

Draft Decision

**Australian Gas Networks (Victoria
and Albury)**

Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 9 Reference tariff setting

December 2022

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Note

This attachment forms part of the AER’s draft decision on the access arrangement that will apply to Australian Gas Networks (Victoria and Albury) (AGN) for the 2023–28 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

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9 Reference tariff setting

This attachment outlines our assessment of the reference tariffs proposed by Australian Gas Networks (Victoria and Albury) (AGN) against the requirements of the National Gas Rules (NGR). Our assessment focuses on the structure of reference tariffs and takes into account the revenue and pricing principles.¹

This attachment describes our assessment of AGN's proposed reference tariffs and sets out the revisions required by this decision. The AER's assessment focuses on the design and structure of tariffs and the allocation of costs to services.

9.1 Draft decision

We accept AGN's proposed structure for its reference tariffs for the 2023–28 access arrangement period, with one exception. We are satisfied the proposed structure of AGN's haulage reference tariffs and most ancillary reference service tariffs comply with the requirements of the NGR.

Our draft decision is to not approve the proposed stand-alone tariff for the newly proposed abolishment ancillary reference service for residential customers (small customer connection abolishments). AGN added a small customer connection abolishment service to its ancillary reference services on the basis of an expected increase in demand for this service. Our draft decision to not approve the tariff for this new service aligns with our draft decision set out in Attachment 1 – Services covered by the access arrangement, to approve introduction of the small customer abolishment reference service but not as an ancillary reference service.

While we, like the Victorian distributors, expect Victoria's Gas Substitution Roadmap (the Roadmap) will see more demand for small customer connection abolishments, we are not yet satisfied that we have sufficient information to approve small customer connection abolishment as an ancillary reference service for the 2023–28 period. This is explained in more detail below.

We are satisfied that AGN is retaining its declining block tariff structure for its haulage reference tariffs as this is consistent with the price cap form of control. We consider the structure of declining block tariffs is well known to AGN's customers and its continuation in the 2023–28 access arrangement will allow customers to respond to the prices within each block (or band) by adjusting their consumption. Doing so will reduce their overall network charges. We discuss the form of control (price cap) and its interactions with the Roadmap and environmental policy objectives below.

We further accept AGN's proposed individual price caps for its ancillary reference services, other than small customer connection abolishments. Our reasons for our draft decision are set out below.

¹ NGL, ss. 24(2)–(7).

9.2 AGN's proposal

AGN's proposed reference tariffs for the 2023-28 access arrangement period are largely consistent with those in the current access arrangement, with minimal changes.

AGN added one new ancillary reference service and one non-reference service:²

- ancillary reference service: 'service abolishment – residential' (small customer connection abolishment)
- non-reference service: 'service abolishment – industrial and commercial' (large customer connection abolishment).

AGN also proposed to make changes to the definitions of two existing ancillary reference services:³

- disconnection
- meter removal.

AGN did not propose to make changes to the current declining block tariff structure for haulage services.

AGN's proposed haulage reference tariffs are set out in Table 9.1. AGN's proposed ancillary reference services, for which individual price caps are applicable, are set out in Table 9.2.

Table 9.1 AGN's proposed initial tariff classes and tariff charge components

| Customer category | Tariff class | Charge components |
|-------------------|--|--|
| Residential | Tariff R Central Tariff R North Tariff R Murray Valley Tariff R Bairnsdale Tariff R Albury | One fixed charge Three volume throughput block charges Ancillary reference charges |
| Non-residential | Tariff C Central Tariff C North Tariff C Murray Valley Tariff C Bairnsdale Tariff C Albury | One fixed charge Four volume throughput block charges Ancillary reference charges |
| Industrial | Tariff D Central Tariff D North Tariff D Murray Valley Tariff D Bairnsdale Tariff D Albury | Three stepped variable demand charges Ancillary reference charges |

Source: AGN (Vic & Albury), AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response - Access Arrangement - MARK UP, 2 September 2022, p. 49-51.

² AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response – Overview, September 2022, p. 17-18.

³ AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response – Overview, September 2022, p. 17-18.

Table 9.2 AGN's proposed ancillary reference services

| Ancillary reference service (individual price caps) |
|---|
| Disconnection |
| Reconnection |
| Special meter read - metropolitan |
| Special meter read – non-metropolitan |
| Meter Removal |
| Meter reinstallation |
| Meter and gas installation test |
| Service Abolishment - residential |

Source: AGN (Vic & Albury), AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response - Access Arrangement - MARK UP, 2 September 2022, p. 51.

9.3 Assessment approach

In an access arrangement a service provider is required to specify for each reference service the reference tariff and proposed approach to setting the reference tariff.⁴ This is done by:

- explaining how revenues and costs are allocated, including the relationship between costs and tariffs⁵
- comparing the revenue to be raised by each reference tariff with the cost of providing each individual reference service⁶
- explaining and describing any pricing principles it employed.⁷

We also had regard to submissions received in the course of our consultation on AGN's proposed access arrangement.⁸

9.3.1 Identifying the reference service

The NGR require service providers to specify a reference tariff for each reference service.⁹ When undertaking our review, we first consider what is (or are) the reference service(s) for the purpose of the NGR. Our initial decision on what constitutes reference services was published in November 2021 and is referenced in Attachment 1 – Services covered by the access arrangement.¹⁰

9.3.2 Assessing the tariff setting method for the reference service

The reference tariffs for an access arrangement must be designed to meet the requirements of the NGR.

⁴ NGR, rr. 48(1)(d)(i), 72(1)(i), 72(1)(j)(ii).

⁵ NGR, rr. 93(1)–(2) NGR, rr. 72(1)(j)(i), 93(1)–(2).

⁶ NGR, rr. 94(1)–(2).

⁷ NGR, r. 94(3). NGR, r. 72(1)(j)(ii).

⁸ NGR, r. 59.

⁹ NGR, r. 48(1)(d)(i).

¹⁰ AER Final decision, AGN *Vic reference service proposal 2023–28*.

We consider how the service provider intends to charge for reference services by:

1. Assessing how AGN intends to allocate costs and revenues between reference services and other services. It must demonstrate that total revenue is allocated between reference and other services in the ratio in which costs are allocated between reference services and other services. Costs must also be allocated to the reference service and other services to which the cost is directly attributable.¹¹
2. Assessing how AGN grouped its customers into tariff classes. AGN is required to group together customers for reference services on an economically efficient basis and to avoid unnecessary transaction costs.¹² We consider if the nature of the reference service (e.g. volume and demand tariff classes) is consistent with the need to group customers for reference services together on an economically efficient basis and avoid unnecessary transaction costs
3. Assessing how:
 - a) the expected average revenue of a tariff class compares with the stand alone cost and avoidable cost of providing the reference service to that tariff class
 - b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
 - c) whether the tariffs take into account the long run marginal costs of providing reference services
 - d) whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.¹³

We have assessed the proposed reference tariffs for consistency with the National Gas Objective (NGO) and have had regard to the revenue and pricing principles.¹⁴

For existing fixed principles that were approved before the commencement of the NGR, these are binding on the AER and AGN for the period for which the principle is fixed and these may only be varied or revoked with AGN's consent.¹⁵

9.3.3 Interrelationships

Reference tariffs have interrelationships across other key parts of our draft decision. For example, they interrelate with the total revenue that can be earned by AGN, the services it provides to its customers to recover those revenues, the tariffs it charges for the use of those services, and the demand forecast volumes used to calculate tariffs.

Our draft decision on:

- the total revenue requirement is set out in the Overview of this draft decision
- the services offered to customers over the 2023–28 period are set out in Attachment 1 – Services covered by the access arrangement

¹¹ NGR, r. 93(2).

¹² NGR, r. 94(2).

¹³ NGR, rr. 94(3)–(4).

¹⁴ NGL, s. 28(2); NGR, r. 100(1).

¹⁵ NGR, r. 99.

- the annual tariff variation mechanisms are set out in Attachment 10 – Reference tariff variation mechanism
- the demand forecast volumes are set out in Attachment 12 – Demand.

9.4 Reasons for draft decision

We accept most of AGN's proposed reference service tariff structures because we are satisfied that they comply with the NGR requirements.¹⁶ We do not accept AGN's proposed stand-alone price cap for the new ancillary reference service small customer connection abolishment.

AGN's proposed reference tariff structures are broadly consistent with those applied in the current access arrangement period.

The remainder of this section sets out the reasons for our draft decision under the following headings:

- allocation of revenues and costs to reference tariffs
- establishment of tariff classes
- tariff classes and revenue limits
- abolishment
- declining block tariffs.

9.4.1 Allocation of revenues and costs to reference tariffs

AGN's 1 July 2022 proposal included information outlining its stand-alone costs, long run marginal costs and incremental costs. On reviewing this, we are satisfied AGN's approach to allocating revenue and costs between reference services and non-reference services complies with the NGR for the following reasons:

- we are satisfied AGN's proposed costs relating to its reference services do not include costs incurred (and recovered) from the provision of its non-reference services
- AGN has not allocated non-reference service revenue to a reference service because the underlying costs have not been included in AGN's building block revenues nor in its proposed ancillary reference service tariffs.

9.4.2 Establishment of tariff classes

AGN groups its customers by the nature of the haulage reference service (residential or non-residential categories, volume or demand tariffs) and classifies them by their location on the distribution network. We consider that these characteristics are likely to be the driver of costs within AGN's gas distribution network. Therefore, using them to group customers into tariff classes is appropriate. We note AGN's proposed tariff classes are consistent with the tariff classes in the current access arrangement.

¹⁶ NGR, rr. 93–94.

Based on the above reasons, we are satisfied that the proposed tariff classes are consistent with the requirements of the NGR.¹⁷

9.4.3 Tariff classes and revenue limits

We have assessed AGN's tariff classes and revenue limits against the following NGR considerations:¹⁸

- a) the expected average revenue of a tariff class compares with the stand-alone cost and avoidable cost of providing the reference service to that tariff class
- b) whether the tariff takes into account transaction costs associated with developing and applying the tariff
- c) whether the tariffs take into account the long run marginal costs of reference services
- d) whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.

9.4.3.1 Stand-alone and avoidable costs

We are satisfied that AGN's proposed reference tariffs are consistent with the NGR requirements because the expected revenue to be recovered lies on or between:

- an upper bound representing the stand-alone cost of providing the reference service to customers who belong to that tariff class
- a lower bound representing the avoidable cost of not providing the reference service to those customers.

We had regard to the quantitative material AGN submitted to us which indicated the above criteria were met.¹⁹

We consider AGN's definitions of avoidable and stand-alone costs for the tariff classes are acceptable for assessing compliance with the NGR.²⁰ We have also reviewed the methodology applied by AGN to demonstrate that for each tariff, the expected tariff revenue lies on or between the avoidable and stand-alone costs. Again, this is comparable to the analysis we have undertaken for other energy businesses over a number of years.

9.4.3.2 Transaction costs

We are satisfied that AGN's proposed reference tariffs take into account transaction costs associated with the tariff and the need to avoid them where possible.²¹ We consider the continuation of the current access arrangement tariff classes and tariff structures will minimise any additional transaction costs across access arrangement periods and thereby avoiding their unnecessary imposition.

¹⁷ NGR, rr. 94(1)–(2).

¹⁸ NGR, r. 94.

¹⁹ AGN (Vic), *Attachment 14.1 - Network Pricing, Formulae and Efficiency*, July 2022, p. 3.

²⁰ AGN (Vic), *Attachment 14.1 - Network Pricing, Formulae and Efficiency*, July 2022, p. 2-3.

²¹ NGR, rr. 94(2), 94(4).

9.4.3.3 Long run marginal cost (LRMC)

The methodology proposed by AGN applies the Average Incremental Cost (AIC) approach.²² AGN explained that this is where the present value of the incremental investment (both capital and operating expenditure) associated with increasing capacity in the long term is divided by the present value of the change in incremental demand. These factors are reflected in AGN's tariff classes and although AGN was unable to quantify the LRMC, it still had regard for the LRMC when determining its tariffs.²³

AGN has designed its tariff parameters consistent with the approach taken in South Australia in order to effectively signal LRMC to network users. AGN submitted that this is evidenced in AGN's tariffs by the use of:

- geographic price signals – which signal the cost to the customer of connecting to a particular geographic zone
- declining block structure – which signal to the customer the declining incremental cost of additional gas consumption (reflecting the low margin cost of services)
- capacity based charges – which signal to demand customers the impact of peak demand on capital expenditure.

We consider AGN's approach is generally consistent with that applied by other gas distribution networks. Moreover, we observe that the calculated values of LRMC are sensitive to the assumptions made around a number of different variables. As such, these provide a guide when assessing price levels and structures, and we accept that AGN's tariffs have taken LRMC into account as far as possible given regional variations in forecast growth.

9.4.3.4 Response to price signals

AGN submitted that its proposed tariffs are structured to allow end-use customers to respond to price signals. AGN also submitted that it proposes to change haulage reference services, with other reference tariff structures remaining unchanged from those in its current access arrangement.

We are satisfied that in proposing its haulage reference tariffs AGN has had regard to whether customers are able, or likely, to respond to price signals. AGN's existing tariff structures are well known to its customers and allow them to respond to prices by adjusting their demand. We accept the simplification of tariffs, to remove the complexity of the seasonal shoulder tariffs due to:

- the expected lower prices
- customer participation in AGN's workshops
- compelling customer support.

²² AGN (Vic), *Attachment 14.1 - Network Pricing, Formulae and Efficiency*, July 2022, p. 4.

²³ AGN submitted that the LRMC estimates it calculated using the Average Incremental Cost method, a commonly used and well accepted method, were either negative or too large.

9.4.4 Abolishment

In the addendum updating its proposal, AGN proposed that small customer connection abolishment be regulated, for the first time, as an ancillary reference service for the 2023-28 period. AGN also proposed that large customer connection abolishments be provided as non-reference ancillary services.

As more customers choose to move from gas to other sources of energy, the costs of removing connection assets for individual premises—abolishing the connection permanently—have come under close scrutiny. In reviewing this proposal, we have considered the costs of abolishing connections and the broader question of how they are recovered from consumers over time.

Our draft decision is to not accept the application of a stand-alone price cap to small customer connection abolishment as an ancillary reference service, as set out in Attachment 1 – Services covered by the access arrangement. As a consequence, nor do we accept the proposed small customer abolishment tariff. Instead, we consider AGN and stakeholders need further time to consider the relative strengths and weaknesses of the two abolishment cost recovery approaches we describe below.²⁴ AGN and stakeholders are encouraged to respond to these in AGN's revised proposal and in submissions on our draft decision and the revised proposal.

Abolishment is a cease of service option which involves the removal of connecting infrastructure, including the meter and connecting pipeline to the mains t intersection. Abolishment is one of 3 types of gas small customer cease of service options:

- disconnection: temporary disconnection where the service is capped at the meter and the meter remains in place.
- meter removal: temporary disconnection where the service is capped and the meter is removed.
- abolishment: permanent disconnection where the service and connecting pipes to the mains t intersection are removed.

Charges proposed by the 3 Victorian distributors for small customer cease of service options are set out in Table 9.3.

²⁴ NGR r. 47A(15).

Table 9.3 Proposed small customer cease of service charges for 2023

| Service type | Multinet Gas Networks | AGN (Vic & Albury) | AusNet |
|---------------|-----------------------|--------------------|----------|
| Abolishment | \$950.00 | \$950.00 | \$825.82 |
| Disconnection | \$62.72 | \$87.00 | \$64.00 |
| Meter Removal | \$72.15 | \$124.00 | N/A* |

Source: Ausnet, ASG - GAAR ARS revenue & expenditure forecast HY23 and 2024-28 - 2 September 2022, Model (Proposed ARS Tariffs); Multinet, MGN Victoria - Revisions to Final Plan 2023-28 - GSR Response - Access Arrangement – MARKUP, 2 September 2022, p. 55; AGN (Vic & Albury), AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response - Access Arrangement - MARK UP, 2 September 2022, p. 51.

Note: * For safety AusNet prefer to disconnect and leave meter, meter typically only removed with abolishment.

Small customer connection abolishment involves the removal of pipes connecting a customer's premises to the mains pipeline, sealing the mains and making the site safe. Small customer connection abolishment is priced by the Victorian distributors from \$825.82 up to \$950. The alternative cease of service options are to either cap supply at the meter (a temporary disconnection) or to have the meter itself removed while connecting pipes are retained (considered by distributors and Energy Safe Victoria to raise safety issues). Both of these alternatives are considerably cheaper than abolishment.

Therefore, a temporary disconnection is a more cost-effective option for customers. However, it raises issues such as the safety aspect of gas pipelines remaining underground and the costs to maintain this unused service.

Evoenergy – a case study in small customer gas disconnections

As a case study of the outcome from allowing customers to undertake a temporary disconnection when permanently disconnecting from a gas network, we note the submission provided by ACT gas distributor, Evoenergy.

In its submission, Evoenergy noted that the ACT Government has recently announced policy objectives to phase out natural gas and set a pathway to electrification by 2045. Since this announcement, Evoenergy has been facing challenges from a number of customers who have ceased using their gas supply. It has found that customers are not undertaking a full abolishment of their gas connection. Rather, they are opting for the less expensive option of a temporary disconnection.²⁵ This approach leaves gasified connecting pipelines under customer properties.

Although the customer has disconnected, Evoenergy continues to be responsible for maintaining the network assets connected to the customer's premises. This is the case even

²⁵ Evoenergy, *AER's review of Victorian gas access arrangements and regulating gas pipelines under uncertainty*, 30 September 2022, p.2.

though there is no active gas account and therefore no associated revenue flowing to the distributor. Evoenergy considers this scenario raises both safety and financial issues.²⁶

Safety issues in Victoria are the jurisdiction of Energy Safe Victoria

In the Victorian context, the Victorian gas distributors are required to submit safety cases to Energy Safe Victoria. Energy Safe Victoria advised us that, to ensure that hazards and risks to the safety of the public and customers arising from gas are minimised as far as reasonably practicable, a connection should be abolished if the customer wishes to permanently disconnect from the gas network.²⁷ Energy Safe Victoria noted that the Victorian distributors have proposed this approach to minimise hazards and risks to the safety of the public and customers in their safety cases and that Energy Safe Victoria supports those safety cases. Energy Safe Victoria considers that leaving gasified connecting pipes under a customer's property for long periods of time unused is an unacceptable safety risk.

As the lead safety regulator, we consider Energy Safe Victoria's position is determinative of which type of cease of service is appropriate in given circumstances. We therefore accept that a customer's connection should be abolished upon that customer choosing to permanently cease their gas supply.

As economic regulator, our role in this case is limited to determining how the cost of the distributor undertaking an abolishment should be recovered.

TRAC Partners (for the Brotherhood of St Laurence)²⁸ and EnergyAustralia²⁹ submitted that abolishment should not be the only option available. However, as noted above we consider Energy Safe Victoria is the appropriate body to make that determination.

Proposed charges for small customer connection abolishments are reasonable

We have assessed the proposed small customer connection abolishment charges. Based on both our benchmarking analysis and cost build up assessment, the proposed charges are reasonable. They are consistent with abolishment charges levied by gas distributors outside Victoria. The proposed Victorian abolishment service charges are almost entirely operating cost, or opex, and do not include additional cost recovery. That is, abolishment charges reflect the labour cost of staff attending the customer's premises to perform the task. They do not incorporate any contribution to shared network cost recovery – they are not exit fees. Rather, proposed small customer connection abolishment charges are cost recovery in nature.

Several submissions commented on the level of the Victorian distributors' proposed small customer connection abolishment charges. Origin Energy submitted that the associated fee (~\$950) may act as a disincentive for customers to disconnect and potentially undermines

²⁶ Evoenergy, *AER's review of Victorian gas access arrangements and regulating gas pipelines under uncertainty*, 30 September 2022, p. 3.

²⁷ Energy Safe Victoria staff email to AER staff, 20 October 2022.

²⁸ TRAC Partners for Brotherhood of St Laurence, *Response to 2023-28 Access Arrangement proposals*, 30 September 2022, p. 88.

²⁹ EnergyAustralia, *Gas Access Arrangement proposals 2023-28 for AusNet, Multinet and AGIG*, 30 September 2022, p. 6.

the intent of the Roadmap initiatives.³⁰ The Brotherhood of St Laurence³¹, Friends of the Earth³² and Darebin Climate Action Now³³ submitted that the proposed small customer connection abolishment charges are too high.

As above, we consider the distributors' proposed small customer connection abolishment charges are reasonable. They reflect the efficient cost of distributor staff attending the property, digging down to the mains intersection, disconnecting and removing (if possible) the customer's connection pipeline, sealing the mains and making the site safe.

While we consider the proposed small customer connection abolishment charges are reasonable, levying those charges on individual customers is not the only cost recovery option available.

Bundling small customer connection abolishment costs with haulage tariffs is an option

There is potential to recover small customer connection abolishment costs from all customers remaining connected to Victoria's gas network rather than from individual customers who choose to cease their gas supply.

We set out below for stakeholder comment the two options for small customer connection abolishment cost recovery:

- as an ancillary reference service (as proposed by distributors)
- bundled with haulage tariffs (socialised).

9.4.4.1 Abolishment as an ancillary reference service

A number of gas distributors across Australia currently provide abolishments as ancillary services. A growing number of distributors provide small customer abolishments as price regulated reference services, consistent with the Victorian distributors' proposals. The trend towards abolishments becoming reference services reflects the growing number of customers permanently disconnecting from gas networks.

The nature of the abolishment service, provided in respect of an individual customer's connection, leads to the service being considered an ancillary service. It is not a haulage service provided using shared network assets. Consistent with this view the Victorian distributors have proposed that small customer connection abolishment be an ancillary reference service. As an ancillary service, abolishment charges are targeted directly to customers who choose to cease their gas supply. This approach benefits customers who choose to remain connected to the reticulated gas network as they are not required to finance other customers' abolishment activities.

We agree with the Victorian distributors that connection abolishment is a service provided in respect of an individual customer's connection assets. However, we consider the traditional

³⁰ Origin Energy, *Submission to Victorian gas access arrangement proposals*, 30 September 2022, p. 4.

³¹ Brotherhood of St. Laurence, *2023-2028 Victorian Gas Distributors' Access Arrangement Submission*, 30 September 2022, p. 27-28.

³² Friends of the Earth Melbourne, *2023-28 gas distribution access arrangement proposals*, 30 September 2022, p. 2.

³³ Darebin Climate Action Now, *Distributors' Access Arrangements 2023-2028*, 28 September 2022, p. 3.

approach of levying a material charge on customers may not be sustainable in the context of large numbers of customers ceasing gas supply. This is because we accept in principle the view expressed by some stakeholders that proposed abolishment charges may act as a disincentive for customers to engage the abolishment service.

Faced with the choice of a \$950 abolishment service and a ~\$90 temporary disconnection service, customers are likely to choose the temporary disconnection service. They may state there is potential to reconnect gas in the future to avoid incurring an abolishment charge. In the context of the Roadmap, such a disincentive may lead to a material number of customer connections remaining in situ with gas in them, contradicting Energy Safe Victoria's determination.

Alternatively, should an abolishment be undertaken then the distributor may compel the retailer to pay the abolishment charge and leave the retailer to recover costs from the customer any way it can. This would seem to entail significant financial risk to the retailer. The customer would no longer have a reticulated gas service so the threat of disconnection in case of non-payment would no longer be applicable. To the extent that retailers are able, or inclined, to pursue a customer who considers they no longer have a gas sector relationship, the transaction costs are potentially large relative to the unrecovered revenue.

9.4.4.2 Bundled with haulage tariffs

The alternative cost recovery mechanism would be to bundle the cost of performing small customer connection abolishments with haulage tariffs. This is sometimes referred to as 'socialising' abolishment costs. As socialised costs, small customer connection abolishments would be funded by haulage tariffs paid by customers using gas network services. That is, customers choosing to permanently disconnect from the gas network would not be required to pay an abolishment charge.

When considering whether to socialise small customer connection abolishment costs, we must first consider the NGR. We consider there is no statutory barrier to bundling of small customer connection abolishment costs with haulage tariffs. Under rule 47A of the NGR, no distinction is made between haulage services and ancillary services. The statutory emphasis rather is on 'pipeline services' and reference vs non-reference services. Both haulage and ancillary services fall within the scope of 'pipeline services'. We consider it is open for the AER to bundle, or socialise, connection abolishment costs should we consider that is the most appropriate approach.

In terms of the implications of socialising small customer connection abolishment costs, we consider equity issues arise. A cross subsidy would be created, benefiting customers who switch earliest. We consider it likely that customers choosing to electrify their gas load in the short to medium term are likely to have greater resources than customers who continue to use the gas network for longer.

As larger numbers of customers permanently disconnect from Victoria's gas distribution networks over time, the financial burden of small customer connection abolishment costs would fall on a diminishing customer base, exacerbating the equity issue. That is, the socialised cost of small customer connection abolishments would be financed by smaller numbers of customers, meaning each customer's cost recovery contribution would need to be greater. Customers who remain connected to Victoria's gas networks the longest, who

may be expected to be amongst the most disadvantaged, would carry the heaviest financial burden under a socialised approach.

In other respects, bundling small customer connection abolishment costs with haulage services may be beneficial. Doing so would reduce the financial barrier to individual customers switching from natural gas to electricity, consistent with the Roadmap. As such it may facilitate realisation of the environmental benefits described by the Roadmap. Any customer choosing to switch from natural gas to electricity, including disadvantaged customers, would receive a benefit financed by those customers who continue to receive gas network supply services.

Perhaps most importantly, socialising small customer connection abolishment costs may best align with Energy Safe Victoria's determination on safety. This is because socialising cost recovery would remove the financial barrier to abolishments being undertaken where safety considerations deem it to be necessary. In the absence of a clear pathway for distributors and retailers to be confident that abolishment costs may be recovered from individual customers who choose to cease their supply, socialising those costs may be the most pragmatic way forward.

Gas distributors propose to continue to provide large customer connection abolishments as non-reference ancillary services. We accept this approach because:

- we expect large customer connection abolishments to be low in number relative to small customer abolishments
- costs associated with large customer abolishments are varied and difficult to determine ex ante.

Bundling small customer abolishment costs across haulage tariffs for all customers means large customers would make a contribution to small customer costs until large customers cease their own gas supply.

Small customers would both carry the financial burden of socialised small customer connection abolishment costs and benefit should they themselves choose to cease their gas supply in that they would not pay a stand-alone abolishment charge.

With their revised access arrangement revision proposals, we ask the Victorian distributors to:

- comment on the option of socialising small customer abolishment costs
- provide updated forecasts of small customer abolishment numbers per annum
- provide estimated bill impacts of socialising small customer abolishment costs through haulage tariffs.

More broadly, we encourage stakeholders to provide us with written submissions on:

- levying ancillary reference service abolishment charges on individual customers as proposed by the Victorian distributors
- the potential to bundle small customer abolishment costs with haulage tariffs
- associated equity and safety issues

- how the various cost recovery approaches may or may not align with the Roadmap.

9.4.5 Ancillary reference services

We are satisfied that AGN's proposed charges for its ancillary reference services are reasonable, noting that our draft decision, as above, is to not approve a stand-alone price cap charge for small customer connection abolishments. These prices are set out in Table 9.4 and will be escalated annually by CPI.

Table 9.4 AGN's proposed ancillary reference services prices

| Ancillary reference service (individual price caps) | 2023-24 |
|---|----------|
| Meter and Gas Installation Test | \$261.00 |
| Disconnections | \$87.00 |
| Meter Removal | \$124.00 |
| Reconnection | \$101.00 |
| Special Meter Reading -- Metropolitan | \$11.10 |
| Special Meter Readings – Non Metropolitan | \$15.20 |
| Service Abolishment – Residential* | \$950 |

Source: *AGN Victoria-Albury - Revisions to Final Plan 2023-28 - GSR Response - Access Arrangement - MARK UP*, p. 51.

Note: Charges excl. GST \$nominal

* Not approved in our draft decision.

Origin Energy submitted³⁴ that there have been some increases in AGN's ancillary reference service tariffs and that these prices vary significantly across distributors. We accept that costs can vary between distributors that serve non-metropolitan areas compared to metropolitan areas. AGN has a predominantly non-metropolitan network and it can reasonably be expected to face higher costs in comparison to Multinet Gas Networks, for example, which is predominantly metropolitan based. We consider that AGN's proposed ancillary reference tariffs are within a reasonable band and that variations across distributors remain reasonable taking into account higher costs for non-metropolitan areas.

9.4.6 Declining block tariffs

We are satisfied that AGN is retaining its declining block tariff structure for its haulage tariffs as this is consistent with the price cap form of control. We consider the structure of declining block tariffs is well known to AGN's customers and its continuation in the 2023–28 access arrangement will allow customers to respond to the prices within each block (or band) by adjusting their consumption. Doing so will reduce their overall network charges.

³⁴ *Origin Energy, Submission Victorian Gas Proposals 2023-28*, September 2022, p. 4.

A number of submissions commented on declining block tariffs, expressing a view that they are no longer appropriate:

- TRAC Partners (for the Brotherhood of St Laurence) submitted that given the changed context for gas in Victoria, consideration should be given to a tariff structure that doesn't incentivise consumers to use more gas³⁵
- Darebin Climate Action Now suggest measures to maintain and stimulate demand, such as block tariffs whereby the price of gas falls the more is used, should be rejected
- Friends of the Earth Melbourne calls for a move away from declining block tariffs because they offer an incentive to use more gas than is necessary.³⁶

Some stakeholders also raised an equity concern in respect of declining block tariffs, because disadvantaged customers may consume smaller quantities of gas and therefore pay higher per unit network tariffs than customers consuming larger quantities.

While we note the concerns described above, we also note that declining block tariffs benefit all customers by promoting gas use by some customers. This is because gas pipeline costs are largely fixed. Greater gas throughput equates to lower per unit transportation costs, including for customers who use relatively little gas themselves. It is for this reason that price caps are applied to gas network services – to incentivise gas networks to grow gas throughput, or volumes.

Now that environmental considerations are increasingly driving energy policy, it is right that the incentive properties of price caps come under greater scrutiny. Although we make decisions using the current framework under the current gas rules, we note that Energy Ministers have agreed that the NGO be amended to incorporate an emissions objective. However, the principal alternative form of control to price caps, revenue caps, have features which may themselves also raise concerns.

Revenue caps would see volume risk placed with customers. This is because revenue caps guarantee the distributors their approved annual regulated revenues. Any revenue shortfall incurred in one year, due to a volume shortfall, would carry over to a following year for recovery on top of the following year's regulated revenue. We expect a range of views on the merits of revenue caps to be expressed given the context of declining per customer gas consumption and expected declines in the number of gas customers.

In light of the above, we consider the pros and cons of price caps compared to revenue caps are not straightforward. There is also significant precedent value for any decision to shift from a price cap to a revenue cap in an individual jurisdiction such as Victoria. We consider it is important to hold a sector-wide discussion on these issues rather than make a decision in the context of an individual gas reset.

The timing of sector wide engagement on the gas pipeline form of control is critical. We consider the application of either price caps or revenue caps is fundamental to gas network

³⁵ TRAC Partners for Brotherhood of St Laurence, *Response to 2023-28 Access Arrangement proposals*, 30 September 2022, p. 88.

³⁶ Friends of the Earth Melbourne, *2023-28 gas distribution access arrangement proposals*, 30 September 2022, p. 1.

service providers' development of their access arrangement revisions proposals. We further consider it is not reasonable for the AER to determine to switch from one form of control to another within an active access arrangement review process. The interlinkages between the form of control and other elements of an access arrangement are so significant that network service providers should be given certainty in advance of an access arrangement review commencing. We will have this in mind as we consider appropriate timing for a sector wide consultation process on the appropriate form of control for the regulated gas pipeline sector.

At this time, we consider application of price caps and declining block tariffs remain in the long-term interest of gas network customers.

9.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 9.5.

Table 9.5 AGN's reference tariff setting revisions

| Revision | Amendment |
|--------------|--|
| Revision 9.1 | Reflect the changes described above in the access arrangement. |

Glossary

| Term | Definition |
|------|---|
| AER | Australian Energy Regulator |
| AGN | Australian Gas Networks (Victoria and Albury) |
| NGL | National Gas Law |
| NGO | National Gas Objective |
| NGR | National Gas Rules |