

 Position paper:

Application to consolidate
Access Arrangements for Australian Gas Networks' Victorian and Albury Networks

February 2016

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1. Shortened forms

| 1. Shortened form
 | 1. Extended form
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| --- | --- |
| 1. AER
 | 1. Australian Energy Regulator
 |
| 1. AGN
 | 1. Australian Gas Networks Limited
 |
| 1. NGL
 | 1. National Gas Law
 |
| 1. NGO
 | 1. National Gas Objective
 |
| 1. NGR
 | 1. National Gas Rules
 |
| 1. PTRM
 | 1. post-tax revenue model
 |
| 1. RFM
 | 1. roll forward model
 |
| 1. RIN
 | 1. regulatory information notice
 |

# Introduction

The Australian Energy Regulator (AER) is responsible for the economic regulation of covered gas pipelines[[1]](#footnote-1) in all states and territories in Australia except for Western Australia.

1. Australian Gas Networks’ (AGN) owns and operates gas distribution networks in Victoria and Albury. The National Gas Law (NGL) and National Gas Rules (NGR) provide the regulatory framework governing gas networks. As with other covered pipelines, we regulate AGN's reference tariffs for these networks—and through these its revenue—under approved access arrangements for each network.

Our last review of the access arrangements for AGN’s Victorian and Albury gas distribution access arrangements was in 2012–13, for the period 1 January 2013 to 31 December 2017. These access arrangements are scheduled for review in 2017.

Under the NGR we may—on our own initiative or on application by a service provider—issue a direction that a single access arrangement be submitted for multiple networks. AGN has applied for a direction from us under rule 53 of the NGR to consolidate the access arrangements for its Victorian and Albury gas distribution networks as part of that review. This would mean that on 1 January 2017 AGN would submit a single access arrangement covering both networks, in place of the two separate arrangements that have applied to date. AGN's application is available on our website.

Our preliminary view is that this is a sensible proposal. Combining the access arrangements for AGN's Victorian and Albury networks is primarily an administrative step. It will streamline the process for our 2017 review, but will not change the framework for that review. Nor will it change the ownership or operation of either network. Consolidation of the access arrangements will not impact the services provided to customers and we consider it is unlikely to impact the prices they pay.

Consolidation will mean that customers will no longer see—or have the opportunity to comment on—revenue proposals that are specific to the Albury or Victorian networks. If the two access arrangements are consolidated AGN will submit, and we will assess, a single revenue proposal that combines its costs of operating both networks. Going forward, prices will be set by reference to the combined revenue requirement. We therefore consider consolidation should be subject to appropriate conditions to ensure the benefits of consolidation for the review process do not have unintended or undesirable impacts on AGN’s customers.

Before a direction is given, we must consult on the proposed terms of the direction with AGN and other stakeholders. This position paper sets out our preliminary view, and seeks feedback from AGN and other stakeholders on whether and on what terms (conditions) consolidation of the access arrangements for the Albury and Victorian networks should proceed.

AGN and other stakeholders are invited to make submissions on the preliminary position set out in this paper, including our proposed conditions, by 4 March 2016. Our final decision will be made with regard to all submissions received by that date.

## How to make submissions

Interested parties are invited to make submissions on AGN's application and this position paper. Submissions will close on 4 March 2016.

We prefer that all submissions are in Microsoft Word or another text readable document format. Submissions on the draft decision and revised proposal should be sent to: AERinquiry@aer.gov.au.

Alternatively, submissions can be sent to:

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

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

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (June 2014), which is available on our website.

# Background

AGN’s Victorian and Albury gas distribution networks currently have separate access arrangements, approved by us in 2013 for the period 1 January 2013 to 31 December 2017. These access arrangements are scheduled for review in 2017.

Figure 1 below shows the Albury network and the four zones making up the Victorian network (Murray Valley, Northern, Central and Bairnsdale).

Figure 1 AGN's Victoria and Albury network zones



Source: AGN, Application to Consolidate the Access Arrangements for the Victorian and Albury Gas Distribution Networks, November 2015, p. 4.

The two networks are interconnected. While it extends into New South Wales, for regulatory purposes the Albury network is effectively treated as a Victorian network. In particular, the same (Victorian) market rules apply to both networks.

AGN owns and operates both networks, and currently offers the same set of reference services and the same tariff structures on each. While reference tariffs vary between the Albury and Victorian network (as they do between the four tariff zones that currently make up the Victorian network), these services are offered under much the same terms and conditions.

AGN has applied for a direction from us under rule 53 of the NGR to consolidate the access arrangements for its Victorian and Albury gas distribution networks, so that it will have a single access arrangement that covers both.

AGN's application, which is available on our website, sets out AGN’s case for consolidation of the access arrangements. It also addresses matters the NGR require us to have regard to in deciding whether to give a direction. These include the nature of the pipelines, and the nature of the pipeline services provided by means of those pipelines. AGN has conducted its own stakeholder consultation in preparing its application, and has submitted that the feedback it has received to date has been supportive.

# Consolidation of access arrangements under the NGR

Rule 53 of the NGR makes provision for the consolidation (or division) of access arrangements. Relevantly, rule 53 provides that:

If pipeline services provided, or to be provided, by a service provider are (or are to be) provided by means of 2 or more covered pipelines, the AER may, by notice to the service provider, direct the service provider to submit a consolidated access arrangement proposal for all the relevant covered pipelines.

Example: The AER might direct the submission of a consolidated access arrangement proposal for 2 or more covered transmission pipelines, 2 or more covered distribution pipelines or a combination of covered transmission and covered distribution pipelines.

The AER may give a direction under this rule either on its own initiative or on application by the service provider.

In deciding whether to give a direction under this rule, the AER must have regard to:

* the nature of the pipeline or pipelines; and
* the nature of the pipeline services provided or to be provided by means of the pipeline or pipelines; and
* any other matter the AER considers relevant.

Before the AER gives the direction, it must consult on the proposed terms of the direction with the service provider and any other persons with whom it considers consultation appropriate.

A direction under this rule may be subject to such conditions as the AER thinks fit and includes in the direction.

A service provider must comply with a direction under rule 53, including any conditions.[[2]](#footnote-2)

This is not a new rule. However, AGN's is the first application under rule 53 that we have considered.

# Benefits of consolidation

The main benefits of consolidation are in streamlining the upcoming review of AGN’s access arrangements. Outside this review, the benefits (and disadvantages) to AGN’s customers and other stakeholders are likely to be small. This view is contingent, however, on how the consolidation of the access arrangements is executed. We therefore recommend that a direction to consolidate the access arrangements be conditional. This is discussed in section 6 below.

We consider the proposed consolidation of the two access arrangements has the following key benefits to the review relative to the current arrangements:

* Reduced administrative burden for the AER and AGN in the reset process: We would serve one regulatory information notice (RIN) setting out the information to be included in AGN's proposal instead of two, AGN would submit one proposal instead of two, and we would consult on and make one decision instead of two.
* Greater regulatory certainty: consolidation removes the risk that the two access arrangements will diverge unnecessarily over time. While this kind of divergence is unlikely, consolidation supports our longer term objective of aligning access arrangements across service providers and jurisdictions, to provide greater consistency in service levels and terms and conditions of access to covered pipelines.
* Reduced administrative burden in regulatory reporting: Going forward, we would issue one annual reporting RIN instead of two, and AGN would submit a single report.

We consider that, if carefully implemented, consolidation of the access arrangements is likely to have little or no impact (in terms of benefits or disadvantages) on AGN’s customers relative to the current arrangements:

* Some reduction in AGN's operating costs should be expected given the simplified review and reporting processes. However, the impact on network charges is likely to be minimal. AGN’s application suggests only limited cost savings of $0.2 million to $2.0 million, and submits that the lower end of this range is more likely. AGN does not suggest that consolidation of the access arrangements will have any impact on its costs of operating the networks more generally.
* Consolidation will not change AGN’s regulatory obligations to customers. Both networks are, and will continue to be, subject to the NGL, NGR and Victorian market rules.
* While AGN may propose changes to any part of its access arrangement(s) as part of its next access arrangement review, consolidation itself will not require changes to:
* the operation of the network;
* the nature of any services provided;
* the terms and conditions governing access to the networks;
* tariff structures and the tariff setting process.
* Under AGN’s proposed approach what is now the Albury network will remain a separate tariff zone after the access arrangements are consolidated. This means that cost allocation for the new Albury zone will be managed in the same way as for the four network zones now covered by the current Victorian access arrangement. However, there will be some loss of transparency in the review process. Stakeholders will no longer be able to review or comment on separate access arrangement and revenue/building block proposals for the Albury and Victorian networks. Instead, AGN will submit, and we will assess and approve, a single revenue proposal covering the combined costs of both networks. Any change in prices for both Albury and Victorian customers will be based on this combined revenue.
* Stakeholders will otherwise have the same opportunities to engage with AGN and with us on AGN's next proposal and our decision. The two access arrangements have always been assessed concurrently, but those who would otherwise have engaged on (and therefore had to review) both proposals will have a simpler task. In its application, AGN has confirmed its commitment to holding a consumer engagement workshop in Albury regardless of our decision on consolidation.

# How would this work?

If the two access arrangements were combined, what is now the Albury network would become a fifth zone under the Victorian access arrangement for regulatory purposes. Consolidation will not affect the operation of either network. Both are already owned and operated by AGN under the NGL and NGR, and Victorian market rules.

The move to consolidate is primarily about the access arrangement revision (or 'reset') process, and to a lesser extent AGN's annual reporting requirements.

Consolidation would change the nature, but not the substance, of AGN’s next access arrangement revision proposal and the access arrangement that will apply from 1 January 2018. Instead of submitting separate access arrangement revision proposals for its Albury and Victorian networks on 1 January 2017, we would direct AGN to submit a single access arrangement covering both networks. Stakeholders would then be given the same opportunity to engage in our review of the combined access arrangement as they would otherwise have had to engage on two separate proposals.

The changes as we see them are reflected in Table 1 below. The initial transition from two access arrangements to one will require transparency to ensure continuity between access arrangement periods is not lost. We discuss potential conditions that would support a transparent transition in section 6 below.

Table 1 – Changes required to transition to a consolidated access arrangement.

|  | Separate access arrangements | Consolidated access arrangement |
| --- | --- | --- |
| Reference services | Two identical reference services | Single reference service. |
| Non-tariff terms and conditions of access | Two sets of terms and conditions that are essentially (but not exactly) the same. | Single set of terms and conditions. |
| Tariff structure and tariff variation mechanism | Two identical tariff structures and tariff variation mechanisms | Single tariff structure and tariff variation mechanism, with Albury as a fifth pricing zone. |
| Forecast revenue requirement | Revenue requirements forecast separately for each access arrangement (including two post tax revenue models (PTRMs)) | Total forecast revenue requirement covering both Albury and Victoria, in a single PTRM. |
| Capital base | Separate capital base (and roll forward model (RFM)) for each access arrangement | Two separate capital bases (and RFMs), with opening and closing capital bases then aggregated into a combined capital base value to calculate the total forecast revenue requirement.  |
| Forecast capital expenditure (capex) | Separate forecasts of capex for Albury and Victoria. | One total capex forecast covering expenditure on both Albury and Victoria, but no change to underlying capex categories. |
| Rate of return, gamma | Set for each access arrangement (but in our last decision the same rate of return and gamma applied in both). | Single rate of return and gamma value for Albury and Victoria. |
| Forecast operating expenditure (opex) | Separate forecasts of opex for Albury and Victoria. | One total opex forecast covering expenditure on both Albury and Victoria, including a combined base year. |
| Depreciation | Separate allowances for each access arrangement. | Total allowance for both Albury and Victoria, with no change to underlying asset classes. |
| Tax | Separate allowances for each access arrangement. | Total allowance for both Albury and Victoria. |
| Opex efficiency carryover mechanism | Carryover amounts determined separately for each access arrangement by reference to separate opex forecasts. | Carryover amounts from the current period combined (summed) in total forecast revenue requirement for the period commencing 1 January 2018.Carryover amounts going forward to be calculated by reference to combined total opex forecast. |
| Annual reporting under the access arrangement | Two annual reporting RINs, with separate reports submitted for Albury and Victoria. | A combined annual reporting RIN, with a single report submitted for Albury and Victoria. (This may require some disaggregation of data for what will be the Albury network zone—see comments on capital base above.) |

# Options for conditional approval

A direction under rule 53 may be subject to such conditions as we think fit and include in the direction.

We consider a direction to consolidate the access arrangements for AGN's Albury and Victorian networks should be subject to three, complementary conditions. These conditions go to ensuring that the benefits of consolidation for the review process do not have unintended or undesirable impacts on AGN’s customers.

## Continuity between access arrangements

First, we want to ensure that continuity is not lost in the transition from two access arrangements to one. This is important to our assessment of AGN's proposal for the next access arrangement period, including for example:

* our assessment of past conforming capex for the current period (because forecasts of prudent and efficient capex for 2013–18 were determined separately for the Albury and Victorian networks)
* our assessment of carryover amounts under the opex efficiency carryover mechanism from the current period (because forecast opex for 2013–18 was determined separately for the Albury and Victorian networks)
* our analysis of AGN’s forecast capex and opex proposals for the forthcoming period, which will include consideration of expenditure in the current and previous periods
* our assessment of the opening capital base for the forthcoming access arrangement period.

We therefore propose that the direction require AGN to explain—in its combined, public proposal for the period commencing 1 January 2018—how it has given effect to the consolidation, and to do so in a way that can be verified by reference to our previous decision and annual reporting data from the current period.

## Separate data on Albury capital base

Second, we consider the direction should require AGN to continue to maintain separate data on the capital base for what will be the Albury network zone on an ongoing basis. This will allow for the possibility that the access arrangements need to be separated again in the future (for example, if pipeline coverage, or the current arrangements that allow the Albury network to operate under Victorian market rules, were to change). A separate capital base will also provide important additional information for stakeholders.

This condition would not impose a new requirement on AGN. All that would be required is that AGN continue to maintain its dedicated asset classes for the Albury network zone. Our preferred option is that AGN do this by maintaining a separate roll forward model (RFM) for the Albury network zone. Alternatively, it could create Albury-specific asset classes within a single RFM. Either way, the asset classes would need to stay the same for the Albury network zone and the Victorian network zone, and the same as those that have applied in the current period. AGN could not, for example, roll all its current asset classes for the Albury network zone into a single “Albury” asset class. This would be the case regardless of our decision on consolidation.

AGN has confirmed that maintenance of separate capital bases is possible, and in its application has confirmed that such a condition would be acceptable.

This condition could be ongoing, or subject to review after one (or more) access arrangement periods.

## Albury to remain a separate pricing zone

Third, we consider consolidation should be contingent on the Albury network remaining an Albury network zone. This is consistent with the approach to consolidation set out in AGN’s application. In combination with the first two conditions this will support transparency and—by ensuring that current relativities between the five tariff zones can be maintained—will mitigate the risk of inappropriate cross-subsidisation and loss of cost-reflectivity in tariffs for Albury customers.

Again, this condition could be ongoing, or subject to review after one (or more) access arrangement periods.

# Next steps

We invite AGN and other interested stakeholders to make written submissions on whether we should issue a direction to consolidate the access arrangements for AGN's Victorian and Albury networks, and if so on what conditions. Information on how to make a submission is provided in section 1.1 above. Submissions will close on 4 March 2016. We will have regard to all submissions made by that date in making our final decision, and will publish that decision on our website as soon as practicable.

If we do decide to issue a direction, AGN will have a further opportunity to engage on the implementation of any conditions in the reset RIN and annual reporting RIN processes, which will commence shortly after.

AGN's proposed access arrangement(s) will be due on or before 1 January 2017, regardless of the outcome of this process.

1. Pipeline ‘coverage’ under the NGL determines the level of regulation that applies to a particular pipeline or network. AGN’s South Australian distribution network is a covered pipeline. Under section 132 of the NGL, AGN must therefore submit for our approval an access arrangement in respect of the services it provides through the covered pipeline. [↑](#footnote-ref-1)
2. Rule 53(X) is a civil penalty provision. [↑](#footnote-ref-2)