Position paper

Approach to six-month extension of access arrangements: Victorian gas distributors

November 2021

AUSTRALIAN ENERGY REGULATOR

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Amendment Record

Version	Date	Pages
1	8 November 2021	17

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1 Introduction

The Australian Energy Regulator (AER) regulates gas transmission and distribution networks in all Australian jurisdictions except Western Australia. As part of this process, regulated gas network businesses must periodically apply to us for a ruling on network charges which in turn influences the expected revenue they will recover from consumers for using their networks. For gas pipelines that are subject to full regulation, these rulings are in the form of an access arrangement specifying certain pipeline services (reference services) and the price and non-price terms and conditions on which those reference services will be offered over a five-year period. Our work under this framework is guided by the National Gas Objective.[1] We use our insights and expertise to determine how much money the network businesses can recover.

Our decisions on the access arrangements currently in place for Victorian gas distributors Australian Gas Networks, Multinet Gas and AusNet were made in November 2017, and cover the period 1 January 2018 to 31 December 2022.

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. The effect of the Act is that our regulatory determinations for affected businesses will now be made for financial years rather than calendar years.

To facilitate this, the 2018-22 access arrangement period for Victorian gas distributors will be extended by six months to 30 June 2023. Prices for the period 1 January to 30 June 2023, over which the current access arrangements will be extended, are to be set by us in accordance with Orders in Council made on 30 September 2021 (the Orders).[2]

We will consider proposals from each business, which under the Orders must be submitted by 1 April 2022. Our final decisions must be made in time for us to determine what prices will apply from 1 January 2023.

The purpose of this paper is to set out a proposed approach to determination of revenue and prices for the 1 January to 30 June 2023 extension period, which will inform both the requirements of the April 2022 proposals and the basis for our decisions.

1.1 How can you get involved?

Interested parties are invited to make submissions on our proposed approach by 3 December 2021.

We will consider and respond to all submissions received by this date in deciding on our final approach.

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1 The NGO is set out under the National Gas Law (NGL), s. 23 which is: "...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 General Gazette Number G39 Dated 30 September 2021, pp. 2076-2081.

Submissions should be sent to: VicGAAR@aer.gov.au

Alternatively, submissions can be sent to:

Sebastian Roberts
General Manager
Australian Energy Regulator
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We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. **We will treat submissions as public documents unless otherwise requested.** All non-confidential submissions will be placed on the AER's website.

For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy, which is available on our website.

We request parties wishing to submit confidential information:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

2 Proposed approach

Our proposed approach to the extension period for gas has been informed by the equivalent process we completed for Victorian electricity distributors in 2020. That approach recognised the Victorian government's policy intent that our decision was to extend the life of the existing determination to cover the additional six months. It drew on the discretion afforded us under Orders in Council to adopt a pragmatic approach to this extension, and to minimise the complexity of the transition process by trending forward most elements of our previous decision as a basis for the additional revenue requirement.

The Orders in place for gas distributors give us a similar level of discretion.[3] In addition, they give us the option to smooth revenue between the extension period of 1 January to 30 June 2023, and the new access arrangement period commencing on 1 July 2023.[4] We consider this additional flexibility provides the best option for the upcoming gas decisions.

Victorian gas distributors operate under weighted average price caps. This means the prices we determine (including the means of varying the prices from year to year) are the binding constraint across an access arrangement period rather than the total revenue requirement set in our decision. Prices are derived from the total revenue requirement after consideration of demand for each price category. Where actual demand over the access arrangement period varies from the demand forecast in the access arrangement, the business's actual revenue will vary from the revenue allowance determined in our decision. In general, if actual demand is above forecast demand, actual revenue will be above forecast revenue and vice versa.

To minimise price volatility for Victorian consumers, we propose to extend 2022 calendar year prices to 30 June 2023. To the extent the expected revenue that would be recovered at those prices is different the building block revenue we approve for that period, any under or over recovery would then be corrected in - and its impact on prices smoothed over - the next access arrangement period commencing on 1 July 2023.

Under this approach, we would make our decision in three parts:

1. We would extend tariffs for the 2022 calendar year so that they continue to apply to the applicable access arrangement extension period (i.e., from 1 January 2023 to 30 June 2023).
2. We will determine the **extension period building block revenue** within the parameters set out in the National Gas Rules and the Orders, applying a similar, trend forward approach to that used for the electricity distribution extension period.
3. We would determine the **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) by reference to the extended, 2022 tariffs and to forecast demand for the extension period. When smoothing revenue and price paths for the new, 2023-28 access arrangement period commencing 1 July 2023, we will complete a **'true up'** of any

3 General Gazette Number G39 Dated 30 September 2021, p. 2078.

4 General Gazette Number G39 Dated 30 September 2021, p. 2080.

difference between extension period allowed revenue and extension period building block revenue. We will then distribute that difference over the next five years to achieve the best outcome for consumers.

We are conscious that this approach could defer outcomes that may otherwise have flowed from interim, six-month revenue decisions and a short-term price change between 1 January and 30 June 2023. However, should our decision on extension period building block revenue suggest a price decrease (or increase) would have been appropriate, the value of that change would still be returned to (recovered from) customers over the next 5-year access arrangement period. Similarly, there is no windfall gain or loss for the affected businesses in a net present value sense, because any under or over recovery in the six-month extension period is trued up.

What this approach does avoid is the potential for price volatility as a result of the extension, and the risk that prices might change materially twice in six months.

There are several reasons prices might change materially on 1 July 2023 irrespective of the prices set for the six-month extension period, including:

- A different Rate of Return Instrument will apply to 2023-28 access arrangement period than in the current period, and in the extension period. Changes in methodology (relative to the 2018 Instrument we must use for the six-month extension period) could result in the rate of return increasing or decreasing.
- Irrespective of change in rate of return methodology, inputs into the rate of return may change over six months. For example, when setting the rate of return, the return on equity averaging period will be six months later and interest rates can change materially in six months.
- The Victorian Government is currently working on a Gas Substitution Roadmap. The Roadmap is expected detail the transition pathways and identify policy mechanisms to achieve Victoria's emissions reduction targets through reduced fugitive emissions, more efficient use of gas, electrification, and increased use of alternative gases such as hydrogen and biogas. To the extent this review impacts the future of Victoria's gas networks, this may warrant changes to our treatment of regulatory depreciation – for example, a reduction in asset lives. Irrespective of the Victorian Government's review, we could ourselves determine a change in asset lives is appropriate with a consequential impact on prices. While we have yet to form a view on this in the context of next year's gas decisions, in recent access arrangement reviews we have seen accelerated depreciation of assets contribute to higher regulated depreciation allowances, and therefore higher revenue and prices, in our determinations.
- Other building block inputs into the AER revenue determination, for example, operating or capital expenditure allowances, could change materially in the new access arrangement period. These cannot be determined until the AER receives and assesses revenue proposals from the gas businesses.

Should any of these factors, either alone or in combination, result in material changes in prices on 1 July 2023, an interim price change on 1 January 2023 may be followed by a second price change in the same, or a different direction on 1 July 2023. We do not consider material fluctuation in prices over such a short period of time to be in the best interest of consumers. Given this, we consider it prudent for our approach to the extension period to limit the risk of price volatility to the extent possible under the Orders.

2.1 Extension period building block revenue

We propose a simple trended-forward methodology for establishing most building blocks, and to apply the 2018 Rate of Return Instrument with minor modifications to reflect the differences in timing for the extension period.

Under this measure the building block inputs for 1 January to 30 June 2023 would be treated as set out in the sections below. Save for the application of the 2018 Rate of Return Instrument, which is required by the Orders, this approach treats the period of 1 January 2023 to 30 June 2023 as an extension of our decisions for the current 2018-22 access arrangement period, consistent with the Victorian Government's policy intention.

We will consider any resultant 'true up' required to adjust for differences between extension period allowed revenue and extension period building block revenue as part of our draft decisions on the 2023-28 access arrangement proposals. This will provide stakeholders with the opportunity to comment on our proposed smoothing of any over or under recovery over the next five years before our final decision on price paths from 1 July 2023 is made in April 2023.

2.1.1 Rate of return

For the purposes of determining the applicable access arrangement extension period building block revenue, and despite anything to the contrary in the National Gas (Victoria) Law or the National Gas Rules, clauses 6 and 7 of the Order:[5]

- Provides that the 2018 Rate of return instrument applies to the applicable access arrangement extension period, subject to the AER's modifications of the Rate of return instrument to give effect to the change of the access arrangement period from a CY to a FY basis
- Permits the AER, if it considers it necessary or expedient for making a variation decision, to apply an alternative averaging period that it considers appropriate instead of an accepted averaging period in applying the extension period rate of return instrument for the purposes the variation decision.

If we do decide to use an alternative averaging period instead of an accepted averaging period in accordance with clause 7, then appropriate adjustments may be made in the 2023–2027 access arrangement.[6] On this we note:

- Any appropriate adjustments would correct for any expected over or under recovery of revenue as a result of the difference of revenue allowed under an alternative averaging period versus the revenue under the accepted averaging period.

5 General Gazette Number G39 Dated 30 September 2021, pp. 2077-2078.
6 General Gazette Number G39 Dated 30 September 2021, p. 2080.

- If we determine to keep prices constant for the applicable access arrangement extension period, with an appropriate true up for expected (overall) under or over recovery, there will be no need to use an alternative averaging period. An overall true up is permitted under Clause 9 of the orders and is discussed below in section 2.2.

A modified 2018 instrument was made by the AER on 29 October 2021. This modified 2018 Rate of return instrument is published on the AER website along with an Explanatory Statement explaining the modifications made.**7**

The modifications to the 2018 Rate of return instrument have been made so that the regulatory rate of return will not make consumers or businesses materially better or worse off due to the change from calendar year regulatory years to financial year regulatory years. Effectively, we achieve this outcome by:

- Calculating and applying a new Return on Equity for the applicable access arrangement extension period calculated in accordance with the 2018 Rate of return instrument methodology; and
- Calculating a new on-the-day return on debt for the applicable access arrangement extension period in accordance with the 2018 Rate of return instrument methodology and having this feed into the trailing average with modified trailing average weights.

The modifications, and the rationale for them, are substantively the same as the ones we made to a modified 2018 Rate of return instrument we applied to Victorian electricity distributors when they moved to financial years in 2021. The proposed changes were consulted on with consumer representatives and industry representatives prior to being made by the AER. The consultation is set out in the Explanatory statement to the modified Rate of return instrument.[8]

The key reasons the application of the 2018 Rate of return instrument and modifications are required are:

- The 2018 Rate of return instrument reduces the allowed return on both debt and equity, all else remaining equal. Therefore, not applying these changes from 1 January 2023 would have made gas consumers materially worse off relative to not changing the regulatory control period to financial years via an access period extension of the current access period.
- Debt yields have changed materially since the commencement of the trailing average. Consequently, not modifying the weights feeding into the trailing average return on debt in an appropriate way could make consumers materially better or worse off. For this reason, we have modified the trailing average weights in a manner that can prevent consumers and businesses from being materially impacted, including to have a new on

7 Available here and on project pages for the Multinet and AusNet access arrangement reviews: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023-28/transitional-decision

8 AER, Explanatory Statement Modified Rate of Return Instrument for the Victorian gas distribution networks during the extension period of 1 January 2023 to 30 June 2023.

the day return on debt for the applicable access arrangement extension period feed into the trailing average.[9]

Finally, we note that our preferred approach is to continue the 2022 tariffs for the applicable access arrangement extension period and do a true up for any overall expected over or under recovery of revenue in the subsequent access arrangement period. This is discussed in section 2.3. Nevertheless, under this proposed approach consumers will still receive the benefit of the application of the modified rate of return instrument from 1 January 2023. This is because it will be captured in the true up and the benefit will flow to consumers in the subsequent access arrangement period.

Expected inflation

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

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

2.1.2 Operating expenditure

For the purposes of determining the extension period building block revenue, clause 8 of the Order requires that the forecast of operating expenditure (opex) for the applicable access arrangement extension period must consist of parts that:[10]

(a) the AER is satisfied meet the criteria governing opex set out in rule 91 of the National Gas Rules; *or*

(b) 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.

Our proposed approach is option (b). To forecast opex for the six months from 1 January to 30 June 2023, we propose to:

- Apply a rate of change to half the forecast opex that we determined for 2022, excluding debt raising costs. That rate of change would be equal to three quarters of the rate of change we used for 2022. This will represent the change in the average level of output, prices, and productivity between the average levels over the 2022 calendar year and the first six months of 2023. This can be represented as the difference in these levels at the end of June 2022 (the middle of 2022) and at the end of March 2023 (the middle of the extension period), which is nine months, or three quarters of a year.

9 The decision on how the trailing average will apply post 1 July 2023 will be determined by future rate of return instruments.

10 General Gazette Number G39 Dated 30 September 2021, p. 2078.

- Forecast debt raising costs using the appropriate benchmarking approach. This separate treatment of debt raising costs is consistent 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 for consistency with the forecast of the cost of debt in the rate of return building block.

This approach recognises the limited time remaining before AusNet, AGN and Multinet must submit proposals for the extension period on 1 April 2022. The six-month period available between the making of the Orders and the due date for proposals is insufficient for us to prepare and serve specifications for a full opex proposal in a Regulatory Information Notice, and for the businesses to then comply with that notice.

The proposed approach is consistent with the approach we took in the equivalent determination for Victorian electricity distributors. There was general support for this approach to the extension period building block revenue, as a way to accommodate the 6-month extension period and allow the movement from the calendar year basis for the regulatory period to a financial year basis.

However, noting that our decisions on levels of expenditure in the 2022 regulatory year were made more than 5 years ago, there was some concern that those forecasts may no longer be reflective of current needs. This was a particular concern where actual expenditure reported over the period of our last decision was observed to be lower than our forecasts.

We consider the risk associated with our proposed approach to be low.

- Annual reporting from AGN and AusNet suggests actual opex over the first three years of the current period has so far been broadly in line with our forecasts: no more than 3.2% ($2.3. million) under for AGN, or 5.6% ($3.1 million) over for AusNet in any given year. The difference between forecast and actual opex for Multinet has been somewhat more pronounced: between 21.6% ($17.1 million) and 17.6% ($14.2 million) lower than forecast.
- Our proposed approach to forecasting opex does not account for any efficiency gains the Victorian gas distributors have achieved by underspending forecast opex. That is, forecast opex for the extension period would allow the distributors to retain any recurrent efficiency gains they have achieved in the 2018–22 access arrangement period. We will account for this when we calculate efficiency carryover amounts so that these efficiency gains are not double counted.
- If, instead, we reflected the efficiency gains revealed in the 2018–22 access arrangement period in the forecast opex for the extension period, we would then need to include these gains in the efficiency carryover amounts. This would reduce forecast opex but increase efficiency carryover amounts. It would not change the overall opex and efficiency carryover revenues since the two impacts would offset each other. We prefer the proposed approach relative to this approach because it is simpler and results in the same outcome.

2.1.3 Capital expenditure

For the purposes of determining the projected capital base for the applicable access arrangement extension period under rule 78 of the National Gas Rules and determining the extension period building block revenue, clause 8 of the Order requires forecast conforming capital expenditure (capex) consists of parts that:[11]

(a) the AER is satisfied meet the new capital expenditure criteria set out in rule 79 of the National Gas Rules; or

(b) 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.

Our proposed approach is option (b). To forecast capex for the six months from 1 January to 30 June 2023, we propose to:

- Halve the forecast conforming capex that we determined for 2022, and
- Escalate the resultant allowance by CPI only.

As we have found with opex, this approach recognises the limited time remaining before AusNet, AGN and Multinet must submit proposals for the extension period on 1 April 2022. The six-month period available between the making of the Orders and the due date for proposals is insufficient for us to prepare and serve specifications for a full capex proposal in a Regulatory Information Notice, and for the businesses to then comply with that notice.

Our proposed approach is consistent with the approach we took in the equivalent determination for Victorian electricity distributors, which was again generally supported. Having considered the same concerns that our forecast capex for 2022 may not be truly indicative of current needs, we again consider the risk associated with our proposed approach to be low.

- Multinet's reported actual capex for the current period has to date been within 5.2% ($4.3 million) over and 5.1% ($4.4 million) under our approved forecasts for the first three years of the current period. Differences between forecast and actual capex reported by AusNet and AGN have been more pronounced (an average of 7.2% and 19% respectively), but in the latest reporting year (2020) have narrowed to 7.7% ($7.8 million) for AusNet and 3.4% ($4.4 million) for AGN.
- While forecast and actual capex amounts have differed, actual capex profiles over the current period have thus far remained similar to those forecast in our final decisions, which in each case provided for a capex allowance that declined towards the end of the current period. This gives us confidence that reliance on the lower, final year forecasts in our previous decisions in preference to an average including years with higher forecasts is likely to remain reasonably reflective of current expenditure needs.
- Irrespective of any over or under spend during the extension period, it is actual capex, which must be assessed by us as conforming capex under the Gas Rules as part of our

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next review, that will ultimately be rolled into the capital base at the conclusion of the 2023-28 access arrangement period.

2.1.4 Forecast demand

Forecast demand plays an important role in the derivation of reference tariffs. A price cap is used as the form of control for gas, meaning that prices, rather than revenue, are set at the time of the determination. The building block revenue requirement forms a target revenue. At a simplistic level, this target revenue is divided by forecast demand to produce reference tariffs. If actual demand is higher, the service provider will earn more than the target revenue. Conversely, if it is lower, the service provider will earn less than the target.

The Orders do not prescribe an approach to our assessment of demand forecasts. Rule 74 of the Gas Rules sets out the principles we must follow when approving forecasts, including forecast demand. These are:

1. Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate
2. A forecast or estimate:
   (a) must be arrived at on a reasonable basis; and
   (b) must represent the best forecast or estimate possible in the circumstances.

Service providers must provide a forecast of demand for each reference service for the extension period, as set out in clause 72(a)(iii) of the NGR. This will allow for the derivation of reference tariffs over the extension period. Our proposed approach is to assess whether the forecast demand is consistent with recent historical trends (e.g., in line with growth or decline in demand of recent available actual demand figures). Given the short length of the extension period, we consider using the most recent actual demand for the equivalent, January to June period is reasonable, and will provide the best forecast of demand in the circumstances.

2.1.5 Application of incentive schemes

Despite anything to the contrary in the National Gas (Victoria) Law or the National Gas Rules, clause 8 of the Orders provides that for the purposes of determining the extension period building block revenue:[12]

(a) The AER may decide that revenue increments or decrements do not apply to the applicable access arrangement extension period in respect of an incentive mechanism included in the access arrangement that applied immediately before the applicable 2018-2022 access arrangement (previous access arrangement);

(b) where the AER decides that revenue increments or decrements apply to the applicable access arrangement extension period in respect of an incentive mechanism included in the previous access arrangement, the AER may make any modifications to the application of the incentive mechanism to the applicable access arrangement extension

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period that it considers necessary to be made as a consequence of the enactment of Subdivision 3 of Division 2 of Part 7 of the National Gas (Victoria) Act 2008.

For 1 January 2023 to 30 June 2023, we propose that in relation to the incentive schemes:

- The Capital expenditure sharing scheme (CESS) would not apply
- The Efficiency carryover mechanism would apply
- Any revenue adjustments from the application of the efficiency carryover mechanism in the 2018–22 access arrangement period would commence from 1 January 2023.

We do not consider applying the CESS for the extension period will necessarily provide the intended incentives of the scheme. The CESS is designed to operate over a five-year period, with service standards and target capex set at the beginning of an access arrangement period. Capital projects occur over longer timeframes, and there is significant opportunity for inefficient deferral of capital in the six-month period to maximise revenue, which would undermine the intent of the CESS.

Applying the efficiency carryover mechanism during the extension period would be consistent with the application of the EBSS to the Victorian electricity distributors. This would provide the gas distributors a constant incentive to reduce opex, including in the six-month extension period. Not applying the efficiency carryover mechanism could provide an incentive to shift reported expenditure, resulting in carryover amounts unrelated to efficiency gains.

We also propose to include revenue adjustments from the application of the efficiency carryover mechanism in the 2018–22 access arrangement period in the extension period. This is a change from how we applied the EBSS to the Victorian electricity distributors. In that case we considered there was insufficient time to determine the carryover amounts and include them in revenues for the extension period. In this case, we consider there is sufficient time and carryovers could be included in the revenues for the extension period.

2.1.6 Modelling of capital base, depreciation, tax, and revenues

For the purposes of determining the extension period building block revenue, clause 8 of the Order allows us to apply:[13]

(a) any financial models that the AER has published under rule 75A of the National Gas Rules;

(b) the revenue model and the capital base roll forward model that the relevant applicable 2018-2022 access arrangement was initially based on when it was approved by the AER; or

(c) some variants of the models referred in paragraph (a) and (b).

Clause 8 of the Order also allows us to apply the depreciation schedules included in the 2018-2022 access arrangements to the extension period, modified to reflect the length of the applicable access arrangement extension period.[14]

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Our proposed approach to revenue modelling for the extension period is (c).

In accordance with rule 75A of the NGR, we have published a Post Tax Revenue Model (PTRM) and Roll Forward Model (RFM) for gas distribution businesses, and associated handbooks.[15] These models have superseded those used in our final decisions on the 2018-22 access arrangements, and under the Gas Rules must be used by the affected businesses for the 2023-28 access arrangement proposals.

The models we propose to use for the extension period are variants on these. Specifically, we have developed a half-year PTRM that would treat the building block inputs for the extension period in the following manner:

- The opening capital base as at 1 January 2023 will be established using the standard published RFM that roll forwards the capital base for 2018-22, based on actual capex/latest estimates, approved depreciation, and actual CPI
- Regulatory depreciation of capex will be based on approved existing asset classes/lives/methods for the 2018-22 period. For regulatory depreciation of existing assets at 1 January 2023, the businesses would be required to use the modified depreciation module of the RFM, which allows for the tracking calculations to include the extension period. The inputs for this depreciation module should reflect the asset values and lives from the depreciation model approved for the 2018-22 period.
- Corporate income tax will be based on the approach used for the current access arrangement period, except for the value of imputation credits (gamma), which is to be based on the modified 2018 Rate of Return Instrument as set out in section 2.1.1
- Rate of return and inflation inputs will be as set out in section 2.1.1.
- Opex will be as set out in section 2.1.2.
- Capex will be as set out in section 2.1.3.
- There would be no revenue adjustments associated with the efficiency carryover mechanism and capital expenditure sharing scheme calculations for the 2018-22 period. As set out in section 2.1.5, these revenue adjustments would be deferred to begin from 1 July 2023.

This is broadly consistent with the modelling approach we took in the equivalent determinations for Victorian electricity distributors. The key difference between this approach and that we took for the Victorian electricity distributors' extension period is the inclusion of our template depreciation module for the Victorian gas distributors. Our template depreciation module was recently published and therefore was not available at the time the Victorian electricity distributors' models were being developed for their extension period. Accordingly, the Victorian electricity distributors' individual depreciation models were continued for use with relevant amendments for the extension period.

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14 General Gazette Number G39 Dated 30 September 2021, p. 2079.

15 AER, *Gas transmission and distribution network service providers, Roll forward models (version 1)*, April 2020; AER, *Gas transmission and distribution network service providers, Post-tax revenue models (version 2)*, April 2021.

For completeness, we note that the reference service prices for the 2023-28 period are to be established using the following models:

- Modified RFM and depreciation module. This is consistent with clause 9 of the Order which allows us to make any modifications to the application of the capital base RFM published under rule 75A of the NGR that we consider necessary to be made:
    - The modified RFM for 5.5 years (based on the standard published RFM expanded for the extension period) is to establish the opening capital base at 1 July 2023.
    - The modified depreciation module of the RFM (based on the module discussed above) is used to calculate the depreciation values of assets at 1 July 2023.
- Standard published PTRM, which incorporates the findings of the 2018 tax review and the 2020 review of inflation treatment.

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

Despite anything to the contrary in the National Gas (Victoria) Law or the National Gas Rules, clause 8 of the Orders require that for the purposes of determining tariffs for the extension period:[16]

(a) AER must determine the revenue to be derived from the provision of the relevant pipeline services for the applicable access arrangement extension period (the extension period allowed revenue) that is an amount between:

   a. the extension period building block revenue, and

   b. 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.

(b) Division 8 of the National Gas Rules applies as if the references to “total revenue” in that Division were references to the extension period allowed revenue.

If there is a difference between the extension period allowed revenue and the extension period building block revenue we determine using the approach set out in section 2.1, clause 9 of the Orders allows us to make appropriate adjustments for the difference through the 2023–2027 access arrangement.[17]

As discussed above, our proposed approach is for the tariffs for the 2022 calendar year to continue to apply to the applicable access arrangement extension period (i.e. from 1 January 2023 to 30 June 2023). However, this will result in an expected revenue that differs to the 'correct' building block revenue. We propose to adjust for any expected difference in these revenue amounts in a net present value neutral way through adjusting tariffs in the subsequent access arrangement period.

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17 General Gazette Number G39 Dated 30 September 2021, p. 2080.

This approach is different to the approach we used for electricity, where network prices changed on 1 January 2021 and again on 1 July 2021. With further time to consider how to deal with the transition issues for the move for gas businesses to financial years, we consider it desirable to only have one network price change on 1 July 2023 (and associated changes for gas consumers).

To facilitate our proposed approach, we propose that the gas businesses will provide us:

- an updated tariff model for the applicable access arrangement extension period. This model would apply the 2022 tariffs (adjusted for half year actual inflation) to the applicable access arrangement extension period with updated customer number and demand forecasts
- evidence and explanation to justify the customer number and demand forecasts for the applicable access arrangement extension period in the tariff model provided.

Following this, the AER propose to undertake the following steps:

- We will assess the customer number and demand forecasts in light of submissions and make adjustments if we consider these are required. We will consult with the businesses and other stakeholders in this process to the extent time permits.
- Following any adjustments to tariff model inputs we will use each of the businesses tariff models to calculate their respective expected extension period allowed revenue over the applicable access arrangement extension period.
- We will calculate the building block revenue each of the businesses should expect to receive over the applicable access arrangement extension period (in accordance with section 2.1).

In the subsequent access arrangement decision, we propose to adjust for the difference (between expected extension period allowed revenue and building block revenue) in a net present neutral way. For example, if a business expected to over (under) recover by $10 million in the applicable access arrangement extension period, the tariffs in the subsequent access arrangement period will be reduced (increased) relative to the correct building block tariffs so the business expects to return (receive) the $10 million dollars to (from) consumers with interest at the regulatory WACC for the time value of money.

The true up should ensure that both gas networks and consumers are not materially better (or worse) off as a result of continuing the 2022 tariffs throughout the applicable access arrangement extension period.

The proposed true up is based on expected revenue and not actual revenue. Any variations due to customer numbers or actual demand varying from forecast customer numbers and demand over the six-month applicable access arrangement extension period will not be adjusted for. We consider this consistent with the application of the price cap regime the gas businesses are all operating under.