Final Plan Attachment 5.8

Written Stakeholder Submissions on the Australian Gas Networks Draft Plan

August 2016

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16 August 2016

Via email

Craig de Laine (General Manager Regulation)
Australian Gas Networks
Level 6, 400 King William St
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Dear Craig

Australian Gas Networks draft plan – Jemena submission

Jemena Gas Networks (**JGN**) welcomes the opportunity to comment on the Australian Gas Networks' (**AGN**) draft plan. JGN is the owner and operator of the NSW Gas Network that delivers gas to over 1.2 million homes and businesses and therefore has many similarities to AGN's Victoria and Albury networks.

JGN undertook its price reset for its 2015-16 to 2019-20 access arrangement with an initial proposal to the Australian Energy Regulator (**AER**) in June 2014. We received our final decision from the AER on 3 June 2015. We make this submission to support positive regulatory development and processes, which is ultimately in customers' long-term interests. We also support AGN's messages on the characteristics of gas, which is a key differentiator between gas distributors and electricity distributors when the AER considers how it applies its regulatory discretion when making its decisions.

We have targeted our submission on five key areas:

- the characteristics of gas as a fuel of choice
- the importance of flexible depreciation
- customers would benefit from AGN proving price impacts by customer cohort
- opex output growth factor
- environmental benefits of gas.

Gas as a fuel of choice – implications for AGN's proposal

AGN note that gas is a fuel of choice in Victoria with declining average consumption driven in part by customers switching to electric appliances (for example, switching from gas heating to reverse cycle air conditioning). As such, JGN considers that is important that the AER give appropriate consideration to AGN's:

- marketing operating expenditure proposal—marketing can help AGN drive new customers to the network and retain existing customers, ultimately putting downward pressure on network prices

- cross price elasticity estimate—which seeks to reflect the impact on demand forecasts of customers moving to electric alternatives

- price cap form of regulation—which promotes an incentive to grow utilisation of the gas network, which is in customers' long-term interests because it also puts downward pressure on network prices.

Flexible depreciation

Customers' long-term interests are promoted when businesses are incentivised to invest efficiently when providing value for money services. In our view, efficient investment can only occur when a business has a reasonable chance of recovering its costs, financing its debts, and earning a fair return.

With the changing role of distribution networks, the regulatory rules need to be flexible enough to ensure that businesses continue to have this reasonable opportunity going forward. Flexible depreciation rules provide options to afford a business a reasonable chance of recovering their capital costs, by aligning cost recovery with expected asset utilisation. We therefore support a considered assessment of AGN's flexible depreciation proposal to ensure that the AER's decision promotes long-term efficient investment in gas infrastructure (both in Victoria, and elsewhere).

Price impacts by customer cohort

Similar to AGN, JGN has undertaken substantial stakeholder consultation, which informed our initial proposal to the AER in June 2014.

We found customers had strong interest in safety and reliability, but were also keen to understand what the plan meant for their bills. We note that AGN has provided a headline figure of an 11% cut in prices on 1 January 2018. We found that customers are aware that they are not homogenous and valued understanding price breakdowns by individual cohort (residential, commercial and industrial). We think there would be value in providing price impacts broken down by these cohorts as part of AGN's 1 January 2017 proposal.

Opex output growth factor

AGN has adopted an output growth factor based on net customer numbers. This differs to the approach adopted by JGN for its 2015-16 to 2019-20 access arrangement, and by the AER in its recent determination for ActewAGL Distribution, which both use forecast customer numbers and throughput to calculate an output growth factor.

JGN is aware of the recent analysis by ACIL Allen, and cited by AGN, which indicates that throughput is no longer a key driver of operating expenditure for gas distribution businesses.[1]

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[1] ACIL Allen, *productivity Study: ActewAGL Distribution Gas Network',* 29 April 2015

AGN has asked stakeholders whether any output growth factor that is developed for gas distribution should be subject to industry-wide consultation before it is introduced. While JGN would participate in an industry-wide consultation process on the estimation of output growth factors for gas distribution businesses, we note that the AER has limited discretion in relation to operating expenditure (NGR rule 91).

Environmental benefits of gas

While the AER does not need to explicitly consider the environmental benefits of gas when making its revenue determination, it is important to understand the operating context for the Australian gas industry. In short, there is continued pressure on the gas industry to promote the long-term benefits of gas as an environmentally-friendly fuel of choice. This in turn drives the industry to remain committed to innovation and cost-effectiveness to maintain and strengthen the gas “brand”, both with customers, but also policy-makers.

The environmental competitiveness of gas is likely to come under increasing focus given the COP21 summit in 2015 agreed to ambitious new international greenhouse gas emission reduction targets that will be reflected in Australia’s longer-term climate policy from 2017 and beyond. Given the strong ambition of the international commitments, policy-makers, in designing their long-term climate policies, will increasingly be contemplating how carbon neutral energy systems are potentially achieved in a few decades from now.

JGN notes AGN’s emphasis that natural gas remains a highly cost-effective and clean domestic fuel compared to electricity. JGN supports providing customers with clear messages on the benefits of gas in the Australian context. This enables them to make a balanced decision based on a range of factors that best suit their needs, which may include running costs, upfront costs, comfort, lifestyle and reducing greenhouse gas emissions.

It terms of its environmental benefits, JGN considers that gas makes sense to help meet Australia’s commitments at least cost. This is by natural gas:

- not just having low carbon emissions, but also from emitting fewer particulates than other fuels
- playing a strong role in meeting Australia’s 2030 emissions reduction target at least cost (independent analysis confirms that there are significant annual cost savings for most NSW families who use gas appliances of up to $250 per year)
- companies like JGN and AGN exploring new technologies to ensure our gas infrastructure continues to support a clean energy future over the longer term.

If you wish to discuss our submission, please contact Chris Stewart on 02 9867 7000 or at christopher.stewart@jemena.com.au.

Yours sincerely

Cameron Herbert
General Manager Regulation (Acting)
Jemena Limited

16 August 2016

Mr Craig de Laine
General Manager Regulation
Australian Gas Networks
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ADELAIDE SA 5000

Via Email: haveyoursay@agnl.com.au

ENA comments on AGN's Draft Plan – A five-year plan for Victorian and Albury natural gas distribution networks

Dear Mr de Laine,

The Energy Networks Association (ENA) welcomes the opportunity to provide its comments in relation to the Australian Gas Networks' (AGN) Draft Plan for its Victorian and Albury natural gas distribution networks.

The Draft Plan outlines AGN's pricing proposal for its natural gas distribution networks for the five-year period from 2018 onwards. AGN is required to submit its access arrangement proposal to the Australian Energy Regulator (AER) by 1 January 2017.

This Draft Plan represents a part of AGN's stakeholder engagement program. Its purpose is to ensure that stakeholders and customers have the opportunity to provide input into the development of AGN's access arrangement proposal. The Draft Plan was developed following previous consumer engagement activities, including public forums and meetings with AGN's Reference Groups.

The ENA strongly supports the enhanced customer engagement with networks. It is important that network firms and their customers engage deeply and that the priorities and preferences of consumers, and the long-term interests of consumers, are reflected in future regulatory proposals and determinations. The ENA has recently released the Customer Engagement Handbook that provides practical advice to energy network businesses on customer engagement approaches and methods.[1]

In its Draft Plan, AGN proposes an upfront reduction in distribution prices of 11 per cent (before inflation), with prices lower on average in real terms over the next access arrangement period when compared to the current period.[2] This price cut reflects forecast lower costs from 2018 relative to costs currently incurred. Despite forecast cuts in expenditure, AGN is planning to deliver improvements in safety performance and to maintain current levels of high reliability.

This is good news for Victoria's households and small businesses who rely on gas for cost-effective and convenient hot water heating, space heating and cooking.

The Draft Plan also proposes a suite of tools to improve and strengthen the incentives for the business to pursue prudent and efficient expenditure and provide incentives to make ongoing improvements in customer service.[3] The proposed incentive arrangements are informed by the incentive arrangements that currently apply to electricity distribution businesses in the National Electricity Market. Given that the existing incentive arrangements for gas businesses lack both a service incentive mechanism and a Capital Expenditure Sharing Scheme (CESS) that currently apply in electricity; the ENA considers that there is a clear opportunity to promote the long-term interests of gas customers by improving the existing incentive arrangements in gas. The AER

[1] http://www.ena.asn.au/customer-engagement-handbook
[2] AGN, Draft Plan for its Victorian and Albury natural gas distribution networks, July 2016, p.5.
[3] AGN, Draft Plan for its Victorian and Albury natural gas distribution networks, July 2016, p.15.

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undertook significant industry consultation through its Better Regulation program in 2013 and it would seem appropriate to adopt common approaches for gas and electricity.

As such, the ENA is a strong supporter of incentive-based mechanisms which promote continuous, effective and stable financial incentives for efficient expenditure. The ENA welcomes AGN's commitment to work constructively with the AER in relation to the specific design of any incentive schemes that are to apply over the next access arrangement period.

AGN's Draft Plan also raises an important issue of financeability. The ENA agrees with AGN that it is appropriate under National Gas Rules for the AER to consider whether the revenues available to businesses are sufficient to maintain financeability and to meet the credit ratios required of the ratings agencies at the benchmark credit rating.

AGN notes that its plan provides sufficient cash flow to maintain the credit rating assumed in setting the cost of debt. This outcome is in part aided by the accelerated depreciation of the remaining low pressure mains that are included in the capital base, but are expected to be replaced by the end of the next access arrangement period. Leaving the issue of financeability aside, the ENA considers that such an adjustment is consistent with clause 89 of the *National Gas Rules*. The AGN-proposed approach is also consistent with a number of recent decisions made by the AER.

The most recent example of this is the AER's draft decision for AusNet Services transmission determination for 2017-22 regulatory period[4], where the AER allowed to adjust depreciation on assets expected to be removed from service. In particular, the AER stated:

> *We accept AusNet Services' proposal to accelerate depreciation on assets expected to be removed from service over the 2017–22 regulatory control period by fully depreciating the remaining value over 5 years. We consider this approach is consistent with the nature of these assets no longer being used and provides for a depreciation schedule of their residual values that aligns with the reduced economic life.*

The ENA acknowledges the proactive approach to customer engagement taken by AGN leading into providing its final plan to the AER. The ENA notes recent comments made by AER Board member Ms Cristina Cifuentes at the ENA 2016 Regulation Seminar where she recognised the AGN's stakeholder engagement program as a positive initiative. Ms Cifuentes encouraged initiatives by network businesses that have the potential to deliver more preferable outcomes that reflect input from consumers from the earliest stage and lead to smoother regulatory processes.[5]

If further information is sought on this matter, please contact Garth Crawford, Executive Director, Economic Regulation, on 02 6272 1555.

Yours sincerely,

John Bradley
Chief Executive Officer

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[4] The requirement is in both the gas and electricity rules to depreciate assets over their economic lives, and to adjust depreciation schedules to reflect changes in the expected economic life of the assets.

[5] A speech at the 2016 Energy Networks Association Regulation Seminar in Brisbane, AER Board member, Cristina Cifuentes, Engagement and energy regulation in a dynamic environment.

22 August 2016

Mr Craig de Laine
General Manager Regulation
Australian Gas Networks
Level 6, 400 King William Street
Adelaide SA 5000

Dear Mr de Laine

RE: SUBMISSION TO AGN DRAFT PLAN FOR VICTORIAN GAS DISTRIBUTION NETWORKS

Origin Energy Electricity Limited (Origin) appreciates the opportunity to provide comments in response to Australian Gas Networks' (AGN) Draft Plan for its natural gas distribution networks in Victorian and Albury for the five year period commencing 1 January 2018.

Origin values the co-operative approach adopted by AGN, most notably through the establishment of its retailer reference group. We consider that the Draft Plan is a worthwhile and constructive initiative which allows stakeholders the opportunity to raise areas of both concern and support ahead of the formal submission of the revised Access Arrangement.

Origin's comments on specific issues are set out below.

Operating Expenditure

AGN has proposed a base year roll-forward approach to forecast operating expenditure (opex) over the Access Arrangement period. Under this approach, AGN has adopted actual opex incurred in 2016. As we understand, the 2016 recurrent opex is expected to be under the AER's benchmark allowance. AGN is proposing to absorb the difference between its recurrent and benchmark to provide $8M of additional opex activities over the next Access Arrangement period. As a result, AGN argue that by absorbing these costs in its base it will be able to provide additional activities without an increase in costs to customers.

Origin understands that the AER's approach to determining whether proposed opex meets the opex criteria involves comparing the proposed costs against its alternative estimate. We understand that the AER's alternative estimate is based on

1. actual opex in the base year;
2. trending the base opex forward over the Access Arrangement period to take account of price changes, output and productivity; and
3. adjusting the total opex for step changes i.e. new regulatory obligations.

It is our understanding that under the AER approach, activities not captured in the base opex are treated as step changes and assessed on their individual merits. We understand that the test the AER applies is whether the step change is needed for the total opex forecast to comply with the opex criteria. It is not enough to demonstrate an efficient cost will be incurred for an activity that was not previously undertaken or opex for a particular cost category is expected to rise. As a result, step changes generally relate to a new obligation or some change in a service provider's operating environment beyond its control, such as new legislation or regulations.

For these reasons, our initial view is the additional opex activities should be assessed as step changes consistent with our understanding of the AER's assessment approach.

In terms of marketing, AGN is proposing additional funding of $5M over the Access Arrangement period to undertake a joint marketing program with the other two Victorian gas networks targeted at increasing gas usage. The marketing campaign will target appliance retailers and offer incentives and rebates for the connection of new appliances.

In principle, we support initiatives to promote increases in gas usage. We also recognise that AGN has yet to provide details regarding the specifics of its marketing campaign. We would expect that further information will set out details regarding: 1) the nature and quantum of rebates; 2) the eligibility criteria for rebates; 3) the time horizon for the campaign; 4) distribution of costs and contributions across each of the networks; 5) success measures; and 6) options analysis.

Capital Expenditure

AGN has proposed growth capital expenditure of $142M over the Access Arrangement period. We understand this expenditure relates to the cost of new connections including any extension to mains, inlets and meters. AGN is forecasting 14,000 new connections per annum; which equates to a cost of about $2,000 per new connection. We request AGN to provide us with a better understanding of how its proposed new connection expenditure compares with other networks in terms of per unit connection cost and the net present value of the program.

With respect to the proposed IT expenditure, we would also like a better understanding of how the total expenditure has been allocated to respective networks, particularly where shared assets are deployed.

Tariff Structures

In principle, Origin supports simple transparent network tariffs so that we can provide transparent bills to our customers. Provided that AGN can demonstrate that there are no material cross-subsidy or equity issues we support a single tariff for residential customers across AGN's network.

Rate of Return

Origin supports AGN's adoption of the AER's preferred approach to calculating the cost of debt as well as the application of the AER's cost of equity parameters.

Terms and Conditions

Origin has a number of observations regarding the following Terms and Conditions:

- Clause 12.8 – Authorised Conveyance: Under this new clause AGN would incur no liability for any loss, cost or damages in the event that AGN conveys gas that does not comply with the specifications required by the Agreement where AGN believes the conveyance is necessary for the safety of the public or security of the network. We understand that this new clause reflects the terms of the *Gas Supply (Safety and Network Management) Regulation 2013* (NSW). We believe that the General Terms and Conditions need to make explicit what legislative obligations apply to AGN in both NSW and Victoria.

- Clause 22.3 – Adjustment of Charges: Under this amended clause, a Network User may not make any claim for an adjustment to distribution charges unless full particulars are provided to AGN within 3 months after the claim becomes known or should become known or in any event more than eleven months after the relevant statement of charges. Origin considers that the time limits for liabilities between the Terms and Conditions and relevant Rules and Codes should align. Specifically, if a retailer's exposure to a billing re-adjustment extends beyond 11 months and this re-adjustment is attributable to the network, we believe a Retailer should not be limited form recovering its exposure. Furthermore, we request greater clarity regarding how the term 'should become known' is defined'.
- Clause 34.7 – Insurance: Origin seeks clarification why this clause has been amended to remove ownership of insurance from AGN and to transfer this risk to the Network User. We believe clause 34.7 should be retained.
- Clause 39.3 – Assignment. Origin considers that with respect to assignment the same provision should apply to both AGN and a Network User. Notably that the prospective AGN assignee is bound, from the time of the assignment, by the agreement between AGN and a Network User as if the assignee stood in the shoes of AGN.

Closing

We are encouraged by the approach taken by AGN to developing its revised Access Arrangements for its Victorian gas distribution network and look forward to continued and more detailed discussions as this process progresses.

If you have any questions regarding this submission please contact Sean Greenup in the first instance on (07) 9507 0620.

Yours sincerely

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