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Mr Kris Funston
Executive General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: APAVTS2023@aer.gov.au

18 February 2022

Dear Mr Funston,

APA Victorian Transmission System 2023-27 Access Arrangement Proposal

AGL welcomes the opportunity to provide comments to the Australian Energy Regulator (AER) in relation to the APA's revenue proposal for the Victorian Transmission System (VTS) for the five year period from 1 January 2023.

AGL currently provides about 4 million energy services in Australia. AGL operates the largest private electricity generation portfolio in the National Electricity Market, comprising coal and gas-fired generation and renewable energy generation. AGL also has a gas supply and transportation portfolio for trading and to supply wholesale and consumer customers. Nationally, AGL has 1.5 million gas customers with about 600,000 customers in Victoria.

We have attended the stakeholder roundtables conducted by APA and the public forum held by the AER on 1 February 2022. We would like to provide some comments from the perspective of a gas wholesaler and retailer.

Stakeholder engagement

We commend APA on their engagement with stakeholders to develop their revenue proposal for the VTS. This program comprising of 12 meetings provided opportunities for APA to test the key components of their proposal and to consider the diverse views of stakeholders. We found this program to be highly informative on the key challenges in developing the revenue proposal in a future with major uncertain variables . We consider the revenue proposal to be generally in line with discussions with stakeholders.

Access Arrangement Proposal

The proposal sought to balance the implications of decarbonisation policies, changing sources of supply, energy transition and the need to provide a reliable service. We note that the proposal forecasts the system-wide tariff is expected to increase by 31% from 2022 to 2027 in nominal terms, an increase well in excess of CPI.

Our comments on aspects of the proposal are presented below.

- We support the expansion of the SWP to 570 TJ/day to allow for an additional 102 TJ/day in delivery from Lochard's Iona LNG facility. We believe that there is significant uncertainty arising from the changing sources of supply and this expansion will be an important contribution to the security of supply during the winter peak over the next regulatory period. The cost of this expansion is forecast to be minimal, adding 2.2c/GJ to tariffs while retailers face a market price cap (Value of Lost Load) of $800/GJ in the Victorian wholesale gas market if there is a shortfall.

- We appreciate the reasoning for the rule 80 proposal comprising of capital expenditure to facilitate three projects – LNG projects at Avalon and Geelong, and a further 100 TJ/day increase in Iona capacity to 670 TJ/day.

  However, we do not support this rule 80 application due to the need for further assessments on:

  - how the market will manage of physical and market constraints that accompany high pressure injections at those locations,
  - system requirements around combinations of these projects occurring, and
  - future gas supply and demand particularly if the Port Kembla Gas Terminal proceeds.

  We believe that it is necessary that a dedicated working group be established by AEMO to work through holistically how the market can resolve these issues and to align the pre-approval conditions to the proposed augmentations.

- A key feature of this VTS proposal is the significant overall increase in capital expenditure of about 20% from the current regulatory period to the next. This is driven primarily by higher replacement capex (+$45.4m) and other expenditure for security of critical infrastructure and hydrogen safety assessment (+49.5m). Capitalised overhead is estimated to add a further $22.5m to capex. We are unable to assess if these expenditures are prudent and efficient.

- APA has proposed the use of the WOOPS model for depreciation. We recommend that the AER consider if other approaches to depreciation are also valid.

- While we agree that hydrogen safety and integrity assessment is necessary, it is worth considering if this assessment and expense is required in the next regulatory period or whether it can be deferred to subsequent regulatory periods as further information on government policies and viability of using hydrogen becomes available. Alternatively, this assessment could be performed over two or more regulatory periods.

- Operating expenditure has been proposed using the base-step-trend approach with step changes for information technology and requirements for security of critical infrastructure. We note that in the 2021-26 Victorian electricity distribution price review, the AER considered efficiency and productivity adjustments. We expect the AER to consider if similar assessments are appropriate for this VTS proposal.

- We note that some shared operating costs are allocated to the VTS on a revenue basis. If the costs are material, we suggest that different allocation methods such as employee numbers or total direct costs, may be appropriate for different cost categories.

Tariff reform

The revenue proposal estimates that the VTS component accounts for about 2% of an average residential customer bill, and about 3% of an average small business customer.

To APA's credit, the issue of tariff reform was initially raised in early stakeholder roundtable. However, it was not developed further and has not been considered in this revenue proposal.

The pricing signal based on injection and withdrawal charges for a transmission pipeline is unclear. The VTS cost comprising 2% to 3% of a customer bill is not material relative to other costs. As a retailer, AGL averages the costs on a $/GJ basis for Tariff V customers. This $/GJ cost is then added to the cost stack when setting Victorian retail gas prices. The pricing approach using injection and withdrawal charges is too complex to replicate in retail gas prices.

We note that at the public forum, APA has stated its intention to review its tariff structures for the regulatory period following the next regulatory period. For Tariff V customers, in our view, it will be a relatively straight forward to simplify the VTS pricing structure to a $/GJ on a postage stamp basis. This is effectively what retailers are already doing.

If you have any questions in relation to this submission, please contact [redacted] Senior Manager Regulatory Strategy, on [redacted]

Yours sincerely,

[redacted]

Elizabeth Molyneux
General Manager Policy and Markets Regulation