be largely the same).
4. The above issue is exacerbated by other gas networks' access arrangements which incorporate the current EBSS version and make such adjustment. A comparison by stakeholders against another network's

[6] Ibid.

[7] JGN Draft 2020 Plan, January 2019, section 6.4.

opex forecast and Jemena's, which has not been subject to an adjustment for one-off costs, may give misleading results.

Accordingly, the variation proposed to clause 12 aligns the EBSS with the AER's current approach and brings it into line with other networks.

2.2.4 THE PROPOSED VARIATION

The proposed variations in the **Attachment A** to this Application proceed on the basis that the 2018-2019 financial year will be the base year used to forecast opex in the 2020-2025 access arrangement period.

The proposed variations in clause 12.1(e) to the calculation of the efficiency gain (or loss) in the 2019-2020 financial year are consistent with the approach set out in the 2013 Scheme. Consequential amendments have been made to clause 12.1(f) consistent with other access arrangements implementing the 2013 Scheme.

Attachment A also includes a minor variation to clause 12.1(d) to correct an error in the definition of A_{t-1}.

2.2.5 THE PROPOSED VARIATION IS NON-MATERIAL

JGN considers that the proposed variation is non-material and therefore it is unnecessary to refer this Application to be dealt with as a full access arrangement proposal.

The AER's Access Arrangement Guideline (March 2009) (**2009 AA Guideline**) provides that its decision as to whether a variation is material or not will be considered on a case-by-case basis, taking into account the significance of the proposed variation on the terms and conditions of access including, as relevant, the impact on reference tariffs.

JGN considers that the proposed variation is non-material and does not require consultation because:

- it is simply updating the 2015-20 AA in accordance with the version of the scheme approved by the AER and which is applied to electricity distribution network businesses and incorporated in other gas network's access arrangements. JGN's use of the 2008 version of the EBSS is an anomaly and will give rise to an inconsistency in the treatment of enterprise-wide transformation costs as between JGN and Jemena Electricity Networks in their upcoming revenue reset processes;
- the adjustment for non-recurrent efficiency gains is well understood and widely supported;[8]
- the adjustment does not impact reference tariffs as it results in a similar revenue outcome to that which would be achieved if the actual base year (with the one-off factor) was used to set the opex forecast in combination with the unadjusted EBSS carryover amounts; and
- the change does not limit the ability of the AER to accept or reject the inclusion of one-off cost adjustment in JGN's base year as part of the its regulatory determination process.

2.3 SUMMARY

In summary, JGN seeks the AER's approval under clause 66(2) of the NGR of the proposal to vary clause 12 of the 2015-20 AA for the following reasons:

[8]See also, Incenta Economic Consulting, Advice on certain issues in relation to the Draft Expenditure Forecast Assessment and Efficiency Benefit Sharing Scheme Guidelines, 20 September 2013, p 13.

- The EBSS as it is currently applied by the AER to other electricity and gas networks includes an adjustment for one-off factors.
- The EBSS currently included in JGN's 2015-20 AA does not include the adjustment for one-off factors.
- If one-off costs (such as JGN's transformation costs) are not removed in determining opex allowance, this may lead to a misleading impression of JGN's performance against its current period opex forecast and higher opex forecast for the next access arrangement period.
- Removal of one-off costs from opex allowance allows customers to understand JGN's recurring opex. Including this mechanism as part of EBSS ensures that JGN is not penalised for undertaking measures to lower its costs that would have long term benefits for customers.
- The amendment proposed to account for one-off factors is simple, will align the EBSS that applies to JGN with the AER's current approach and accepted by other gas networks.
- The variation to the scheme results in a similar revenue outcome without the adjustment, but has the benefit of ensuring that one-off factors that will not be incurred in future periods do not skew the impression of JGN's efficiency.

3. AMENDMENT TO REFERENCE SERVICE AGREEMENT

3.1 BACKGROUND

Schedule 4 of the 2015-20 AA includes the RSA which sets out the terms and conditions on which JGN provides reference services in the network.

The RSA reflects the current operation of the network and market, being that the "gas day" commences at 06:30 Australian Eastern Standard Time (**AEST**). For reasons set out below, it is necessary to amend the RSA to reflect the change in the definition of "gas day" in the NGR which takes effect from 1 October 2019.

3.2 REASONS FOR THE VARIATION APPLICATION

In February 2017, the AEMC made a rule change to harmonise the start time of the gas day used in the short term trading market hubs and the gas supply hub trading locations with the gas day start time used in the Victorian declared wholesale gas market.[9] Under that rule change, the gas day in each market at each location will start at 6.00 am AEST. This change will apply from 1 October 2019.[10]

The following defined terms in the RSA reflect the current situation – being that the gas day commences at 06:30 AEST:

- Calendar Month
- Calendar Year
- Day
- Hour

The establishment of a standard, harmonised "gas day" requires that these terms are updated to reflect that the gas day will commence at 06:00 AEST.

3.2.1 THE PROPOSED VARIATION

The proposed variations is shown in the Attachment B to this Application.

3.3 THE PROPOSED VARIATION IS NON-MATERIAL

In light of the criteria in the 2009 AA Guideline, JGN considers that the variations proposed to the RSA are non-material because the variation will simply align the terms of the RSA with the operation of the market, including the NGR, and will not have any impact on reference tariffs.

In light of this, we consider that the Application is capable of being approved by the AER under clause 66(2) as a non-material variation.

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[9] https://www.aemc.gov.au/rule-changes/gas-day-harmonisation.

[10] See, National Gas (Capacity Trading and Auctions) Amendment Rule 2018, which revoked the AEMC's final rule and provided for the gas day to commence at 6 am AEST from 1 October 2019.

3.4 SUMMARY

JGN seeks the AER's approval under clause 66(2) NGR of the proposal to vary the RSA by including a new clause 1.7 as set out in Attachment B because the variation will align relevant definitions in the RSA with the recent rule change which alters the definition of gas day in the NGR.

Appendix A
Variation to clause 12 of the 2015-20 AA

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12 Operating expenditure efficiency carryover mechanism

12.1 Incentive mechanism

(a) The incentive mechanism will apply to operating expenditure.

(b) The incentive mechanism will operate in the following way:

(i) the Service Provider will retain the benefit of actual operating expenditure being lower, or incur the cost of actual operating expenditure being higher, than forecast operating expenditure included in the Total Revenue in each Financial Year of the Access Arrangement Period;

(ii) the mechanism carries forward the Service Provider's incremental efficiency gains (or losses) for five Financial Years from the Financial Year those gains (or losses) occur;

(iii) annual carryover amounts accrue in each Financial Year of the subsequent access arrangement period as the summation of the incremental efficiency gains (or losses) in the immediately prior access arrangement period that are carried forward for five years or less into the Financial Year; and

(iv) the annual carryover amounts are added to the Service Provider's Total Revenue in each Financial Year of the subsequent access arrangement period. If necessary, the annual efficiency gain (or loss) is carried forward into the access arrangement period commencing 1 July 2020 until it has been retained by the Service Provider for a period of five years.

(c) The incremental efficiency gain (or loss) for the Financial Year 2015-16 will be calculated as:

$$F_{2015-16} - A_{2015-16}$$

where:

$F_{2015-16}$ is the forecast operating expenditure for Financial Year 2015-16; and

$A_{2015-16}$ is the actual operating expenditure for Financial Year 2015-16.

(d) The incremental efficiency gain (or loss) for Financial Years 2016-17 to 2018-19 (inclusive) will be calculated as:

$$E_t = (F_t - A_t) - (F_{t-1} - A_{t-1})$$

where:

E_t is the incremental efficiency gain (or loss) in Financial Year *t* of the Access Arrangement Period;

F_t is the forecast operating expenditure in Financial Year *t* of the Access Arrangement Period;

A_t is the actual operating expenditure in Financial Year *t* of the Access Arrangement Period;

F_{t-1} is the forecast operating expenditure in Financial Year *t*–1 of the Access Arrangement Period; and

A_{t-1} is the ~~forecast~~actual operating expenditure in Financial Year *t*–1 of the Access Arrangement Period~~.~~.`

(e) ~~Actual~~The incremental efficiency gain (or loss) for Financial Year 2019-20 will be calculated as:

$$(F_{2019-20} - A_{2019-20}*) - (F_{2018-19} - A_{2018-19})$$

where actual operating expenditure in the Financial Year 2019-20 is to be estimated using the following equation:

$$A_{2019-20}* = ~~A_{2018-19} +~~ = F_{2019-20} ~~- F_{2018-19}~~ - (F_{2018-19} - A_{2018-19}) + non-recurrent\ efficiency\ gain_{2018-19}$$

and where:

$A_{2019-20}*$ is the estimate of operating expenditure for Financial Year 2019-20;

~~$A_{2018-19}$ is the actual operating expenditure for Financial Year 2018-19;~~

$F_{2019-20}$ is the forecast operating expenditure for Financial Year 2019-20; ~~and~~

$F_{2018-19}$ is the forecast operating expenditure for Financial Year 2018-19;

$A_{2018-19}$ is the actual operating expenditure for Financial Year 2018-19 ; and

$non-recurrent\ efficiency\ gain_{2018-19}$ is the adjustment made to $A_{2018-19}$ used to forecast operating expenditure in the access arrangement period commencing 1 July 2020 to account for operating expenditure associated with one-off factors.

(f) For the avoidance of doubt:

(i) ~~the incremental efficiency gain (or loss) for Financial Year 2019-20 will be assumed to equal zero;~~

(ii) the incremental efficiency gain (or loss) for Financial Year 2020-21 will be carried over for 5 years and be calculated with reference to the actual operating expenditure for Financial Year 2019-20 and not $A_{2019-20}*$; and

(iii) the incremental efficiency gains (or losses) are carried over from Financial Year to Financial Year in real dollars to ensure that these gains (or losses) are not eroded by inflation. The price indices used in this calculation are to be consistent with those used in the Access Arrangement Information.

(g) Increments or decrements from the summation of incremental efficiency gains or losses calculated in accordance with the approved incentive mechanism in the Access Arrangement Period will give rise to an additional 'building block' in the calculation of the Total Revenue amounts for each Financial Year of the subsequent access arrangement period.

(h) The following costs will be excluded from the operation of the efficiency carryover mechanism:

(i) UAG Costs;

(ii) licence fee costs;

(iii) debt raising costs;

(iv) Carbon Costs;

(v) the cost of any Relevant Tax; and

(vi) any cost category that: (1) is not forecast using a single year revealed cost approach in the access arrangement period following this Access Arrangement Period (intended to commence 1 July 2020); and (2) the AER determines, as part of a decision on revisions to apply to this Access Arrangement (and following the consultation processes associated with that decision), to exclude from the operation of the efficiency carryover mechanism because it is satisfied that it would not promote the National Gas Objective.

(i) For the avoidance of doubt, the forecast expenditure amounts that are used as the basis for measuring efficiencies are equal to the forecast operating cost for that year as shown in the table below, which exclude the costs listed in clause 12.1(h), adjusted for any Determined Pass Through Amounts:

	2015-16	2016-17	2017-18	2018-19	2019-20
Forecast operating expenditure for incentive mechanism purposes ($million, real 2015)	137.08	137.92	138.84	143.45	142.67

(j) Where the Service Provider changes its approach to classifying costs as either capital expenditure or operating expenditure during the Access Arrangement Period, the Service Provider will adjust the forecast operating expenditure in the Access Arrangement Information so that the forecast expenditures are consistent with the capitalisation policy changes.

(k) If there is a change in the Service Provider's approach to classifying costs as either capital expenditure or operating expenditure, the Service Provider must provide to the AER a detailed description of the change and a calculation of its impact on forecast and actual operating expenditure.

12.2 Fixed principle

Except for clause 12.1(h)(vi), the principle in clause 12.1 is a fixed principle (as provided for in Rule 99 of the National Gas Rules). This fixed principle remains in force for the Access Arrangement Period covered by this Access Arrangement. The principle is also fixed for the next two access arrangement periods.

Appendix B
Variation to the RSA

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Reference Service Agreement

JGN's NSW gas distribution networks

1 July 2015 – 30 June 2020

(Incorporating revisions required by AER Remade Decision 28 February 2019)

Amended March 2019 for changes to "gas day"

Contents

1.6 References to User's Customer where User is the Customer

In this Agreement, where the User is a Customer at premises serviced by a Delivery Point, a reference in this Agreement to a "Customer", a "relevant Customer", the "User's Customer" and the "User's relevant Customer" in relation to that Delivery Point is to be interpreted as a reference to the User.

1.7 Change to definition of "gas day" in National Gas Rules

If the definition of "gas day" in the National Gas Rules is amended to commence from 6:00am, then from the commencement of that rule change, the references to "06:30h" in the definitions of "Calendar Month", "Calendar Year", "Day" and "Hour" in clause 1.1 will be replaced with "06:00h".