

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018

Rule Proponent(s)

Jemena Gas Networks (NSW) Ltd (JGN)

7 June 2018

**RULE
CHANGE**

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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Summary

The Australian Energy Market Commission (Commission) has made a draft rule in response to a rule change request from Jemena Gas Networks (NSW) Ltd (**JGN**) to amend the National Gas Rules (NGR). The rule change request has sought to minimise network pricing volatility for JGN's gas customers¹ that may occur due to the delay in the finalisation of the Australian Energy Regulator's (AER) remade final decision for JGN's 2015-20 access arrangement period (remade 2015 decision).² The delay was caused by merits review and judicial review proceedings relating to the AER's final decision for JGN's current access arrangement period.

The draft rule, which is a more preferable rule, enables the AER to shift JGN's revenue between the current access arrangement period and the subsequent access arrangement period.³ The process provides a mechanism that:

- minimises network price volatility⁴ that may occur for consumers as a result of the outcome of the remade 2015 decision
- allows JGN to recover the revenue that it is entitled to, but no more, for the current access arrangement period.

The Commission invites stakeholder submissions on this draft determination and draft more preferable rule by **19 July 2018**.

Overview of the draft rule

The draft rule incorporates elements of the proposed rule, and is designed to achieve the same outcome of minimising price volatility for JGN's customers. The key features of the draft rule are:

- the draft rule enables the AER to determine whether any revenue adjustments (increases or decreases) should be made to enable the timing of revenue recovery to be shifted between the current access arrangement period and the subsequent access arrangement period, to minimise network price volatility that may occur for JGN's customers as a result of the remade 2015 decision

¹ That are supplied gas through JGN's NSW gas distribution network. This does not apply to NSW gas customers located outside JGN's NSW gas distribution network.

² Throughout this draft determination, 'remade 2015 decision' refers to the AER's remade final decision (remittal) for JGN's 2015-20 access arrangement period.

³ The current access arrangement is the access arrangement period for JGN commencing 1 July 2015. The subsequent access arrangement period is the access arrangement period for JGN immediately following the current access arrangement period. In the rule change request, JGN pose that the current access arrangement period is for '2015-20' and the subsequent access arrangement period is for '2020-25'. Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p1.

⁴ Network costs are one of a number of cost components that a retailer may include in a customer's total gas price. Changes in other cost components (i.e. gas wholesale costs) could contribute to volatility in a customer's total gas price and are outside the scope of this rule change.

- the AER must take into account a revenue recovery principle, which states that JGN must be given the ability to recover the same revenue (in net present value equivalent terms), but no more than it would have, had the remade 2015 decision been in force from the commencement of the current access arrangement period. The revenue recovery principle makes it clear that revenue can be shifted between the current and subsequent access arrangement periods, provided that it meets the NPV neutral requirement, which prevents any windfall gains or losses for JGN.
- when determining the adjustment amount and the subsequent adjustment amount, the AER must take into account the National Gas Objective (NGO) and may take into account the revenue and pricing principles
- the draft rule enables the AER to make an adjustment determination. If the AER decides to make an adjustment determination, it must do it on or before 1 March 2019.⁵ The adjustment determination is a separate decision from the remade 2015 decision and can be published at the same time from the remade 2015 decision or at another time. The adjustment determination will be given effect through the annual tariff variation process provided for by the access arrangement. The AER's adjustment determination will not affect the making of the remade 2015 decision.

The main differences between the proponent's proposed rule and the draft rule are as follows:

- the draft rule includes a revenue recovery principle
- the draft rule includes changes to clarify the processes that need to apply for the AER's making of an adjustment determination
- in the proposed rule, the effect of the adjustment determination is to vary the remade 2015 decision. The draft rule does not change the application of the rules to the making of the remade 2015 decision.

Reasons for the Commission's draft determination

The Commission considers that the draft rule is in the long-term interests of consumers, because it provides stable network prices for consumers, outlines a mechanism that best minimises network price volatility and enables JGN to recover the efficient costs of providing reference services.

Providing stable network prices

Consumers may experience a price variation of a large magnitude over the three regulatory years from 2018/19 to 2020/21. This may arise from the delay in the finalisation of the remade 2015 decision and may lead some of JGN's customers to

⁵ If the AER has not made an adjustment determination on or before 1 March 2019, the rule expires.

make decisions on their investment and use of natural gas services that in the long term are inefficient.

A process that allows revenue recovery to be shifted between the current and subsequent access arrangement periods in order to minimise network price volatility would lead to more stable network prices that would allow consumers to make better informed decisions. The Commission considers that this is in long term interests of consumers.

Outlining a mechanism that best minimises network price volatility

The Commission considers that the draft rule is better able to minimise network price volatility than the proposed rule.

The Commission considers that the AER, in consultation with JGN and other relevant stakeholders, is in the best position to make informed decisions as to how to shift revenue between the current and subsequent arrangement periods to minimise network price volatility. The draft rule enables the AER to make these decisions in accordance with a set of requirements on net present value neutrality and consultation with JGN and stakeholders the AER considers relevant.

Enabling JGN to recover its efficient costs of providing reference services

The draft rule provides that the AER can include revenue adjustments in the current access arrangement period and subsequent access arrangement period, so that JGN is provided with a reasonable opportunity to recover its efficient costs of providing reference services.

The need to provide an opportunity for JGN to recover at least its efficient costs is further clarified by the inclusion of the revenue recovery principle in the draft rule, which provides that:

“means the principle that Jemena must be given the ability to recover the same, but no more, revenue (in net present value equivalent terms) as it would have recovered if the remade 2015 decision had been in force from the commencement of the 2015 access arrangement period.⁶”

⁶ Refer to clause 53 of the draft rule.

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1 Rule change request and rule making process

1.1 The rule change request

On 14 December 2017, Jemena Gas Networks (NSW) Ltd (**JGN**) submitted a rule change request to the Commission seeking to amend the National Gas Rules (NGR). The rule change request has sought to provide a mechanism to minimise network pricing volatility for JGN's gas customers⁷ that may occur due to the delay in the finalisation of the Australian Energy Regulator's (AER's) remade 2015 decision. The delay was caused by merits review and judicial review proceedings relating to the AER's final decision for JGN's current access arrangement period. The rule change proposes to enable the AER to shift revenue between the current access arrangement period and the subsequent access arrangement period.

1.2 Current arrangements and relevant background

1.2.1 Overview of economic regulation of gas distribution service providers

Framework for pipeline regulation

Due to their capital intensive nature, gas distribution pipelines in one geographic area are most efficiently provided by one supplier and this results in a natural monopoly market structure. Under the current regulatory framework, different forms of economic regulation apply to gas pipelines in different circumstances. A tailored level of regulation is applied based on the extent of the market failure the regulation is intended to address, and the relative regulatory burden of each form of regulation.

JGN operates the NSW gas distribution network. The NSW gas distribution network is a covered pipeline that is subject to full regulation. This means that its reference tariffs for the provision of reference services are regulated through its access arrangement.

Review of AER's access arrangement decisions

The AER is responsible for the making of an access arrangement for covered gas pipelines.⁸ Prior to October 2017, an access arrangement decision by the AER was generally a 'reviewable regulatory decision' under the (National Gas Law) NGL.⁹ Parties that were interested or affected by the AER's access arrangement decision could apply to the Australian Competition Tribunal (Tribunal) for a review of the decision

⁷ That are supplied gas through JGN's NSW gas distribution network. This does not apply to NSW gas customers located outside JGN's NSW gas distribution network.

⁸ This responsibility applies in all Australian states and territories except Western Australia and Tasmania. An access arrangement period usually covers five years.

⁹ Section 244 of the NGL.

under the limited merits review framework in the NGL.¹⁰ In general terms, the applicant needed to demonstrate an error of fact, incorrect exercise of discretion, or unreasonableness by the AER in respect of the access arrangement decision.¹¹ In addition, the applicant needed to demonstrate why the Tribunal varying or setting aside that decision on the basis of one or more of those grounds would, or would be likely to, result in a decision that was materially preferable to the existing decision in terms of making a contribution to the achievement of the National Gas Objective (NGO).¹²

If the applicant or the AER was not satisfied with the decision of the Tribunal, it could apply to the Federal Court of Australia for judicial review of the Tribunal's decision.

The affected party also has an option to apply to the Federal Court of Australia for judicial review of the AER's access arrangement decision. This relates to the legality of the administrative decision (e.g. an error of law).

1.2.2 Access arrangements relevant to this rule change request

Status of access arrangement, reviews and remittal

The final decision on the access arrangement relevant to this rule change was made by the AER in June 2015 and related to JGN's access arrangement for the period from 1 July 2015 to 30 June 2020.

In June 2015, JGN applied to the Tribunal for merits review and the Federal Court for judicial review of the AER's final decision for its current access arrangement. In February 2016, the Tribunal set aside the AER's final decision and remitted the decision to the AER to remake its decision in accordance with the Tribunal's directions.¹³

In March 2016, the AER applied to the Federal Court for judicial review of the Tribunal's decision to set aside the AER's final decision on JGN's current access

¹⁰ Chapter 8, Part 5, Division 2 of the NGL. The effect of this section has been significantly altered in October 2017 as a result of the commencement of the *Competition and Consumers Amendment (Abolition of Limited Merits Review) Act 2017 (Cth)*. The commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017 (Cth)* in October 2017 significantly altered the availability of merits review by both preventing a decision of the AER being subject to merits review by a body established under a State or Territory law and also by broadly denying consent to the conferral on the Tribunal of merits review under a State/Territory energy law or the Australian Energy Market Act 2004, although limited jurisdiction remains in relation to a decision relating to the disclosure of confidential or protected information.

¹¹ Section 246(1) of the NGL. The effect of this section has been significantly altered in October 2017 as a result of the commencement of the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017 (Cth)*.

¹² s. 246(1a) of the NGL.

¹³ AER, *Jemena Gas Networks (NSW) - Access arrangement 2015-20 - Remittal*, website viewed 18 May 2018.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20-remittal>

arrangement.¹⁴ The Federal Court upheld the AER's application on imputation tax credits (gamma), but otherwise dismissed the AER's application for judicial review.

As a result of the Federal Court's decision, the AER is now required to remake its decision on return on debt and market expansion capital expenditure (capex) for JGN's current access arrangement. In December 2017, the AER commenced this remittal process by publishing a position paper in relation to return on debt.¹⁵

Undertakings provided to the AER by JGN

Since the Tribunal set aside the AER's final decision on revisions to JGN's access arrangement, JGN has submitted undertakings to the AER under section 230A of the NGL which set out the reference tariffs to apply for 2016-17,¹⁶ 2017-18¹⁷ and 2018-19¹⁸. The undertakings were used to set reference tariffs in these years, whilst legal and regulatory processes were still to be finalised. The reference tariffs set in 2016-17, 2017-18 and 2018-19 were higher than they would have been had the AER's original final decision not been set aside.¹⁹

1.3 Issues the rule change request seeks to address

1.3.1 Potential for significant price volatility in the absence of a rule change

As outlined in section 1.2.2, there has been a delay in the finalisation of the AER's final decision on JGN's current access arrangement due to merits review and judicial review proceedings. During this delay, JGN provided undertakings to the AER which set

14 Ibid.

15 AER, *Position paper - Remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access arrangement*, December 2017.
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20-remittal>

16 Jemena Gas Networks (NSW), *Enforceable undertaking*, May 2016.
<https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20%28NSW%29%20enforceable%20undertaking%20-%20May%202016.pdf>

17 Jemena gas Networks (NSW), *Enforceable undertaking*, May 2017.
<https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20%28NSW%29%20-%20Enforceable%20undertaking%20-%20May%202017.pdf>

18 Jemena Gas Networks (NSW), *Enforceable Undertaking*, April 2018.
<https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20-%20Enforceable%20undertaking%202018-19.PDF>

19 Tariffs for 2016-17, 2017-18 and 2018-19 were set in accordance with undertakings provided to the AER by JGN under section 230A of the NGL. Tariffs for 2016-17 remained unchanged from tariffs in 2016-17, which were higher than the 12 per cent reduction in real terms set out in the AER's original final decision. Tariffs for 2017-18 reduced by 7 per cent in real terms (but from tariffs applicable in 2015-16), which JGN considered was consistent with the price change in the AER's original final decision. Tariffs for 2018-19 reduced by 5.4 per cent in real terms, which JGN considered was consistent with the price change in the AER's original final decision. Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p5 and Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, pp1-2.

JGN's tariffs higher than what it considered would have been the case had the AER's original final decision not been set aside.²⁰

JGN considers that, due to these delays, potential exists for network price volatility for customers over the next three regulatory years (from 2018-19 to 2020-21), in the absence of a rule change.²¹ JGN considers that there is uncertainty around the extent of price volatility, given the range of outcomes that could result from the AER's remade 2015 decision.²² Based on modelling by JGN,²³ it considers that in the absence of a rule change, the tariff path outcomes are likely to lie somewhere at or between the following scenarios:²⁴

- a 38.3% decrease in real prices between 2018-19 and 2019-20 and a 49.9% increase in real prices between 2019-20 and 2020-21 if the AER's remade 2015 decision is as per the AER's original final decision,²⁵ and
- an 14.7% decrease in real prices between 2018-19 and 2019-20 and a 17.2% increase in real prices between 2019-20 and 2020-21 if the AER's remade 2015 decision is as per JGN's revised proposal^{26,27}

Forecast smoothed revenue under these scenarios, based on modelling by JGN,²⁸ is shown in Figure 1.1 below.

20 Ibid.

21 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.5

22 Ibid.

23 JGN provided initial modelling in its rule change request, prior to the setting of JGN's reference tariffs for 2018-19. In its submission to the Consultation Paper, JGN provided updated modelling which included JGN's reference tariffs for 2018-19, which had by that time been set. The changes in reference tariffs (prices) and revenues referred to in this draft determination are based on JGN's updated modelling.

24 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.5-6 and B1-B2; and Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, Appendix A.

25 These are JGN's estimated real changes in prices for distribution costs only, which represent approximately 50 per cent of a customer's total annual gas bill. These do not equate to estimated changes in a customer's total annual gas bill. AER, *Final decision - Jemena Gas Networks (NSW) Ltd - Access arrangement 2015-20 - Overview*, June 2015, p8.

26 Ibid.

27 That is, JGN's revised proposed settings for return on debt for the current access arrangement period.

28 Based on JGN's updated modelling which incorporates the 5.4% real price decrease in 2018-19, as per JGN's 2018-19 enforceable undertaking, which was accepted by the AER on 23 April 2018. Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, pp1-2 and Appendix A.

Figure 1.1 JGN's forecast revenue based on AER remade 2015 decision as per original AER final decision or JGN revised proposal (return on debt), without cross period smoothing



Source: Modelling by JGN²⁹

1.3.2 The NGR does not address the issue

JGN submits that there is currently no mechanism in the NGR to shift revenue recovery between access arrangement periods in order to reduce price volatility.³⁰

JGN recognises that there are potentially other approaches in the current NGR that could be used to shift revenue between two access arrangement periods. For example, JGN recognise that it may be possible to adjust the depreciation schedule with the effect of increasing revenue in the current access arrangement period, by bringing forward revenue from the subsequent access arrangement period.³¹ However JGN suggests that adjusting the depreciation schedule in this way is likely to be contentious and complex and is unlikely to be cost effective or efficient.³²

²⁹ JGN notes that these smoothed revenues do not present a forecast of JGN's revenue requirements for the purposes of JGN's subsequent access arrangement proposal, which is due for submission to the AER in June 2019. JGN note that the modelling for this rule change has made necessary simplifying assumptions of the operating and capital expenditure and cost of capital required in the subsequent access arrangement period. Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, p4 and Appendix A.

³⁰ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.10

³¹ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.13

³² Ibid, p13.

While this alternative approach may allow smoothing of JGN's total revenue over two access arrangement periods, it would involve changes to the depreciation schedule of one or more asset classes over multiple access arrangement periods, which may not be cost effective or efficient and therefore may not accord with the revenue and pricing principles.³³

1.4 Solution proposed in the rule change request

In order to minimise this potential network pricing volatility, JGN submitted the rule change request to allow for revenue recovery to be shifted between the current access arrangement period and the subsequent access arrangement period. This would involve bringing forward some revenue recovery from the subsequent access arrangement period into the current access arrangement period.³⁴

JGN proposes to provide the AER with discretion to decide whether or not to make an 'adjustment determination'. The proposed rule provides the AER with the power to make an 'adjustment determination' if it is satisfied that doing so is likely to reduce volatility in reference tariffs for JGN's customers and is likely to contribute to the NGO.³⁵

JGN is proposing a rule change that only applies to JGN and only for the current and subsequent access arrangement periods, as opposed to a rule change that would apply to all covered gas network service providers.³⁶ For more detail on JGN's reasoning for proposing a limited rule change, refer to section 3.1.

An overview of the operation of the proposed revenue smoothing mechanism is outlined in Box 1.1. Stakeholders should refer to the rule change request for a further explanation of how it is intended to operate.³⁷

³³ Section 24 of the NGL.

³⁴ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.9

³⁵ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p.A-1.

³⁶ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p14.

³⁷ Source: Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017. Proposed rule, pp. A1-A3

Box 1.1**Overview of the operation of the revenue smoothing mechanism, as proposed by JGN**

JGN states that the proposed rule would be implemented by the AER by making a separate determination ('an 'adjustment determination') that must be made no earlier than the remade 2015 decision and no later than 1 March 2019. As noted above, the AER would have discretion to decide whether or not to make an 'adjustment determination'.

If the AER decides to make an 'adjustment determination', the proposed effect would be to vary the AER's remade 2015 decision. The 'adjustment determination' must be designed to minimise volatility in reference tariffs for JGN's customers across both the current and subsequent access arrangement periods and be Net Present Value (NPV) neutral.³⁸ The 'adjustment determination' would have regard to:

- the effect of the 'adjustment determination' on the reference tariff variation mechanism for the current access arrangement period
- the effect of the 'adjustment determination' on the reference tariff variation mechanism for the subsequent access arrangement period, and
- the current best estimate of total revenue and demand for reference services for each regulatory year in the subsequent access arrangement period.

JGN proposes that the 'adjustment determination' must include:

- an adjustment amount
- a revised calculation of the portion of total revenue that is allocated to reference services for the current access arrangement period, with the adjustment amount added
- a revised reference tariff variation mechanism for the current access arrangement period, reflecting the revised calculation of total revenue allocated to reference services for that period, including the adjustment amount, and
- any consequential amendments to the remade 2015 decision as the AER considers necessary, which must be limited to those amendments necessary for, or directly consequential on, revision of the reference tariff variation mechanism for the current access arrangement period.

Source: Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017. Proposed rule, pp. A1-A3

³⁸ The determination of the adjustment amount must have regard to the fact that the adjustment amount affects revenue (and hence reference tariffs) in both access arrangement periods in an offsetting manner.

If JGN's proposed rule is made, there would be various tariff path outcomes that could arise, which vary depending on a range of factors including:

- whether the AER's remade decision is as per its original decision, JGN's revised proposal³⁹ or somewhere in between these scenarios
- the adjustment amount determined by the AER
- the way in which the AER decides to revise total revenue and the reference tariff variation mechanism in each of JGN's current and subsequent access arrangement periods.

Based on modelling by JGN, if the rule change is made and the AER minimise network price volatility by smoothing JGN's revenue over the current and subsequent access arrangement periods, the reference tariff path outcomes are likely to lie somewhere between:⁴⁰

- a 5.3% decrease in real prices between 2018-19 and 2019-20 and a 5.3% decrease in real prices between 2019-20 and 2020-21 if the AER's remade 2015 decision is as per the AER's original final decision,⁴¹ and
- a 2.2% decrease in real prices between 2018-19 and 2019-20 and a 2.2% decrease in real prices between 2019-20 and 2020-21 if the AER's remade 2015 decision is as per JGN's revised proposal^{42, 43}

Forecast smoothed revenue under these scenarios,⁴⁴ based on updated modelling by JGN,⁴⁵ is shown in Figure 1.2 below.

³⁹ That is, JGN's proposed settings for return on debt and market expansion capex for the current access arrangement period

⁴⁰ Based on JGN's updated analysis which incorporates the 5.4% real price decrease in 2018-19, as per JGN's 2018-19 enforceable undertaking, which was accepted by the AER on 23 April 2018. Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, pp1-2 and Appendix A.

⁴¹ These are JGN's estimated real changes in prices for distribution costs only, which represent approximately 50 per cent of a customer's total annual gas bill. These do not equate to estimated changes in a customer's total annual gas bill. AER, *Final decision - Jemena Gas Networks (NSW) Ltd - Access arrangement 2015-20 - Overview*, June 2015, p8.

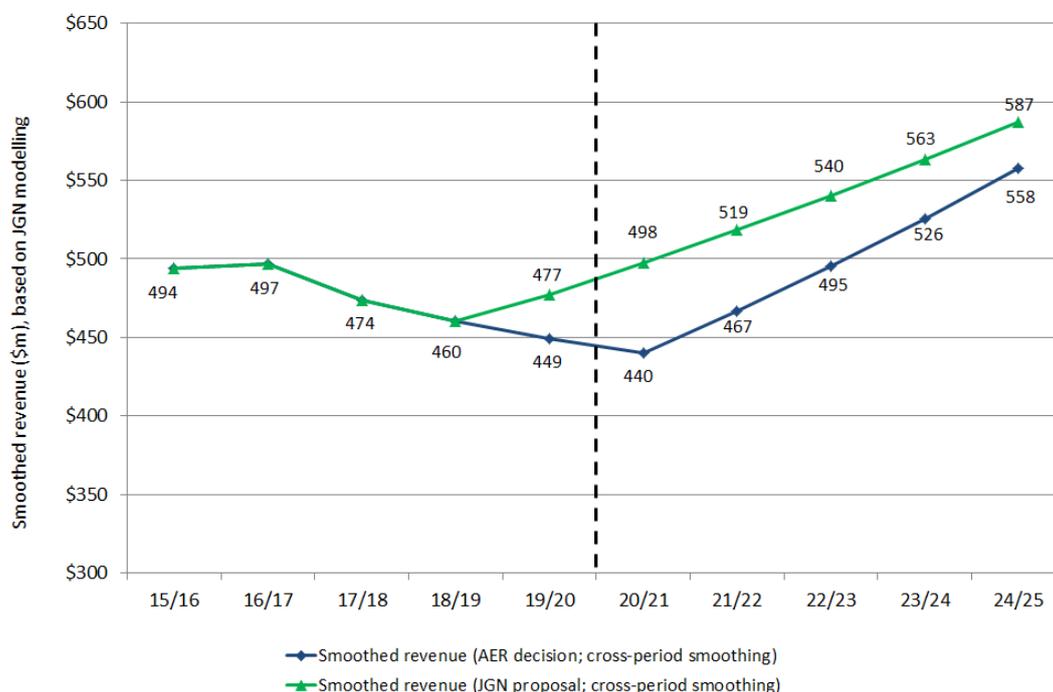
⁴² Ibid.

⁴³ That is, JGN's revised proposed settings for return on debt for the current access arrangement period.

⁴⁴ The possible revenue outcomes are not limited to these two scenarios.

⁴⁵ Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, Appendix A.

Figure 1.2 JGN's forecast revenue based on AER remade 2015 decision as per original AER final decision or JGN revised proposal (return on debt), with cross period smoothing



Source: Modelling by JGN⁴⁶

1.5 The rule making process

On 27 March 2018, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.⁴⁷ The Commission also published a consultation paper that identified specific issues for consultation. Submissions closed on 24 April 2018.

The Commission received six submissions as part of the first round of consultation.⁴⁸ The Commission considered all issues that have been raised by stakeholders in submissions, and key issues are discussed throughout the draft determination. Appendix A sets out a summary of all the other issues that the submissions have raised, in addition to the Commission's response to each issue.

⁴⁶ JGN notes that these smoothed revenues do not present a forecast of JGN's revenue requirements for the purposes of JGN's 2020-25 access arrangement proposal, which is due for submission to the AER in June 2019. JGN note that the modelling for this rule change has made necessary simplifying assumptions of the operating and capital expenditure and cost of capital required in the 2020-25 access arrangement period. Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, p4 and Appendix A.

⁴⁷ This notice was published under s. 303 of the NGL.

⁴⁸ One of these was a late submission. This was JGN's supplementary (second) submission as part of the first round of consultation.

1.6 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination by 19 July 2018.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 14 June 2018.

Submissions and requests for a hearing should quote project number GRC0043, and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

2 Draft rule determination

2.1 The Commission's draft rule determination

The Commission's draft rule determination is to make a more preferable draft rule, under which:

- the AER may determine whether any revenue adjustments (increases or decreases) should be made to enable the timing of revenue recovery to be shifted between the current access arrangement period and the subsequent access arrangement period, to minimise network price volatility that may occur for JGN's customers as a result of the remade 2015 decision
- the AER must take into account a revenue recovery principle, which states that JGN must be given the ability to recover the same revenue (in net present value equivalent terms), but no more than it would have, had the remade 2015 decision been in force from the commencement of the current access arrangement period. The revenue recovery principle makes it clear that revenue can be shifted between the current and subsequent access arrangement periods, provided that it meets the NPV neutral requirement, which prevents any windfall gains or losses for JGN.
- when determining the adjustment amount and the subsequent adjustment amount, the AER must take into account the NGO and may take into account the revenue and pricing principles
- the draft rule enables the AER to make an adjustment determination. If the AER decides to make an adjustment determination, it must do it on or before 1 March 2019.⁴⁹ The adjustment determination is a separate decision from the remade 2015 decision and can be published at the same time as the remade 2015 decision or at another time. The adjustment determination will be given effect through the annual tariff variation process provided for by the access arrangement. The AER's adjustment determination will not affect the making of the remade 2015 decision.

The Commission's reasons for making this draft determination are set out in Chapter 3.

This chapter outlines:

- the rule making test for changes to the NGR and Commission's consideration of the draft rule against the NGO, and
- the assessment framework for considering the rule change request.

Further information on the legal requirements for making this draft rule determination is set out in Appendix B.

⁴⁹ If the AER has not made an adjustment determination on or before 1 March 2019, the rule expires.

2.2 Rule making test

2.2.1 Achieving the national gas objective (NGO)

Under the NGL, the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NGO.⁵⁰ This is the decision making framework that the Commission must apply.

The NGO is:⁵¹

“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.”

The Commission considers that the most relevant aspects of the NGO are the efficient operation and use of natural gas services with respect to the price of natural gas.

2.2.2 Revenue and pricing principles

In addition to having regard to the NGO, the Commission has had regard to the revenue and pricing principles in making a rule with respect to (amongst other things) the regulation of reference tariffs from the provision of reference services that are the subject of an access arrangement decision.

2.3 Assessment framework

In assessing the rule change request against the NGO the Commission has considered the following principles

- **Is reducing network price volatility in the long term interests of consumers?**

Consumers may experience a network price variation of a large magnitude from one year to another arising from the delay in the finalisation of JGN's current access arrangement. This network price volatility may lead some of JGN's consumers to make decisions on their investment and use of natural gas services that, in the long term, are inefficient. This Commission has considered whether minimising network price volatility would be in the long term interests of consumers in this case.

⁵⁰ Section 291(1) of the NGL.

- **If so, what is the best method to minimise network price volatility?**

If minimising price volatility is in the long term interests of consumers, the Commission has assessed the best method to achieve minimisation of price volatility.

- **Does the rule change align with the revenue and pricing principles?**

The Commission has considered whether the draft rule is consistent with the revenue and pricing principles as set out in the NGL,⁵² specifically the following revenue and pricing principles:

- a service provider should be provided with a reasonable opportunity to recover at least the efficient costs of providing reference services
- a service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides, and
- a reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which that tariff relates.

2.4 Summary of reasons for making a more preferable rule

2.4.1 Key features of the draft rule

Having considered the rule change request against the assessment framework set out in section 2.3 and having considered the NGO and revenue and pricing principles, the Commission has decided to make a draft rule. The draft rule is published with this draft determination. The key features of the draft rule are:

- the draft rule enables the AER to determine whether any revenue adjustments (increases or decreases) should be made to enable the timing of revenue recovery to be shifted between the current access arrangement period and the subsequent access arrangement period
- the draft rule gives JGN the ability to recover any increased or decreased revenue for the current access arrangement period as a result of the remade 2015 decision. The draft rule incorporates a revenue recovery principle to make clear that:

"...Jemena must be given the ability to recover the same, but no more, revenue (in net present value equivalent terms) as it would have recovered if the remade

51 Section 23 of the NGL.

52 Section 24 of the NGL.

2015 access arrangement decision had been in force from the commencement of the 2015 access arrangement period."⁵³

- the AER's adjustment determination under the draft rule occurs separately from the making of the remade 2015 decision. The AER has discretion to make the adjustment determination at the same time or at another time from the making of the remade 2015 decision. If the AER decides to make an adjustment determination, it must make it on or before 1 March 2019.⁵⁴ The AER's adjustment determination is given effect through the annual tariff variation notice in the last year of the current access arrangement period and the access arrangement revision processes for the subsequent access arrangement period.

The Commission is satisfied that the draft rule will, or is likely to, contribute to the achievement of the NGO. The Commission's reasons for making this rule are briefly discussed in section 2.4.3 below. Chapter 3 of this determination provides a more in depth discussion of the Commission's reasons.

2.4.2 How the draft rule compares with the proposed rule

Under s. 296 of the NGL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NGO than the proposed rule.

The draft rule incorporates elements of JGN's proposed rule and is designed to achieve the same outcome of minimising price volatility for consumers.

The Commission is satisfied that the draft rule, which is a more preferable rule, will, or is likely to, better contribute to the achievement of the NGO for the following reasons:

- **the draft rule incorporates a revenue recovery principle** as discussed in section 2.4.1. The Commission has included the principle to enable the AER to make adjustments under the draft rule to give JGN the ability to recover the revenue it would have been entitled to recover during the current access arrangement period under the remade 2015 decision, had the remade 2015 decision been in force from the commencement of the 2015 access arrangement period
- **the draft rule does not vary the remade 2015 decision** The draft rule does not change the application of the rules to the making of the remade 2015 decision
- **the draft rule incorporates revised definitions, terms and requirements** to improve clarity and transparency relating to the process of making an adjustment determination. This includes requirements for the AER to consult with JGN and other relevant stakeholders in making the adjustment determination and to

⁵³ Refer to clause 53 of the draft rule.

⁵⁴ If the AER has not made an adjustment determination on or before 1 March 2019, the rule expires.

publish the adjustment determination and the reasons for making the adjustment determination.

2.4.3 Key reasons for this decision

This section outlines the reasons for the Commission's decision.

Reducing network price volatility

The Commission considers that enabling the timing of revenue recovery to be shifted between the current and subsequent access arrangement periods will help to minimise network price volatility. The Commission also considers that the minimisation of price volatility is in the long term interests of consumers.

In the absence of a rule change, JGN's prices could:

- fall significantly in the final year of the current access arrangement period, followed by
- a sharp increase in the first year of the subsequent access arrangement period.

Under these circumstances, this price volatility may lead some of JGN's consumers to make decision on their investment and use of natural gas services, that in the long term, are inefficient.

The Commission considers that stable network prices allow consumers to make informed decisions as to their energy spending and usage. If the timing of revenue recovery is shifted between the current and subsequent access arrangement periods, network prices would be more stable. In this case, minimising pricing volatility would benefit consumers.

The Commission notes that JGN has requested that the rule change request apply to JGN only and only to apply in the current and subsequent access arrangement period. The Commission agrees with JGN's position and considers that a rule change that only applies to JGN is more appropriate than a rule change that would apply to all covered gas network service providers. The Commission considers that JGN is in a unique situation due to the delay in the finalisation of its remade 2015 decision. These circumstances only apply to JGN and only in relation to its current access arrangement period.

Method of minimisation of pricing volatility

The Commission considers that the draft more preferable rule is better able to minimise network price volatility than the proposed rule, for the reasons outlined above in section 2.4.2.

The Commission considers that the AER, in consultation with JGN and other relevant stakeholders, is in the best position to make informed decisions as to whether and how to minimise network price volatility across access arrangement periods. The draft rule

enables the AER to make these decisions in accordance with the following requirements:

- the AER's determination of whether, and how, to shift revenue (referred to under the draft rule as the 'adjustment determination') needs to take into account the revenue recovery principle which states that JGN must be given the ability to recover the same revenue (in net present value equivalent terms), but no more, than it would have had the remade 2015 decision been in place from the commencement of the current access arrangement period
- the AER may only decide to shift revenue between the current and subsequent access arrangement periods if the remade 2015 decision and the adjustment determination are made on or before 1 March 2019 and the AER is satisfied that doing so is reasonably likely to minimise variations in reference tariffs between regulatory years and access arrangement periods
- the AER must set out in its adjustment determination the amounts that are to operate as a revenue increase or decrease (as the case may be) in the current and subsequent access arrangement periods
- the impact of the AER's adjustment determination under the draft rule must be neutral in terms of net present value
- the AER must consult with JGN and other relevant stakeholders as part of the decision making process.

Alignment with revenue and pricing principles

The Commission considers that the draft rule is compatible with the application of the following relevant revenue and pricing principles:

- a service provider should be provided with a reasonable opportunity to recover at least the efficient costs of providing reference services
- a service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides, and
- a reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which that tariff relates.

The Commission considers that enabling the AER to determine any revenue adjustment to be shifted between the current and subsequent access arrangement periods in accordance with the requirements set out in the draft rule would:

- provide JGN with a reasonable opportunity to recover at least its efficient costs, as well as
- achieve the most efficient outcomes for consumers.

3 Reasons for making more preferable rule

This chapter outlines the rationale for the Commission's draft more preferable rule to enable the AER to shift JGN's revenue between the current and subsequent access arrangement periods to minimise network price volatility. This chapter is structured to discuss the Commission's reasoning on the following key issues:

- reducing price volatility
- method of minimisation of price volatility
- alignment with revenue and pricing principles.

3.1 Reducing price volatility

3.1.1 Proponent's view

As discussed in section 1.3, JGN submits that due to delays in the finalisation of its 2015-20 access arrangement, potential exists for network price volatility for customers over the next three regulatory years (from 2018-19 to 2020-21), in the absence of a rule change.⁵⁵ JGN submits that there is currently no mechanism in the NGR to shift revenue recovery between access arrangement periods in order to reduce price volatility.⁵⁶

JGN has sought to resolve this issue by proposing a mechanism that allows the timing of revenue recovery to be shifted between the current access arrangement period and the subsequent access arrangement period. The proposed mechanism is described in section 1.4.

JGN considers that the proposed rule promotes the NGO as it:

- creates a mechanism to minimise network price volatility in a short period of time, which has the potential to distort consumers' budgetary decisions on energy spending and investment decisions on energy usage, which can potentially lead to long term inefficient outcomes⁵⁷
- promote efficient use of natural gas services.⁵⁸

JGN note that it is not just pricing volatility per se that causes inefficient usage or investment decisions, but it is also that the volatility is not related to actual year on

⁵⁵ Jemena Gas Networks (NSW) Ltd, *Rule change request - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p5.

⁵⁶ Jemena Gas Networks (NSW) Ltd, *Rule change request - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p10.

⁵⁷ Jemena Gas Networks (NSW) Ltd, *Rule change request - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p15.

⁵⁸ *Ibid*, p15.

year changes in JGN's costs.⁵⁹ JGN considers that where prices are not based on cost (and are significantly below cost), it could distort customer's decisions to invest in new long life gas appliances or develop usage patterns (habits) that become more difficult to sustain in future years.⁶⁰ JGN also note that minimising the difference between cost of service and final year forecast revenues is often applied in practice by the AER for gas distributors.⁶¹

Limited or wider rule change

JGN considers that given its unique circumstances, a rule change that only applies to them is more appropriate than a wider rule change that would apply to all covered gas service providers.⁶² JGN is proposing a rule of limited application as it is seeking to address what it considers to be a one-off issue, due to the following events:

- the findings of the Tribunal in its merits review
- the AER's application for judicial review, and
- as a result, the delay in the making of the remade 2015 decision.

According to JGN, these circumstances only apply to JGN in relation to its current access arrangement period. Therefore, JGN is proposing a rule which only applies to JGN for the current and subsequent access arrangement periods.⁶³

3.1.2 Stakeholder views

All stakeholder submissions supported the general purpose of the rule change request to minimise network price volatility for consumers.

The AER supports the aim of the rule change request to reduce the price/revenue volatility that may arise from the outcome of the remade 2015 decision.⁶⁴ The AER considers that significant price volatility, even if one-off, can lead customers to incorrectly assume that it will continue into the future, which can lead customers to make inefficient decisions.⁶⁵

The Public Interest Advocacy Centre Ltd (PIAC) agreed with JGN that price volatility may lead some consumers to make inefficient decisions on energy spending and

⁵⁹ Jemena Gas Networks (NSW) Ltd, *Jemena submission on consultation paper - Cross period revenue smoothing- GRC0043*, 24 April 2018, p2.

⁶⁰ Ibid.

⁶¹ Ibid, p3.

⁶² Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p14

⁶³ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, p14

⁶⁴ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p1.

⁶⁵ Ibid, p6.

investments.⁶⁶ PIAC cautioned that price stability is not always inherently preferable, for example if consumers were able to choose between energy prices that are stable at an unaffordable level, compared to volatile but affordable prices, it may well be in their interests to choose the latter.⁶⁷ However given that the proposal is for a NPV neutral adjustment determination, PIAC supports it and does not consider that it inappropriately trades off affordability for price stability.⁶⁸

Red and Lumo Energy consider that limiting "bill shock" would be beneficial to customers. Red and Lumo Energy noted that distribution charges are a significant part of a customer's end bill, so a sudden change in distribution charges could significantly impact a customer's end bill.⁶⁹

Limited or wider rule change

ATCO Gas Australia (ATCO Gas) supports JGN's proposed rule as it addresses a 'one-off' issue related to the delay in the finalisation of JGN's 2015-20 access arrangement due to limited merits review and judicial review processes.⁷⁰ ATCO Gas agrees with JGN's proposal that it should have limited application in that it should only apply to JGN, and only allow for smoothing of network revenue and prices across JGN's current access arrangement period and subsequent access arrangement period.⁷¹ However, as a general proposition and for the reasons outlined in section 3.2.1, ATCO Gas has reservations about the efficacy of cross-period revenue smoothing as a means of minimising "bill shock" for gas customers.⁷² Therefore, ATCO Gas does not support broadening the application of the proposed rule to give the AER (or the Economic Regulation Authority in Western Australia) a more general power to make cross-period price and revenue adjustments.⁷³

3.1.3 Analysis and conclusions

Taking into account stakeholder submissions, the Commission has concluded that a mechanism that provides for the ability to minimise network price volatility by shifting the recovery of revenue between the current and subsequent access arrangement periods is less likely to result in inefficient outcomes for customers. The Commission therefore considers such a mechanism to be in the long term interests of consumers.

⁶⁶ Public Interest Advocacy Centre Ltd, *Consultation paper on the JGN Cross period revenue smoothing (Gas) rule change*, 20 April 2018, p1.

⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ Red Energy and Lumo Energy, *National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018*, 24 April 2018, p1

⁷⁰ ATCO Gas Australia Pty Ltd, *National Gas Amendment (Cross period revenue smoothing) - Reference code: GRC0043*, 24 April 2018, p2.

⁷¹ Ibid.

⁷² Ibid.

⁷³ Ibid.

Limited or wider rule change

The Commission notes that JGN has proposed a limited rule change that only applies to JGN. The Commission agrees with JGN that this is more appropriate than a wider rule change that would apply to all covered gas network service providers.

3.2 Method of minimisation of price volatility

3.2.1 Shifting revenue recovery between the current and subsequent access arrangement periods

Proponent's views

JGN's proposed approach to minimise network price volatility by shifting the recovery of revenue between the current access and subsequent access arrangement periods is outlined in section 1.4.

JGN consider that its proposed rule:⁷⁴

- was designed to be consistent with the AEMC final rule for the NSW Distribution Network Service Provider (DNSP) Revenue smoothing rule change⁷⁵
- provides the AER with discretion to decide whether or not to allow cross period smoothing, and to determine the adjustment amount that minimises variations as far as possible across the current access arrangement period and the subsequent access arrangement period
- ensures that JGN is not better or worse off as a result of cross period smoothing.

Stakeholder's views

The AER agrees with JGN that enabling smoothing of price/revenue adjustments over two access arrangement periods would provide greater scope to achieve the aim of minimising price volatility.⁷⁶ The AER largely supports the drafting of the proposed rule and considers that the simple, clear and principles-based drafting style of the proposed rule would enable the AER, JGN and other stakeholders to facilitate the aim of minimising price volatility.⁷⁷ However the AER considers that it would benefit from the addition of a 'revenue recovery principle' and revised timing arrangements, as outlined below in section 3.2.2 and section 3.2.3.⁷⁸

⁷⁴ Jemena Gas Networks (NSW) Ltd, *Jemena submission on consultation paper - Cross period revenue smoothing - GRC0043*, pp2-3.

⁷⁵ AEMC, *Participant derogation - NSW DNSPs Revenue Smoothing*, 1 August 2017. <https://www.aemc.gov.au/rule-changes/participant-derogation-nsw-dnsps-revenue-smoothing>

⁷⁶ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p1.

⁷⁷ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, pp6-7.

⁷⁸ *Ibid*, p1.

PIAC agrees with JGN that a one-off measure to allow the recovery of revenue to be shifted between two access arrangement periods may be desirable. PIAC supports JGN's proposal to provide the AER with discretion as to whether the smoothing mechanism is beneficial and required.⁷⁹

Red and Lumo Energy consider that the proposed rule provides the appropriate mechanism to enable the timing of revenue to be shifted between two access arrangement periods.⁸⁰ Red and Lumo Energy support the rule change provided that any adjustment determination made by the AER minimises network price volatility across both the current and subsequent access arrangement periods and is NPV neutral.⁸¹

As noted in 3.1.2, ATCO Gas supports the rule change request and the limited application of the rule change request to JGN. However, as a general proposition, ATCO Gas has reservations about the efficacy of cross-period smoothing as a means of minimising "bill shock" for customers. ATCO Gas notes that cross-period smoothing involves either bringing forward or deferring revenue that should be recovered within one access arrangement period, which tends to push network prices out of alignment with the efficient costs of providing network services, which is not necessarily conducive to promoting the efficient use of natural gas services. In JGN's proposal, cross-period smoothing involves bringing forward the recovery of revenue from the subsequent access arrangement period to the current access arrangement period, which ATCO Gas notes brings forward the cost recovery for future services onto current users of the network.⁸²

Analysis and conclusions

The Commission agrees with JGN that enabling revenue to be shifted between the current and subsequent access arrangement periods would provide greater scope to minimise network price volatility, which is in the long term interests of consumers. The Commission supports the high level drafting of the proposed rule which is generally in line with the drafting of the NGR, however has proposed some amendments to the rule in the more preferable draft rule, including:

- the more preferable draft rule aims to not affect the making of the remade 2015 decision, or the terms of the access arrangement for the subsequent period, other than to include the adjustment amounts, and
- the more preferable draft rule incorporates revised definitions, terms and requirements.

⁷⁹ Public Interest Advocacy Centre Ltd, *Consultation paper on the JGN Cross period revenue smoothing (Gas) rule change*, 20 April 2018, p1.

⁸⁰ Red Energy and Lumo Energy, *National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018*, 24 April 2018, p1

⁸¹ Red Energy and Lumo Energy, *National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018*, 24 April 2018, p

⁸² ATCO Gas Australia Pty Ltd, *National Gas Amendment (Cross period revenue smoothing) - Reference code: GRC0043*, 24 April 2018, p2.

These changes are described in section 2.4.2.

3.2.2 Revenue recovery principle

Proponent's views in the rule change request

JGN did not propose to include a revenue recovery principle in the proposed rule in the rule change request.

Stakeholder's views

The AER suggested that the proposed rule would benefit from the addition of a revenue recovery principle. The revenue recovery principle means that JGN must be given the ability to recover only the revenue to which it is entitled, and should not receive any windfall gains or losses from the revenue smoothing process.⁸³ The AER considered that, as with the revenue smoothing participant derogations for the NSW/ACT DNSPs,⁸⁴ the proposed rule should include a provision that explicitly states the revenue recovery principle. The AER proposed specific phrasing for the revenue recovery principle:⁸⁵

“in respect of JGN, means the principle that JGN must be given the ability to recover the same, but no more, revenue (in net present value equivalent terms) as it would have recovered if the remade 2015 access arrangement decision had been in force from the commencement of the 2015 access arrangement period, and any control mechanisms specified in the remade 2015 access arrangement decision had been implemented in each relevant regulatory year.”

The AER considers that the revenue recovery principle should be added to the proposed rule for the following reasons:

- to ensure that the proposed solution works as intended, such that JGN recovers only the revenues it is entitled to recover. The AER considers that while JGN's proposed rule may be interpreted to enable JGN to recover only the revenues it is entitled to recover, for the avoidance of doubt, a provision should be added which explicitly reflects the revenue recovery principle. The AER considers that such a provision would guide the process for determining price/revenue amounts to be smoothed across two access arrangement periods, including any disputes arising from that process⁸⁶

⁸³ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p1.

⁸⁴ AEMC, *Participant derogation - NSW DNSPs Revenue Smoothing*, 1 August 2017. <https://www.aemc.gov.au/rule-changes/participant-derogation-nsw-dnsps-revenue-smoothing>; and AEMC, *Participant derogation - ACT DNSP Revenue Smoothing*, 1 August 2017. <https://www.aemc.gov.au/rule-changes/participant-derogation-act-dnsp-revenue-smoothing>

⁸⁵ See AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p3.

⁸⁶ *Ibid*, pp3-4.

- to enable the AER to ensure JGN faces the intended properties of its control mechanism when determining the revenue entitlement. JGN operates under a weighted average price cap, in which prices are set based on a formula using X factors based on building block revenues and forecast volumes. Where actual volumes across the access arrangement period vary from forecast volumes across the access arrangement period, JGN's actual revenue will likewise vary from the forecast revenue in the AER's final decision. Therefore, JGN bears the volume risk (positive and negative). The AER considers that the final rule (if made) should preserve the volume risk inherent in JGN's control mechanism,⁸⁷ and that this can be achieved through the inclusion of a revenue recovery principle.

Proponent's views in response to stakeholder's views

As outlined above, in its submission on the Consultation Paper, the AER suggested including a revenue recovery principle in the rule (if made).⁸⁸

In response to the AER's submission on the Consultation Paper, JGN submitted a supplementary submission which opposes the inclusion of a revenue recovery principle in the rule (if made).⁸⁹ JGN's reasons for opposing the inclusion of a revenue recovery are as follows:

- the AER should adopt a consistent approach to the making of the remade decision and the adjustment determination. The revenue recovery principle is not a factor that the AER can consider in making the remade 2015 decision, which JGN considers does not reduce the AER's ability to make a decision in customer's interests in the remade 2015 decision⁹⁰
- the revenue recovery principle is not required to ensure that JGN only recovers the revenues it is entitled to recover. JGN agrees that it should not be allowed to recover more revenue than would otherwise be the case. JGN considers that its proposed rule protects against windfall gains or losses through the NPV neutral requirement⁹¹
- it detracts from the simplicity of the proposed rule. JGN considers that the revenue recovery principle introduces ambiguity in how the rule (if made) is interpreted and applied, for example:⁹²

⁸⁷ The AER considered that the net effect of the final rule (if made) should be to put JGN in the same position it would have been in had the remade 2015 decision been in place from the commencement of the current access arrangement period. *Ibid*, p4.

⁸⁸ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p1 and pp3-4.

⁸⁹ Jemena Gas Networks (NSW) Ltd, *Jemena supplementary submission to consultation paper - Cross period revenue smoothing (Gas) - GRC0043*, 11 May 2018.

⁹⁰ *Ibid*, p1.

⁹¹ *Ibid*, pp1-2.

⁹² *Ibid*, pp4-5.

- whether the principle is to be applied over the current access arrangement period only, or over both the current and subsequent access arrangement periods
- whether JGN must be able to recover the same amount of revenue as it would have recovered under the remade 2015 decision under its Weighted Average Price Cap (WAPC) form of control, and hence on the basis of forecast volumes (as at the commencement of the current access arrangement period) or on the basis of actual and/or updated forecast volumes
- how to give effect to the application of the remade 2015 decision control mechanism in each historical year, which may be relevant to determining the amount of over-recovery in the current access arrangement period, but not to determining the adjustment amount.

Analysis and conclusions

The AER considers that the inclusion of a revenue recovery principle would better assist in achieving the intended outcome of the rule change request. Consistent with the approach in the NSW and ACT DNSP Revenue smoothing rule changes,⁹³ the Commission has included in the draft rule a principle that is based on the AER submission. The revenue recovery principle in the draft rule has been amended from that proposed by the AER to simplify and better fit the context of the NGR.

The Commission notes that JGN considers that the AER should use a consistent approach to the making of the remade 2015 decision and the adjustment determination, and that the revenue recovery principle only applies to the making of the adjustment determination and not the making of the remade 2015 decision. The Commission considers that it is appropriate that the adjustment determination be made in accordance with the revenue recovery principle as this enables the AER to shift revenue between the current and subsequent access arrangement periods to give JGN the ability to recover the same revenue (in net present equivalent terms) as it would have recovered if the remade 2015 decision had been in force from the commencement of the current access arrangement period. The revenue recovery principle does not apply in the making of the remade 2015 decision and this is appropriate as the remade 2015 decision only relates to the current access arrangement period and not two access arrangement periods.⁹⁴

The Commission notes that JGN considers that adding a revenue recovery principle detracts from the simplicity of the proposed rule and introduces ambiguity into how the rule (if made) is interpreted and applied. JGN provided examples regarding this

⁹³ AEMC, *Participant derogation - NSW DNSPs Revenue Smoothing*, 1 August 2017. <https://www.aemc.gov.au/rule-changes/participant-derogation-nsw-dnsp-revenue-smoothing>; and AEMC, *Participant derogation - ACT DNSP Revenue Smoothing*, 1 August 2017. <https://www.aemc.gov.au/rule-changes/participant-derogation-act-dnsp-revenue-smoothing>

⁹⁴ The remade 2015 decision will be made under the current NGR. Any changes to the application of the NGR for the making of the remade 2015 decision are out of scope for this rule change.

potential ambiguity above. The Commission considers that, if the rule was made as per the proposed rule, the AER would have needed to address such matters anyway to meet the NPV neutrality obligation in Jemena's proposed rule. The revenue recovery principle makes it clear that revenue can be shifted between the current and subsequent access arrangement periods, provided that it meets the NPV neutral requirement, which prevents any windfall gains or losses for JGN. Therefore, the Commission considers that it is appropriate to include the revenue recovery principle to guide the AER in its application of the draft rule.

The principle included in the draft rule states that JGN must be given the ability to recover the same, but no more, revenue (in net present value equivalent terms) as it would have recovered if the remade 2015 decision had been in force from the commencement of the current access arrangement period. The principle applies in respect of the AER's determination of each of the relevant revenue adjustments under the draft rule to allow JGN to recover the revenue it would have been entitled to recover during the current access arrangement period under the remade 2015 decision.⁹⁵

3.2.3 Timing and process for adjustment determination

Proponent's views in the rule change request

JGN's proposed rule is that the AER may only make an adjustment determination:⁹⁶

- no earlier than the date for the remade 2015 decision, and
- no later than 1 March 2019.

Stakeholder's views

The AER expects to be able to complete both the remade 2015 decision and the adjustment determination by 1 March 2019, which is the expiry date for completion of the adjustment determination in JGN's proposed rule.⁹⁷ However the AER suggests amending JGN's proposed timing for completion of the adjustment determination, to one of the following two alternative options:

- extending the end date to some point in the next access arrangement period, similar to what was done for the NSW/ACT participant derogations,⁹⁸ or
- retaining JGN's suggested timeframes, but providing flexibility in case of unexpected delays in making either the remade 2015 decision or the adjustment determination. The AER suggested that this, for example, could allow the AER to

⁹⁵ See the definition of the revenue recovery principle in clause 53 of the draft rule.

⁹⁶ Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, 14 December 2017, pA-1.

⁹⁷ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p4.

⁹⁸ *Ibid*, p4.

extend the time within which it was required to publish the adjustment determination if the adjustment determination involves issues of unusual complexity or difficulty, or the extension of time became necessary because of circumstances beyond the AER's control.⁹⁹

ATCO Gas agrees with JGN that the AER's power to make an adjustment determination should expire after a defined period, by 1 March 2019.¹⁰⁰

PIAC supports the transparency of the process by having the AER make the adjustment determination through a separate process,¹⁰¹ on the understanding that consumers and other stakeholders will have the opportunity to provide input to the adjustment determination process.¹⁰²

Proponent's views in response to stakeholder's views

In its submission on the Consultation paper, the AER suggested alternative timing options, including extending the end date for making an adjustment determination to some point in the next access arrangement period,¹⁰³ as outlined above.

In response to the AER's submission on the Consultation paper, JGN submitted a supplementary submission which:¹⁰⁴

- extending the end date to some point in the next access arrangement period, similar to what was done for the NSW/ACT participant derogations,¹⁰⁵ or
- opposed extending the end date beyond 1 April 2019 as there would then be insufficient time for any adjustment to be reflected in the final year of the current access arrangement period (the 12 month period commencing on 1 July 2019). JGN considers that extending the date beyond 1 April 2019 is unlikely to achieve the core purpose of the proposed rule change, which is to provide for smoothing of tariffs between the current access arrangement period and the subsequent access arrangement period. JGN considers that if the AER is not able to finalise the remade 2015 decision and the adjustment determination by 1 April 2019 at the latest, a solution which goes beyond the shifting of revenue recovery to achieve tariff smoothing would be required.

99 Ibid, pp4-5.

100 ATCO Gas Australia Pty Ltd, *National Gas Amendment (Cross period revenue smoothing) - Reference code: GRC0043*, 24 April 2018, p2.

101 From the making of JGN's access arrangement.

102 Public Interest Advocacy Centre Ltd, *Consultation paper on the JGN Cross period revenue smoothing (Gas) rule change*, 20 April 2018, p1.

103 AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p4.

104 Jemena Gas Networks (NSW) Ltd, *Jemena supplementary submission o consultation paper - Cross period revenue smoothing (Gas) - GRC0043*, pp5-6.

105 Ibid, p4.

Analysis and conclusions

The timing of the end date for the AER to make the adjustment determination should be on or before 1 March 2019, as originally proposed by JGN. This timing is preferable over a later end date as it allows for an adjustment to be reflected in the final year of the current access arrangement period, which meets the core purpose of the rule change to allow for the shifting of revenue between the current and subsequent access arrangement periods, to minimise network price volatility over the next three regulatory years (from 2018-19 to 2020-21). The AER expects to be able to complete both the remade 2015 decision and the adjustment determination by 1 March 2019, which is the expiry date for completion of the adjustment determination in JGN's proposed rule.¹⁰⁶

To provide flexibility for the AER, the adjustment determination need not be published at the same time as the remade 2015 decision. The Commission considers that, to provide transparency, the adjustment determination should be made through a separate process from the remade 2015 decision.

The draft rule only includes one scenario in which the adjustment determination is to be published by 1 March 2019 or otherwise the rule expires. This differs from the NSW / ACT DNSP electricity revenue smoothing rule changes which each included four scenarios to cater for different potential timing for the remaking of the electricity distribution determinations.¹⁰⁷

3.3 Alignment with revenue and pricing principles

3.3.1 Revenue and pricing principles

The Commission has had regard to the revenue and pricing principles set out in the NEL¹⁰⁸ as the Commission considers that these are relevant to the key issues raised in the rule change request. The following revenue and pricing principles are most relevant in the context of this rule change request:

- a service provider should be provided with a reasonable opportunity to recover at least the efficient costs of providing reference services
- a service provider should be provided with the effective incentives in order to promote economic efficiency with respect to reference services the service provider provides, and
- a reference tariff should allow for a return commensurate with the regulatory and commercial risk involved in providing the reference service to which that tariff relates.

¹⁰⁶ AER, *Submission on cross period revenue smoothing (Gas) rule change*, 19 April 2018, p4.

¹⁰⁷ AEMC, *Participant derogation - NSW DNSPs Revenue Smoothing*, 1 August 2017, p39; and AEMC, *Participant derogation - ACT DNSP Revenue Smoothing*, 1 August 2017, p37.

3.3.2 Proponent's views

JGN raises issues closely related to the revenue and pricing principles, in that the rule change request is intended to:

- minimise network price volatility for consumers and more closely aligns network prices with the efficient cost of supply, which promotes efficient use of natural gas services¹⁰⁹
- enhance certainty of price outcomes, which results in more efficient investment and consumption decisions¹¹⁰
- result in administrative costs that are likely to be negligible for the AER and JGN¹¹¹

3.3.3 Stakeholder views

Red and Lumo Energy requested that the Commission satisfy itself that the rule change complies with the revenue and pricing principles as set out in the NGL.¹¹²

ATCO Gas consider that cross period revenue smoothing tends to push network prices out of alignment with the efficient costs of supply, which is not necessarily conducive to promoting the efficient use of natural gas services.¹¹³

3.3.4 Analysis and conclusions

The Commission considers that the draft rule is consistent with the revenue and pricing principles discussed in section 3.3.2. The rule change minimises network price volatility and enhances certainty of price outcomes for consumers between regulatory years and access arrangement periods. This promotes efficient decision making by consumers by minimising price volatility in a short period of time. Therefore the draft rule satisfies the principle that a service provider should promote economic efficiency with respect to reference service it provides.

The draft rule provides a reasonable opportunity for JGN to recover at least its efficient costs of providing reference services. The draft rule should also allow for a return for JGN that is commensurate with the regulatory and commercial risk involved in providing reference services.

108 Section 24 of the NGL.

109 Jemena Gas Networks (NSW) Ltd, *Rule change proposal - Cross period revenue smoothing - National Gas Rules*, p8 and p15.

110 Ibid, p8 and p15.

111 Ibid, p15.

112 Red Energy and Lumo Energy, *National Gas Amendment (Cross period revenue smoothing (Gas)) Rule 2018*, 24 April 2018, p1

113 ATCO Gas, *National Gas Amendment (Cross-period revenue smoothing) - Reference code: GRC0043*, 24 April 2018, p2.

4 Operation of the draft rule

The chapter provides an explanation of the operation of the draft rule.

The chapter is structured as follows:

- section 4.1 provides a summary of the key aspects of the draft rule
- section 4.2 details the operation of the draft rule - recovery of revenue in both the current access arrangement period and the subsequent access arrangement period.

4.1 Key aspects of the draft rule

4.1.1 The draft rule does not change the application of the NGR to the process of making the remade 2015 decision

The draft rule does not change the application of the NGR to the process of making the remade 2015 decision. The AER must make the remade 2015 decision in accordance with the Tribunal's orders (as varied by the Federal Court's decision), as well as the applicable NGR provisions that cover the making of a revision to an access arrangement.

The draft rule is designed to work alongside the existing regulatory framework and to provide a mechanism to allow revenue to be shifted between the current and subsequent access arrangement periods to minimise network price volatility if the need arises. The draft rule does not have the effect of changing the application of the rules to the making of the remade 2015 decision.¹¹⁴

4.1.2 The AER's discretion under the draft rule

The draft rule provides the AER with discretion to decide whether revenue should be shifted between the current and subsequent access arrangement periods.

If the AER is satisfied that the shifting of revenue between the current and subsequent access arrangement periods would be reasonably likely to minimise variations in reference tariffs, the AER may make an adjustment determination to determine an adjustment amount and a subsequent adjustment amount.¹¹⁵

4.1.3 Provides transparency of process

The draft rule requires the AER to make a determination in relation to revenue adjustment that is separate from any access arrangement decision, and to publish that

¹¹⁴ Clause 55(3) of the draft rule.

¹¹⁵ Clause 56 of draft rule.

separate process (referred to as an adjustment determination under the draft rule) that sets out the reasons for its determination. Before making the adjustment determination, the AER must consult with JGN as well as key persons as the AER considers appropriate. The adjustment determination sets out the amounts that will operate as revenue increases or decreases for the current and subsequent access arrangement periods, where the AER makes the decision to determine such amounts. The draft rule requires that reasons for these decisions to be published.¹¹⁶

Once the AER has decided on the revenue adjustment required, it is given effect through the annual tariff variation notice in the last year of the current access arrangement period¹¹⁷ and the access arrangement revision processes for the subsequent access arrangement period.

4.2 Operation of the draft rule - recovery of revenue in current and subsequent access arrangement periods

To minimise network price volatility, the AER may decide to increase JGN's portion of total revenue allocated for reference services in the current access arrangement period by a specified amount and decrease JGN's portion of total revenue allocated for reference services in the subsequent access arrangement period by an equivalent amount in NPV terms, or vice versa.

4.2.1 The making of the adjustment determination

At the same time or at a later time as the making of the remade 2015 decision, the AER must make a separate decision (adjustment determination) on whether to allow revenue to be shifted between the current and subsequent access arrangement periods. The adjustment determination must be published, including the reasons for the AER's decision.¹¹⁸

The draft rule requires the AER to publish reasons for its determination (if it makes an adjustment determination on or before 1 March 2019), even where it decides not to shift revenue between the current and subsequent access arrangement periods.

4.2.2 Determining the adjustment amount and subsequent adjustment amount

If the AER determines to allow revenue recovery to be shifted between the current and subsequent access arrangement periods, the adjustment determination must set out the following:

- **Adjustment amount** - is a revenue increase / decrease to that portion of the total revenue that is allocated to reference services that may be earned by JGN for the final regulatory year of the current access arrangement period, as determined

¹¹⁶ Clause 53, clause 56 and sub-clause 58(3) of the draft rule.

¹¹⁷ Subclause 57(2) of the draft rule.

¹¹⁸ Subclauses 58(2) and 58(3) of the draft rule.

under the remade 2015 decision. This amount represents the revenue that is shifted to the current access arrangement period from the subsequent access arrangement period, to minimise network price volatility

- **Subsequent adjustment amount** - is an amount that is equivalent in net present value terms to the adjustment amount, that is determined by the AER to achieve the revenue recovery principle. This amount is a revenue increase / decrease to that portion of the total revenue that is allocated to reference services that may be earned by JGN in one or more regulatory years of the subsequent access arrangement period.¹¹⁹

To determine the above amounts, the AER must be satisfied of the following:

- that the revenue recovery principle would be achieved. That is, that JGN be given the ability to recover the same revenue (in net present equivalent terms), but no more than it would have, had the remade 2015 decision been in force from the commencement of the current access arrangement period
- the revenue adjustment would be reasonably likely to minimise variation in reference tariffs between the next three regulatory years (2018/19 to 2020/21).

4.2.3 Recovery of adjustment amount in current access arrangement period

In the current access arrangement period, the AER's adjustment determination is given effect through the annual tariff variation notice,¹²⁰ to be submitted by JGN, for the final regulatory year of the current access arrangement period.¹²¹ The AER must approve the reference tariffs specified in the annual tariff variation notice if they only provide for the recovery of:

- JGN's portion of total revenue allocated for reference services for the final regulatory year under the remade 2015 decision, plus¹²² or minus¹²³ (as applicable)
- the adjustment amount, that is determined by the AER to achieve the revenue recovery principle.¹²⁴

119 The Commission considers that the AER has the discretion to smooth the subsequent adjustment amount over the subsequent access arrangement period through the application of the X factor.

120 The annual variation notice is the method in which JGN seeks the AER's approval to make changes to its reference tariffs under the access arrangement.

121 Clause 57(2) of the draft rule.

122 Clause 57(2)(a) of the draft rule

123 Clause 57(2)(b) of the draft rule

124 Clauses 57(2)(a)(ii) and 57(2)(b)(ii) of the draft rule

4.2.4 Recovery of adjustment amount in subsequent access arrangement period

As discussed above, the subsequent adjustment amount is to be included as an increase or decrease to JGN's portion of total revenue allocated for reference services in one or more regulatory years of the subsequent access arrangement period.¹²⁵ The AER may smooth this amount across the whole of the subsequent access arrangement period under the AER's normal process of setting smoothed revenue through the application of the X factor.

125 Clause 57(3) of the draft rule

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
DNSP	Distribution Network Service Provider
JGN	Jemena Gas Networks (NSW) Limited
NGL	National Gas Law
NGO	National gas objective
NPV	Net Present Value
PIAC	Public Interest Advocacy Centre Ltd
WAPC	Weighted Average Price Cap

A Summary of other issues raised in submissions

This appendix sets out the issues raised in the submissions on the Consultation Paper for this rule change request, and the Commission's response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

Stakeholder	Issue	AEMC Response
JGN	<p>Notes that in Figures 3.1 and 3.2 of the AEMC's Consultation Paper, the AEMC has demonstrated potential price volatility graphically by representation of smoothed revenues, based on modelling by JGN.¹²⁶</p> <p>JGN notes that, for the avoidance of doubt, these smoothed revenues do not present a forecast of JGN's revenue requirements for the purposes of JGN's 2020-25 access arrangement proposal due for submission to the AER in June 2019.¹²⁷ The modelling for this rule change request made some necessary simplifying assumptions of the operating and capital expenditure and cost of capital required in the 2020-25 access arrangement period.¹²⁸</p>	<p>Noted.</p> <p>In this draft determination, the AEMC has used JGN's updated modelling of smoothed revenues in Figure 1.1 and Figure 1.2.¹²⁹ The AEMC also notes that JGN's updated modelling has also been estimated for the purposes of this rule change process and does not reflect a forecast of JGN's revenue requirement for the purposes of JGN's 2020-25 access arrangement proposal, that is due for submission to the AER in June 2019.</p>

¹²⁶ Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, p4.

¹²⁷ Ibid.

¹²⁸ Ibid.

¹²⁹ Based on JGN's updated modelling. Jemena Gas Networks (NSW) Ltd, *Jemena submission to consultation paper - Cross period revenue smoothing - GRC0043*, 24 April 2018, Appendix A.

Stakeholder	Issue	AEMC Response
JGN	JGN notes that price volatility is the issue faced by customers - given prices depend on forecast demand levels, a change in smoothed revenue will not necessarily require an equivalent percentage change in price. To best understand the issue this rule change seeks to address, JGN considers that external stakeholders would be best served by both price and revenue impact analysis. ¹³⁰	The main objective of the draft rule is to minimise network price volatility and the Commission considers that the draft rule provides the AER with sufficient discretion to do so.

130 Ibid.

B Legal requirements under the National Gas Law

This appendix sets out the relevant legal requirements under the National Gas Law (NGL) for the Commission to make this draft rule determination.

B.1 Draft rule determination

In accordance with s. 308 of the NGL the Commission has made this draft rule determination in relation to the rule proposed by JGN.

A copy of the more preferable draft rule is published with this draft rule determination. Its key features are described in section 2.4.

The Commission's reasons for making this draft rule determination are set out in Chapter 3.

B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within s. 74 of the NGL as it relates to regulating access to pipeline services and the activities of Registered participants, users, end users and other persons in a regulated gas market.¹³¹

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NGL to make the rule
- the rule change request
- submissions received during first round consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the national gas objective.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.¹³²

¹³¹ Refer to s74(1)(a)(I) and s74(1)(a)(vi) of the NGL.

¹³² Under s. 73 of the NGL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)'s declared system functions.¹³³ The more preferable draft rule is compatible with AEMO's declared system functions because it is unrelated to them and therefore does not affect the performance of those functions.

B.4 Civil penalties

The Commission's more preferable draft rule does not amend any clauses that are currently classified as civil penalty provisions under the National Gas (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the draft rule be classified as civil penalty provisions.

B.5 Conduct provisions

The more preferable draft rule does not amend any rules that are currently classified as conduct provisions under the National Gas (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the draft rule be classified as conduct provisions.

¹³³ Section 295(4) of the NGL.