



**DRAFT DECISION**  
**Multinet Gas**  
**Access arrangement**  
**2018 to 2022**

**Attachment 14 – Other**  
**incentive schemes**

July 2017

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## Note

This attachment forms part of the AER's draft decision on the access arrangement for Multinet Gas for 2018-22. 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 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

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## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
DRP	debt risk premium
ECM	(Opex) Efficiency Carryover Mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	Value of Imputation Credits
MRP	market risk premium
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
NPV	net present value
opex	operating expenditure
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STTM	Short Term Trading Market
TAB	Tax asset base
UAFG	Unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

# 14 Other incentive schemes

## 14.1 Draft decision

Multinet proposed to promote innovation through a new Gas Network Innovation Competition (Gas NIC) to apply for the 2018-22 access arrangement period.<sup>1</sup> In this attachment we set out our reasoning and draft decision on this proposed scheme.

Our draft decision does not accept the introduction of a Gas NIC. We consider that the current framework provides sufficient opportunity to invest in innovation while allowing Multinet to retain any efficiency benefits.

## 14.2 AER Assessment approach

A full access arrangement may include (or we may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.<sup>2</sup> Incentive mechanisms may provide for carrying over increments for efficiency gains, or decrements for efficiency losses, from one access arrangement period into the next.<sup>3</sup> An incentive mechanism must be consistent with the revenue and pricing principles.<sup>4</sup>

We consider the following revenue and pricing principle is most relevant for assessing Multinet's proposed incentives:

A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides.

The economic efficiency that should be promoted includes—

- (a) efficient investment in, or in connection with, a pipeline with which the service provider provides reference services; and
- (b) the efficient provision of pipeline services; and
- (c) the efficient use of the pipeline.<sup>5</sup>

Under the NGR we have full discretion in our decision as to whether to approve the introduction of an incentive scheme.

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<sup>1</sup> Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 136.

<sup>2</sup> NGR, r.98(1)

<sup>3</sup> NGR, r.98(2)

<sup>4</sup> NGR, r.98(3)

<sup>5</sup> NGL, s. 24(3)

## 14.3 Multinet's proposal

In its proposal Multinet stated:

that there is a gap in the regulatory framework because it does not currently provide any funding for, or explicit incentives for gas distributors to pursue, network innovation.<sup>6</sup>

Multinet also stated that network innovation is important in the 2018–22 access arrangement period because gas is a fuel of choice, the operating environment is continuously changing and Multinet needs to continually improve and provide cost efficient and customer focused services.<sup>7</sup>

Multinet proposed a Gas NIC that would be specifically designed to encourage gas distributors to pursue entrepreneurship with a view to reducing costs or improving performance outcomes, in relation to safety, reliability and/or customer service.

Multinet's proposal is based on Ofgem's gas network innovation competition in Great Britain, where companies compete for a pool of funding in order to develop and demonstrate new technologies.<sup>8</sup>

Multinet did not provide a detailed design of how the Gas NIC would operate in Australia. However, Multinet indicated that the detailed design could be formulated through an engagement process.<sup>9</sup>

## 14.4 Reasons for draft decision

We understand that, in general, regulated monopolistic businesses face a reduced incentive to innovate when compared to competitive businesses. For a regulated network business, any savings resulting from innovation in one period may lead to a lower revenue allowance in the next period. Therefore, businesses may avoid investments that could have a significant social benefit but would ultimately result in decreased revenue allowance in the subsequent period.

While we acknowledge this reduced incentive to innovate, we do not consider that the Gas NIC will encourage efficiency in the provision of services by Multinet in the long term interests of consumers for the following reasons:

- Consumers bear the cost of investment and therefore take 100 per cent of the risk that the innovation project will fail.
- It is not clear how the benefits of the innovation projects will be shared between Multinet and its customers.

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<sup>6</sup> Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 135.

<sup>7</sup> Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 135-136.

<sup>8</sup> Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 136.

<sup>9</sup> Multinet Gas, *2018 to 2022 Access Arrangement Information*, December 2016, p. 136.

- The proposed Gas NIC is not targeted at a specific social problem (such as emissions reduction as the scheme is in Great Britain).<sup>10</sup>

There are also significant disadvantages and costs with implementing the proposed Gas NIC including:

- transaction and enforcement costs associated with the introduction and implementation of an innovation scheme.
- higher prices for consumers in the short-run, with no guaranteed efficiency gains in the long-term.

Stakeholders were generally supportive of encouraging innovation in light of the potential for rapid changes in the energy sector.<sup>11</sup> However, the Consumer Challenge Panel (CCP11) was concerned as to whether an innovation scheme is necessary in addition to an opex efficiency carryover mechanism.<sup>12</sup> We agree that these schemes are compounding and should be considered together.

On balance, we do not believe that a Gas NIC will encourage efficiency in the provision of services by Multinet in the long term interests of consumers. We consider the current framework provides sufficient opportunity to invest in innovation while allowing businesses to retain any efficiency benefits.

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<sup>10</sup> See: <https://www.ofgem.gov.uk/gas/distribution-networks/network-innovation>

<sup>11</sup> Jemena Gas Networks, *Submission on 2018-22 Victorian gas distribution access arrangement proposals*, 2 March 2017, p. 1; Energy Network Australia, *Submission on Australian Gas Networks (Vic and Albury) Access Arrangement Proposal 2018-22*, pp 1-2; Origin Energy, *Submission to the Victorian gas access arrangement review 2018-22, Response to gas distribution businesses' proposals*, 10 March 2017, p. 5; and ATCO Gas Australia, *Submission to Victorian Gas Networks AGN and AusNet Services Access Arrangement 2018-22*, 3 March 2017, p.3.

<sup>12</sup> Consumer Challenge Panel (CCP11), *Response to proposals from AGN, AusNet and Multinet for the 2018-22 Access Arrangements*, 3 March 2017, p. 11.