Draft Decision

AusNet Gas Services
Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 6
Operating expenditure

December 2022

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to AusNet Gas Services (AusNet) 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

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Attachment 13 – Capital expenditure sharing scheme

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6 Operating expenditure

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses, incurred in the provision of pipeline services. Forecast opex is one of the building blocks we use to determine a service provider's total revenue requirement.

This attachment outlines our assessment of AusNet's proposed opex forecast for the 2023–28 access arrangement period.

6.1 Draft decision

Our draft decision is not to accept AusNet's proposed opex forecast of $306.4 million ($2022–23)[1], excluding ancillary reference services, for the 2023–28 access arrangement period. This is because we are not satisfied it reflects the opex criteria[2] and the requirements for forecasts and estimates.[3]

Our draft decision is to include our alternative estimate of total opex forecast of $335.7 million ($2022–23) for AusNet.[4] This draft decision is:

- $29.3 million ($2022–23) (or 9.6%) higher than AusNet's proposal for the 2023–28 access arrangement period
- $48.5 million ($2022–23) (or 16.9%) higher than AusNet's actual (and estimated) opex in the 2018–23 access arrangement period.

After its initial proposal in July 2022, AusNet submitted an addendum in September 2022, to reflect changes to estimates following release of the Victorian Government's *Gas Substitution Roadmap.* From an opex perspective, this primarily impacted the trend forecasts including updated output and productivity growth forecasts. We have considered this updated proposal, and the opex forecast it contained, in making our draft decision to not accept the proposed opex forecast.

The key area of difference leading to our alternative estimate of total opex being higher than AusNet's updated proposal is that we have included $28.6 million ($2022–23), for recovery of Energy Safe Victoria (ESV) levies, in base opex. AusNet's proposal removed the levies from base opex, proposing to recover the expenditure via the price control mechanism. We are satisfied that our higher alternative estimate of forecast opex reasonably reflects the opex criteria and provides a total opex forecast such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services. We consider it appropriate that the ESV levy costs, as with all other opex costs, are subject to the ex-ante incentive based regime rather than a cost of service approach as would be the case under the price control mechanism.

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1 AusNet, *Access arrangement information 2024-28 - Addendum,* September 2022, p. 36.

2 NGR, r. 91.

3 NGR, r. 74.

4 This includes debt raising costs.

We note that while we may have arrived at our alternative estimate in a different way to AusNet, it is unlikely that there would have been a material difference between AusNet's proposed opex forecast and our alternative estimate if AusNet had included ESV levy costs in base opex. Given this, we consider that this means that AusNet should only need to make minimal updates in its revised proposal of forecast opex for the 2023–28 period. In forming its revised proposal, AusNet should consider all of the corrections, amendments and reasoning we have made in forming our alternative estimate.

Table 6.1 sets out AusNet's updated opex proposal, our alternative estimate that is the basis for the draft decision and the difference between our draft decision and AusNet's updated proposal.

Table 6.1 Comparison of AusNet's updated proposal and our draft decision on opex ($million, 2022–23)

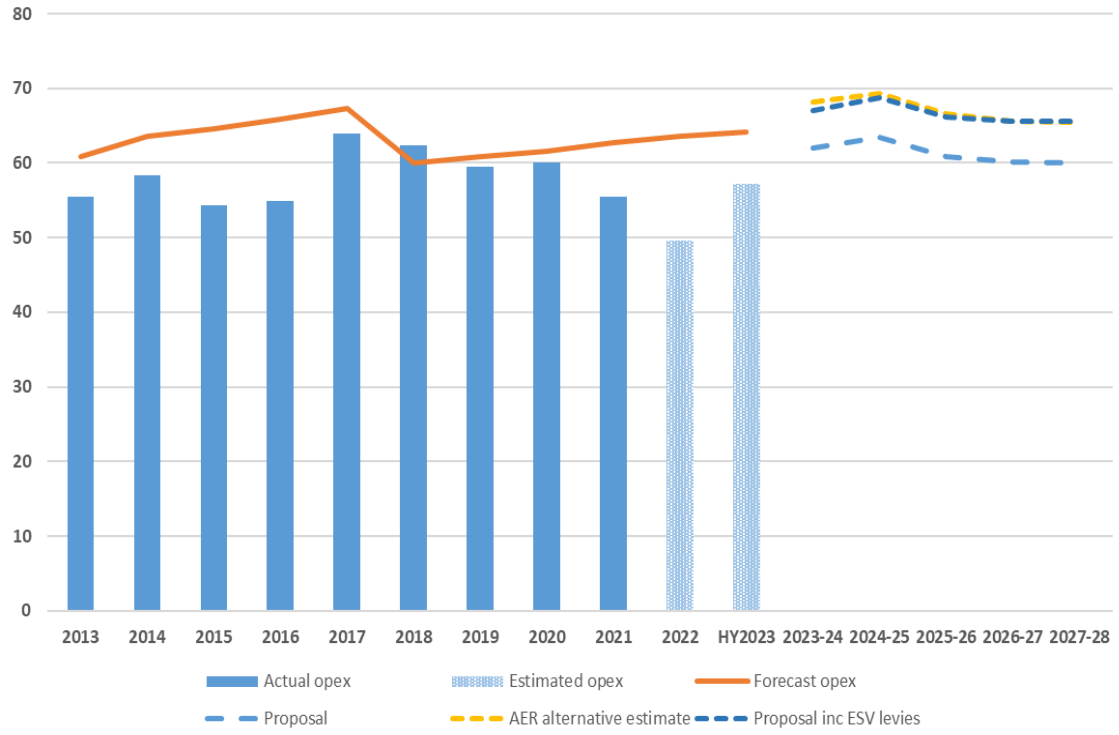
	AusNet's updated proposal	AER draft decision	Difference
Base (reported opex in 2021)	**300.2**	**277.9**	**–22.2**
Base year adjustments	**–25.2**	**–1.3**	**23.9**
Remove category specific forecasts	**0.9**	**0.2**	**–0.7**
Final year increment	**–7.1**	**6.5**	**13.6**
Trend: Real price growth	3.8	6.0	2.1
Trend: Output growth	11.0	8.2	–2.8
Trend: Productivity growth	–	–2.1	–2.1
Total trend	**14.8**	**12.0**	**–2.8**
IT Cloud and SaaS	12.4	31.2	18.7
Environmental Protection Act (EPA) obligations	1.5	–	–1.5
Total Step changes	**13.9**	**31.2**	**17.2**
Category specific forecasts	**4.5**	**4.4**	**–0.2**
Total opex (excluding debt raising costs)	**302.0**	**330.9**	**28.9**
Debt raising costs	**4.4**	**4.8**	**0.4**
Total opex (including debt raising costs)	**306.4**	**335.7**	**29.3**
Percentage difference to updated proposal			**+9.6%**

Source: AusNet, *Access arrangement information 2024–28 – Addendum – Opex model*, September 2022; AER analysis.

Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

Figure 6.1 compares the opex forecast we approve in this draft decision to AusNet's updated proposal, the forecasts we approved for the last two access arrangement periods from 2013–2022 and AusNet's actual and estimated opex across that period. It also includes our estimate of AusNet's updated proposal if it had of included the ESV levies in its opex forecast.

Figure 6.1 Historical and forecast opex ($2022–23)



Source: AusNet *Regulatory accounts,* 2013 to 2021; AusNet, *Access arrangement information 2024–28* – Addendum – *Opex model*, September 2022; AER, *AusNet revenue determination*, *PTRM* (multiple periods 2013–17, 2018–22, 2023–28), AusNet, *Access arrangement information – Information request #017 Q.5–7,* 12 August 2022; AER analysis.

Note: Includes debt raising costs and movements in provisions. We have removed software as a service opex in 2021 and added capitalised leases to estimated opex for 2019 to 2021, to align with accounting standards applied in the 2018–22 final determination (see section 6.4.1.3.2 for further explanation and discussion).

As noted above, the key driver of our higher alternative estimate of total opex compared to AusNet's proposal is that we have not removed the recovery of ESV levies from base opex ($28.6 million ($2022–23) over the access arrangement period) in our alternative estimate. This is because we do not agree with AusNet's proposed cost of service approach to recovering the actual levy costs annually through the price control mechanism and consider it should be recovered as opex under the ex-ante incentive based regime. Further to this, there are a number of largely offsetting changes as we have included in our alternative estimate:

- more recent inflation forecasts from the Reserve Bank of Australia[5]
- base year opex, which is $22.2 million ($2022–23) less than AusNet's proposal as we have not applied the mid-period accounting standard changes for Software-as-a-Service (SaaS) and capitalised property lease payments until the beginning of the next access arrangement period (see the next dot point), combined with correcting for an error in AusNet's proposal related to applying forecast inflation to get to $2022–23

5 RBA, *Statement on Monetary Policy – Appendix: Forecast,* November 2022.

- the IT Cloud and SaaS step change, which is $18.7 million ($2022–23) higher than AusNet's proposal because, as noted above, we have applied the mid-period accounting standard changes for SaaS at the start of the next access arrangement period[6]
- a final year increment, which is $13.6 million ($2022–23) higher than proposed by AusNet, as we have included the final decision six-month extension period allowance for 2023 and corrected for inflation to get to $2022–23
- a lower trend forecast, which is $2.8 ($2022–23) million less than AusNet's proposal, as we applied our alternative forecasts for price, output, and productivity growth to a lower base year opex.

In our alternative estimate we have included corrections to what in our view are errors in the calculation of some of AusNet's forecasts. These largely relate to converting dollars into a $2022–23 basis. While this in some cases has increased forecast opex, we consider this is appropriate as it provides a total opex forecast that would be incurred by a prudent service provider acting efficiently to deliver pipeline services.

6.2 AusNet's proposal

AusNet's proposal applied a "base-step-trend" approach to forecast opex for the 2023–28 access arrangement period, consistent with our preferred approach.

After its initial submission in July 2022, AusNet submitted an addendum in September 2022, to reflect changes to estimates following release of the Victorian Government's *Gas Substitution Roadmap.* From an opex perspective this primarily impacted the trend forecasts in terms the addendum included updated output and productivity growth forecasts.

In applying our base-step-trend approach to forecast opex for the 2023–28 period, AusNet:[7]

- used reported opex in 2021 as the base from which to forecast ($60.0 million ($2022–23) or $300.2 million ($2022–23) over the next access arrangement period)
- removed $29.6 million ($2022–23) from base opex to reflect ESV levies being recovered annually through the price control mechanism
- added $4.3 million ($2022–23) to base opex to reflect the proposed expensing of previously capitalised overheads
- added $0.9 million ($2022–23) of debt raising costs, accounted as category specific opex
- removed $7.1 million ($2022–23) for the final year increment (from 2021 to 2022–23)
- applied a rate of change comprising of:
  - output growth ($11.0 million ($2022–23))
  - price growth ($3.8 million ($2022–23))

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6 Our approach to the treatment of mid period accounting changes is explained in 6.4.1.3.2.

7 AusNet, *Access arrangement information 2024-28 – Addendum - Opex model*, September 2022

  - zero productivity growth ($0.0 million ($2022–23))
- added two step changes totalling $13.9 million ($2022–23) for:
  - IT Cloud and SaaS ($12.4 million ($2022–23))
  - Environmental Protection Act (EPA) new obligations ($1.5 million ($2022–23))
- added $4.5 million ($2022–23) for a priority service program (PSP), accounted for as a category specific forecast
- added $4.4 million ($2022–23) of debt raising costs to arrive at a total opex forecast of $306.4 million ($2022–23) over the 2023–28 access arrangement period.

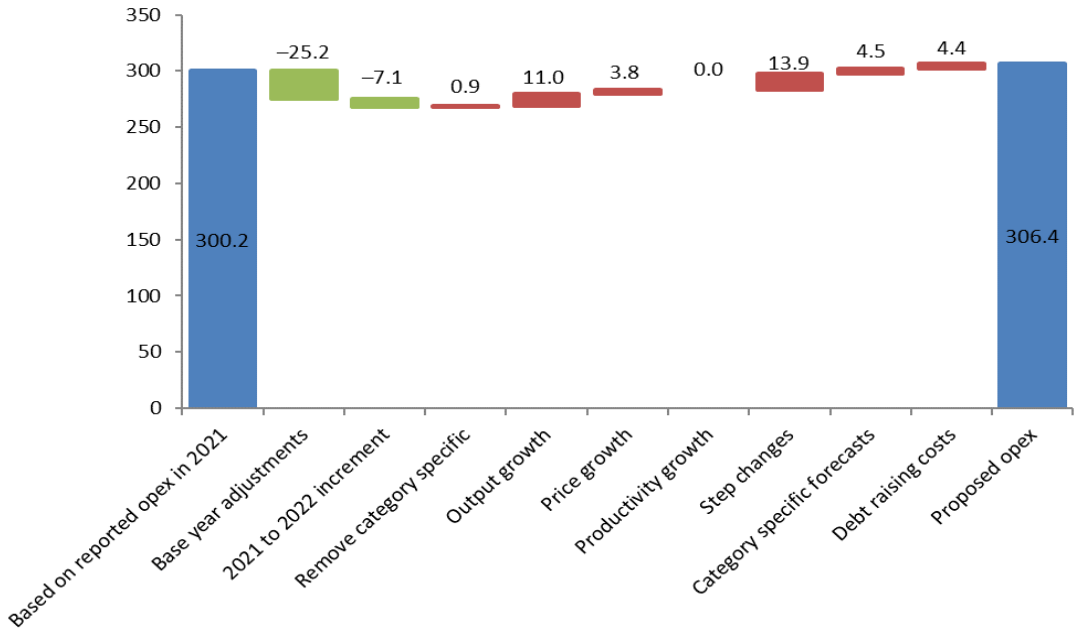
Table 6.2 AusNet's opex for the 2023–28 period ($million, 2022–23)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Total Opex, excluding debt raising costs	61.0	62.5	60.0	59.2	59.2	302.0
Debt raising costs	0.9	0.9	0.9	0.9	0.9	4.4
Total Opex, including debt raising costs	**61.9**	**63.4**	**60.9**	**60.1**	**60.1**	**306.4**

Source: AusNet, Access arrangement information 2024–28 – Addendum – Opex model, September 2022; AER analysis.
Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

Figure 6.2 shows the different components that make up AusNet's opex forecast for the 2023–28 period.

Figure 6.2 AusNet's proposed opex ($million, 2022–23)



Source: AusNet, Access arrangement information 2024–28 – Addendum – Opex model, September 2022; AER analysis.
Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

AusNet's total opex forecast of $306.4 million ($2022–23) for the 2023–28 period is $2.3 million ($2022–23), or 0.7%, lower than the amount we determined in our 2018–22 decision for AusNet[8] and $19.2 million ($2022–23), or 6.7%, higher than its actual / estimated spend over the 2018–22 access arrangement period.[9]

6.2.1 Stakeholder views

We received 14 submissions on AusNet's proposal which discussed opex issues, including a joint submission of 8 Victorian community organisation stakeholders and one from the AER's Consumer Challenge Panel, sub-panel 28 (CCP28).

We have taken these submissions into account in developing the positions set out in this draft decision. Table 6.3 summarises the stakeholder issues raised in the submissions in relation to opex.

Table 6.3 Submissions on AusNet's 2023–28 opex proposal

Stakeholder(s)	Issue	Description
Brotherhood of St Laurence (BSL), Joint Victorian Community Organisation (VCO), BSL (TRAC Partners)	Total opex	BSL considered that due to stranding risk, opex increases should be avoided or minimised. [10] The Joint VCO submission considered that a high standard of evidence is required for any opex increases.[11] TRAC Partners, on behalf of BSL, also expressed concerns that the benchmarking provided was dated, items moved to base opex will be recovered later, and considered that ESV levies should be excluded as proposed and considers that base opex should be minimised considering cost of living impact and asset stranding risk.[12]
Origin Energy, BSL (TRAC Partners)	Base adjustments	Origin Energy noted the relative ease of migrating costs between capex and opex and considered that cost allocation should be consistent with the cause of the costs and should only change in exceptional circumstances.[13] TRAC Partners, on behalf of BSL, expressed concerns about expensing corporate overheads as opex that, until now, have been capitalised, further increasing the cost of living pressures for today's consumers. TRAC Partners stated that the AER should consider whether AusNet has provided supporting justification to support the case that these costs are opex in nature. It considered it is in the best interests of consumers for these costs to remain as capex.[14]
Energy Users Association of Australia (EUAA),	Rate of change/trend	The EUAA considered the *Gas Substitution Roadmap* does not inhibit productivity improvements and that businesses are still incentivised to make productivity improvements.[15]

8 AER, *AusNet – Final decision post tax revenue model, November 2017*; AER analysis.

9 AusNet, *Access arrangement information 2024-28 – Addendum - Opex model*, September 2022; AER analysis.

10 Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, pp.23-24.

11 Victorian community organisations, *2023–28 Access arrangement proposal submission*, September 2022, p. 2.

12 TRAC Partners prepared on behalf of Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, pp. 61-62.

13 Origin Energy*, 2023-28 Access arrangement proposal submission*, September 2022, p.3.

14 TRAC Partners prepared on behalf of Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, pp. 61-62.

15 EUAA, *2023–28 Access arrangement proposal submission*, September 2022, p.9.

Stakeholder(s)	Issue	Description
BSL, Origin Energy, BSL (TRAC Partners)		BSL's view was that higher productivity targets should be applied.[16] Origin Energy considered zero productivity growth reasonable considering the demand projections.[17] TRAC Partners, on behalf of BSL, did not consider zero productivity growth appropriate as, even if demand declines, costs are also likely to decrease somewhat, and there is still opportunity for technical change.[18]
CCP28, EUAA, Energy Australia, BSL, Joint VCO Submission, Red Energy and Lumo Energy, BSL (TRAC Partners)	Category specific forecasts – PSP	CCP28 expressed concerns about consumer consultation on the PSP, noting the need to distinguish between willingness to pay and in-principle/values-based support. CCP28 stated that it appears businesses did not explore whether the costs should be business as usual expenditure, who should pay and who should be responsible for providing the service.[19] The EUAA appreciated the efforts in engagement for the PSP but questioned if it is a genuine step change, favouring base opex funding given zero productivity.[20] Energy Australia also considered the initiative admirable but thought that the businesses should fund the PSP internally as the expenditure is more discretionary in nature and thus inconsistent with the lowest cost of delivering pipeline services. It was also concerned the services provided under the PSP may be duplicative.[21] BSL and the Joint VCO submission appreciated the PSP initiative but opposed additional consumer funding and considered that there is not a demonstrated need for the step change. BSL also noted that some consumers stated their support was dependent on consultation with the community sector.[22] The Joint VCO submission also highlighted issues it had with self-identification for the register and considered that the views of some on the PSP advisory panel were misrepresented as support.[23] TRAC Partners, on behalf of BSL, also questioned whether the program could be implemented industry wide more efficiently instead of by individual networks.[24] Red and Lumo Energy also did not support additional funding for the PSP. They considered it reflects business as usual activities and offered limited additional value over retailer customer hardship programs. They were also concerned that they have not yet seen any benefits from the AGN (SA) PSP.[25]
CCP28, EUAA, BSL	Consumer engagement	CCP28 considered that the engagement was broad, genuine in intent and provided depth on some topics. However, CCP28 had concerns about how topics were raised, adequacy of the level of engagement, the methods used (such as the use of live polls), customer attrition, distinction of in-principle support versus willingness to pay and the absence of engagement with consumers since March 2022, noting economic and policy changes since. CCP28 felt that divergent views from stakeholders were insufficiently resolved on some issues and viewed the

16 Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 27.

17 Origin Energy, *2023–28 Access arrangement proposal submission*, September 2022, p.3.

18 TRAC Partners prepared on behalf of Brotherhood of St Laurence *2023–28 Access arrangement proposal submission*, September 2022, p. 63.

19 CCP28, *2023–28 Access arrangement proposal submission*, September 2022, pp.12-13, 18-20.

20 EUAA, *2023–28 Access arrangement proposal submission*, September 2022, p.9.

21 Energy Australia, *2023–28 Access arrangement proposal submission*, September 2022, p.3.

22 Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 24.

23 Victorian community organisations, *2023–28 Access arrangement proposal submission*, September 2022, pp. 2–3.

24 TRAC Partners prepared on behalf of Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 64.

25 Red Energy and Lumo Energy, *2023–28 Access arrangement proposal submission*, October 2022, pp. 3-4.

Stakeholder(s)	Issue	Description
		statistics presented as not a meaningful quantitative measures of consumer support, although it considered the Communication Link engagement to be more open than others.[26] The EUAA considered the combined network engagement process excellent.[27] BSL felt engagement was well coordinated and supported by useful information, but not all consumer advocate concerns were addressed, and it felt some of their views were misrepresented.[28]

6.3 Assessment approach

Our role is to decide whether or not to accept a business's forecast opex. We approve the business's forecast opex if we are satisfied that it meets the opex criteria. The opex criteria require that:

> Operating expenditure must be as such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.[29]

In deciding whether forecast opex meets the opex criteria, we also apply the forecasting and estimate requirements under the National Gas Rules (NGR), which include that:

> A forecast or estimate must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.[30]

We use a form of incentive based regulation to assess the business's forecast opex over the access arrangement period at a total level. To do so, we develop an alternative estimate of total opex using a 'top-down' forecasting method, known as the 'base–step–trend' approach.[31]

Once we have developed our alternative estimate of total opex, we compare it with the business's total opex forecast to form a view on the reasonableness of the business's proposal. If we are satisfied the business's total forecast meets the NGR requirements, we accept the forecast. If we are not satisfied, we substitute the business's forecast with our alternative estimate.

In making this decision, we take into account the reasons for the difference between our alternative estimate and the business's forecast, and the materiality of that difference. We also take into consideration the interrelationships between the opex forecast and other

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26 CCP28, *2023–28 Access arrangement proposal submission*, September 2022, pp. 14-18.

27 EUAA, *2023–28 Access arrangement proposal submission*, September 2022, p.3.

28 Brotherhood of St Laurence, *2023–28* Access *arrangement proposal submission*, September 2022, pp. 5, 9-10

29 NGR, r. 91(1). Rule 91(2) also provides that the forecast of required operating expenditure of a pipeline service that is included in the full access arrangement must be for expenditure that is allocated between reference services in accordance with Rule 93.

30 NGR, r. 74(2).

31 A 'top-down' approach forecasts total opex at an aggregate level, rather than forecasting all individual projects or categories to build a total opex forecast from the 'bottom up'.

constituent components of our decision, such that our decision is likely to contribute to the achievement of the National Gas Objective (NGO).[32]

6.3.1 Incentive regulation and the 'top-down' approach

Incentive regulation is designed to prevent network businesses from exploiting their natural monopoly position by setting prices in excess of efficient costs.[33] A key feature of the regulatory framework is that it is based on incentivising networks to be as efficient as possible. We apply incentive-based regulation across the energy networks we regulate, including gas networks. More specifically for opex, we rely on the efficiency incentives created by both ex ante revenue regulation (where an opex allowance is granted over a multi-year regulatory period) and the efficiency carryover mechanism (ECM).[34]

The incentive-based regulatory framework partially overcomes the information asymmetries between the regulated businesses and us.[35] It is intended to align the commercial goals of the network businesses to the objectives of the regulatory regime—especially the long term interests of consumers (the NGO).[36]

Incentive regulation aligns these goals by encouraging regulated businesses to reduce costs below our forecast, in order for them to make higher profits, and 'reveal' their costs in doing so. The information revealed by the businesses allows us to develop better expenditure forecasts over time. Revealed opex reflects any efficiency gains made by a business over time. As a network business becomes more efficient, this translates to lower forecasts of opex in future access arrangements, which means consumers also receive the benefits of the efficiency gains made by the business. Incentive regulation therefore aligns the business's commercial interests with consumer interests.

The Productivity Commission explains:

> Under incentive regulation, the regulator forecasts efficient aggregate costs over the upcoming regulatory period (of usually five years), which it uses to set a revenue allowance for that period. The business makes higher profits if it reduces costs below those forecast by the regulator. In doing so, the business reveals the efficient costs of delivering the service, which would then influence the regulator's determination in the next period. Accordingly, incentive

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32 NGL, s. 28(1)(a); NGL, s. 23.

33 Productivity Commission, *Electricity Network Regulatory Frameworks, volume 1, No. 62*, 9 April 2013, p. 188.

34 The approach we apply to assessing a business's opex (and which we have applied in this decision) is more fully described in the Expenditure Assessment Guideline and its accompanying explanatory materials, which are published on the AER's website.

35 Productivity Commission, *Electricity Network Regulatory Frameworks, volume 1, No. 62*, 9 April 2013, p. 189.

36 The NGO is set out under the NGL, s. 23 which is: "...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

> regulation encourages efficiency while reducing the risks that networks use their monopoly positions to set unreasonably high prices.[37]

Incentive regulation is designed to leave the day-to-day decisions to the network businesses.[38] It allows the network businesses the flexibility to manage their assets and labour as they see fit to comply with the opex criteria[39] and achieve the NGO.[40]

Our general approach is to assess whether opex, in aggregate, is sufficient to satisfy the opex criteria over the access arrangement period, rather than to assess all individual opex projects or programs. As noted above, to do so, we develop an alternative estimate of total opex using the 'base–step–trend' forecasting approach (section 6.3.2). This is generally a 'top-down' approach, but there may be circumstances where we need to use 'bottom-up' analysis, particularly in relation to our base opex assessment and for step changes.

6.3.2 Building an alternative estimate of total forecast opex

As a comparison tool to assess a business's opex forecast, we develop an alternative estimate of the business's total opex requirements in the forecast period, using the base–step–trend forecasting approach. We apply the forecasting and estimate requirements under the NGR.[41]

If a business adopts a different forecasting approach to derive its opex forecast, we develop an alternative estimate and assess any differences with the business's forecast opex

Figure 6.3 summarises the base-step-trend forecasting approach:

37 Productivity Commission, *Electricity Network Regulatory Frameworks, volume 1, No. 62*, 9 April 2013, p. 27.

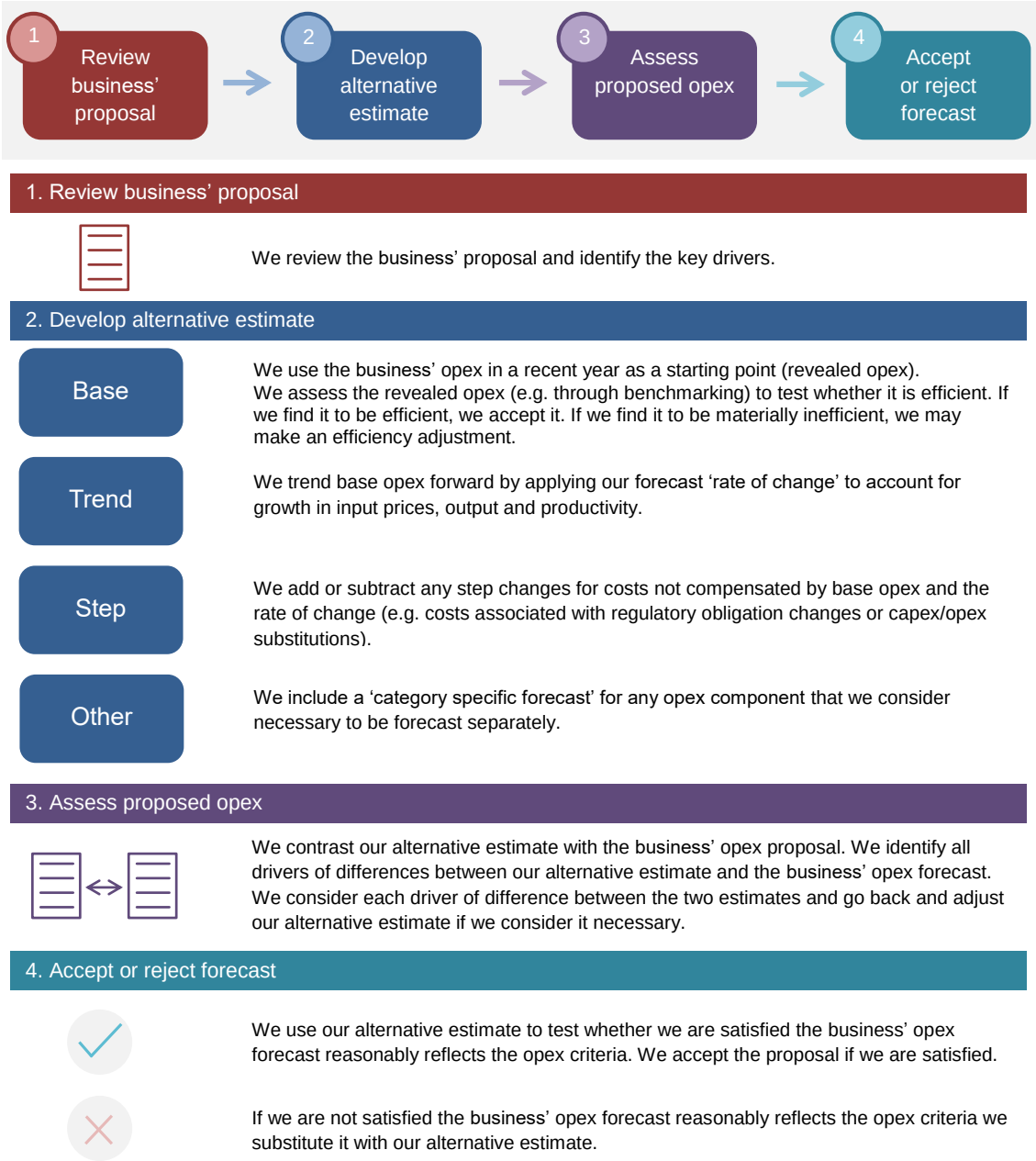
38 Productivity Commission, *Electricity Network Regulatory Frameworks, volume 1, No. 62*, 9 April 2013, pp. 27–28.

39 NGR, r. 91.

40 NGL, s. 28(1)(a) and s. 23.

41 NGR, r. 74.

Figure 6.3 Our opex assessment approach



6.3.3 Interrelationships

In assessing AusNet's total forecast opex, we also take into account other components of the access arrangement proposal that could interrelate with our opex decision. The matters we considered in this regard included:

- the ECM carryover—the level of opex used as the starting point to forecast opex (the final year of the current access arrangement period (2018–22)) should be the same as the level of opex used to forecast the ECM carryover. This consistency ensures that the business is rewarded (or penalised) for any efficiency gains (or losses) it makes in the final year the same as it would for gains or losses made in other years

- the operation of the ECM in the 2018–22 access arrangement period, which provided AusNet an incentive to reduce opex in the base year
- our assessment of forecast demand growth, including AusNet's forecast growth in customer numbers and mains length, which we have used to forecast output growth
- the impact of cost drivers that affect both forecast opex and forecast capital expenditure (capex). For instance, forecast labour price growth affects forecast capex and our forecast price growth used to estimate the rate of change in opex
- the approach to assessing the rate of return, to ensure there is consistency between our determination of debt raising costs and the rate of return building block
- the outcomes of AusNet's engagement with consumers and stakeholders in developing its proposal.

6.4 Reasons for draft decision

We do not accept AusNet's proposed opex forecast of $306.4 million ($2022–23)[42] for the 2023–28 access arrangement period because we are not satisfied that it reflects the opex criteria[43] and the requirements for forecasts and estimates.[44]

Our draft decision is to include our alternative total opex forecast of $335.7 million ($2022–23). This is $29.3 million, or 9.6%, higher than AusNet's forecast. We are satisfied our alternative estimate of total forecast opex for AusNet reasonably reflects the opex criteria. We also consider that our higher alternative estimate provides a total opex forecast such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.

Table 6.4 sets out AusNet's updated proposal, our alternative estimate that is the basis for the draft decision and the difference between our draft decision and the proposal.

42 AusNet, *Access arrangement information 2024-28 - Addendum*, September 2022, p. 36.

43 NGR, r. 91.

44 NGR, r. 74.

Table 6.4 Comparison of AusNet's proposal and our draft decision on opex ($million, 2022–23)

	AusNet's updated proposal	AER draft decision	Difference
Base (reported opex in 2021)	**300.2**	**277.9**	**–22.2**
Base year adjustments	**–25.2**	**–1.3**	**23.9**
Final year increment	**0.9**	**0.2**	**–0.7**
Remove category specific forecasts	**–7.1**	**6.5**	**13.6**
Trend: Real price growth	3.8	6.0	2.1
Trend: Output growth	11.0	8.2	–2.8
Trend: Productivity growth	–	–2.1	–2.1
Total trend	**14.8**	**12.0**	**–2.8**
IT Cloud and SaaS	12.4	31.2	18.7
Environmental Protection Act obligations	1.5	–	–1.5
Total step changes	**13.9**	**31.2**	**17.2**
Category specific forecasts	**4.5**	**4.4**	**–0.2**
Total opex (excluding debt raising costs)	**302.0**	**330.9**	**28.9**
Debt raising costs	**4.4**	**4.8**	**0.4**
Total opex (including debt raising costs)	**306.4**	**335.7**	**29.3**
Percentage difference to updated proposal			**+9.6%**

Source: AusNet, *Access arrangement 2024–28 – Addendum - Opex model*, September 2022; AER analysis.
Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

The main drivers for the differences are set out in Section 6.1 and we discuss the components of our alternative estimate, and our assessment of AusNet's updated proposal, below. Full details of our alternative estimate are set out in our opex model, which is available on our website.

6.4.1 Base opex

This section provides our view on the prudent and efficient level of base opex that we consider AusNet would need for the safe and reliable provision of services over the 2023–28 access arrangement period.

In its updated initial proposal, AusNet proposed a base year of 2021 and base year opex of $60.0 million ($2022–23) or $300.2 million ($2022–23) over the five years of the next access arrangement period.[45]

In our alternative estimate, we also used 2021 as the base year but used a base year opex of $55.6 million ($2022–23) or $277.9 million ($2022–23) over 5 years to form our alternative estimate of forecast opex.

[45] AusNet, *Access arrangement 2024-28 Addendum- Opex model*, September 2022; AER analysis.

AusNet's opex in the base year of 2021 was $2.7 million ($2022– 23) or 4.3% lower than allowed in our last determination.[46] AusNet explained that the main causes of lower-than-expected opex relative to our last determination were lower maintenance costs from outsourcing and other cost optimisation measures, and other cost reductions from a company-wide cost reduction program. This was offset by higher safety levies and meter reading set up costs.[47] Opex in 2021 was also $0.7 million ($2022–23) lower than the average opex for previous three years of the current period (2018–2020).

We do not undertake our own economic benchmarking or category analysis review of gas distributors to assess the efficiency of the base year opex. Instead, we rely on the economic benchmarking undertaken by the gas network businesses.

AusNet's initial proposal referred to gas distribution benchmarking analysis (from the AGN (SA) revenue determination process) to support its view that its base year was efficient.[48] This was undertaken in 2020 by Economic Insights and AusNet noted that it is the most recent industry benchmarking available. This analysis indicated that AusNet's actual opex per customer was relatively low compared to the other gas distribution businesses over the 2015–19 period.[49] Similarly, the results from the benchmarking which normalised the opex per customer measure also found AusNet's normalised results were typically below average.[50]

Also as indicated in AusNet's proposal, Economic Insights undertook opex multilateral partial factor productivity benchmarking for AGN (SA) in 2020, which included other gas distribution businesses. This showed that AusNet was one of the most efficient businesses in terms of opex multilateral partial factor productivity benchmarking over the 1999–2019 period.[51]

Our assessment of the efficiency of opex in the base year has been informed by the benchmarking studies undertaken by Economic Insights in 2020. While these studies do not include updated data for 2020 or 2021, we consider that the results are indicative of the broader performance of AusNet, including in the proposed base year. We consider the information provided suggests that AusNet's base opex is likely to be efficient. We note that AusNet's opex was also subject to the incentives of the ECM over the 2018–22 access arrangement period. Typically, where a service provider is subject to an ECM, we are satisfied that there is a continuous incentive for a service provider to make efficiency gains and it does not have an incentive to increase its opex above efficient levels in the proposed base year.[52]

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46 AER, *AusNet Services access arrangement 2018-22 - Final Decision PTRM*, November 2017.

47 AusNet, *Access arrangement information 2024–28 – Information request #05 Q1*, 25 August 2022.

48 AusNet, *Access arrangement information 2024-28*, July 2022, p.125.

49 AusNet, *Access arrangement information 2024-28,* July 2022, p.128.

50 Economic Insights, *Benchmarking Operating and Capital Costs of Australian Gas Networks' South Australian Network Using Partial Productivity Indicators*, 15 June 2020, pp.22-23; AusNet, *Access arrangement information 2024-28*, July 2022, p.128.

51 Economic Insights, *The Productivity Performance of Australian Gas Networks' South Australian Gas Distribution System*, report prepared for Australian Gas Networks (AGN), 15 June 2020, pp. 25-27; AusNet, *Access arrangement information 2024-28*, July 2022, p.126.

52 NGR, r. 71(1)

In summary, we have not identified any evidence that AusNet's proposed 2021 base year is materially inefficient and, as the most recent year with complete actual data, consider it an appropriate choice of base year.

6.4.1.1 Adjustments to base year opex

AusNet proposed a total adjustment to its estimated $300.2 million ($2022–23) base opex, of –$6.3 million ($2022–23) or –$31.5 million ($2022–23) over the five years. We have adjusted our alternative estimate of opex in the base year of $277.9 million by $1.1 million ($2022–23) or $5.4 million ($2022–23) over 5 years to:

- add $0.8 ($2022–23) million for the expensing of corporate overheads. This increases our alternative estimate of total opex by $4.2 million ($2022–23) over 5 years. We explain this adjustment in section 6.4.1.1.1
- remove capitalised leases worth $1.1 million ($2022–23). This reduces are alternative estimate of total opex by $5.5 million ($2022–23) over 5 years. We explain this adjustment in section 6.4.1.1.2
- add $0.0 million[53] ($2022–23) for the estimated final year opex for categories forecast specifically. This increases our alternative estimate by $0.2 million ($2022–23) over the 5 years. We explain this adjustment in 6.4.1.1.3
- add $1.3 million ($2022–23) for the increase in opex between 2021 and 2023–24 (final year increment). This increases our alternative estimate by $6.5 million ($2022–23) over the 5 years. We explain this adjustment in 6.4.1.1.4

The key differences between our total adjustment and that of AusNet is driven by its proposed cost of service approach for ESV levies (section 6.4.1.1.5) and the treatment of mid period accounting changes for leases (section 6.4.1.1.2).

6.4.1.1.1 Expensing of corporate overheads

AusNet proposed an increase in base opex of $0.9 million ($2022–23) ($4.3 million over the next access arrangement period), to reflect a change to its current capitalisation practices, which from 1 July 2023 will be to fully expense corporate overheads.[54] In our alternative estimate we have adjusted base year opex by $0.8 million ($2022–23) (or $4.2 million ($2022–23) over access arrangement period) to reflect the change in AusNet's proposed capitalisation practices which we consider reasonable. The difference between our total adjustment and that of AusNet is driven by the difference in actual and forecast inflation applied.

AusNet stated in its proposal that its current practice is to capitalise a portion of corporate overheads that provide support to capital activities.[55] AusNet is proposing to change the way it treats its capitalised corporate overhead because:

- while a transfer from capex to opex will increase prices in the short term, it lowers prices in the longer term

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53 This is a positive number but less than the one decimal place we generally report to.

54 AusNet, *Access arrangement information 2024–28 – Information request #05 Q.3,* 12 August 2022.p. 2

55 AusNet*, Access arrangement information 2024-28,* July 2022, p. 123.

- it will deliver longer term benefits for customers as these costs will not increase the asset base and therefore incur a return on and return of capital.

AusNet provided information about the corporate work divisions included in its corporate overhead estimate which relate to costs associated with governance, strategy and transformation, people and safety, and finance.[56] AusNet provided further information stating that we should assess whether its proposed approach is consistent with the National Gas Objective (NGO) and in the long-term interests of consumers.[57] AusNet also noted that it openly acknowledged that customer consultation on this approach received a diversity of views from customers, with some supporting the change and others not.

Some submissions (Origin Energy[58] and Brotherhood of St Laurence[59]) did not agree with the proposed expensing of overhead costs. Origin Energy requested a more principled and consistent approach to cost allocation should be in place and the Brotherhood of St Laurence argued expensing overheads and other large capex items will increase tariffs in the near term and is not in the best interest of consumers in the current environment.

We consider that changes to capitalisation practices are generally driven by accounting practices and the nature of the costs being considered. We have previously approved changes to capitalisation approaches and the expensing of (all) corporate overheads across several electricity businesses, including for costs of the nature noted above in relation to governance, strategy, people and safety, etc. The acceptance in the electricity businesses' decisions were based on our approved changes to their cost allocation methodologies (CAM) reflecting principled / causation-based changes. Under the National Electricity Rules (NER), network services providers must submit their proposed CAM to us for approval, and we must approve a proposed CAM that complies with the Cost Allocation Guidelines. By contrast, the NGR do not contain a formal cost allocation framework for gas networks and we do not have such a role.

Given the proposed change to fully expensing corporate overheads is consistent with the approaches adopted by other energy sector businesses which we have approved, we propose to include the base adjustment for the change in capitalisation approach in our alternative estimate. We have also reviewed and confirmed the appropriate capex reductions have been made for the 2023–28 access arrangement period because of the change in capitalisation approach.

6.4.1.1.2 Treatment of SaaS and leases accounting changes

There are two accounting changes implemented by the Australian Accounting Standards Board (AASB) and the International Financial Reporting Interpretations Committee (IFRIC) that affect AusNet's expenditure reporting in the 2018–22 access arrangement period. These are:

1. SaaS implementation and customisation costs were treated as capex at the time of our 2018–22 determination for AusNet. SaaS costs are now considered as opex

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56 AusNet, *Access arrangement information 2024–28 – Information request #04 Q.1,* Confidential, 11 August 2022.p. 2.

57 AusNet, *Access arrangement information 2024–28 – Information request #05 Q.3,* 19 August 2022.p. 2.

58 Origin Energy, *2023–28 Access arrangement proposal submission*, September 2022. p. 3.

59 Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 26.

under new International Financial Reporting Standards (IFRS) guidance published in April 2021[60]

2. property leases were included in forecast opex at the time of our 2018–22 determination for AusNet. Under AASB16, which came into effect on 1 July 2019, property leases are now treated as capex.[61]

In its proposal, AusNet adopted the new accounting standards for SaaS and leases in 2021, which is its base year to forecast opex for the 2023–28 access arrangement period.[62] This reflected the actual costs AusNet reported in its regulatory information notice responses for 2021. Therefore its base opex included $3.1 million ($nominal) in SaaS implementation and customisation costs but did not include $1.0 million ($nominal) in property leases.

We have reviewed AusNet's proposal after receiving additional information as part of our information request process.[63] We are satisfied that the increase in base year opex due to the recurrent SaaS costs is accompanied by the appropriate decrease in capex, and that these costs have not been double counted in other aspects of AusNet's proposal. We also believe that the costs identified by AusNet fall within the relevant categories impacted by the recent IFRS accounting guidance and the reclassification of these expenses is appropriate.

However, as discussed in Attachment 8 of our draft decision on Transgrid's 2023-28 transmission determination,[64] we have undertaken analysis which demonstrates that the movement of expenditure mid access arrangement period under these accounting changes from opex to capex, and vice-versa, can cause windfall gains/losses for businesses under the incentive schemes in the case of short-lived assets, such as SaaS and leases. Therefore, we consider it is more appropriate to align the accounting treatment of expenditure within a period with the approved expenditure for that period. In other words, we consider mid-period accounting changes should not be implemented until the start of the new period.

Accordingly, in developing our alternative estimate, we removed $3.1 million ($nominal) of SaaS related expenditure from AusNet's reported base year opex.[65] We have instead treated it as capex in 2021. To account for these costs being opex going forward, from the start of the next access arrangement period we have included these costs in our alternative estimate of the IT Cloud and SaaS step change and have removed them from forward capex forecasts over the 2023–28 access arrangement period.

Similarly, to implement the accounting standard changes for property leases we have treated property leases as opex for the remainder of the current access arrangement period. To account for them being treated as capex from the start of the new period, we have removed $1.1 million ($2022–23) from each year of our alternative estimate of total forecast opex.

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60 International Finance Reporting Standards*, Configuration or customisation costs in a cloud computing Arrangement* (*IAS 38 Intangible Assets),* April 2021.

61 Australian Government, *Australian Accounting Standards Board – AASB16,* February 2016.

62 AusNet*, Access arrangement information 2024-28,* July 2022, p. 134.

63 AusNet, *Access arrangement information 2024–28 – Information request #17, 6 October* 2022.

64 AER, *AER-Transgrid 2023-28 – Draft Decision – Attachment 8 – Efficiency benefit sharing scheme,* September 2022, pp. 5-6

65 Under our approach, SaaS costs will be treated as capex in the regulatory accounts until the end of the 2018–22 access arrangement period.

6.4.1.1.3 Removal of category specific forecasts

In some circumstances a particular category of opex may be removed from the base year expenditure if it is more appropriate to forecast that category separately. We refer to these as 'category specific forecasts' (see section 6.4.4). We have removed unaccounted for gas (UAFG) and debt raising costs from base opex, to be forecast separately. This is consistent with our standard approach as well as AusNet's proposal.

Despite the consistency in approach, we have added $0.0 million ($2022–23) to base opex to account for category specific forecasts, which is $0.1 million ($2022–23) less than the $0.2 million ($2022–23) increase to base opex AusNet proposed.[66] This difference is caused by the correction of an error in AusNet's calculation for inflation to get to $2022–23. The reason the removal of category specific forecast is a positive number and being added to base opex, rather than a negative number which is generally removed, is due to AusNet not reporting debt raising costs in its reported 2021 actual opex.[67]

6.4.1.1.4 Final year increment

Our standard practice to calculate final year opex is to add the estimated change in opex between the base year (2021) and the final year (2022) of the current (2018–22) period to the base year opex amount.[68] As a result of the six-month extension to the current regulatory control period, we have updated our final year increment calculation by exchanging the opex forecast for 2022 with the annualised six-month extension period (1 January–1 July 2023) forecast. This approach is consistent with AusNet's proposal and our past decisions for the Victorian electricity distribution networks.

Despite the consistency in approach, we have included $6.5 million ($2022–23) for the estimate of 1 January–1 July 2023 opex in our alternative estimate, which is $13.6 million ($2022–23) higher than AusNet's proposed amount of –$7.1 million ($2022–23).[69]

The variance between our alternative estimate and AusNet's proposal is due to:

- our use of the latest inflation figures when we escalated base year opex into $2022–23
- correction of an error AusNet made in its proposal when escalating its base opex for the six-month extension period, which applied a full year's inflation instead of only six months' worth of inflation.

6.4.1.1.5 Energy Safe Victoria (ESV) levies

AusNet proposed to remove $5.9 million ($2022–23) in relation to the ESV levy from base opex and proposed it to be recovered through the price control mechanism.[70] This is equivalent to a $29.6 million ($2022–23) reduction in opex over the next access arrangement period.

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66 AusNet, *Access arrangement information 2024-28 – Addendum - Opex model*, September 2022.

67 AusNet, *Access arrangement information 2024–28 – Information request #05 Q. 14, 19 August* 2022.

68 AER, *Expenditure forecast assessment guideline for electricity transmission,* November 2013, pp. 24-25.

69 AusNet, *Access arrangement information 2024-28 – Addendum - Opex model* September 2022.

70 AusNet, *Access arrangement information 2024-28 – Addendum - Opex model*, September 2022.

AusNet submitted the annual levy is determined exogenously and notes unexpected and substantial increases over recent years.[71] AusNet proposed to recover the ESV levy through the price control mechanism on the basis that it ensures that the business can recover the actual amount incurred and customers only pay for the exact levied amount. AusNet noted its proposed approach is consistent with the treatment of ESV levies in the Victorian electricity distribution sector, where the exact levies are recovered as a jurisdictional scheme amount in the price control mechanism formula.[72] AusNet further stated that if we do not accept this approach, the levy should be added back into the base year and an additional step change will be required for future increases.

The ESV levy is used to fund the ESV activities related to regulating the Victorian distribution businesses (electricity and gas) and is spread across the network operators based on the proportion of customers on each distribution businesses' network.

We note that for electricity distribution businesses, unlike for gas distribution businesses, there are express provisions which deal with the recovery of jurisdictional scheme amounts, such as the ESV levies. It was in this context that we approved the recovery of the ESV levies through the price control mechanism for the Victorian electricity distribution businesses.

We have not removed the ESV levy from base year opex in our alternative estimate of total opex as we consider this cost should remain a part of base year opex and that increases in the levy can be managed within existing base year opex and the forecast rate of change. We consider these costs, as with other opex costs, should be subject to ex-ante incentive based regulation rather than a cost of service approach as would occur if they were recovered via the price control mechanism.

Base opex already reflects the cost of meeting existing regulatory obligations and maintaining the reliability, safety, and quality of supply of standard control services. This includes ESV levy costs, which reflects existing regulatory obligations. In the absence of exceptional circumstances, fluctuations in the ESV levy should be managed within base opex and the forecast rate of change. While we are satisfied that there will be increases in the ESV levy for the 2023–28 access arrangement period, based on documentation provided by AusNet, we do not consider these are likely to be materially higher that would be allowed for in our price growth forecast.[73] In this regard we acknowledge that some costs may increase by more than the forecast rate of change; however, this is likely offset by other costs that increase by less than the forecast rate of change or by decreases in other cost categories over the 2023–28 access arrangement period.

Our alternative estimate includes the ESV levy in base year opex and we do not propose to include an annual adjustment of the price control formula for the ESV levy.

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71 AusNet, *Access arrangement information 2024-28,* July 2022. p. 123.

72 AER, AusNet Distribution Determination 2021 to 2026, Attachment 6 operating expenditure, Final Decision, April, p. 35.

73 AusNet, Access arrangement information 2024–28 – Information request #017 Q4, 6 October 2022.

6.4.2 Rate of change

Once we estimate opex in the final year of the 2018–23 period, we apply a forecast annual rate of change to forecast opex for the 2023–28 access arrangement period. We have applied an annual average rate of change of 1.1% to derive our alternative estimate of opex. This is lower than AusNet's forecast of 1.5%. We compare both forecasts in Table 6.5.

Table 6.5 Forecast annual rate of change in opex, %

	2023–24	2024–25	2025–26	2026–27	2027–28
AusNet's updated proposal					
Price growth	0.4	0.6	0.6	0.4	0.3
Output growth	1.9	1.4	1.1	0.7	0.4
Productivity growth	–	–	–	–	–
Rate of change	**2.3**	**2.0**	**1.7**	**1.0**	**0.7**
AER alternative estimate					
Price growth	0.6	0.9	0.9	0.4	0.3
Output growth	1.6	1.0	0.7	0.2	–0.0
Productivity growth	0.4	0.2	0.2	0.1	0.1
Rate of change	**1.8**	**1.7**	**1.3**	**0.5**	**0.2**
Difference	**–0.5**	**–0.3**	**–0.4**	**–0.5**	**–0.5**

Source: AusNet, Access arrangement information 2024–28 – Opex model, July 2022; AER analysis.
Note: The rate of change = (1 + price growth) × (1 + output growth) × (1 – productivity growth) – 1. Numbers may not add up to totals due to rounding. Amounts of '0.0' and '–0.0' represent small non-zero values and '–' represents zero.

The differences between our forecast rate of change and AusNet's are that:

- we have used more recent wage price index (WPI) forecasts to forecast labour price growth
- we have used the output weights derived by ACIL Allen in its 2022 report to forecast output growth
- we have used the opex partial productivity forecasts derived by ACIL Allen in its 2022 report, updated to reflect AusNet's updated output growth, to forecast productivity growth.

We discuss each of these issues below.

6.4.2.1 Forecast price growth

AusNet proposed average annual price growth of 0.4%, which increased its total opex forecast by $3.8 million ($2022–23). We have used real average annual price growth of 0.6% in our alternative estimate of total opex. This increases our total opex alternative estimate by $6.0 million ($2022–23).

Both we and AusNet forecast price growth as a weighted average of forecast labour price growth and non-labour price growth:

- both we and AusNet used an average of two WPI growth forecasts for the electricity, gas, water and waste services (utilities) industry in Victoria to forecast labour price

growth. AusNet used forecasts from its consultant, BIS Oxford Economics, and Deloitte Access Economics.[74] It sourced the Deloitte Access Economics forecasts from our final decision for AusNet's 2023–27 electricity transmission revenue determination. In our alternative estimate, we have replaced the Deloitte Access Economics forecasts with the more recent forecasts from our new consultant KPMG[75]

- both we and AusNet applied a forecast non-labour real price growth rate of zero
- we and AusNet have applied the same weights to account for the proportions of opex that is labour and non-labour, 62% and 38%, respectively.

Consequently, the key difference between our real price growth forecasts and AusNet's is that we have updated our labour price growth forecast to include the more recent forecasts from KPMG, instead of the older Deloitte Access Economics forecasts.

We have updated our forecasts of WPI to reflect the latest available information

Our standard approach to forecasting labour price growth is to use an average of two WPI growth forecasts for the utilities industry in the relevant state. We use one set of forecasts provided by the network, and one set that we receive from our own consultant. For this determination we engaged KPMG to provide WPI growth forecasts for the Victorian utilities industry.

Consistent with this approach, AusNet used forecasts from its consultant, BIS Oxford Economics, and Deloitte Access Economics. It sourced the Deloitte Access Economics forecasts from our final decision for AusNet's 2023–27 electricity transmission revenue determination, being the most up-to-date set of forecasts available to it at the time it submitted its access arrangement proposal.

Since AusNet submitted its access arrangement proposal, we have received new WPI growth forecasts from KPMG, which reflect more up-to-date economic information. We used these newer forecasts in place of the Deloitte Access Economics forecasts that AusNet used.

We show the labour price growth forecasts from BIS Shrapnel, KPMG and the average WPI growth rate in Table 6.6. We then added the legislated superannuation guarantee increases to forecast labour price growth. The last legislated superannuation guarantee increases is due to occur on 1 July 2025.[76] We do this because the WPI does not include superannuation and thus the WPI growth forecasts do not capture the increase in the price of labour when the superannuation guarantee increases.

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74 AusNet, *Access arrangement information 2024-28*, July 2022, p. 132.

75 KPMG, *WPI forecast report*, September 2022, p. 41.

76 https://ato.gov.au/SuperRate

Table 6.6 Forecast labour price growth, %

	2023–24	2024–25	2025–26	2026–27	2027–28
WPI growth — KPMG	0.6	1.1	0.8	0.4	0.4
WPI growth — BIS Oxford Economics	0.4	0.9	1.0	0.9	0.7
Average WPI growth	0.5	1.0	0.9	0.6	0.5
Superannuation guarantee increase	0.5	0.5	0.5	–	–
Forecast labour price growth	1.0	1.5	1.4	0.6	0.5

Source: BIS Oxford Economics, *Input price escalation forecasts to 2027/28*, p. 4; KPMG, *WPI forecast report*, September 2022, p. 41; AER analysis;
Note: Numbers may not add up to totals due to rounding. Amounts of '0.0' and '–0.0' represent small non-zero values and '–' represents zero.

6.4.2.2 Forecast output growth

AusNet proposed average annual output growth of 1.1%, which increased its proposed opex forecast by $11.0 million ($2022–23). We have forecast average annual output growth of 0.7%. This increases our alternative estimate of total opex by $8.2 million ($2022–23).

For electricity distribution determinations, we typically forecast output growth based on the forecast growth in a defined output measure, based on econometric modelling. However, for gas distribution decisions, we have not undertaken the modelling needed to determine a standard industry output specification.

To assess AusNet's output and productivity growth forecasts, we tested how the proposed output growth, net of productivity growth, compares to the output and productivity growth forecast using the output specifications derived from the available econometric studies. These econometric studies have been submitted in previous gas reset processes and were undertaken between 2015 and 2022.[77] We have taken the opex cost function estimated by each of these studies and forecast output and productivity growth using the forecast growth in energy throughput, customer numbers, mains length and the regulated asset base. In this way we have produced output and productivity growth forecast specific to AusNet's circumstances. When we compared the results of the different studies, we compared forecast output growth and productivity growth together because an output specification that leads to higher output growth often tends to also give higher forecast productivity growth.

When we compared AusNet's average annual output growth net of productivity growth of 1.1% against the forecasts based on each of the available econometric studies, we found it to be higher than all of them, as shown in Table 6.7. Consequently, we are not satisfied that AusNet's forecast of output growth, net of productivity growth, has been arrived at on a reasonable basis and is the best forecast possible in the circumstances.[78]

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77 ACIL Allen, *Opex partial productivity analysis, Report to Australian Gas Networks Limited*, 20 December 2016; Economic Insights, *Relative opex efficiency and forecast opex productivity growth of Jemena Gas Networks*, February 2015; Economic Insights, *Gas distribution businesses opex cost function, Report prepared for Multinet Gas*, 22 August 2016; Economic Insights, *Relative efficiency and forecast productivity growth of Jemena Gas Networks (NSW)*, 24 April 2019; ACIL Allen, *Opex partial productivity study 2022, Report to Australian Gas Networks (VIC and Albury), Multinet and AusNet*, 16 June 2022.

78 NGR, r. 74(2).

Table 6.7 Comparison of forecast output growth net of productivity growth, %

Model Specification	Output growth	Productivity growth	Output growth net of productivity growth
AusNet's initial forecast	2.3	0.4	1.9
AusNet's updated forecast	**1.1**	**–**	**1.1**
ACIL Allen (2016)	0.6	0.8	–0.2
Economic Insights (2015)	–0.8	0.5	–1.3
ACIL Allen (2016)	0.6	0.8	–0.1
Economic Insights (2016)	1.3	2.2	–1.0
Economic Insights (2019)	1.1	2.0	–1.0
ACIL Allen (2022)	**0.7**	**0.2**	**0.5**

Source: AusNet, *Access arrangement information 2024-28 – Opex Forecast Model*, July 2022; AusNet, *Access arrangement information 2024-28 – Addendum – Opex Forecast Model*, September 2022; AER analysis.
Note: Amounts of '0.0' and '–0.0' represent small non-zero values and '–' represents zero.

The highest forecast of output growth net of productivity growth is based on the econometric modelling done by ACIL Allen in 2022, which AusNet submitted with its proposal. AusNet's forecast is greater than the forecast using ACIL Allen's specification because:

- ACIL Allen modelled two output specifications. One with customer numbers and mains length as the outputs. The other with customer numbers and energy throughput as the outputs. AusNet only used the output specification that used customer numbers and mains length
- AusNet did not use the output weights estimated by ACIL Allen. Instead, it used weights it said would 'ensure better alignment with the AER's more recent determinations for AGN (SA), Evoenergy and Jemena'
- AusNet did not use the productivity growth estimated by ACIL Allen in its 2022 report.

We discuss each of these differences below.

ACIL Allen's model specification is the best available in the circumstances

We have considered the econometric modelling of gas distribution networks undertaken in the past and previously submitted to the AER. We are satisfied that the model specifications in ACIL Allen's 2022 report are a reasonable basis to forecast output and productivity growth and represent the best forecast possible in the circumstances.

We also considered the older studies but recognised that they were completed up to seven years ago and have not been updated for data published since. This likely explains why these older studies are producing results which appear unlikely. These studies are forecasting negative output growth net of productivity growth because they are forecasting greater productivity growth than output growth. We consider the outlook facing AusNet is more likely to result in lower productivity growth, not higher productivity growth. These counterintuitive results may reflect that they were undertaken and based on data from an increasing output environment. Given this, we have placed less reliance on these older econometric studies to inform our assessment.

Applying the results of ACIL Allen's 2022 econometric results gives an average annual output growth of 0.7% and annual productivity growth of 0.2%. This gives annual average output growth net of productivity of 0.5%.

Both output specifications should be used

ACIL Allen modelled two output specifications. One with customer numbers and mains length as the outputs and the other with customer numbers and energy throughput as the outputs. We consider both output specifications should be used to forecast output growth.

AusNet, however, did not use the output specification that included energy throughput in forming its output growth forecast. It stated that:[79]

> … ACIL Allen's report suggests that customers and mains length exhibit a stronger relationship with opex than customers and energy throughput.

AusNet reached this conclusion on the basis that the elasticities measured for mains length were higher than those measured for energy throughput. However, both output specifications deliver similar R^2 values (around 0.95) and both mains length and energy throughput achieve similar p values. Further, ACIL Allen undertook a model validation and testing process and concluded that both output specification should be included in its analysis.[80] Given this, we consider both output specifications should be used to forecast output growth.

Further, ACIL Allen, in forecasting productivity growth for AusNet, followed the advice of Armstrong[81] and combined the forecasts derived from four different sets of econometric results (reflecting two separate output specifications each modelled using two different estimation techniques) to improve forecast accuracy.[82] It did this by using a simple average of the four opex partial productivity forecasts. We agree with ACIL Allen that using an average of multiple modelling results is more likely to produce a more accurate forecast than relying on fewer modelling results. We consider this applies equally to output growth as it does to productivity growth. This also ensures forecast output growth reflects the same output specification as is reflected in the productivity growth forecast. For this reason, we used the average of the four different output forecasts reflecting both output specifications.

Output weights

To forecast output growth, we have relied on the econometric results in ACIL Allen's 2022 report to derive our output weights. AusNet did not use the output weights estimated by ACIL Allen. Instead, it used weights it said ensured better alignment with our recent determinations for AGN (SA), Evoenergy, Jemena and Multinet.[83] For those decisions we concluded the output weights now proposed by AusNet produced forecasts of output growth net of productivity growth that were reasonable when compared to the results of the various econometric studies available at the time. Consequently, those decisions reflected the output

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79 AusNet, *Access arrangement information 2024-28*, July 2022, p. 130.

80 ACIL Allen, *Opex partial productivity study 2022*, June 2022, pp. 19–23.

81 Armstrong, *Principles of forecasting: A Handbook for Researchers and Practitioners*, 2001, pp. 417–439.

82 ACIL Allen, *Opex partial productivity study 2022*, June 2022, p. 46.

83 AusNet, *Access arrangement information*, July 2022, pp. 129–130.

growth facing the relevant networks while also considering the proposed productivity growth forecasts. Given all the factors we consider, we may not find a given set of output weights reasonable in all circumstances. This is particularly the case when the weights are not based on econometric results.

For the same reasons we consider both output specifications should be used, we consider the econometric analysis done by ACIL Allen in its 2022 report is a reasonable basis to determine output weights. We also consider those weights represent the best forecast possible in the circumstances. We compare AusNet's proposed weights to the four sets of weights derived by ACIL Allen in Table 6.6.

Table 6.8 Output weights, %

	AusNet proposed	ACIL Allen Model 1	ACIL Allen Model 2	ACIL Allen Model 3	ACIL Allen Model 4	ACIL Allen Average
Customers	**45.0**	79.8	96.1	27.0	73.5	**69.1**
Mains length	**55.0**	–	–	73.0	26.5	**24.9**
Energy throughput	**–**	20.2	3.9	–	–	**6.0**

Source: ACIL Allen, *Opex partial productivity study 2022*, 16 June 2022, pp. 24–25; AER analysis.
Note: Amounts of '0.0' and '–0.0' represent small non-zero values and '–' represents zero.

The impact of using the ACIL Allen's output weights, rather than those proposed by AusNet, is to transfer some of weight applied to mains length to customer numbers and some to energy throughput.

6.4.2.3 Forecast productivity growth

AusNet proposed average productivity growth of zero. We have forecast a higher average productivity growth of 0.2% per year. This decreases our alternative opex estimate by $2.1 million ($2022–23).

AusNet reduced its productivity growth forecast from 0.4% in its initial proposal to zero when it updated its proposal to account for the Victorian Government's *Gas Substitution Roadmap*.[84] We agree that the *Gas Substitution Roadmap* is likely to reduce the productivity growth that can be achieved. However, we do not consider AusNet arrived at its productivity growth forecast on a reasonable basis.

The available evidence supports positive productivity growth

To forecast productivity growth, we have relied on ACIL Allen's 2022 report and econometric analysis. As outlined above, we consider it is important that forecast productivity reflects the same output specification as used for output growth and is forecast on a consistent basis.

The econometric analysis conducted by ACIL Allen in 2022, and submitted by AusNet, found both returns to scale and positive technical change. These results indicate that an efficient gas distributor should achieve positive productivity growth, to the extent that output is forecast to grow. Productivity growth can also be impacted by changes in business conditions. ACIL Allen included the regulatory asset base and customer density as business conditions in its econometric analysis. ACIL Allen included productivity growth forecasts for

84 AusNet, *Access arrangement information 2024-28 - Addendum*, September 2022, p. 35.

AusNet in its report, but these forecasts reflected the output growth and the change in business conditions forecast prior to AusNet amending its proposal to account for the *Gas Substitution Roadmap*. We have updated ACIL Allen's forecasts of opex partial productivity growth to reflect AusNet's updated output growth forecasts in the addendum to its initial proposal.

We note that to forecast productivity growth we have included technical change, returns to scale and changes in business conditions. ACIL Allen only included technical change 'following the standard approach recommended by the AER'.[85] However, this is not our standard approach, and it is unclear why ACIL Allen considered this to be the case (it did not provide a reference to support this position). Nonetheless, this is a theoretical concern since the forecast change in business conditions offsets the forecast returns to scale such that forecast productivity growth matches the forecast technical change.

Consistent with the ACIL Allen 2022 report we have included technical change of 0.2% in our productivity growth forecast.

Regarding returns to scale, we note that ACIL stated:[86]

> We would expect there to be economies of scale with regard to opex in the gas distribution business. This is both logical and supported by a significant number of empirical studies of both gas and electricity distribution businesses.

AusNet, however, stated that economies of scale will not exist, due to slowing and negative growth in customer numbers.[87] We consider that lower output growth will reduce the expected returns to scale. However, given we and AusNet have forecast positive average output growth we expect some returns to scale. Based on ACIL Allen's econometric analysis we expect this to contribute 0.1% to average annual productivity growth.

We have also considered the impact of the expected change in business conditions on productivity growth. We expect these to reduce average annual productivity growth by 0.1%, largely due to the expected decline in customer density.

The net impact of technical change, returns to scale and the change in business conditions is forecast average annual opex partial productivity growth of 0.2%. We have used this as our forecast of productivity growth.

Stakeholder submissions

We received several submissions that addressed productivity growth. The Energy Users Association of Australia and the Brotherhood of St. Laurence considered the gas distributors should be able to achieve positive productivity growth forecasts.[88] Historically we have expected this for gas distributors, given econometric studies have consistently found positive technical change and positive returns to scale. However, the forecast of productivity growth

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85 ACIL Allen, *Opex partial productivity study 2022*, June 2022, p. 24.

86 ACIL Allen, *Opex partial productivity study 2022*, June 2022, p. 20.

87 AusNet, *Access arrangement information, Addendum to proposal*, 2 September 2022, p. 35.

88 EUAA, 2023–*28 Access arrangement proposal submission*, September 2022, p. 9; Brotherhood of St. Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 27.

should reflect the outlook facing the network, particularly forecast output growth and the forecast change in business conditions. In this case, having considered these factors, we have forecast positive productivity of 0.2%.

Origin Energy, however, considered zero productivity growth to be 'a reasonable approach given the networks are no longer expected to grow'.[89] Origin Energy's submission recognises that fewer returns to scale can be expected in a low growth environment. We have taken this into account and our forecast of productivity growth reflects expected output growth as well as the expected change in business conditions.

6.4.3 Step changes

In developing our alternative estimate for the draft decision, we include prudent and efficient step changes for cost drivers such as new regulatory obligations or efficient capex / opex trade-offs. As we explain in the *Expenditure forecast assessment guideline* for electricity, we will generally include a step change if the efficient base opex and the rate of change in opex of an efficient service provider do not already include the proposed cost for such items and they are required to meet the opex criteria.[90]

AusNet's proposal included two step changes totalling $13.9 million ($2022–23) or 4.5% of its proposed total opex forecast.[91] These are shown in Table 6.9 along with our alternative estimate for the draft decision, which is to include step changes totalling $31.2 million ($2022–23), being $17.2 ($2022–23) higher than AusNet's proposal. Our higher alternative estimate is largely due to not including SaaS adjustments to the base year (as proposed by AusNet) and instead these being included in our alternative estimate for the IT Cloud and SaaS step change. This reflects our approach to the treatment of mid period accounting changes. We discuss this in section 6.4.1.1.2 and also explain this in further detail below in section 6.4.3.1.

Table 6.9 AusNet's proposed step changes and the AER's draft decision ($million, 2022–23)

Step change	AusNet proposal	AER's draft decision	Difference
IT Cloud and SaaS	12.4	31.2	18.7
Environment Protection Act obligations	1.5	–	–1.5
Total step changes	**13.9**	**31.2**	**17.2**

Source: AusNet, *Access arrangement information 2024–28 – Addendum - Opex model*, September 2022; AER analysis.
Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '–0.0' represent small non-zero amounts and '–' represents zero.

6.4.3.1 IT Cloud and SaaS

AusNet proposed a step change of $12.4 million ($2022–23) for IT Cloud and SaaS over the 2023–28 access arrangement period.[92] This relates to costs that enable AusNet to move

89 Origin Energy, *2023–28 Access arrangement proposal submission*, September 2022, p. 3.
90 AER, *Expenditure forecast assessment guideline for electricity distribution*, August 2022, p. 26.
91 AusNet, *Access arrangement information 2024-28 - Addendum*, September 2022, p. 36.
92 AusNet, *Access arrangement information 2024-28 - Addendum*, September 2022, p. 36.

from current on-premise IT solutions to the cloud as well as capex to opex transfers for SaaS due to an accounting rule change. Our draft decision is to include a forecast step change of $31.2 million ($2022–23) for the proposed IT Cloud and SaaS step change in our alternative estimate, which is $18.7 million ($2022–23) higher than AusNet's proposal. As discussed in section 6.4.1.1.2, our treatment of mid period accounting changes has resulted in our alternative estimate removing $3.1 million ($nominal) in SaaS implementation and customisation costs from base year opex and increases our step change forecast by $18.7 million ($2022–23). These costs are a part of the broader step change. We have included this step change in our alternative estimate as we consider the capex/opex trade-off results in forecast expenditure that is likely to be prudent and efficient and reflects the accounting standard changes to expense all SaaS costs.

Table 6.10 AusNet's IT Cloud and SaaS step change ($million, 2022–23)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
AusNet's proposal	4.4	5.2	2.0	0.6	0.3	12.4
AER draft decision	8.0	8.9	5.7	4.4	4.1	31.2
Difference	**3.6**	**3.7**	**3.7**	**3.9**	**3.9**	**18.7**

Source: AusNet, *Access arrangement information 2024–28 – Addendum - Opex model*, September 2022; AER analysis.
Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '–0.0' represent small non-zero amounts and '–' represents zero.

In its proposal, AusNet noted that being the owner and operator of three different networks (electricity distribution, electricity transmission and gas distribution) it has shared IT services across all businesses and the costs have been allocated to AusNet gas distribution using its cost allocation method.[93]

AusNet also explained that moving IT software to the cloud, instead of the traditional capex approach of purchasing and maintaining IT equipment and services, is an international and domestic trend amongst network businesses.[94] AusNet noted the migration to the cloud will also place downward pressure on its capex requirements in the medium to long term. AusNet's proposal included five programs of IT investment being migrated to the cloud, where it considered the cost of the migration is not fully captured in the base or trend parameters, being workforce collaboration, corporate enablement, information management, corporate communications and customer information systems.

AusNet further submitted that a recent Agenda Decision (April 2021) to the IFRS guidance has explicitly required that all implementation, customisation, and subscription costs for SaaS must be treated as opex.[95] AusNet had previously treated SaaS subscription costs as opex, but capitalised implementation and customisation costs. AusNet noted that because of the IFRS guidance it has subsequently reclassified an amount from capex to opex over the 2023–28 access arrangement period with a zero-net impact on its total expenditure (while

93 AusNet, *Access arrangement information 2024-28,* July 2022, p. 134.
94 AusNet, *Access arrangement information 2024-28,* July 2022, p. 134.
95 AusNet, *Access arrangement information 2024-28,* July 2022, p. 135.

forecast opex increased, capex decreased), which includes all SaaS expenditure in the 2021 base year being expensed.

We approved an IT cloud step change in AusNet transmission's 2022–27 final decision determination[96] for corporate enablement, information management, corporate communications, and workforce collaboration as we considered the step change met the requirements for a capex/opex trade-off and the costs were prudent and efficient. AusNet's proposal includes the same ICT programs as its transmission business proposal, with the addition of a customer information systems program. We consider the customer information systems program to also meet the requirements of a capex/opex trade-off with the costs not being material.

We also consider that this movement to IT cloud and SaaS based IT solutions is an industry trend being adopted by prudent and efficient gas and electricity businesses regulated by us, and the trade-off between capital and operating expenditure produce a better outcome for customers and costs. Further, our internal technical review of the proposed costs has concluded they are likely to be prudent and efficient and combined with the cited accounting standard changes we have included a step change of $31.2 million ($2022–23) in our alternative estimate.

6.4.3.2 Environment Protection Act 2018 obligations

AusNet proposed a step change of $1.5 million ($2022–23) over the 2023–28 access arrangement period to comply with its new obligations under the *Environment Protection Amendment Act 2018 (Amending Act 2018*), which came into effect on 1 July 2021.[97] The changes under the *Amending Act 2018* include specific elements in assessing and managing the inherent residual risks to human health and/or the environment if AusNet has reasonable grounds for believing there may be contamination. While we are satisfied that the *2018 Amending Act* represents a change to regulatory obligations, we have not included the EPA step change in our alternative estimate for the reasons detailed below.

Table 6.11 AusNet's EPA step change ($million, 2022–23)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
AusNet's proposal	0	0.4	0.4	0.4	0.3	1.5
AER draft decision	–	–	–	–	–	–
Difference	**0**	**–0.4**	**–0.4**	**–0.4**	**–0.3**	**–1.5**

Source: AusNet, *Access arrangement 2024–28 – Addendum - Opex model*, September 2022; AER analysis.
Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '–0.0' represent small non-zero amounts and '–' represents zero.

Under the *Amending Act 2018*, AusNet noted it is exposed to an additional class of potential costs that it has not previously been exposed to. The approach required under the *Amending Act 2018* represents a departure from the prior regime, which focussed on how to respond to an imminent threat to human health or the environment, or to manage pollution once it has

96 AER, Final decision – *AusNet Services transmission 2022-27 – Attachment 6 – Operating expenditure*, 28 January 2022. p. 23.

97 AusNet, *Access arrangement information 2024–28 – Addendum - Opex model*, September 2022.

occurred. The step change amount is based on several factors including undertaking soil and groundwater testing at selected sites.[98]

We considered in our final decision for AusNet's electricity transmission 2022–27 determination that step changes should not double count the cost of an increasing regulatory burden over time, which forecast productivity growth may already account for.[99] The productivity growth that networks have achieved, and which we use to forecast productivity growth, is what has been achieved historically while the networks have complied with new regulatory obligations. Therefore, we consider step changes are not required for the historic 'average' change in costs with new regulatory obligations. We also state in the *Expenditure forecast assessment guideline* that only exceptional events are likely to require explicit compensation as step changes.[100]

Further, we note that a business only has incentives to propose a step change for those components of opex it expects will increase. It does not have incentives to identify step changes for components of opex it expects will decrease. These asymmetric incentives potentially introduce an upward bias into the total opex forecast proposed by businesses.

We have not included the $1.5 million step change, which represents 0.5% of total opex in our alternative estimate of total forecast opex, consistent with our assessment of relatively small step changes in AusNet's 2022–27 transmission final decision.

6.4.4 Category specific forecasts

AusNet's proposal included three expenditure items, or category specific forecasts, which were not forecast using the base-step-trend approach. These were for debt raising costs, UAFG and the PSP. We have included category specific forecasts for debt raising costs, UAFG and the PSP in our alternative estimate of total opex.

6.4.4.1 Debt raising costs

We have included debt raising costs of $4.8 million ($2022–23) in our alternative estimate. This is $0.4 million ($2022–23) higher than the $4.4 million ($2022–23) proposed by AusNet.[101]

Debt raising costs are transaction costs incurred each time a business raises or refinances debt. Our preferred approach is to forecast debt raising costs using a benchmarking approach rather than a service provider's actual costs in a single year. This provides consistency with the forecast of the cost of debt in the rate of return building block.

We used our standard approach to forecast debt raising costs, which is discussed further in Attachment 3 to the draft decision.

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98 AusNet, *Access arrangement information 2024-28,* July 2022, p. 136.

99 AER, *Final decision – AusNet Services transmission 2022-27 – Attachment 6 – Operating expenditure*, 28 January 2022. p. 21.

100 AER, *Expenditure forecast assessment guideline for electricity distribution*, August 2022, p. 26.

101 AusNet, *Access arrangement information 2024-28 - Addendum,* September 2022, p. 37.

6.4.4.2 Unaccounted for gas

Consistent with AusNet's proposal and our past decisions, in our alternative estimate we propose to include a category specific forecast of zero dollars for any UAFG penalties or rewards AusNet receives. Consistent with this we also propose to exclude UAFG costs from actual opex in the ECM model.

UAFG refers to the difference between the quantity of gas delivered into and out of the distribution system. UAFG may be attributable to gas leakage or inaccurate gas measurement. The Essential Services Commission of Victoria sets a UAFG 'benchmark' within which AusNet is expected to operate. To provide an incentive for AusNet to minimise gas losses, it incurs a penalty if UAFG exceeds the benchmark and receives a reward if it falls under the benchmark. To preserve this incentive, the business itself should incur the penalty or keep the reward, not consumers. As a result, we include a zero forecast for UAFG in our alternative estimate.

6.4.4.3 Priority Service Program

AusNet proposed $4.5 million ($2022–23) additional funding for a PSP to support customers experiencing vulnerability. The program includes:

- dedicated staff to design, manage and deliver the program
- development of a 'priority services register'
- household meter reading
- improved communications for culturally and linguistically diverse customers
- gas safety checks, emergency repairs and outage support.

AusNet also proposed to fund staff training, translation services and energy efficiency advice through base opex.[102]

For the purpose of the draft decision we have included the PSP costs as proposed, but with a small adjustment to include the correct inflation for $2022-23, resulting in alternative estimate of this category specific forecast of $4.4 million ($2022–23). However, we encourage AusNet in preparing its revised proposal to continue to work with customers and relevant stakeholders to potentially refine and revise the scope of the program, test customer support and demonstrate an efficient use of resources.

The PSP was proposed as a category specific forecast, consistent with the final decision for the vulnerable customer assistance program (VCAP) in AGN (SA)'s 2021–26 access arrangement. In AGN (SA)'s final decision we advised that customer supported initiatives, such as the VCAP, should be classified as a category specific forecast instead of a step change as this ensures the funding is spent as intended, requires businesses to report expenditure and allows AER to remove this spend from the ECM.[103] It is also consistent with

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[102] AusNet, *2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, pp.3-4, 27-32,38-39; AusNet, *Access arrangement Information - 2024-28*, p.119. Note that the cost in the final plan is higher than in the business case as it is adjusted for $2022-23.

[103] AER Final Decision, *Australian Gas Networks (SA) Access Arrangement, 2021-26, Attachment 6, Operating expenditure*, April 2021, p.23

the Better Resets Handbook, which states that category specific forecasts should be limited to cost categories that have been included as category specific costs in previous AER decisions.[104]

AusNet proposed this additional expenditure on the basis of:[105]

- customer support, with in-workshop polls indicating that 81% of customers support the development of a PSP
- likely prevalence of customers experiencing vulnerability in AusNet's network
- recognition that inclusive and response services can minimise inadvertent exacerbation of harm.

Other stakeholders appreciated the initiative but did not support additional funding for the PSP.[106] TRAC Partners, on behalf of Brotherhood of St Laurence, also raised concerns about the efficiency of network-specific programs given both AGN and MGN proposed the same program.[107] The Joint VCO submission raised concerns about the use of a register becoming a barrier for participation.[108] We note that AusNet considered the advantages and disadvantages of a register and the burden of proof required for participation in its business case, and intends to minimise this burden.[109] However, in light of stakeholder concerns we encourage AusNet to work with stakeholders further to minimise risks and potential barriers associated with requiring registration. These considerations may also benefit from experience and learnings in other sectors, such as financial services.

In addition, CCP28, while considering AusNet's engagement to be genuine, raised concerns about the consultation's limitations in assessment of customer support, including participant attrition, use of live polls and apparent absence of discussion about who should pay.[110]

We have reviewed the materials provided by AusNet to support its PSP, including information provided in response to additional requests. For the purpose of the draft decision have included the PSP costs as proposed in our alternative estimate. This is an on-balance decision and reflects that, while this proposed step up in costs is not driven by a new obligation or capex/opex trade off:

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104 AER, *Better Resets Handbook – Towards Consumer Centric Network Proposals*, December 2021, p.29

105 AusNet*, 2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, pp. 3-6.

106 Submissions from: EUAA, *2023–28 Access arrangement proposal submission*, September 2022, p.9: Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission*, September 2022, p. 26*;* Victorian community organisations, *2023–28 Access arrangement proposal submission*, September 2022, pp. 2–3; Energy Australia submission, *2023–28 Access arrangement proposal submission,* September 2022, p.3; Red Energy and Lumo Energy, *2023–28 Access arrangement proposal submission*, October 2022, p. 3-4.

107 TRAC Partners prepared on behalf of Brotherhood of St Laurence, *2023–28 Access arrangement proposal submission,* p. 64.

108 Victorian community organisations, *2023–28 Access arrangement proposal submission*, September 2022, p.2.

109 AusNet*, 2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program, Business Case*, April 2022, pp.23-24.

110 Consumer Challenge Panel (CCP28), *2023–28 Access arrangement proposal submission*, September 2022 pp.5, 17-20

- the PSP is similar to the VCAP program approved for AGN (SA), and that we consider that the activities proposed result in a material increase in services, including:[111]
  - a dedicated customer service lead and manager to deliver the program and improve the customer experience for customers experiencing vulnerability
  - a priority services register resulting in a more responsive customer environment
  - gas safety appliance checks, outage support and emergency appliance repairs improving the safety and reliability of our vulnerable customers gas appliances and gas use
- we recognise the genuine effort and processes undertaken to engage with customers in relation to the PSP to test their support or otherwise for it, noting
  - that the modest number of diverse, but not representative customers directly consulted were of the view that it was important or very important to support vulnerable customers in the context of a $1.30 annual cost per customer
  - the effort to engage relevant stakeholders via the PSP Advisory Panel, which, while not supportive of additional costs, appreciated the initiative.
- AusNet's efforts to research and minimise duplication of services, align with other networks for consistency and consult with relevant stakeholders to develop the program, and commitment to ongoing consultation with these groups, as well as government agencies and other parts of the energy supply chain[112]
- in the *Towards Energy Equity Strategy*,[113] we recognised the need to deliver better outcomes for customers experiencing vulnerability and avoid exacerbating harm, which is a core objective of this program.[114]

We consider the total expenditure proposed by AusNet for the PSP to be reasonable noting it is slightly lower than proposed by AGN and MGN. However, we do have concerns about the proposed administrative costs, particularly communications and IT/web development, for the program and encourage AusNet to assess whether the services could be met more efficiently within this total. At present, over 60% of program will fund administrative and communication costs, including staff and register development and maintenance, leaving less than 40% for direct support of customers via emergency and outage support and safety checks[115] which we consider offers more value to customers experiencing vulnerability.

In addition, while recognising the genuine effort by AusNet to engage and consult, as raised by some stakeholders we acknowledge that the customer and stakeholder consultation and assessment of support could have been improved. This includes more clearly establishing and explaining the degree of need for these programs, and for them to be customer funded,

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111 AER, *Final Decision*, *Australian Gas Networks (SA) Access Arrangement, 2021-26, Attachment 6, Operating expenditure*, April 2021, p.24; AusNet*, 2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, pp. 3-6.

112 AusNet, *2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, pp.11-14, 20-23.

113 AER, *Towards energy equity – a strategy for an inclusive energy market*, October 2022 p.2.

114 AusNet, *2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, p.6.

115 AusNet, *2024-28 Access arrangement proposal – Attachment 12 – Priority Service Program - Business Case*, April 2022, p.31.

and more widely and robustly testing customer and stakeholder willingness to pay for additional programs and addressing and / or reconciling any differences of view in terms of willingness to pay. We also encourage further consideration of the sample size and representation / mix of customers consulted.

In this regard, we encourage AusNet in preparing its revised proposal to continue to work with customers and relevant stakeholders to potentially refine and revise the scope of the program, test customer support and demonstrate an efficient use of resources, as reasonable for the scale of the program. This could include reviewing and refining the services proposed in consideration of stakeholder feedback, particularly concerns around issues with the register being a barrier to participation (as noted above). We also encourage AusNet to consider how costs are best funded, further explore whether there are efficiencies that can be achieved via collaboration, or review, and address other specific stakeholder comments on the program, particularly where there are differing views between customers and stakeholders. As noted by CCP28, this is particularly pertinent given economic and policy changes that have occurred since the customer workshops ended in March 2022, including increased energy prices, high inflation and the release of the Victorian Government's *Gas Substitution Roadmap*.

We also note that category specific funding ensures the program will be reviewed and/or discontinued should customer's needs or preferences change in the future. This includes if the program fails to meet expectations or is replaced by other programs. In this regard there may also be more efficient alternatives in the future, noting the AER is exploring the potential for centralised assistance for customers experiencing vulnerability through its *Towards Energy Equity* strategy.[116]

6.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 6.12.

Table 6.12 AusNet's opex revisions

Revision	Amendment
Revision 6.1	Make all necessary amendments to reflect our draft decision on the proposed opex allowances for the 2023–28 access arrangement period, as set out in section 6.1.

[116] AER, *Towards Energy Equity – a strategy for an inclusive energy market*, October 2022 p.41.

Glossary

Term	Definition
ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
AESCSF	Australian Energy Sector Cyber Security Framework
AGN (SA)	Australian Gas Networks (South Australia)
AusNet	AusNet Gas Services
CAM	Cost allocation methodology
Capex	Capital expenditure
CCP28	Consumer Challenge Panel 28
CPI	Cost price index
ECM	Efficiency carryover mechanism
MIL-3	Maturity Indicator Level 3
MGN	Multinet Gas Networks
NER	National Energy Rules
NGO	National Gas Rules
Opex	Operating expenditure
PSP	Priority service program
RBA	Reserve Bank of Australia
RMP	Risk management program
SP3	Security Profile 3
UAFG	Unaccounted for gas
VCAP	Vulnerable customer assistance program
WPI	Wage price index